

The Dizzying Speed

Raising our expected inflation and more tightening for 2022

Mona Bedeir

Chief Economist

T +202 3300 5722

mbedeir@egy.primegroup.org

At its highest reading since mid-2019, annual urban headline inflation in February came well above our expectations. Annual urban headline

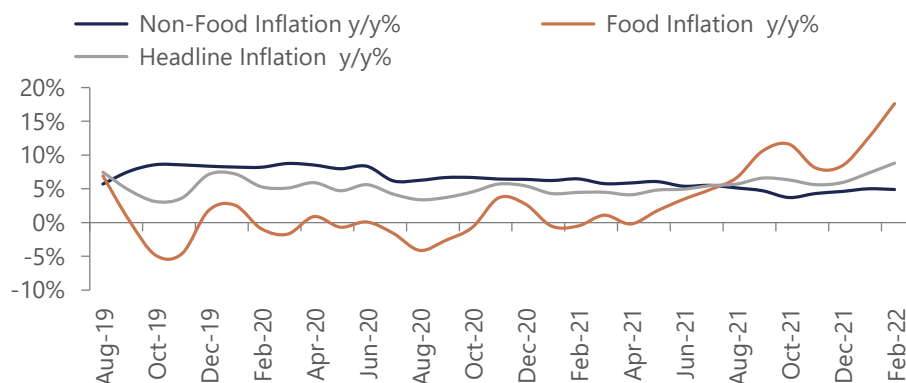
inflation surged to +8.8% y/y in February from +7.3% y/y in January 2022, owing to an unfavorable base-year effect, fuel price hike, and the ongoing effect of globally higher prices of commodities, primarily food. **The acceleration in inflation reflects a continued increase in food basket inflation which stood at +17.6% y/y (vs. 12.4% y/y in January), while non-food inflation edged down to +4.9% y/y (vs. +5% y/y in January).**

The inflation of most of the food basket components accelerated in February, except for a slight fall in the cooking oil and fat basket (+33.2% y/y vs. +34% y/y in January). This reflected not only the seasonality of Ramadan, which historically puts additional pressure on food prices, but also the fear and panic caused by the escalating Ukrainian crisis, which prompted food stockpiling and increased price pressure. Meanwhile, non-food inflation was driven mainly by increased transportation inflation due to fuel price hikes in addition to the higher contributions of most of other baskets save for housing and utility.

On a monthly basis, inflation was at a two-year high as it accelerated to +1.6% m/m from +0.9% m/m in January. Monthly inflation was driven by

a sharp increase in food prices to +4.6% m/m, the highest since September 2018, from +2.1% m/m in January. Inflation was on an upward trend for most of the food basket components, mainly bread and cereals baskets (+2.4% m/m vs. +1.5% m/m in January), meat and poultry (+5.3% m/m vs. +2.1% m/m in January), vegetables (+17.3% m/m vs. +3.5% m/m in January), and fruits (+4.6% m/m vs. -1% m/m in January). Monthly non-food inflation, on the other hand, slipped to +0.13% m/m (vs. +0.36% m/m in January), as falls in the inflation of housing and utility, clothing, and medical basket offset higher transportation basket inflation due to gasoline price increases. **We had expected the monthly price pressures related to Ramadan to be more pronounced in March (a month prior to Ramadan), but the Black Sea crisis accelerated food prices beyond our expectations in February.**

Figure 1: Food inflation has been accelerating since the end of 2021



Source: CAPMAS, Prime Research.



The rapid rise of geopolitical tensions in Eastern Europe, combined with the chaotic reaction of commodity markets, is jeopardizing the CBE's inflation target. Global commodity prices have been thrown into instability by two forces: **(1)** uncertainty regarding *how* and *when* the current geopolitical tension in Eastern Europe is going to end and **(2)** the inherent imbalances in commodity markets produced by a two-year epidemic shock. As [we previously stated in our note](#) on how the Ukrainian crisis and Russian sanctions will impact Egypt, the CBE's inflation target is under significant pressure from a variety of sources, the majority of which is beyond its control, and a tightening of its stance is now expected sooner than we had anticipated.

We revise our inflation forecast higher, anticipating at least 200-300bps hikes in 2022, the first of which we think will occur at the March 24 meeting. Prior to the Russia-Ukraine war, we had expected inflation to continue near the midpoint of the CBE's target, only to accelerate more rapidly in Q2 and Q3 of 2022. As a result, we had not anticipated any change in the CBE's monetary policy, at least in March. However, the war and its widespread impact on the country's external vulnerability and capacity to access external funds as well as the mounting risks of aggressive capital outflows all compel us to adjust our inflation and monetary policy forecasts. Egypt is now confronted with a combination of the 2008 food crisis, the 2016 floatation, and the 2018 emerging markets (EM) disruption caused by aggressive Fed tightening. All considered, not only will global commodity prices fuel domestic inflation, but also accumulating pressures on the external account will likely push the CBE to be more flexible with the local currency, further adding to inflation pressures. **As a result, we now anticipate inflation to average 9% in 2022, up from our previous forecast of 8.3%, and the CBE to begin its tightening cycle next March with a 50bps hike.**

We do not think the CBE will begin its tightening cycle with aggressive rate hikes, as uncertainty remains high, and a de-escalation of the conflict will have a significant impact on global commodity markets.

Furthermore, the monetary policy is ineffective at reining in cost-push inflation. The CBE's expected tightening is a precautionary measure designed to **(1)** alleviate pressures on the country's EGP-denominated assets in the face of accumulating pressures on the local currency and **(2)** keep inflation expectations anchored within the CBE's target. We had previously anticipated in our investment strategy for 2022 that the CBE would have room to allow some flexibility in the exchange rate market by loosening its grip on the currency, thereby increasing its resilience and reducing the risk of overshooting. This room, however, has shrunk and is pressured by the worst possible conditions because of the significant pass-through effect of the exchange rate on inflation and inflation expectations, which has already risen. Thus, we expect the USD/EGP rate and the CBE's monetary stance to reflect the deterioration of global risk aversion, but this will depend on **(1)** the country's ability to secure external assistance from the IMF and its strategic partners, **(2)** the size and pace of capital outflows, **(3)** the trajectory of geopolitical tensions on the ground, and **(4)** the Federal Reserve's monetary policy stance following next week's widely-anticipated 25bps rate hike.

Prime Securities

Shawkat El Maraghy

Managing Director

T +202 3300 5622

SElmaraghy@egy.primegroup.org

Sales

Mohamed Ezzat

Head of Sales & Branches

T +202 3300 5784

MEzzat@egy.primegroup.org

Mohamed Ashmawy

Head of Institutional Sales

T +202 3300 5612

MAshmawy@egy.primegroup.org

Amr Alaa CFTe

Team Head –Institutional Desk

T +202 3300 5609

AAAlaa@egy.primegroup.org

Mohamed El Metwaly

Manager

T +202 3300 5610

MElmetwaly@egy.primegroup.org

Emad El Safoury

Manager

T +202 3300 5624

EElsafoury@egy.primegroup.org

Shawkat Raslan

Heliopolis Branch Manager

T +202 3300 8130

SRaslan@egy.primegroup.org

Nashwa Abuelatta

Alexandria Branch Manager

T +202 3300 5173

NAbuelatta@egy.primegroup.org

Research

Amr Hussein Elalfy CFA

Head of Research

T +202 3300 5724

AElalfy@egy.primegroup.org

Head Office

Prime Securities S.A.E.

Regulated by FRA License No. 179.
 Member of the Egyptian Exchange.

2 Wadi Elnil St, Liberty Tower, 7th Fl.
 Mohandessin, Giza, Egypt

T +202 3300 5700 / 770 / 650 / 649

F +202 3760 7543

Branches

Heliopolis

7 Elhegaz Square

Heliopolis, Cairo, Egypt

T +202 2777 0600

F +202 2777 0604

Alexandria

7 Albert Al Awal St.

Smouha, Alexandria, Egypt

T +202 3300 8170

F +202 3305 4622

Website

www.primeholdingco.com

Disclaimer

Information included in this report has no regard to specific investment objectives, financial situation, advices or particular needs of the report users whether they received them directly or through any research pool and other specialized websites. The report is published for information purposes only and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. Unless specifically stated otherwise, all price information is only considered as indicator. No express or implied representation or guarantee is provided with respect to completeness, accuracy or reliability of information included in this report. Past performance is not necessarily an indication of future results. Fluctuation of foreign currency rates of exchange may adversely affect the value, price, or income of any products mentioned in this report. Information included in this report should not be regarded by report users as a substitute for the exercise of their own due diligence and analysis based on own assessment and judgment criteria. Any opinions given are subject to change without notice and may significantly differ or be contrary to opinions expressed by other Prime business areas as a result of using different assumptions and criteria. Prime Group is under no obligation responsible to update or keep current the information contained herein. Prime Group, its directors, officers, employees or clients may have or have had interests or long or short positions in the securities and/or currencies referred to herein, and may at any time make purchases and/or sales in them as principal or agent. Prime Group, its related entities, directors, employees, and agents accept no liability whatsoever for any loss or damage of any kind arising from the use of all or part of these information included in this report whether it is received directly or through research pools and other specialized websites. Certain laws and regulations impose liabilities which cannot be disclaimed. This disclaimer shall, in no way, constitute a waiver or limitation of any rights a person may have under such laws and/or regulations. Furthermore, Prime Group or any of the group companies may have or have had a relationship with or may provide or have provided other services, within its objectives to the relevant companies.

Copyrights © 2022, Prime Group, ALL RIGHTS RESERVED. You are hereby notified that distribution and copying of this document is strictly prohibited without the prior approval of Prime Group.