

Much Higher Inflation ... and Longer

Mona Bedeir

Chief Economist

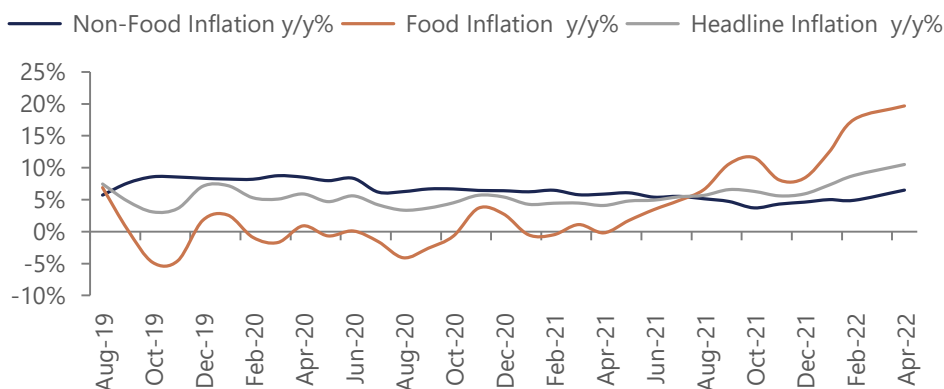
T +202 3300 5722

mbedeir@egy.primegroup.org

The first figure in double digits since May 2019, March's annual urban headline inflation came well above the CBE's target. Annual urban headline inflation accelerated to +10.5% y/y in March from +8.8% y/y in February 2022, owing to a cocktail of an unfavorable base-year effect, demand seasonality induced by Ramadan, and the effect of higher global commodity prices—primarily food. **The acceleration in inflation came to reflect the sustained rise in food basket inflation at +19.7% (vs. +17.6% y/y in February) and non-food inflation to +6.5% y/y (vs. +4.9% y/y in January), the strongest non-food inflation figure in over a year.** The sharp increase in wheat prices triggered by the Ukrainian crisis and its influence on supply accelerated bread and cereals basket inflation to +19.1% in March (vs. +9.4% y/y in February). Meanwhile, inflation in most food basket constituents rose in March, except for volatile fruit and vegetable (+5.9% y/y and +32.6% y/y compared to +12.4% y/y and +41.9% y/y in February, respectively). Meanwhile, non-food inflation was mostly driven by increasing housing and utility expenses as a result of rising costs for domestic and commercial butane gas cylinders, which also boosted hotel and restaurant prices.

It's been a long time since inflation increased at such a clip on a monthly basis. Monthly inflation increased to +2.2% m/m, the highest level since December 2018. This was owing to a 4% monthly increase in food costs and a 1.5% monthly increase in non-food inflation. The inflation of most food basket components was increasing, except for fruit and vegetable prices, which alleviated pressures on monthly food inflation. On the other hand, the monthly non-food inflation acceleration came to reflect the increase in tobacco prices in March and the effect of the butane gas cylinder price increase on both the housing and utility baskets as well as the restaurant basket. **Monthly inflation is still expected to be driven in April by a further upward adjustment to gasoline prices, given that the effect of currency depreciation has yet to be felt in the coming months.**

Figure 1: Food and Non-Food Inflation at their highest level in more than two years



Source: CAPMAS, Prime Research.

The inflation prognosis remains shrouded by uncertainties, with a summer peak predicted. Prior to the EGP depreciation in March, we had forecasted inflation to average +8.3% y/y in 2022, assuming a 2-3% EGP depreciation. However, following the 21 March, the EGP depreciation was harsher than expected, and global commodity prices showed no signs of abating. **As a result, we updated our 2022 prediction to 12% on average, with inflation peaking in the summer. However, in a very uncertain environment, the strong pass-through effect of the FX rate on inflation and inflation expectations should put inflation forecasts under severe pressure.** The Egyptian government's recent move to increase local food supply and control the non-subsidized bread market, as well as the introduction of one-year high-yield CDs, should relieve some of the burden.

Another 200-300bps is still expected, and the CBE's inflation target may be revised upward. The CBE will have two inflation readings for March and April at its next meeting on 19 May. Both are on track to exceed the upper end of the current CBE target; **we project April inflation to be between 10.6-11%, implying that another 100bps rate hike could be in the cards.** However, the Egyptian government is still in talks with the IMF, and the IMF program includes an inflation consultation provision, which simply means defining an inflation path, generally in terms of bands, which is consistent with an official inflation objective. **As a result, it is envisaged that the ongoing IMF negotiations would prompt the CBE to modify its inflation goal range to reflect fundamental changes in global and domestic inflation drivers.**

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

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