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Emirates NBD

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Egyptian Disinflation

Egypt's headline CPI inflation rate fell to 5.1% y/y in March, down from 5.3% in February. This marked the slowest price growth since November, driven in large part by a 1.7% decline in food prices. Core inflation was 1.9% while on a m/m basis, inflation stood at 0.6%. However, these figures will largely preclude the wider impact of Egypt's domestic coronavirus crisis, which escalated through the month of March and continues to wreak havoc – as indeed does that in the rest of the world which is having knock-on effects on the Egyptian economy. As such, price growth will likely tick up in the coming months. Indeed, Egypt's cabinet approved a sustainable development plan for 2020/21 on March 26, which adjusted projections in light of the disease. Among the plan's projections was an expectation that inflation would rise to 9.8% y/y if the crisis was not contained by December.

There are a number of channels which will drive the acceleration in inflation, not least greater competition for resources as households look to stock up on essential items as they are increasingly forced to self-isolate at home. In a bid to combat this, on March 30 the Central Bank of Egypt imposed limits on cash withdrawals, and in addition called for individuals and businesses to use e-payments where possible. Food prices rose by 0.7% m/m in March, and could see strong monthly gains in April and May as disruption to supply chains and a measure of panic buying escalate.

The last month of disinflation?



Source: Bloomberg, Emirates NBD Research

The other primary factor which will likely see inflation push higher is a probable weakening of the Egyptian pound after the second quarter – we project that there will be a modest depreciation to EGP 16.00/USD in Q3, from the current EGP 15.74/USD. However, we expect that this will be staved off for the time being as the central bank prioritises FX stability.

The sizeable decline (USD 5.4bn) we saw in FX reserves last month has explained how the EGP has remained comparatively stable in recent weeks, especially compared with some of its EM peers. According to the CBE, it drew down its reserves to 'partially cover foreign portfolio investment'. However, while reserves remain fairly ample at USD 40.1bn (over seven months import cover), it is likely that the bank will allow some moderate depreciation of the currency down the line, else it will raise questions over flexibility and potentially put off the portfolio investment it hopes to maintain. There has likely been a marked outflow since the outbreak of the disease, probably comparable to the USD 10.9bn of outflows seen over March-December 2018 as EMs globally sold off. – Given that other sources of FX such as tourism inflows, remittances and canal duties are unlikely to rebound any time soon, there will be mounting pressure on the balance of payments. In this regard, the fall in inflation last month is especially positive as it keeps real interest rates attractive even after the unscheduled 300bps cut to the overnight deposit rate last month.

It should be noted that one factor which seasonally boosts inflation higher each year is the month of Ramadan, which is likely to start around April 23, and usually drives inflation as consumer spending rises. However, the effects of this may well be muted this year, depending on what limits are still in place in terms of public gatherings and business closures.

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