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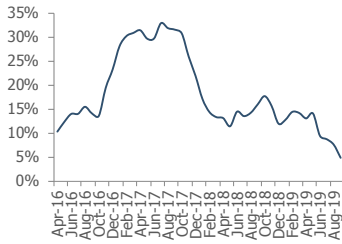
Macro | Egypt

September inflation: all odds are in favor of aggressive monetary easing

Macro Note | Egypt

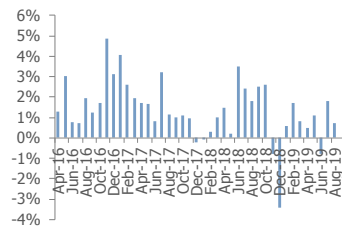
October 10, 2019

Headline inflation confirms single-digit reading



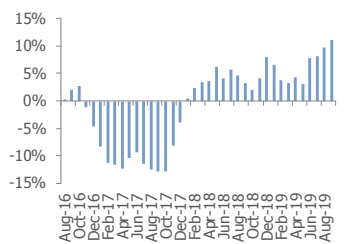
Source: CAPMAS,

Muted monthly change



Source: CAPMAS

Rising real interest rates



Source: Bloomberg, CAPMAS

Positive inflation reading in September, below expectations

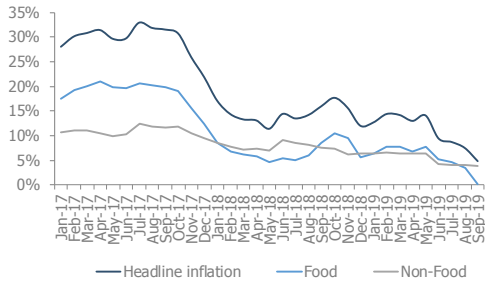
Annual headline inflation saw a significant deceleration to 4.8% in September, well below both our estimate of 5.9% and August's reading of 7.5%, on the back of stable prices on a monthly basis vs our estimates of a rise of 1% and August's monthly rise of 0.7%. We believe the favorable base effect, EGP strength, and a more cautious spending behavior have continued to reflect positively on the monthly change. The deceleration was driven by a softer rise in food prices on an annual basis by 0.3% vs 6.9% in August, which was supported by a monthly drop of 1.8%. Meanwhile, the transportation segment is the only segment that saw a rise both y-o-y and m-o-m of c7%. something that we expect to be reversed in October with the c4% average drop in selected fuel prices upon the first review under the newly implemented automatic fuel indexation mechanism; therefore, we expect a soft decline in this segment of 1.5-2% during October. We note that the transportation segment that will likely be affected by the 3.2% drop in gasoline prices accounts for 5.7% of the headline CPI basket.

Higher chances of a 50-100bps cut in interest rates in November 14 meeting

We reiterate our view that muted inflationary pressures coupled with the solid macro stance will allow for continued aggressive easing cycle. A favorable base effect and EGP strength will continue to advocate benign annual inflation readings till year-end, keeping inflation rates within the CBE's target zone of 9% (+/-3%) by end of 2020. We foresee inflation averaging 4.2% in 4Q19. Hereby, we raised our expectations for the magnitude of the upcoming interest rates on November 14, 2019 cut to a 50-100bps. We expect a further 300bps cut in 2020. Other key factors on our watch list to confirm our view along the road include: i) Foreign inflow in the fixed income after the impact of the cut on yields; ii) performance of banks' and CBE NFAs; and iii) stability of the Egyptian pound within our expected range of EGP16-17/USD.

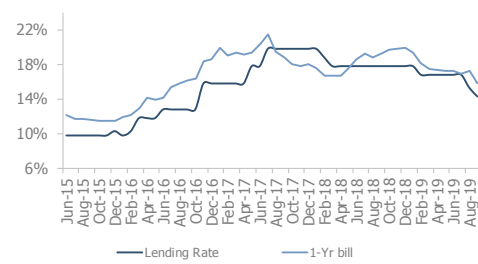
I. Illustrating Charts

Figure 1: Food inflation stabilizes



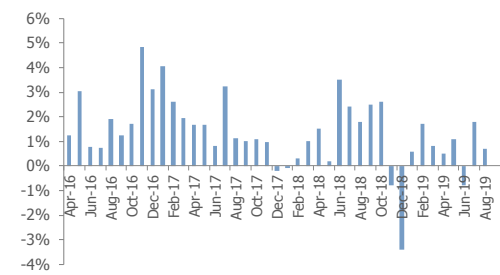
Source: CAPMAS

Figure 2: Treasury yields still above lending rates



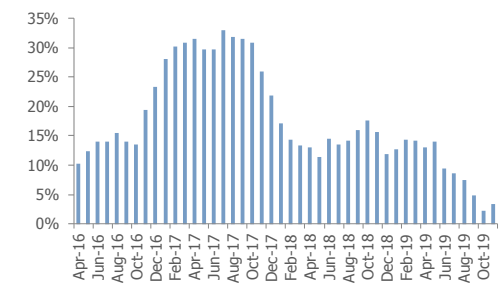
Source: CBE, Bloomberg

Figure 3: Inflation muted on a monthly basis



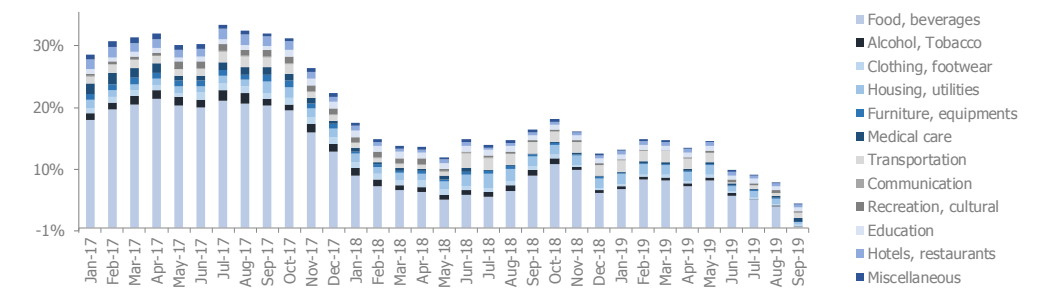
Source: CAPMAS

Figure 4: Annual headline inflation confirms single digit stance



Source: CAPMAS, Beltone estimates

Figure 5: Annual headline inflation breakdown (% weighted change)



Source: CAPMAS

II. Macro-economic Indicators

	FY14/15	FY15/16	FY16/17	FY17/18	FY18/19e	FY19/20e	FY20/21e
Real sector							
GDP, current (USDbn)	332	333	235	250	304	384	443
Real GDP growth (%)	4.4%	4.3%	4.3%	5.3%	5.5%	5.9%	6.2%
GDP/capita, current (USD)	3,554	3,608	2,548	2,654	3,161	3,928	4,450
External sector							
Trade balance (USDbn)	(39.1)	(38.7)	(37.3)	(37.3)	(37.7)	(39.6)	(41.1)
Tourism revenues (USDbn)	7.4	3.8	4.4	9.8	12.3	14.0	15.1
Suez Canal revenues (USDbn)	5.4	5.1	4.9	5.7	6.0	6.3	6.6
Transfers (USDbn)	21.9	16.8	21.8	26.5	25.6	25.6	25.8
Current account (USDbn)	(12.1)	(19.8)	(14.4)	(6.0)	(4.6)	(3.9)	(4.3)
Current account % GDP	-3.7%	-6.0%	-6.1%	-2.4%	-1.5%	-1.0%	-1.0%
FDI (USDbn)	6.4	6.9	7.9	7.7	7.3	7.5	7.7
FDI % GDP	1.9%	2.1%	3.4%	2.6%	2.4%	2.0%	1.7%
EGP/USD exchange rate (period avg)	7.36	8.15	14.76	17.72	17.67	17.10	17.86
Net international reserves (end of period) (USDbn)	20.1	17.5	31.3	44.3	46.5	47.4	46.0
Reserves/imports coverage (months)	3.9	3.7	6.4	8.4	8.2	7.8	7.1
Monetary sector							
Inflation (CPI, %)	11.0%	10.2%	23.3%	21.6%	13.9%	10.1%	11.4%
M2 Growth (%)	16.4%	18.6%	39.4%	18.3%	18.3%	19.1%	17.2%
Deposits rate (end of period, %)	8.75%	10.75%	16.75%	16.75%	15.75%	13.75%	12.25%
Lending rate (end of period, %)	9.75%	12.75%	17.75%	17.75%	16.75%	14.75%	13.25%
Fiscal sector							
Fiscal deficit (EGPbn)	279.4	339.5	379.6	433.9	461.5	514.6	540.6
Fiscal deficit % GDP	-11.4%	-12.5%	-10.9%	-9.8%	-8.6%	-7.8%	-6.8%
Primary balance % GDP	-3.5%	-3.5%	-1.8%	0.1%	1.9%	2.0%	1.9%

Source: CBE, MoF, Beltone estimates

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