MPC maintains rates against expectations citing "transitory" inflation factors

The MPC has decided to maintain rates unchanged last Thursday, against our and consensus' expectations. The reason noted was the fact that the inflation spike witnessed in August was mainly caused by "transitory cost-push factors," including the higher electricity bills and the increased demand on food items because of Eid El Adha, rather than demand factors, which means that raising rates would not have controlled inflation. We have continuously noted that interest rate has not been the most effective tool to control inflation, since Egypt is a country where 10% of the population is banked and inflation continues to be largely driven by the exchange rate due to a high importation bill.

We believe that growth and budget deficit concerns have come in play

We project that concerns over weakened real GDP growth had a significant impact on the decision, especially with the current weakness in investment expenditure. In addition, raising interest rates would have added to the debt service burden, which currently represents c. 30% of fiscal expenses. We had noted on our MPC Monitor Note, published on September 18, that we realize the growth dynamics are not supportive of a rate hike and that our leading indicator, Industrial Production Index, depicts weak growth figures over the last three quarters, mostly due to the FX shortage overhang, which had its toll on business confidence and activity.

As Fed maintained rates, there was less pressure to raise rates on EGP at this point of time

We have previously argued that the CBE would need to raise rates in order to create an attractive spread between the return on USD and EGP fixed income instruments, thus attracting foreign fund inflows into the Egyptian market. With Fed maintaining rates unchanged last week, there was less pressure to raise rates in order to create an attractive spread on the EGP, at least at this point.

Devaluation Would Still Happen; FX Availability and Magnitude of Devaluation are Key

Foreign inflows require confidence in the system and one exchange rate rather than high interest rates

The MPC decision to maintain rates will probably raise question marks on devaluation. Devaluation should happen and would still happen without raising rates. *Attracting foreign fund inflows is not only a matter of attractive rates, but also a matter of confidence in the banking system, exchange rate stability, absence of a parallel currency market, removal of capital controls and a functioning repatriation mechanism*. If these pre-requisites are secured, lower rates should actually follow, in order to spur investment expenditure and steer the wheel of the economy.

EGX would probably witness a cautious rebound over held rates and in anticipation of a potential currency movement on Tuesday's FX auction

EGX should start the week on a positive note after maintaining rates and in anticipation of the FX auction on Tuesday. Farther trend will be dictated by the actual devaluation rate versus rate expectations and signs of foreign investor confidence in the system. We reiterate our view that the market will trade within the 7,700-8,500 range and that foreign participation will be a key catalyst to drive another EGX spike, above the high end of that range.

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