Expect MPC to Raise Rates 1%; Eyeing Another 1% Hike in November

We believe that the MPC will raise policy rates by 1% during its upcoming meeting on September 22nd, mostly due to inflationary concerns and in preparation for devaluation, in order to increase the attraction of holding EGP versus USD and in a bet to attract foreign fund inflows into the EGP fixed income market, post-devaluation.

We believe that another 1% hike in policy rates is much needed for EGP defense, but would probably be implemented on the November 17th MPC meeting, to account for the inflation spike induced by VAT and depreciation.

Inflation and Currency Defense to Drive Rate Hike; Despite Growth Concerns

Inflation Spiked in August; More to Show After VAT and Devaluation

Headline CPI recorded 15.5% y-o-y growth in August 2015, the highest in seven years. This was the result of +1.9% m-o-m increase in headline CPI, which is the highest monthly growth since October 2015. Inflation in Egypt is mostly tied to the exchange rate due high reliance on imports and was negatively affected by the price hikes in non-regulated items like fruits and vegetables (+36.2% y-o-y). In addition, the spike in electricity prices has reflected on August CPI numbers. We believe that higher figures will be recorded for September and October 2016, with VAT implementation that started in early September and devaluation that should strike in September end or October, once USD liquidity is injected into the banking system. The government is on track to secure USD5-6 billion of external funding, much needed to unlock the IMF funding shortly afterwards.

We Realize Growth Dynamics Not Supportive of a Rate Hike

We track the Industrial Production Index (IPI) as a leading indicator for real GDP growth. IPI depicts weaker growth potential, mainly driven by FX shortage. The rate hike is necessary for the successful transition in monetary policy and FX shortage resolution, which will eventually reflect positively on growth. That is why we believe that while current growth dynamics are not supportive of a hike in rates, it will be implemented with the intention to resolve currency shortage, a key obstacle for GDP growth.

Higher Rates Hurt Equities; Market to Move Sideways

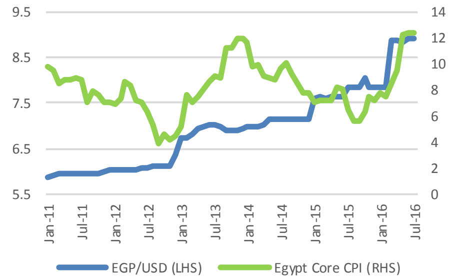
Market Will Trade Range; Needs Higher Foreign Participation to Drive Another Spike

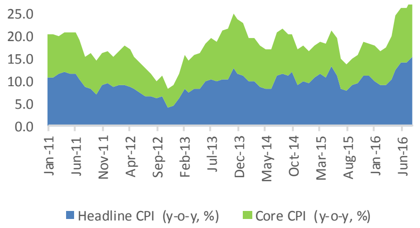
We believe that the market has already cheered the IMF reform program and the FX shortage resolution. If we look at the big caps and highly liquid names, we would see current market prices closer to fundamental fair values, which creates less room for price appreciation (within c.20%). This tells us that the market will probably trade within the 7,700-8,500 range and would need higher foreign participation to break the high end of that range.

Maintain Conservative ST Trading Tactics; Security Selection is Key

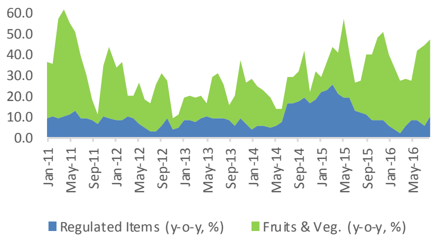
Banks' margins will continue to benefit from the hike in rates, given the high allocation to treasury investments (CIEB, HDBK). If FX shortage is resolved, balance sheet growth will revive. EFG-Hermes and EK Holding are well positioned in their respective space and offer good value/growth dynamics. Real estate developers (TMGH, PHDC, OCDI) will continue to deliver strong results, at least over the next 2-3 quarters, driven by higher inflation/devaluation concerns. Do not forget land bank owners (MNHD, HELI). High infrastructure spending beneficiaries including Orascom Construction and El Sewedy Electric continue to be on our list. Keep an eye on oversold names like JUFO, which was pressured by FTSE Russel Index exclusion.

Inflation is highly related to exchange rate

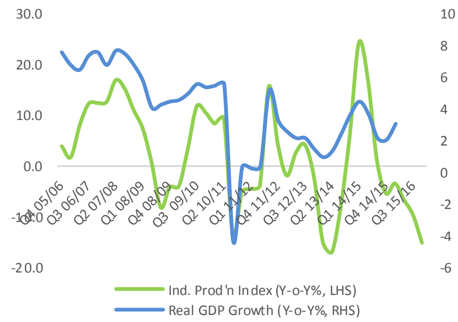




Inflation driven by items whose prices are non-regulated



Industrial Production Index depicts weak real GDP growth



Source: Central Bank of Egypt, Pharos Research

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