

March 26, 2017

Monthly inflation decelerated in February, but an uptick is expected ahead of mixed seasonal effects

Monthly headline inflation decelerated, from 4.1% MoM in January, to 2.6% MoM in February. Core food items, which excludes fruits and vegetables, continue to be the major contributor to the increase in prices in February. The exchange rate has stabilized at EGP18 per USD, which is above EGP15.8 recorded in February and below the historical-high level of EGP19. We reiterate that we do not expect significant monthly price increase, in reaction to the exchange rate movements, due to the wide decline in sales volumes across different sectors. Looking ahead, we highlight two key drivers of the monthly inflation rate:

1. The holy month of Ramadan traditionally marks a relatively higher consumption level compared with the rest of the year, which tend to push the monthly inflation rate upwards. On the other hand, we note that the risk of an aggressive import activity is subdued given the current high level of exchange rate.
2. The wheat harvest season, which starts by mid-April 2017, possibly diffuses sharp food price increases.

Financial Conditions Index depicts tightness in March; Slightly changed from February's level

Examining the impact of recent financial market developments on the Pharos Financial Conditions Index components provides vital insights into the future direction of the monetary policy. We highlight the following:

1. The one-year T-bill yield rose from an average of 19.03% in February, to an average of 19.24% in March. The slope of the yield curve remains negative, which reflects tight monetary conditions.
2. The real effective exchange rate (REER) depreciated by 12.5% MTD. We reiterate that a REER depreciation makes domestic assets more attractive for foreign investors, hence, capital inflows would increase the liquidity in the economy.
3. The EGX30 Index rose 9.1% MTD resulting in an increase in the liquidity, however, it is expected to resume trading in side-way range this week.

MPC to keep interest rates unchanged on Thursday's meeting

On one hand, given that 'financial conditions' in March continue to depict tightness that is close to February's level, another interest rate hike is not needed. On another hand, we reckon that an interest rate cut is not appropriate due to the aforementioned inflation level and outlook. Therefore, we believe that the CBE's Monetary Policy Committee will hold interest rates unchanged in March.



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