Expect MPC to Keep Rates Unchanged

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Different price indicators suggest that the inflationary shock is cooling off, Financial conditions remain tight

Examining the recent trend of different price indicators, the inflationary shock that followed the implementation of economic reform measures, mainly the exchange rate liberalization and the fuel price hike in November 2016, seems to be cooling off. **The headline consumer price index monthly change decelerated from 4.8% MoM in November to 1.7% in April 2017. Moreover, the monthly core-CPI, which measures the underlying inflationary pressure by excluding both the most-volatile and regulated items, decelerated from 5.3% in November to 1.1% in April 2017. On the other hand, the producer price index (excluding mining and quarrying activity), which measures prices at the factory gate, decelerated from 6.9% in November to 1.9% in April 2017.** As a measure of companies' pricing power, the PPI showed that companies across the economy did pass the extra cost to the end-users instead of tightening their margins. **Furthermore, our preliminary Financial Conditions Index reading suggests that monetary conditions remain reasonably tight across the economy.**

MPC to keep policy rates unchanged in the next meeting

The aforementioned data support the CBE's Monetary Policy Committee (MPC) keeping the interest rate unchanged at the next policy meeting on May 21. We note that the recent uptick in the monthly core-CPI and PPI reflects seasonal effects ahead of the holy month of Ramadan. **Going forward, we identify two key events on the interest rate short-run outlook horizon:**

- **The timing of the next round of the next fuel price hike would be crucial in deciding on the interest rate reaction.** If the government could manage to undertake the next fuel price hike post-November 2017, by then the inflation rate will be on a notable downward trend. Taking advantage of the favorable base effect, a decelerating annual inflation rate would keep inflation expectation anchored, without an interest rate hike, despite the fuel price hike.
- **The expected Federal Reserve interest rate hike in June may add some pressure on the exchange rate, but not a big deal.** However, adapting a flexible exchange rate provides the Egyptian makers with autonomy regarding the domestic interest rate decision. In other word, the MPC will not be obliged to mirror the Fed's rate hike automatically, unlike the GCC economies. Moreover, the fact that the Fed interest rate hike is well-communicated in advance implies that the impact on emerging markets' currencies, including Egypt, is already priced-in. Finally, the second IMF-EFF tranche disbursement would represent a confidence booster that would help ease the potential pressure on the exchange rate following the FOMC expected interest rate hike.

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