

In normal times, an active policy communication helps achieve the desired policy outcome and stabilize the economy by managing economic agents' expectations and/or reducing economic uncertainty. Moreover, the importance of a clear policy communication grows more essential in unusual economic circumstances and/or the case of introducing new policy tools/measures. Regarding the monetary policy, a clear communication also helps improve the central bank's transparency and credibility. Since Egypt has been going through a massive economic turbulence leading to the introduction of a broad economic reform plan under the IMF-EFF, we decided to run a simple quantitative exercise looking into the evolution of the CBE monetary policy communication since 2005. This exercise will help raise our clients' monetary policy visibility going forward. For example, the time-lag between the CBE governor's declaration that fixing the exchange rate had been a mistake and the CBE's decision to liberalize the exchange rate on November 3 gave the parallel market a significant breadth (Chart1). A timely policy communication could have possibly reduced such an economic cost in terms of the exchange rate severe overshooting afterwards.

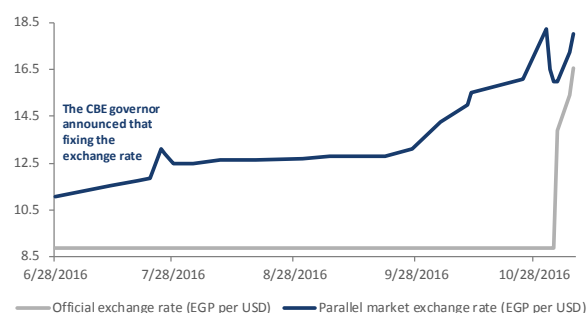
### The length of the MPC statements rose significantly since 2005

Measured by the number of words, the length of the MPC statement rose from c.150 words on average in 2005 to c.550 words on average in 2017. Such an increase denotes a better communication. Moreover, we note that the number of words witnessed exceptional spikes that were related to unusual occasions (i.e. the financial crisis, the liberalization of the exchange rate and the introduction of a quantitative inflation target). This implies the CBE's commitment to better explain its policy stance during irregular economic events.

### The readability of the MPC statements remains a challenge due to the complexity of terminology and the timing of the release

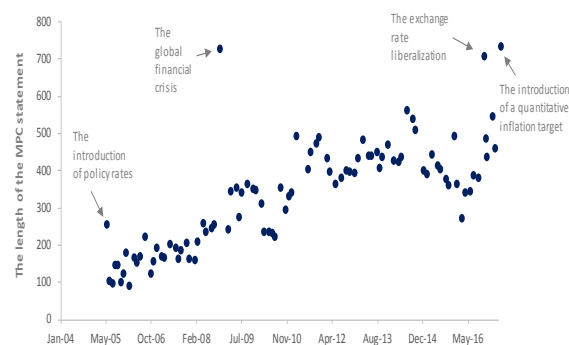
We ran the Flesch-Kincaid test in order to measure the readability level of the MPC statements since 2005. We note that a higher score signifies more difficult for an average reader to understand the content of the MPC statement. The CBE's Flesch-Kincaid score has been scattered, albeit hovering recently around 12. On one hand, this reflects the complexity of the monetary policy dealing with the challenging economic conditions in Egypt. On the other hand, it shows a communication constraint, which requires the CBE to make its policy statements easier for the public to read and to interpret. Moreover, the timing of the MPC press release, which coincidences a late hour at the end of the business week in Egypt, reduces the readability of the MPC statements.

Chart 1| A timely policy communication could have reduced the FX parallel market breadth



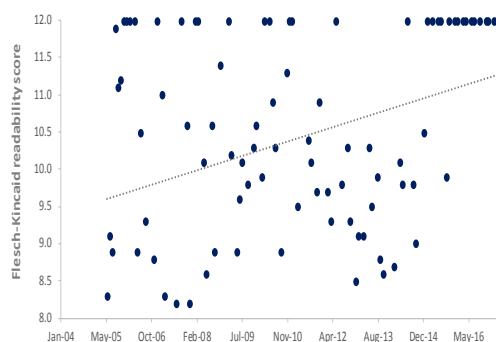
Source: Central Bank of Egypt, Pharos research

Chart 2| The CBE tended to better explain its policy stance during irregular economic events



Source: Central Bank of Egypt, Pharos research

Chart 3| The complexity of the monetary policy represents a communication constraint



Source: Central Bank of Egypt, Pharos research

## Puzzled with contradicting monetary policy priorities the CBE's forward guidance rose slowly

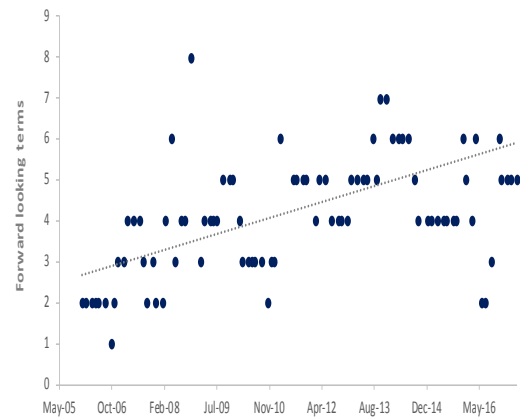
Forward guidance remains another important factor, especially in unusual economic circumstances and/or introducing new policy tools/measures, in order to reduce economic uncertainty and minimize the impact of negative externalities. Measured by the use of forward looking terms, we note that the CBE's forward guidance has been slowly rising. In our view, such a pace had been negatively affected by periods of fiscal dominance and managing the exchange rate, which in many cases overshadowed the CBE's price stability priority.

## What is the CBE's favorite inflation indicator?

We note that the share of reference to the core inflation rate compared with the overall reference to inflation in the MPC statements has witnessed two different trends. In 2005-2010, the data showed that the core inflation had been the CBE's favorite inflation rate indicator. After 2011, the trend has significantly reversed, which partly reduced the monetary policy predictability. The aforementioned conclusion is supported by the fact that the current CBE inflation rate target refers to an annual headline inflation rate of 13% (+/- 3%) by 4Q 2018. While the core inflation rate remains an important indicator of underlying inflationary pressures, we advise our clients to consider various inflation rate indicators such as the headline inflation rate in anticipating the MPC decisions.

Shifting to an active inflation targeting as the nominal anchor of the monetary policy in Egypt, the role of communication becomes truly essential. We reiterate that a better monetary policy communication helps improve the CBE's credibility, which would defiantly support the CBE's price stability mandate. Moreover, a better monetary policy communication would avoid unneeded surprises, which leave investors, among other economic agents, struggling to anticipate the economic policy direction in the short run. While the frequent issuance of the Monetary Policy Report is a positive development, more is still needed in terms of improving the MPC statement readability and forward guidance. In that context, we refer to the international practice of holding pre-planned press conferences and speeches as additional tools to smoothly communicate the CBE's monetary policy decisions.

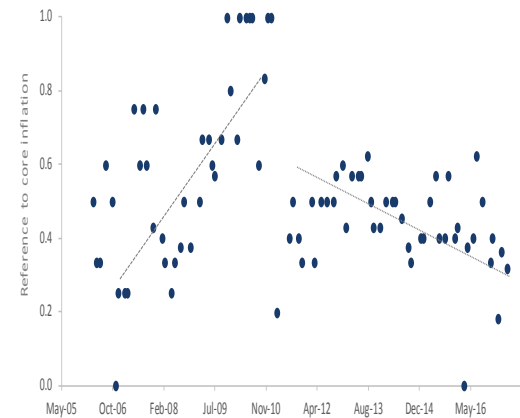
Chart 3| The monetary policy forward guidance has been negatively affected by fiscal dominance and managing the exchange rate\*



\*Measured by the number of forward looking terms in the MPC statements (i.e. looking ahead, going forward, will, expect, may, shall)

Source: Central Bank of Egypt, Pharos research

Chart 4| The core inflation rate is no longer the CBE's favorite inflation indicator



Source: Central Bank of Egypt, Pharos research



## Sales and Trading

Essam Abdel Hafiez  
Managing Director  
+202 27393687  
[essam.abdelhafiez@pharosholding.com](mailto:essam.abdelhafiez@pharosholding.com)

Ahmed Raafat  
VP Local Institutional Sales  
+202 27393627  
[ahmed.raafat@pharosholding.com](mailto:ahmed.raafat@pharosholding.com)

Seif Attia  
Head Local Sales  
+202 27393682  
[seif.attia@pharosholding.com](mailto:seif.attia@pharosholding.com)

Ahmed Abutaleb  
Head Foreign Sales  
+202 27393632  
[ahmed.abutaleb@pharosholding.com](mailto:ahmed.abutaleb@pharosholding.com)

Sherif Shebl  
AVP Foreign Sales  
+202 27393634  
[sherif.shebl@pharosholding.com](mailto:sherif.shebl@pharosholding.com)

Omar Nafie  
Associate Foreign Sales  
+202 27393635  
[omar.nafie@pharosholding.com](mailto:omar.nafie@pharosholding.com)

Sally Refaat  
Head Online Trading  
+202 27393675  
[sally.refaat@pharosholding.com](mailto:sally.refaat@pharosholding.com)

## Disclaimer

This Report is compiled and furnished solely for informative purposes to be considered by the intended recipients who have the knowledge to assess the information contained herein. Pharos Research ("Pharos") makes no representation or warranty, whether expressed or implied, as to the accuracy and/or completeness of the information contained herein or any other information that may be based on the data/ information enclosed. Furthermore, Pharos hereby disclaims any and all liabilities of any nature relating to or resulting from the use of the contents of this Report. This Report shall not be approached as an investment solicitation nor shall it be considered as legal or tax advice. Pharos highly recommends that those viewing this Report seek the advice of professional consultants. None of the materials provided in this Report may be used, reproduced or transmitted, in any form or by any means, electronic or mechanical, including recording or the use of any information storage and retrieval system, without written permission from Pharos.

This report was prepared, approved, published and distributed by Pharos Securities Brokerage company located outside of the United States (a "non-US Group Company"). This report is distributed in the U.S. by LXM LLP USA, a U.S. registered broker dealer, on behalf of Pharos Securities Brokerage only to major U.S. institutional investors (as defined in Rule 15a-6 under the U.S. Securities Exchange Act of 1934 (the "Exchange Act")) pursuant to the exemption in Rule 15a-6 and any transaction effected by a U.S. customer in the securities described in this report must be effected through LXM LLP USA.

Neither the report nor any analyst who prepared or approved the report is subject to U.S. legal requirements or the Financial Industry Regulatory Authority, Inc. ("FINRA") or other regulatory requirements pertaining to research reports or research analysts. No non-US Group Company is registered as a broker-dealer under the Exchange Act or is a member of the Financial Industry Regulatory Authority, Inc. or any other U.S. self-regulatory organization.

**Analyst Certification.** Each of the analysts identified in this report certifies, with respect to the companies or securities that the individual analyses, that (1) the views expressed in this report reflect his or her personal views about all of the subject companies and securities and (2) no part of his or her compensation was, is or will be directly or indirectly dependent on the specific recommendations or views expressed in this report. Please bear in mind that (i) Pharos Securities Brokerage is the employer of the research analyst(s) responsible for the content of this report and (ii) research analysts preparing this report are resident outside the United States and are not associated persons of any US regulated broker-dealer and that therefore the analyst(s) is/are not subject to supervision by a US broker-dealer, and are not required to satisfy the regulatory licensing requirements of FINRA or required to otherwise comply with US rules or regulations regarding, among other things, communications with a subject company, public appearances and trading securities held by a research analyst account.

**Important US Regulatory Disclosures on Subject Companies.** This material was produced by Analysis Pharos Securities Brokerage solely for information purposes and for the use of the recipient. It is not to be reproduced under any circumstances and is not to be copied or made available to any person other than the recipient. It is distributed in the United States of America by LXM LLP USA and elsewhere in the world by Pharos Securities Brokerage or an authorized affiliate of Pharos Securities Brokerage. This document does not constitute an offer of, or an invitation by or on behalf of Pharos Securities Brokerage or its affiliates or any other company to any person, to buy or sell any security. The information contained herein has been obtained from published information and other sources, which Pharos Securities Brokerage or its Affiliates consider to be reliable. None of Pharos Securities Brokerage accepts any liability or responsibility whatsoever for the accuracy or completeness of any such information. All estimates, expressions of opinion and other subjective judgments contained herein are made as of the date of this document. Emerging securities markets may be subject to risks significantly higher than more established markets. In particular, the political and economic environment, company practices and market prices and volumes may be subject to significant variations. The ability to assess such risks may also be limited due to significantly lower information quantity and quality. By accepting this document, you agree to be bound by all the foregoing provisions.

LXM LLP USA assumes responsibility for the research reports content in regards to research distributed in the U.S. LXM LLP USA or its affiliates has not managed or co-managed a public offering of securities for the subject company in the past 12 months, has not received compensation for investment banking services from the subject company in the past 12 months, does not expect to receive and does not intend to seek compensation for investment banking services from the subject company in the next 3 months. LXM LLP USA has never owned any class of equity securities of the subject company. There are not any other actual, material conflicts of interest of LXM LLP USA at the time of the publication of this research report. As of the publication of this report LXM LLP USA, does not make a market in the subject securities.