

August 13, 2017

The inflation rate accelerated; financial conditions remain tightened

The monthly headline inflation pace accelerated to 3.2% MoM, leading the annual inflation rate to a record high level of 33.0% YoY in July. This was no surprise following earlier energy products price hike, in addition to the VAT rate increase to 14%. We expect the monthly pace to decelerate going forward as the impact of the inflationary shock gradually fades away. Moreover, our preliminary Financial Conditions Index (FCI) reading for August suggests continued monetary tightening despite the recent decline in the government treasuries' yield.

Moved ahead of the curve, now the MPC shifts to Wait-and-See mode

In tandem with the second round of the energy subsidy cut, the Central Bank of Egypt (CBE) raised nominal interest rate by 400 basis points. A Monetary policy 'rule of thumb' states that the central bank should raise the nominal interest rate by more than the increase in the inflation rate. **Hence, we see no need for a further interest rate hike given July's inflation figures.** On the other hand, we reiterate that the first round inflationary reaction to the recently applied fiscal measures is inevitable and transitory. The monetary policy preemptive move, in this case, is meant to contain the second round effects (the demand-side reaction) of the inflationary shock. **Accordingly, in line with the transmission lags of the monetary policy, we deem it too early to start monetary easing in August.**

Mixed signals from the fixed income market; A demand surge reflects confidence and suggests a rate cut; The MoF selling more treasuries suggests holding interest rates unchanged

The yields on the EGP-denominated treasuries dropped by an average of 2.0% as of August 10. This coincides with a surge in foreign investors' demand, who felt more confidence seeing the CBE's foreign reserves reverting back to the pre-2011 levels. While this may reflect an interest rate cut expectation on Thursday's MPC meeting, the fact that the Ministry of Finance accepted higher-than-initially-planned amounts would suggest the opposite prediction.

We expect the MPC to hold the interest rate unchanged in August

Given the aforementioned developments, we believe that the current interest rate level is appropriate for the CBE to achieve its inflation rate target range of 13% ($\pm 3\%$) by 4Q2018. We reiterate that the inflation outlook, versus the CBE's target, remains the key factor to consider in order to anticipate the MPC's policy interest rate decision.



Ramy Oraby

Ramy.Oraby@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.