



Egypt MPC Watch|

10 March 2019

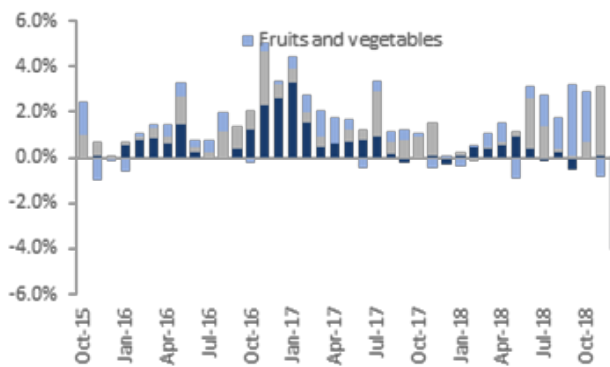


Despite Unsupportive Inflation Numbers, Rate Cut Still Possible

Inflation Spikes on Volatile Items

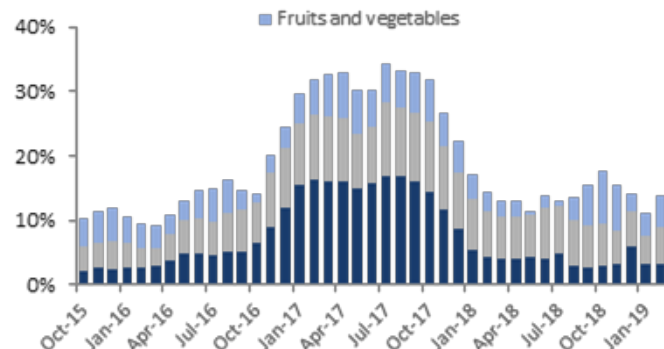
Inflation for February 2019 hits 13.9% YoY for total Egypt (urban and rural), against our expectations of 12.2%, which represents a 1.8% growth MoM, above our expectation of 0.4%. The increase reflects price hikes of 8.0% MoM for vegetables, 9.8% MoM for poultry and 1% MoM for dairy products. The highest by far contributing category to inflation this month is Food and Beverages. Within this category, the change is mainly driven by the Vegetables sub-category, reflecting hikes in the prices of tomatoes, cucumbers, potatoes and zucchini. The food and beverages category is also on top of the contribution to YoY inflation with 8.41 points against less than 2 points for the rest of the categories.

Chart 1: Contribution to Monthly Inflation



Source: Pharos Research, CAPMAS

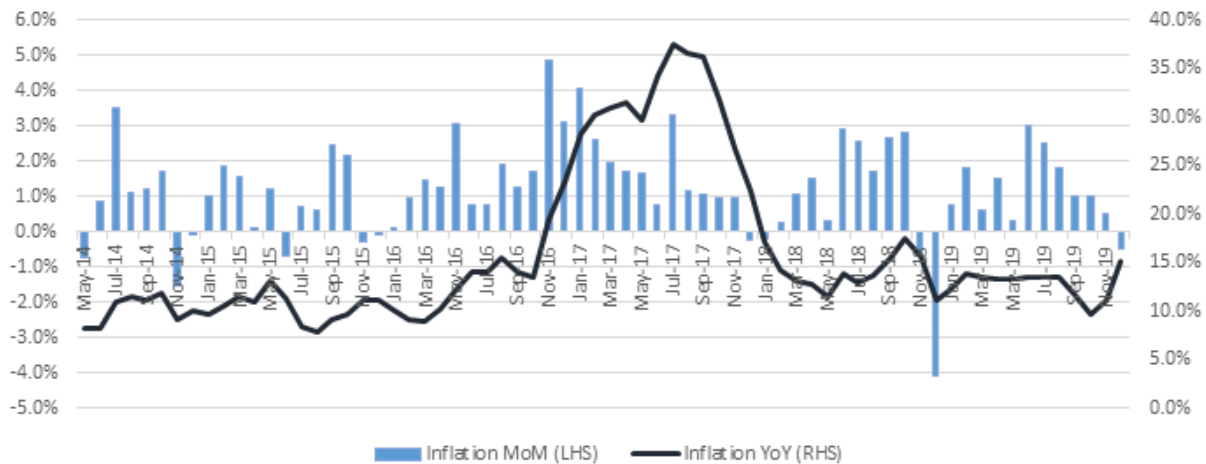
Chart 2: Contribution to Annual Inflation



Source: Pharos Research, CAPMAS

Inflation to Stabilize Going Forward

Going forward, we see annual inflation rates at 13-14% YoY over March - September 2019. Despite the spike in inflation over June-August 2019 as a result of the subsidy cuts, the base effect will contribute to stability in annual inflation figures.



Another 1% Rate Cut Still Possible

Despite the spike in inflation, we still see another 1% cut in rates on March 28. Several reasons support the rate cut, including:

1. If a rate cut was not made this meeting, there will be no window for rate cuts except six months down the line, on September 26. The new debt control strategy, which incorporates reducing the debt service as a percentage of total fiscal budget expenses, does need a rate cut and the six months window is long enough to create some savings for the budget.
2. With the high demand from foreign investors for EGP treasury instruments, and the consequent influx of USD into the Egyptian banking system, along with the resulting strength of the EGP (+2.6% YTD) tell us that foreigners like the Egypt story and will continue to inject portfolio investments in Egypt even after another 1% cut, since the strength in the currency (+2.6%) would have compensated them for the drop in rates (possibly 2% in 1Q19), which makes the overall carry trade still very attractive from their point of view. It is notable though that if the cut in rates results in some pressure on the EGP, any potential pressure on the currency will not push the exchange rate higher than the EGP18.00 mark, and consequently will not impact inflation.

In conclusion, despite the spike in inflation rate, due to highly volatile items, the debt reduction strategy and foreign interest in Egyptian treasury instruments support rate cut on March 28th.

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