FUNDAMENTALS

EGYPT MPC UPDATE: INFLATION FEARS FUEL HAWKISHNESS

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IN BRIEF

- The Central Bank of Egypt hiked its overnight deposit rate by 100bps to 19.25% in its August 2023 MPC meeting. Amidst sustained inflation in the second quarter, the policymakers delivered the first hike decision in three MPC meetings.
- Notwithstanding subdued external factors, broad-based pressures have given domestic inflation an upward lift. Inflation climbed to a record high of 35.7% y/y (2.1% m/m) in June 2023, driven by an uptick in core inflation to 41.0% y/y (1.7% m/m).
- The surge in banking system's net foreign liabilities to USD 27.1bn in June 2023 (Dec 2022: USD 20.1bn) cements further Egyptian Pound (EGP) wobbles in the near-term, exacerbated by the slow implementation of IMF reforms.
- Foreign investors increased their holdings of T-Bills at the end of 1Q2023, resulting in reduced portfolio outflow in the quarter. Nevertheless, we flag some jittery amongst foreign investors looking into Egypt due to the uncertain FX policy and the potential outcome of Moody's 'review for negative downgrade' which we expect will be completed this week.
- Squaring the circle of the authorities meeting end-March quantitative performance criteria and indicative targets, the delay in implementing FX reforms raises the bar for the upcoming IMF review. Although Egypt's Prime Minister announced signing contracts worth c. USD 1.9bn, effecting the sale of public assets mid last month, we assess a lack of urgency in executing these set of reforms
- Thus, we foresee a higher likelihood of another devaluation event prior to the completion of IMF review, to make up for the lost momentum with the privatization plan. We suspect that the monetary authorities held monetary policy consultation with the IMF; with June inflation at 20.7pp above the upper outer band of 15.0%.

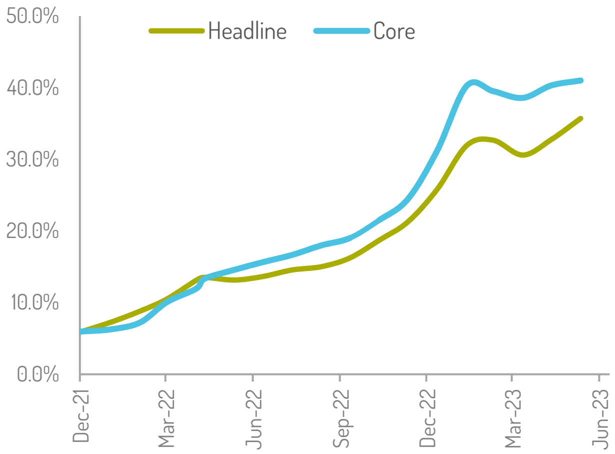
Inflation surge strengthens MPC hawkish bias

The Central Bank of Egypt hiked its overnight deposit rate by 100bps to 19.25% in its August 2023 MPC meeting. Amidst sustained inflation in the second quarter, the policymakers delivered the first hike decision in three MPC meetings. Nonetheless, the Committee noted an abating in key international commodity prices which has partly nudged the disinflation trend in global economies.

Notwithstanding subdued external factors, broad-based pressures have given domestic inflation an upward lift. Inflation climbed to a record high of 35.7% y/y (2.1% m/m) in June 2023, driven by an uptick in core inflation to 41.0% y/y (1.7% m/m). Base effect and the implementation of higher select subsidized food prices as announced by the Ministry of Internal Trade and Supply took food, excluding fruits and vegetables to 76.3% y/y, lifting the core segment of the CPI basket.

Other services and paid services, with a weighting of 27.3% and 7.0% of the CPI basket, respectively, each edged high by 0.9% m/m, sustaining the broad-based price increments of the core components. Outside the core sub-group, regulated items rose by 17.0% y/y (4.1% m/m), propelling the headline print higher. The inflation for regulated items was driven by a rise in prices of tobacco, diesel - as announced by the Fuel Indexation Committee – and the subsequent increase in inland transportation. With the lingering higher inflation outlook amidst the spillover from the higher price adjustments, the 100bps rate hike by the policymakers was warranted to quell inflation.

INFLATION

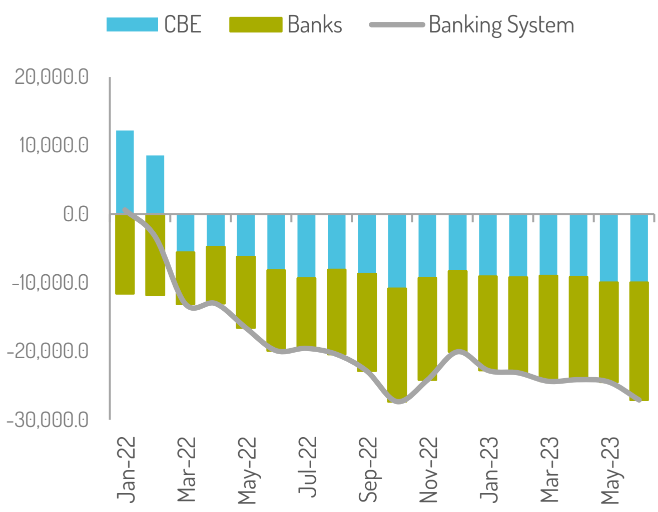


SOURCE: CAPMAS, CBE

Vulnerable external sector suggests future FX wobbles

The surge in banking system's net foreign liabilities to USD 27.1bn in June 2023 (Dec 2022: USD 20.1bn) cements further Egyptian Pound (EGP) wobbles in the near-term, exacerbated by the slow implementation of IMF reforms. The devaluation at the start of the year and the clearing of the FX backlogs were market positive. However, we observed a sharp rise in net foreign liabilities in the banking system in June 2023 by USD 2.6bn that was mainly attributed to the decline in commercial banks' foreign assets by USD 1.7bn and an increase in commercial banks' foreign liabilities by USD 905.5mn. This implies some future FX divergence between central bank and commercial banks, which points to elevated risk of EGP devaluation ahead.

NET FOREIGN LIABILITIES, USD MN



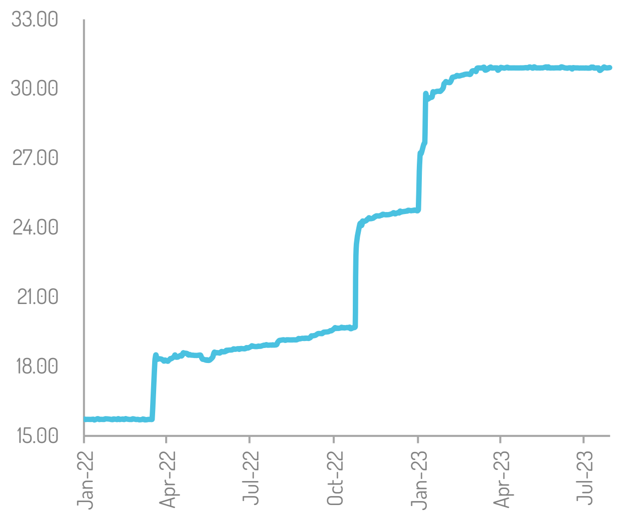
SOURCE: CBE

Despite the rising net foreign liabilities in the banking system, we can take some positives from the external sector. Cumulative 12-month Current Account Deficit as of March 2023 came in lower at USD 8.2bn (March 2022: USD 18.7bn), boosted by import compression and improvement in the Services balance from transportation and travel receipts. However, worker remittances in USD terms declined 18.7% in the period, but against the backdrop of 40.8% drop in the EGP against the USD, this implies some healthy pick up in EGP terms. Foreign investors increased their holdings of T-Bills from 11.6% (4Q2022) to 19.3% at the end of 1Q2023, leading to a reduced portfolio outflow of USD 412.7mn in the quarter. Nevertheless, we flag some jittery amongst foreign investors looking into Egypt due to the uncertain FX policy and the potential outcome of Moody's 'review' for negative downgrade which we expect will be completed this week.

But why the delay when everything seems okay?

Shifting gears to the ongoing IMF programme, the delayed first review implies a combined first and second reviews by mid next month. We commend the authorities' efforts of shoring net international reserves, as per the IMF programme's definition, to USD 37.2bn and above the target USD 23.0bn as at end June 2023. End-March 2023 targets for primary fiscal balance and tax revenue came in at EGP 47.0bn and EGP 740.7bn, respectively; meeting the targets. Squaring the circle of the authorities meeting the quantitative performance criteria and indicative targets, the delay in implementing FX reforms raises the bar for the upcoming IMF review. Although Egypt's Prime Minister announced signing contracts worth c. USD 1.9bn, effecting the sale of public assets mid last month, we assess a lack of urgency in executing these set of reforms.

EGYPTIAN POUND SPOT



SOURCE: BLOOMBERG

Staying on the sidelines of Egyptian assets

We perceive a higher likelihood of another EGP devaluation prior to the IMF review, to make up for the lost momentum with the privatization plan. In our view, FX adjustment remains the path of least resistance for the authorities. We suspect that the monetary authorities held monetary policy consultation with the IMF; with June 2023 inflation at 20.7pp above the upper outer band of 15.0%. We hold the view that there is some room for the MPC to tighten further this year c. 300bps as it restores credibility. With the 12-month T-Bill real yield printing 4.7% on an ex-post inflation basis, the return is less commensurate to our balance of risk assessment. As such, we remain less constructive on Egyptian assets.

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