MPC Watch
Research Report

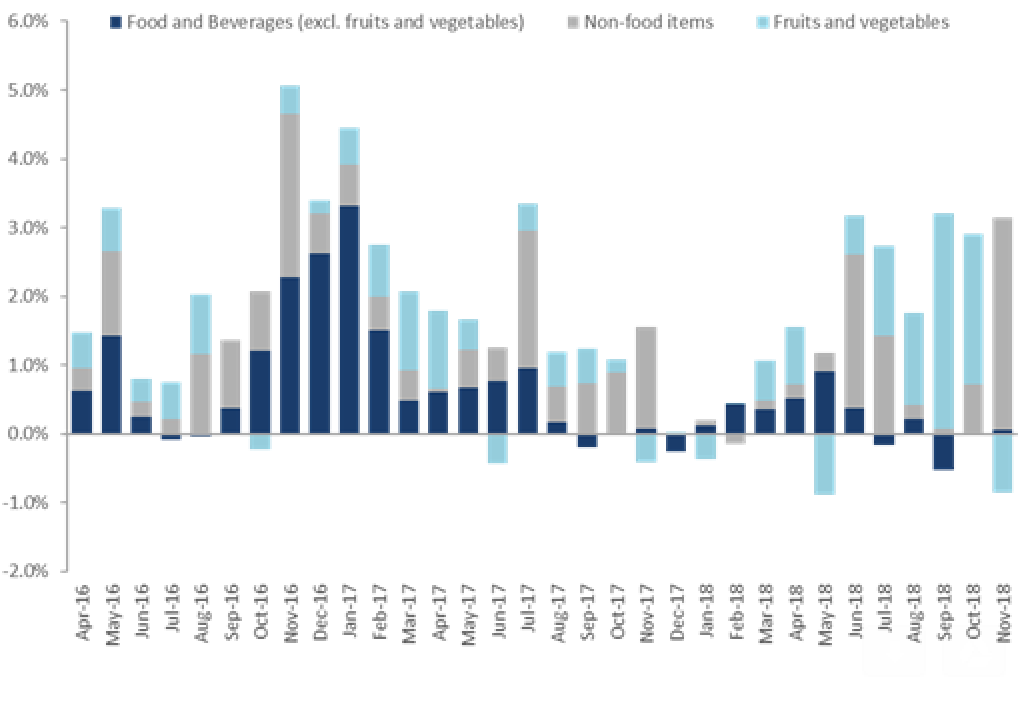
10 December 2018

Domestic Inflation Dynamics and EM Conditions Support Maintaining Rates

Monthly Deflation Recorded in November

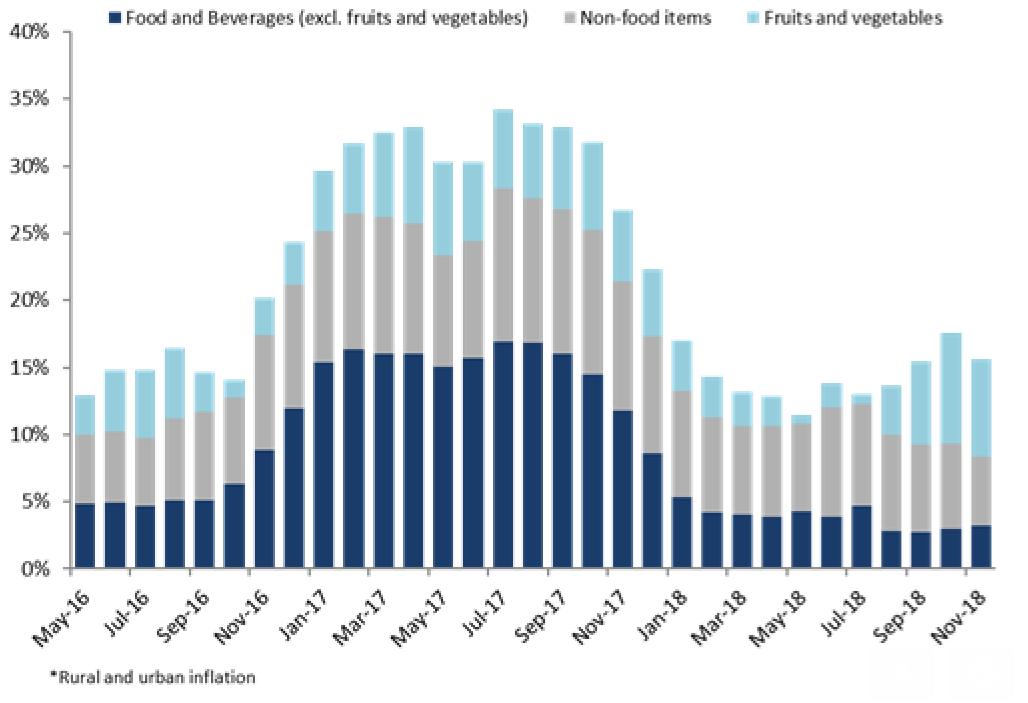
November has witnessed CPI decline of 0.67% in November, after recording 2.8% in October, while the annual inflation rate recorded 15.6% in November, down from 17.7% in October 2018. The monthly deflation in November was mainly attributed to the decrease in food and beverage prices by -1.40% MoM.

Chart 1: Contribution to Monthly Inflation



Source: Pharos Research, CAPMAS

Chart 2: Contribution to Annual Inflation

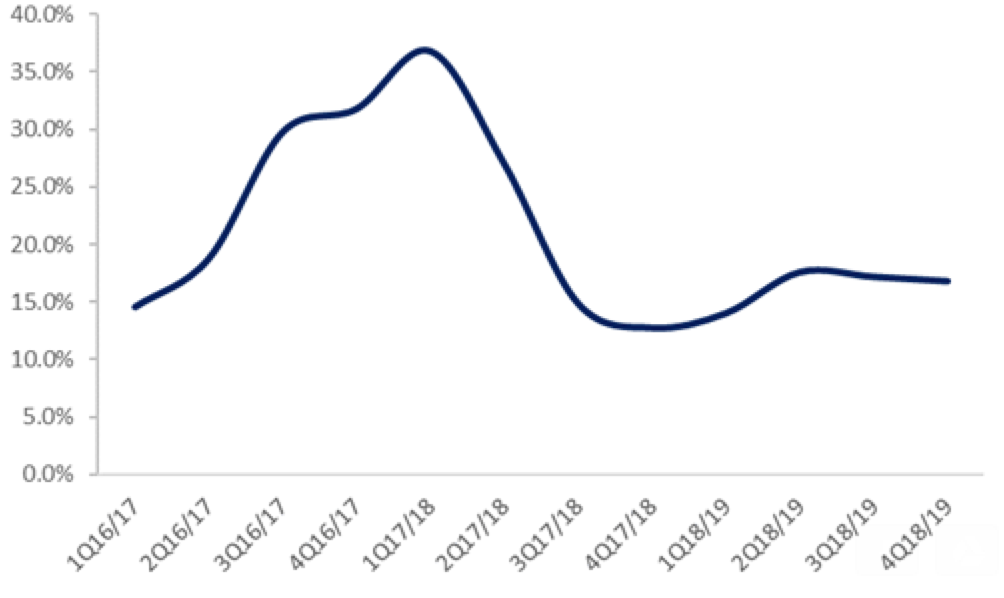


Source: Pharos Research, CAPMAS

Inflation will Stabilize in 3Q FY2018/2019, Assuming No Change in Energy Costs

Going forward, we expect the monthly inflation rate to accelerate by 0.5% in December 2018 (+16.4% YoY), mainly due to potential spillover effects from the change in the Customs exchange rate, despite the absence of a direct link between the decision and the CPI basket of goods. Furthermore, we expect inflation to accelerate from 14% YoY in 1Q FY2018/19 to 16.5% in 2Q FY2018/19. However, we expect it to decelerate again to be 16.4% YoY in 3Q FY2018/19 and 16.1% in 4Q FY2018/19.

Chart 3: Average Quarterly Inflation



Source: Pharos Research, CAPMAS

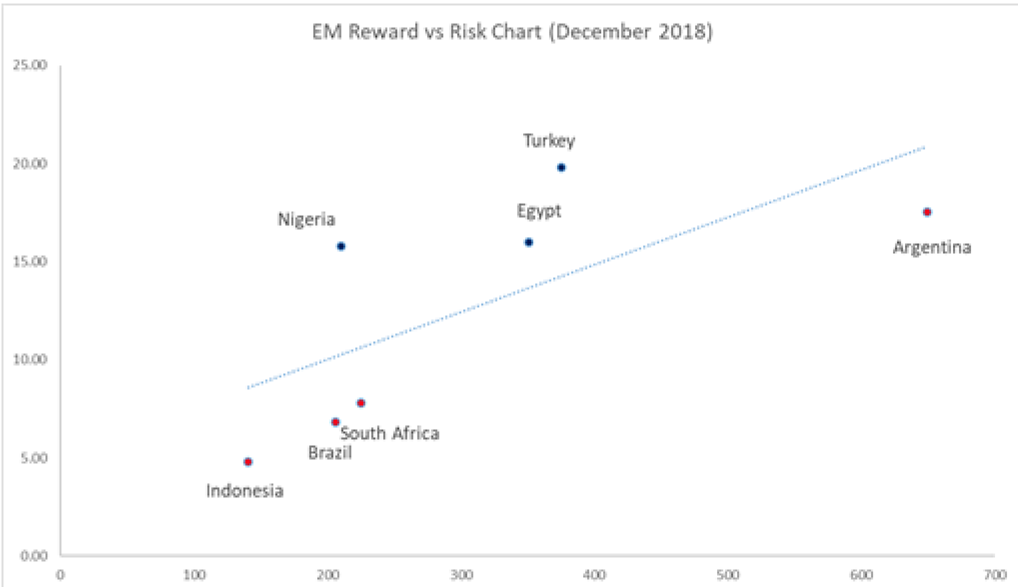
Foreign Ownership of Domestic Short Term Debt Declines

The foreign ownership of domestic short term debt has declined 17% MoM at the end of October 2018 to USD 11.8 billion, down from USD 13.2 billion in September 2018. It is worth mentioning that foreign holdings of T-bills to total outstanding T-bills issued has decreased to its 17-month low down from its peak in March 2018.

Emerging Markets High Yields Dictate Rate Stability

The yields in other EM such as Argentina, Turkey, and Nigeria have leveled off in November 2018, compared to October 2018, which creates room for Egypt to maintain policy rates. The *after-tax* yield on 1Y Turkish government T-bill has dropped to 19.80%, while the net yield on 1Y Argentinian government T-bill has reached 17.52%, and the yield on the Nigerian government T-bill has reached 15.77%. Egypt's after-tax yield is 15.98%, which is still competitive among these high yields due to Egypt's moderate risk levels, as reflected by the CDS rates.

Chart 5: EM Risk/Reward Matrix



Source: Pharos Research, CBE, Bloomberg

In conclusion, domestic inflation dynamics and EM monetary conditions support maintaining rates in the upcoming MPC meeting on December 27.

Radwa El Swaify

radwa.elswaify@pharosholding.com

Omar El Akhrass

omar.elakhrass@pharosholding.com