# Market Insights & Strategy

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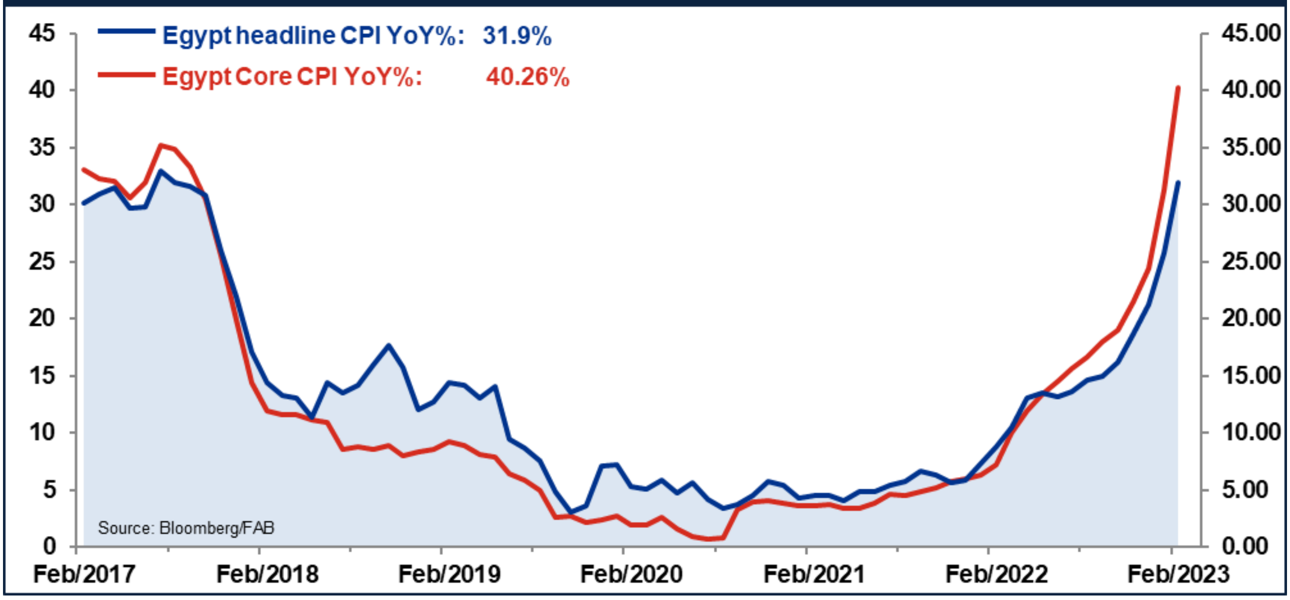
## FAB Insights
## Pre-CBE Thoughts - Walk like an Egyptian

- Spiraling inflation and widening currency gap call for action
- We would favour a consensus-busting 300bp rate increase
- But the FX market calling for a bold move, may be disappointed
- Runaway, record inflation also requires decisive policy action
- And the country's bigger reform strategy is dependent on it

For the latter half of this week our focus and anticipation will be targeted toward Egypt and in particular the CBE monetary policy decision, due for release tomorrow (March 30). With inflation pressures running hot in Egypt (as well as more broadly around the globe), and after the bank left rates unchanged at the last meeting (Feb 2 2023), we now expect the Central Bank of Egypt to resume its walk through the tightening process this week with the delivery of a new rate hike. The question though is how big a rate increase it might deliver on this occasion. We believe a 300bp hike could be appropriate, and with more to come after that.

**Runaway bride; inflation is being fueled by imported foods costs**



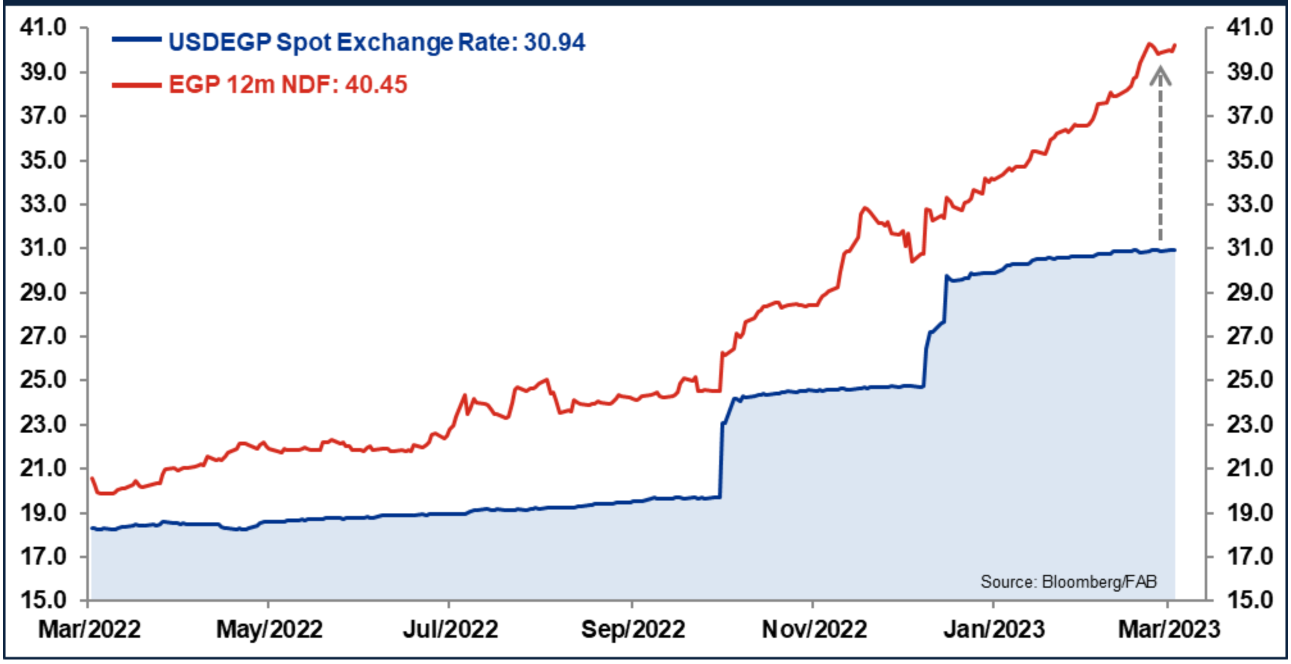
Given the magnitude of inflation – urban CPI accelerated to 31.9% last month from 25.8% in January – we believe that the balance of risk for the CBE this week lies to the more hawkish side. Indeed, there was clear evidence of persistent price pressures in the February CPI report, with both headline and core inflation rates recording significant acceleration, thereby indicating once again the broad-based nature of Egypt's inflation problem. With the CPI core YoY rate coming in at a whopping all-time high of 40.26% in February, it is easy to argue the case that the CBE now needs to step up with decisive, timely and comprehensive rate tightening in order to stop inflation becoming entrenched.

As is the case with other central banks around the globe, the major aim of the CBE is to wrestle control of inflation, but while price pressures may already be receding slightly in some geographies, they are not in Egypt. Rather, inflation seems likely to only rise further in Egypt in the coming months. And we know that the key driving force behind current inflation pressures in Egypt is imported food costs. Food prices are the largest single component in Egypt's CPI basket, accounting for 33% of the index.

As such, in our view, the CBE still has a lot of tightening work to be done, supporting the case for a larger-than-consensus rate increase on Thursday. Bloomberg consensus suggests that rates should be increased by 200bps this week – taking the Deposit Rate to 18.25% - but we see the possibility of a larger (perhaps 300bps) increase. Given its track record though, perhaps we should not be surprised if the CBE does not deliver in its entirety. For sure though the investor community would be left disappointed if the Bank only delivers a smaller incremental tightening – and even more so if it fails to deliver at all – and the market would react accordingly.

We certainly believe that the FX (EGP) market will also be hoping for a bold rates move from the Central Bank. With accelerating inflation having sent real Egypt rates deep into negative territory, resuming and maintaining the tightening cycle could be meaningful in terms of supporting investor expectations, not only by improving the outlook for positive portfolio flow, but also the extent to which it could help to support the pound – or at least limit further depreciation.

**Mind the gap between this and the parallel universe**




Indeed, after adopting a period of 'pause' last month, allowing the market to digest the 800bps of tightening delivered last year (in 2022), we would conjecture that the market will now be well positioned for a more significant rate move at this latest CBE meeting. But this is unlikely to be the end of the rate tightening story. As the government continues to try to entice hard currency capital inflows back into the country and underpin the currency (EGP) and as inflation remains elevated, we would suggests that further rate increases will be needed. The CBE terminal (deposit) rate will likely need to push above 20%, with 22.75% perhaps not an unreasonable target to hold for now.

A decisive rate hike this week would help to add some credibility to – and positive performance in – Egypt risk pricing, which has underperformed recently amid growing investor skepticism toward the macro outlook. With credit spreads having widened sharply in recent months and Egypt CDS currently in distressed territory (Egypt 5y CDS indicated on Bloomberg around 1400) the CBE clearly needs to act firmly to address investors' persistent concerns over financing needs as well as doubts around the government's commitment (or otherwise) to adhere to the IMF reforms.

In aggregate, we would suggest that a rate increase by the CBE this week will be an integral and necessary part of the economy's bigger reform strategy. Alongside the intended government asset sales, it is hoped that a higher rate structure and more flexible currency regime should all help to encourage the return of foreign capital and help to reduce FX pressures as well as narrow the gap between the official EGP rate and the parallel market rate, the latter of which has been widening again in recent weeks as investor uncertainty drives a more defensive FX positioning. The EGP spot rate is currently seen in the context of 30.90, whereas the 12-month NDF market currently shows the pound trading out to around the 40.00 level in a year's time.

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