

## EEMEA Strategy Watch

## Egypt is most exposed to El Nino

## El Nino might cause a delay in EGP depreciation

Egypt's high inflationary backdrop and exposure to soft commodities make it most vulnerable to El Nino (Exhibit 1). An inflation shock could reduce authorities' willingness to allow near-term EGP flexibility, especially in the lead-up to early presidential elections. This opens the door for the EGP carry trade through NDFs in the short term.

## Not much impact on front-end rates from El Nino

We see limited risks to our baseline for policy rates in major EEMEA countries from El Nino. The highest risks are in SA, which is one reason we do not receive front end there.

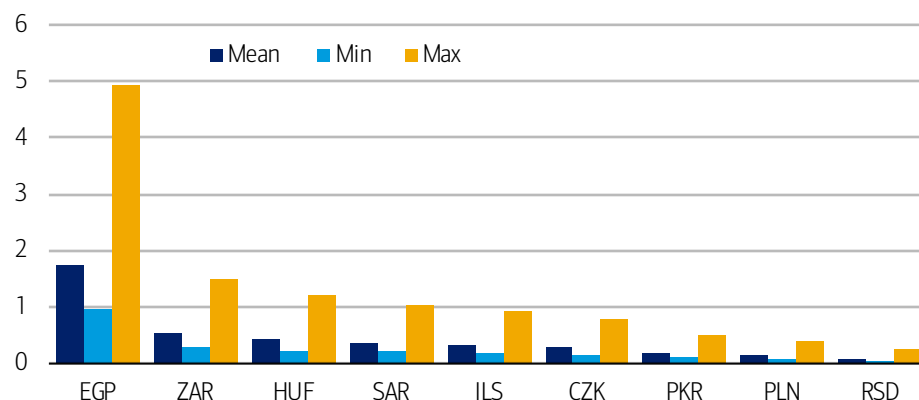
## Hiking cycles are over in EEMEA: receive in Czechia

In all EEMEA countries, central banks have either ended hiking or started easing. Everywhere, except Israel and South Africa, the 1y swap is below the interbank rate suggesting that receiver trades have started (Exhibit 2). For more details, see [Emerging Insight: Front-end rates: the most inefficient market in EEMEA 16 August 2022](#).

Our highest conviction receiver trade is in Czechia where we like to receive FRA 12x15 and pay the November central bank meeting to hedge the risk of a delayed start to the cutting cycle (open: -2.44, current: -2.50, target: -2.84, stop: -2.19). For more details, see [EM Alpha: Cuts are around the corner: enter a FRA flattener in Czechia 16 August 2023](#). El Nino risks are unlikely to significantly impact the easing cycle in Czechia, in our view.

## Exhibit 1: Egypt is most exposed to El Nino

Average peak inflationary impact of a mild, average, and severe El Nino in EEMEA



Source: Haver, BofA Global Research

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EEMEA Strategy  
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For a list of open trade recommendations and trade recommendations closed in the last 12 months, see [Global Emerging Markets Weekly: Trading cycles 15 September 2023](#)

## Abbreviations

EEMEA is Emerging Europe, Middle East and Africa

BOI is Bank of Israel

CEE is Central and Eastern Europe

SA is South Africa

NDF is non-deliverable forward

## Egypt is most exposed to El Nino

We use the methodology developed by our LatAm colleagues to estimate the potential impact of El Nino on EEMEA countries. For more details on methodology, see [Emerging Insight: LatAm – El Nino may complicate disinflation 17 July 2023](#)

### Besides the Czech front end receiver, we pay in Poland

In Poland, we have broken our rule of thumb and pay 1y swap with the December IMM start date (open: 4.28, current: 4.25, target: 5.1, stop: 3.75) as the central bank is unlikely to deliver the amount of easing priced into the curve either in our baseline or more dovish alternative scenario. We also think the usual strong correlation between 1y/2y swaps and the policy rate is likely to break down as the NBP cuts rates when inflation is at 10%.

We have a receiver bias in South Africa and Hungary as we like to receive after the last hike and because the market is more hawkish than our policy rate forecast in South Africa. However, with oil prices rising and the entry point not looking particularly attractive, we await better entry levels in both countries. Moreover, El Nino is also an upside risk for food prices in South Africa. As a result, we might see a delay in the cutting cycle.

In Israel, politics drives the front end and, without stabilization (or reduction) of political risks, it would be difficult to see it repricing lower.

### Egypt: El Nino exacerbates inflation vulnerabilities

Egypt's high inflationary backdrop and exposure to soft commodities make it vulnerable to a deterioration in global weather conditions. A further inflation shock could reduce the authorities' willingness to allow EGP flexibility and limit their ability to get the International Monetary Fund (IMF) program back on track. Urban inflation stood at 37.4% year-on-year (yoy) in August, with food price inflation at 68.7% yoy. The weight of food in the Consumer Price Index (CPI) is high at 34.4%.

El Nino could worsen drought conditions in Nile river countries (including Egypt), and impact Nile river annual water levels. The completion of the filling of the Grand Ethiopian Renaissance Dam (GERD) could further jeopardize water availability in Egypt as weather conditions warm up. Egypt's national adaptation strategies include prioritizing crops with lower water requirements, modernizing irrigation methods, and introducing water consumption saving schemes.

Egypt is also among the world's largest importers of wheat, most of which comes from Russia and, to a lesser extent, from Ukraine. To improve purchase terms, Egypt's General Authority for Supply Commodities (GASC) shifted to direct purchases rather than tenders, and diversified suppliers (despite reported payment lags). Authorities also provided incentives for local farmers to boost local wheat production. Egypt's wheat stockpiles remain relatively comfortable at 4.6 months as of August 2023, according to the authorities.

The authorities have also focused on raising trade and multilateral financing to reduce external financing pressures emanating from exogenous commodity price shocks. In August 2023, the authorities agreed to a US\$0.5bn 5-year wheat supply deal with the UAE-based Al Dahra and the Abu Dhabi Exports Office. In May 2023, the Saudi-based International Islamic Trade Finance Corporation (ITFC) doubled its credit limit to Egypt to US\$6bn to support purchases of wheat and petroleum products.

In June 2022, the World Bank approved a US\$0.5bn loan under the Emergency Food Security and Resilience Support Project to support reforms in food security policies, and in December of that year it approved US\$0.5bn in financing to expand and strengthen Egypt's social safety net.

### **El Nino phenomenon is a low to moderate risk in South Africa**

Weather experts are flagging the risk of the El Nino phenomenon in the coming months. The direct impact is likely to be drought conditions that could lead to a delayed start to planting and below normal rainfalls which negatively impact crop yields resulting in higher food prices.

The rainy season falls around November to March, which coincides with the summer. South Africa has been experiencing La Nina, the opposite phenomenon, over the past three years – in effect, above-average rainfall. So that can help mitigate the El Nino phenomenon given some reserves are already in the system. The last El Nino was in the 2015/16 rainy season and largely resulted in higher food prices and inflation exceeding the upper end of the 6% target, from around 5%.

### **El Nino impact on food prices in CEE muted in short run, but watch longer term**

El Nino typically affects CEE relatively less than in other regions, but it may add to the risk of persistent inflation in 2024, following a prolonged period of high inflation. Food inflation patterns since 2000 do not reveal any major impact of past El Nino events on CEE food inflation in the short run.

We investigate monthly food price growth in the years when El Nino started (T) and one year after (T+1) vs the sample. We do not see any significant evidence of higher food prices in CEE between Mar-Dec (T) through to May (T+1) compared to the sample median. Together with the currently high food retailers' margins (well above long-term trends in Hungary, Poland and Romania), we do not see any major risks to near-term food disinflation trends in the region.

However, in Jun-Dec (T+1), CEE food price growth tends to outperform the sample – Czechia, followed by Hungary, records the most deviation during this period. The keen-to-cut central banks may thus want to be cautious with the easing cycle, particularly in Hungary and Poland where inflation will likely remain well above targets in 2024.

### **El Nino should not make a difference to BOI's path**

Inflation in Israel has been moderating since it peaked at 5.4% in January. BOI expects headline inflation to hit the upper-bound of the target range of 3% by 1Q 2024. Food inflation (excluding fruit and vegetables) decreased from a peak of 5.9% to 4.4% in July. Results of our study show that on average episodes of El Nino could have an adverse effect on food inflation in Israel but at low levels of c.0.3%. This is mainly due to agricultural imports, mostly grain and animal feed that impact food prices locally. However, even in extreme cases, our study shows the impact would not be large enough to tame the moderation in headline inflation this winter. Therefore, we don't expect El Nino to impact the monetary policy path implied by our forecasts. If Israel harmonizes its food regulation with that of the EU as planned, this may help ease medium term food inflation.

### **Pakistan: El Nino is one of many risks**

The UN Global Climate Risk index lists Pakistan as the fifth-most vulnerable country to climate change globally as it is exposed to an increasingly high risk of severe extreme weather events. Taking this into account, our findings of a relatively small exposure to the El Nino effect is a bit surprising. We attribute this to the fact that apart from El Nino Pakistan seems to be impacted by many other climatic effects, most of which could have a dramatic inflationary impact like devastating 2022 floods, which happened outside of the El Nino period. As the country has seen some form of a climatic emergency almost every year since 2000, such exposure might have distorted the statistical dependence of domestic inflation on El Nino. Nevertheless, although we see no statistically significant impact from El Nino on Pakistan inflation, we note that with food accounting for some 39.5% of country CPI - any major material increases in global food prices may still constrain the expected disinflation trend in the near future. All of this, on top of any potential related climatic emergency as a result of El Nino could further escalate

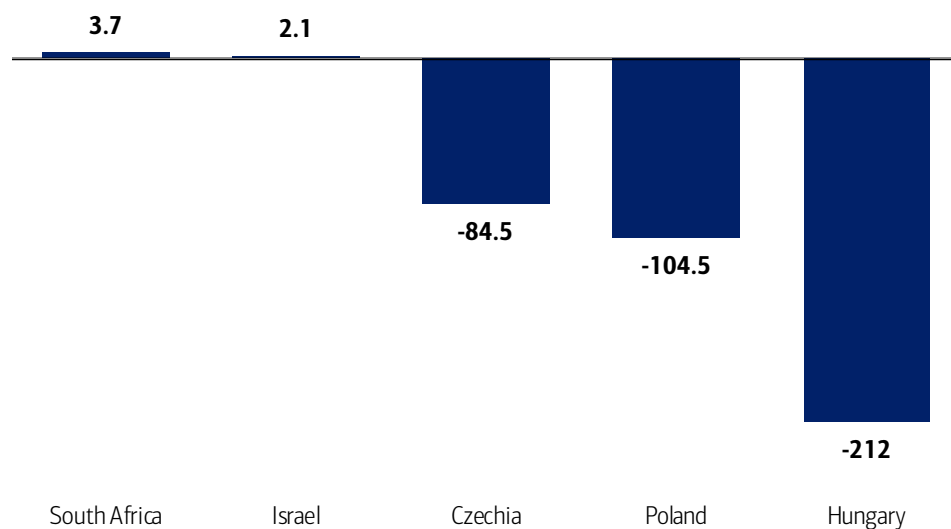
Pakistan's fiscal and debt tensions, as well as complicate compliance with the IMF conditionality.

### Serbia: plenty of other inflation drivers

According to our findings, Serbia appears to be one of the least exposed to El Nino in terms of inflation. We think this can be attributed to the fact that, to a significant degree, the country is the only one in the region that is a net exporter of food. On top of that, over the period of the study, the country had seen idiosyncratic trends in domestic inflation related to its post-war recovery as well as drastic shifts of the monetary policy regime, which seem to have distorted correlations further.

### Exhibit 2: 1Y swap minus 3M interbank

Receiver trades in the front end have started in Czechia and Hungary, in our view



Source: Bloomberg, BofA Global Research

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