Central Bank of Egypt

Press Release

July 6, 2017

In its meeting held on July 6, 2017, the Monetary Policy Committee (MPC) decided to raise the overnight deposit rate, overnight lending rate, and the rate of the Central Bank of Egypt's (CBE) main operation by 200 basis points to 18.75 percent, 19.75 percent, and 19.25 percent, respectively. The discount rate was also raised by 200 basis points to 19.25 percent.

Annual headline inflation in May 2017 fell for the first time since October 2016 to record 29.7 percent compared to 31.5 percent in the preceding month. The drop was partly due to a favorable base effect stemming from the exchange rate depreciation in March 2016 that strongly impacted prices in May 2016. Meanwhile, annual core inflation continued to be supported by favorable base effects since March 2017, dropping to 30.6 percent in May from 33.1 percent in February.

Monthly headline inflation stabilized at 1.7 percent in May 2017, while monthly core inflation rose to 2.0 percent in May from 1.1 percent in April. The impact of the November 2016 economic reform measures on prices of goods and services has largely passed-through, with the lagged impact affecting prices of items that witnessed delayed or seasonal consumption such as pilgrimage services in May, which contributed by 0.6 percentage points and 0.9 percentage points to headline and core inflation, respectively.

Excluding effects of transitory shocks, underlying inflation remained somewhat higher than consistent with achieving the CBE's target, affected by price-setting behavior in line with annual inflation of 10 percent historically, which has been further magnified recently due to second-round effects of the economic reform measures. This has been reflected especially in food components of core consumer as well as producer prices. Additionally, higher prices of hydrocarbon products effective June 29, 2017, higher value added taxes effective July 1, 2017, higher electricity prices scheduled for July 2017 as well as other potential regulated price adjustments further increase inflationary pressures.

Annual real GDP grew by a revised 4.3 percent in 2016/17 Q3, strengthening from the 3.8 percent and 3.4 percent recorded in the preceding quarters as well as from the 3.6 percent recorded in 2015/16 Q3. This coincided with the narrowing of the unemployment rate to 12.0 percent in 2016/17 Q3 from 12.4 percent and 12.6 percent in the preceding quarters. The structure of economic growth shifted with declining contribution of consumption and increasing contribution of net exports as well as investment by a lesser extent. Tourism, natural gas, trade, construction and non-petroleum manufacturing were the main sectors driving economic growth. This was partly supported by looser monetary conditions stemming from the exchange rate depreciation.

Annual broad money (M2) growth has been strongly affected by revaluation effects of its foreign currency components, recording 39.4 percent in May 2017. Excluding revaluation effects, annual broad money growth increased to 22.1 percent in May 2017, mainly due to the recovery of net foreign assets as well as higher loans to the private sector, while the contribution of net claims on the government eased given higher net external and non-bank financing. In the meantime, annual reserve money (M0) growth adjusted by overnight deposits and seven-day deposit auctions declined to reflect the absorption of short-term excess liquidity, consistent with the tighter monetary policy stance. Furthermore, currency in circulation outside the CBE as a percent of local currency deposits has been reverting to pre-2011 averages, implying normalization of money holding behavior.

Developments in the external environment show some firming of international commodity prices on annual terms, despite registering monthly declines since March 2017 mainly on the back of crude oil prices, while food prices declined at a relatively slower pace. Meanwhile, global inflation and economic growth continue to maintain weak pressures on domestic prices, given their moderate recovery which supports the gradual tightening of global monetary conditions.

Against this background, the balance of risks surrounding the inflation outlook has tilted more strongly to the upside with recent economic and monetary developments. Consequently, the MPC decided that tightening monetary conditions is warranted to achieve the inflation target of 13 percent (+/- 3 percent) in 2018 Q4 and single digits thereafter. The MPC reiterates that the objective of its tighter stance is not to offset first-round effects of supply-shocks, rather to contain second-round effects and ensure that the inflation outlook is consistent with achieving the targeted disinflation path. As soon as underlying inflation starts to moderate, the MPC envisages a measured easing of the monetary stance to allow for a reduction in interest rates.

The MPC will continue to closely monitor all economic and monetary developments as well as the balance of risks, and will not hesitate to adjust its stance to offset anticipated upside or downside deviations from the inflation target.

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