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EGYPT'S INCREASING FOOD PRICES DRIVING HIGHER INFLATION

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Report Highlights:

On July 10, 2016, the Central Administration for Public Mobilization and Statistics (CAPMAS) released its latest headline Consumer Price Index (CPI) numbers for the month of June, reflecting an increase of 0.78 percent from May, bringing headline inflation to a seven-year high of 13.97 percent. According to CAPMAS, one of the key drivers was food prices, increasing by 2.1 month-over-month. Restrictive measures on grain and soybean imports have contributed to higher food prices in Egypt.

General Information:

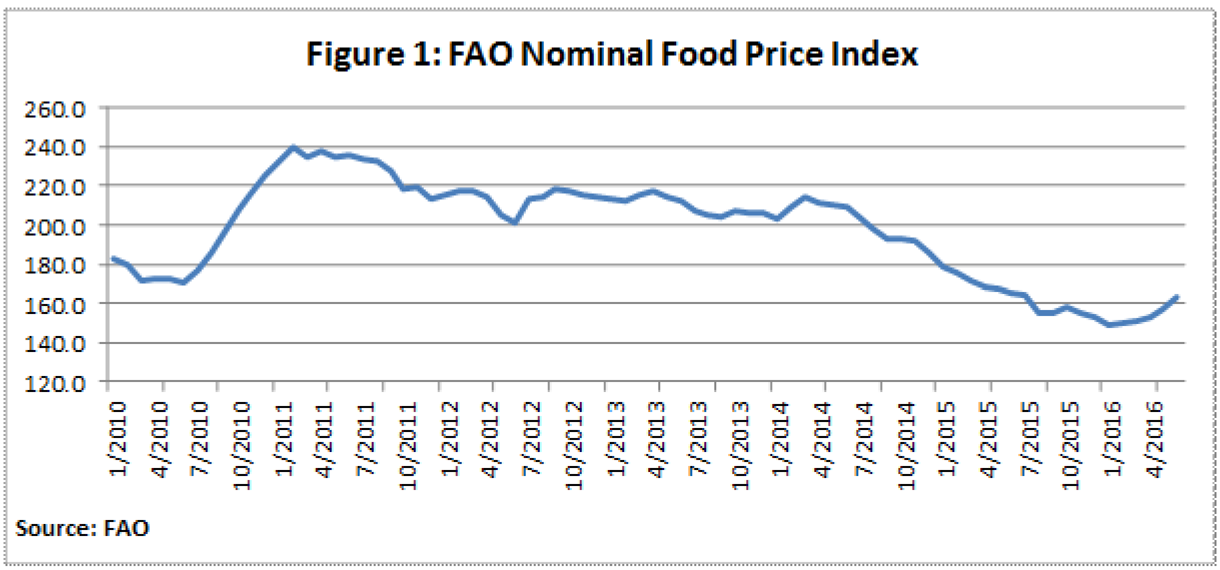
EGYPT'S HIGHER FOOD PRICES CONTRIBUTING TO INCREASING INFLATION

On July 10, 2016, a CAPMAS report stated that the CPI for the month of June increased 0.78 percent from May, a slowdown from May's monthly increase of 3.05 percent from April, which was the largest monthly increase since July of 2014. In both cases the key drivers were food prices, increasing 3.8 percent and 2.1 percent in May and June, respectively.

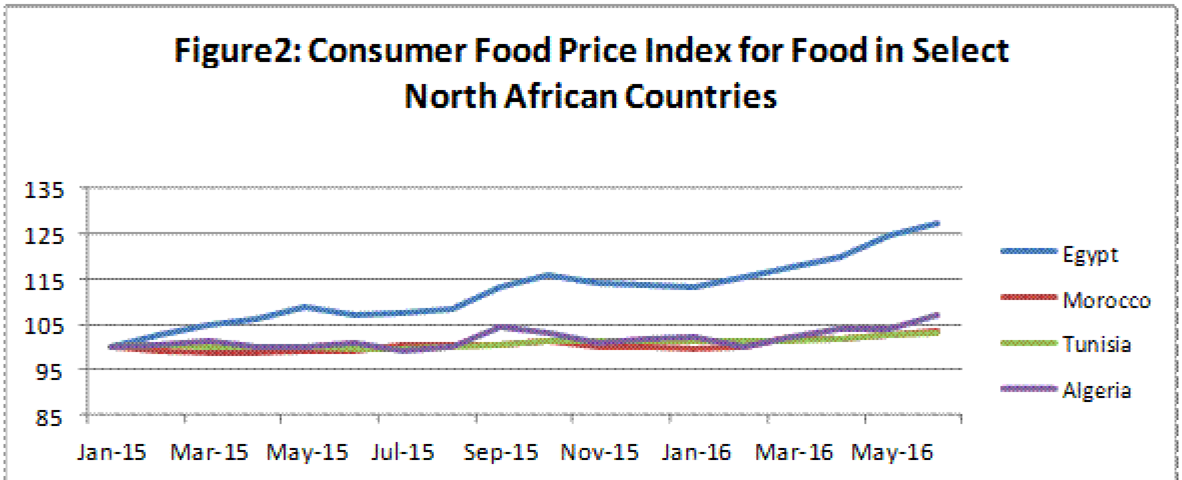
As a result, with the latest June numbers, despite attempts to control inflation, the official annualized rate reached a seven year high of 13.97 percent. On June 16, the Central Bank, reacting to May's increasing inflation, again raised interest rates by 100 basis points, hiking the overnight deposit rate to 11.75 percent. In its press release announcing the interest rate increase, the Central Bank stated that it needed to curb medium term inflation due to "…regulated price adjustments which contributed 0.4 percentage points, supply shocks such as the increase in rice prices which contributed by 0.5 percentage points, seasonal effects of the holy month of Ramadan, and a lagged pass-through effect from the March 14, 2016 exchange rate adjustment. [sic]"

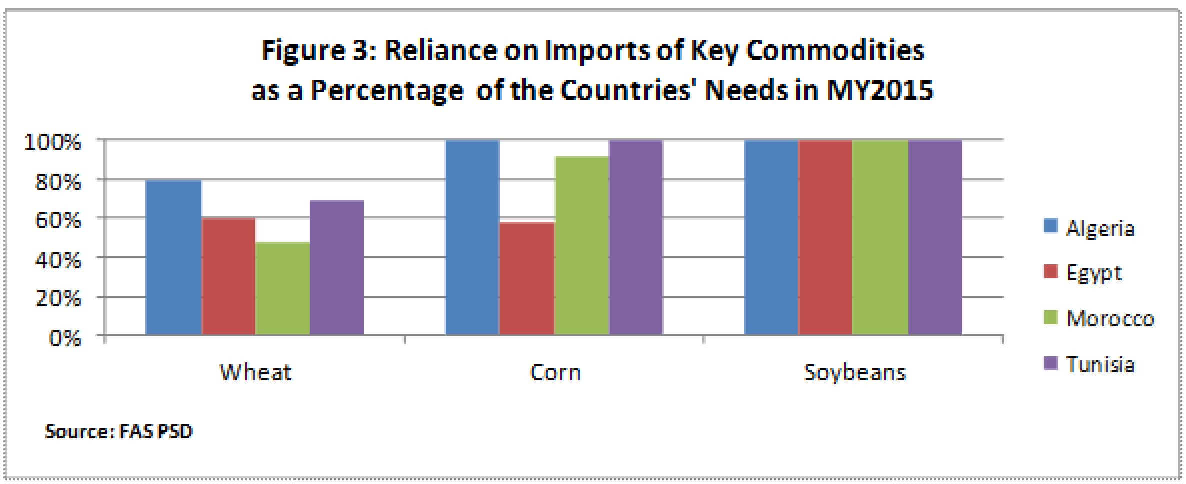
SUPPLY SHOCKS

Part of the supply shocks have been caused by the Ministry of Agriculture and Land Reclamation's Central Administration for Plant Quarantine's (CAPQ) agricultural import measures (see June 2016 report) and the Central Bank's efforts to address its foreign exchange shortfall, which have helped cause distortions in the Egyptian food market at a time of low global commodity pricing. Figure 1 illustrates global decreases in food prices, as demonstrated by FAO's Food Price Index.



In North Africa, Egypt is in a unique situation, as its domestic food prices have risen despite the global decrease in food prices. The downward trend in food prices accelerated in 2015, diverging significantly from its North African neighbors (Figure 2) that face similar sufficiency challenges in key commodities (Figure 3). From January 2015 to April of 2016, Egypt's North African neighbors have been able to maintain food inflation below six percent, in the same period Egypt's food inflation soared to 27 percent. Much of the increase in Egypt's food prices has been caused by foreign exchange shortages that led to an official devaluation of the Egyptian pound in March and a much-higher exchange rate in the parallel Egyptian pound market. Since Egypt imports 60 percent of its food requirements, Egyptian customers have had to pay more for much of the food they consume.



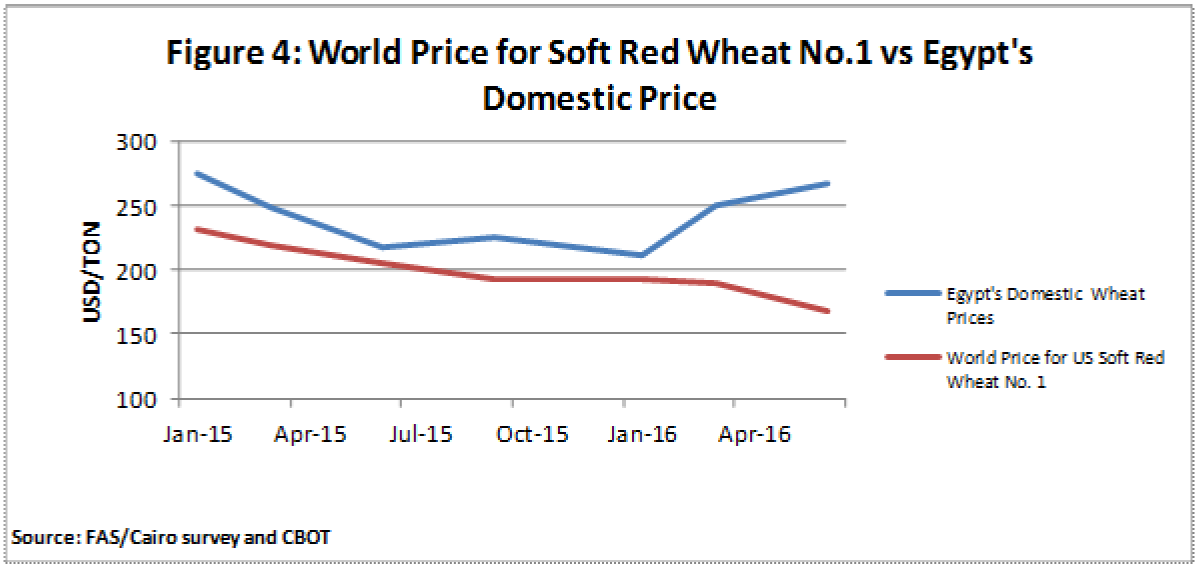


Additional Drivers of Higher Food Prices

Wheat

In December of 2015, Egypt's Central Administration for Quarantine (CAPQ) rejected a 63,000 MT shipment of French wheat due to the presence of ergot fungus. The shipment was rejected despite having ergot levels below the 0.05 percent threshold stipulated in Egyptian and international wheat standards. This was the first time that Egypt's CAPQ rejected a wheat shipment on the premise of zero tolerance for ergot.

This decision rattled world grain markets, with a-larger-than-expected spillover in Egypt's domestic market. Figure 4 highlights how CAPQ's actions decoupled Egypt's domestic price from the world price. Usually the wheat price differential includes transport fees and costs due to specification and inspection requirements, as well as the domestic support price. However, after the December rejection, the domestic market price reflected a premium that traders are now charging Egypt in order to hedge against the uncertainty caused by CAPQ's new policy stance. The spread in world market prices and domestic prices went from an average of $40/MT to a range of $80-110/MT.



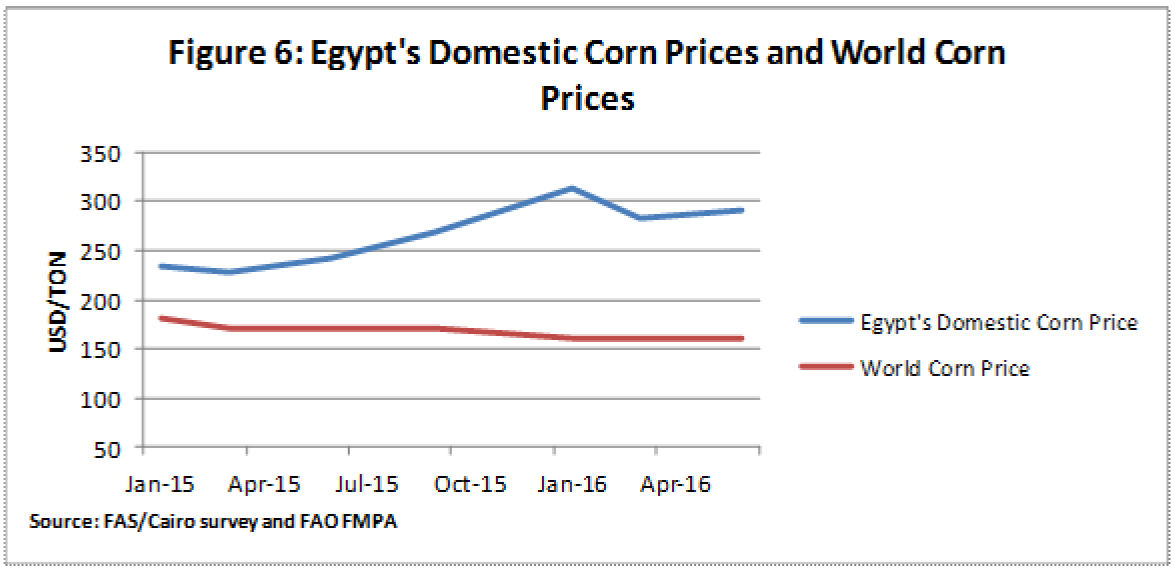
Egypt would be hard-pressed to import ergot-free wheat which is present in 66 countries, including all the major exporters: Argentina, Australia, Canada, France, Romania, Russia, Ukraine and the United States. As a result of the Prime Minister's intervention in June 2016 on this issue, it appears that Egypt will abide by the aforementioned internationally-accepted ergot tolerance level of 0.05 percent.

Figure 5: *Claviceps purpurea* distribution

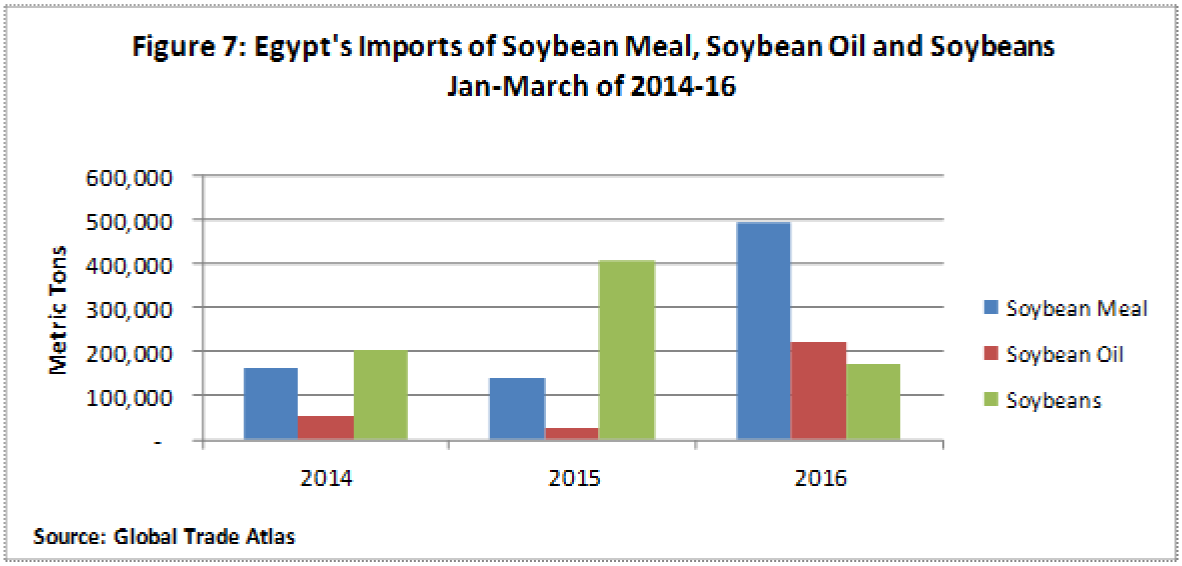
Source: CABI

Corn
Egypt's relies on imported corn to meet 60 percent of its consumption needs; however, its animal production sector relies on imported corn to meet more than 90 percent of their requirements. Any price movement in corn directly impacts key domestic products that account for the bulk of the consumption demands of Egypt's consumers. These include poultry, dairy, eggs, fish and breakfast cereals.

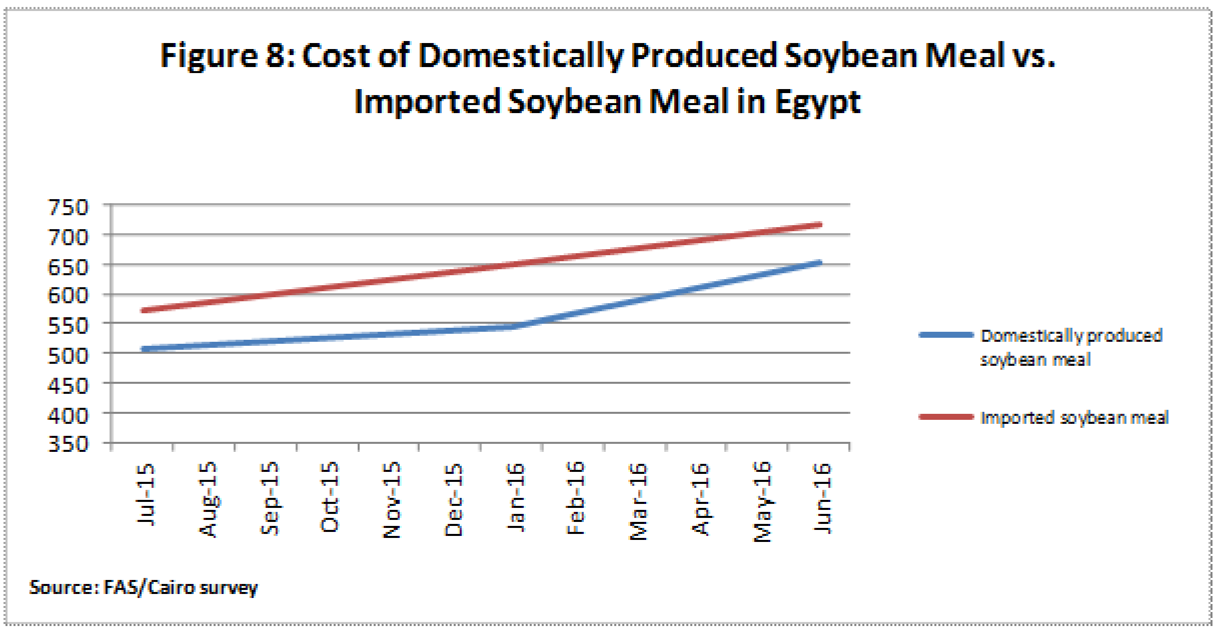
Corn imports have been affected by the shortage of foreign exchange and CAPQ's restrictive measures. Despite being a commodity on the Central Bank's priority list, corn traders and importers have struggled to obtain forex to conduct business. Consequently, they have been pressed to source forex in the parallel market at a premium of 15-30 percent. In December 2015, domestic corn prices surged significantly when CAPQ rejected soybean and wheat shipments due to *Ambrosia spp*. and ergot findings. The corn industry reacted swiftly by charging a risk-premium on imported corn, fearing that they would also suffer from CAPQ's new policy approach. Figure 6 illustrates the surge in the spread between international and domestic prices, escalating from \$50/MT to \$120/MT with an all-time high in January of 2016 of \$160/MT.



Soybeans
Egypt is 100 percent dependent on soybean imports, and soy is the commodity that has been hit the hardest by CAPQ's stringent application of new regulatory standards. Egypt's expanding and once thriving soybean crushing industry has incurred enormous losses as it has reduced its soybean sourcing due to a growing number of rejected shipments on *Ambrosia spp*. concerns. The rejected shipments have forced the country to increase its forex spending on much needed soybean meal and soybean oil products (Figure 7), rather than produce them domestically using imported soybeans, which add value domestically.



Risks associated with *Ambrosia spp.* are mitigated when soybeans are crushed and processed, a measure widely accepted by much larger importing nations including China, the EU, Japan and Mexico. Should CAPQ continue rejecting soybean shipments, Egypt will import close to one million metric tons (MMT) of additional soybean meal, paying a premium of $60/MT (Figure 8) or $60 million in 2016 alone.



In addition to the loss of value addition and increasing foreign exchange expenditures, the domestic price of soybeans in Egypt has increased disproportionally to world soybean prices. Traders and end users need to access forex at a significant premium in the parallel market, and suppliers factor in the risk premium due to CAPQ's practices. The spread between domestic and international prices has surged from an average of $120 to an average of $320 (Figure 9).

Figure 9: Egypt's Domestic Soybean Prices and World Soybean Prices