

## Strong external FX buffers, resilient growth, and multilateral support shield Egypt against the worst outcomes

### Mona Bedeir

Senior Economist

Tel.: +202 3300 5722

[MBedeir@egy.primegroup.org](mailto:MBedeir@egy.primegroup.org)

**According to the CBE, Egypt is standing on a more solid ground to withstand any economic shocks, including the current unprecedented novel virus outbreak, than any time before thanks to:**

- 1) The strong stock of foreign currency buffers where foreign currency holdings at the CBE reached USD48.7bn (equivalent to more than 8 months of merchandise imports), by the end of February 2020.
- 2) The surge in foreign currency liquidity in the banking sector, including USD23bn in foreign assets and banks' NFA of USD7bn by the end of February 2020.
- 3) The growth dynamics that depend on diversified sectors.
- 4) The successful economic reform backed by the IMF bold reform agenda that put the public finance on a more sustainable footing and shored up confidence in the local currency.
- 5) The well-capitalized and healthy banking system.

**The collapse of oil prices, lower demand for petroleum products during the partial lockdown measures, and the expected plunge in non-essential consumption imports should offset the fall in exports.** We share the same view with the CBE ([please read our last BoP note](#)) that the trade deficit has a room to narrow during this crisis. Non-hydrocarbon exports will gain some support from higher gold prices (6% of Egypt's total exports). Additionally, raw food exports will have a growth opportunity at a time when shutdown and government draconian measures are affecting capacities of Egypt's export competitors. Furthermore, consumer goods, which account for 20% of total imports, are projected to fall due to weaker demand.

**The travel balance and transfers will bear the brunt of the crisis.** The CBE, however, still expected the crisis to be manageable as the expected fall in tourism revenues will be partially offset by the fall in travel expenses. Also, the IMF support should help the country in financing the shortfall in current account FX revenues.

***In our view, the crisis is manageable over the short term, where the country can rely on its external buffers and multilateral supports to ease the sharp fall in current FX revenues. The current stock of foreign currency at the CBE is USD36.4bn, which still cover around 7 months of merchandise imports. With the duration of the current crisis still a major risk, it was not clear for us how the CBE is assessing the length of the virus-led global turmoil and the impact of longer-than-expected duration of the crisis.***

**Exchange rate policy was consistent with the CBE strategy to depend on its buffers to mitigate the effect of non-fundamentally-driven shocks like COVID-19.** The CBE aims to shield the local currency against speculation and suppress any dollarization trend that would be triggered by fears and uncertainties. The CBE also emphasized that this policy has not accumulated imbalances, and unlike in 2016, there is no risk of pronounced FX adjustments down the road.

*In our view, the CBE had the capacity and the reasons to keep the local currency stable in such cataclysmic events, and when it became expensive the CBE started to balance between the cost and risks of currency depreciation. In this respect, we have to bear in mind that the CBE is dealing with a complicated crisis with protracted duration and uncertainty risks that affects: 1) FX revenues, 2) FX buffers at the CBE and the banking sector, 3) capital flows, and 4) borrowing conditions in global markets. The CBE has to address carefully how each of these channels affects exchange rate movements, import cost, and costs of debt service.*

*In this respect the CBE is going to: 1) depend more on multilateral funding to mitigate the crisis, including using the IMF's RFI and SBA lending facilities, given their lower cost and longer maturities, 2) roll over the GCC deposits, which account for 15% of the total external debts, and 3) diversifying its external financing instrument.*

**The outlook for restoring foreign appetite in the local debt market is still favorable.** The CBE acknowledged that the country has lost c.USD17bn of foreign investments in the local debt market during the last two months. The wave of these outflows has eased since then, and the CBE managed to counterbalance disruptions caused by this sudden stop without undergoing sharp and costly depreciation, unlike most other EM peers.

*We share with the CBE the positive outlook over the future capital mobility, thanks to four key fundamentals that foreign investors base their decision on:*

- 1) Underlying favorable macro fundamentals that Egypt built over the last four years, thanks to successfully-implemented reforms.*
- 2) Expected economic growth, where Egypt is projected to outperform its EM peers and preserve its growth level within the positive territory.*
- 3) Expected return differentials, which also are still favorable for Egypt given the current low-interest environment in advanced countries and the stable domestic inflation environment.*
- 4) Egypt's perceived creditworthiness, where the credit rating agencies have recently maintained their ratings with a positive outlook. Egypt's 5-year CDS rates started to show some improvement after the announcement of the IMF's support package.*

*Recently, the yield on Egypt's 10-year Eurobond has declined from 10.5% by the end of March to 7% currently, paving the way for the government to tap international markets when it needs to without bearing substantially high cost.*

## PRIME SECURITIES

### Shawkat El Maraghy

Managing Director

Tel.: +202 3300 5622

[SElmaraghy@egy.primegroup.org](mailto:SElmaraghy@egy.primegroup.org)

## SALES

### Mohamed Ezzat

Head of Sales & Branches

Tel.: +202 3300 5784

[MEzzat@egy.primegroup.org](mailto:MEzzat@egy.primegroup.org)

### Mohamed Ashmawy

Head of Institutional Sales

Tel.: +202 3300 5612

[MAshmawy@egy.primegroup.org](mailto:MAshmawy@egy.primegroup.org)

### Amr Alaa, CFTe

Team Head – Institutional Desk

Tel.: +202 3300 5609

[AAlaa@egy.primegroup.org](mailto:AAlaa@egy.primegroup.org)

### Mohamed El Metwaly

Manager

Tel.: +202 3300 5610

[MElmetwaly@egy.primegroup.org](mailto:MElmetwaly@egy.primegroup.org)

### Emad El Safoury

Manager

Tel.: +202 3300 5624

[EElsafoury@egy.primegroup.org](mailto:EElsafoury@egy.primegroup.org)

### Shawkat Raslan

Heliopolis Branch Manager

Tel.: +202 3300 5110

[SRaslan@egy.primegroup.org](mailto:SRaslan@egy.primegroup.org)

### Mohamed El Henawy

Nasr City Branch Manager

Tel.: +202 3300 5166

[MElhenawy@egy.primegroup.org](mailto:MElhenawy@egy.primegroup.org)

### Nashwa Abuelatta

Alexandria Branch Manager

Tel.: +202 3300 5173

[NAbuelatta@egy.primegroup.org](mailto:NAbuelatta@egy.primegroup.org)

## HEAD OFFICE

### PRIME SECURITIES S.A.E.

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*Member of the Egyptian Exchange.*

2 Wadi Elnil St., Liberty Tower, 7<sup>th</sup> Fl.

Mohandessin, Giza

Egypt

Tel: +202 3300 5700/770/650/649

Fax: +202 3760 7543

## BRANCHES

### HELIOPOLIS

7 Elhagaz Square

Heliopolis, Cairo

Egypt

Tel: +202 2777 0600

Fax: +202 2777 0604

### NASR CITY

9 Elbatrawy St.

Nasr City, Cairo

Egypt

Tel: +202 3300 8160

Fax: +202 3305 4622

### ALEXANDRIA

7 Albert Al Awal St.

Smouha, Alexandria

Egypt

Tel: +202 3300 8170

Fax: +202 3305 4622

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