

CAD gains eroded by financial account vulnerability

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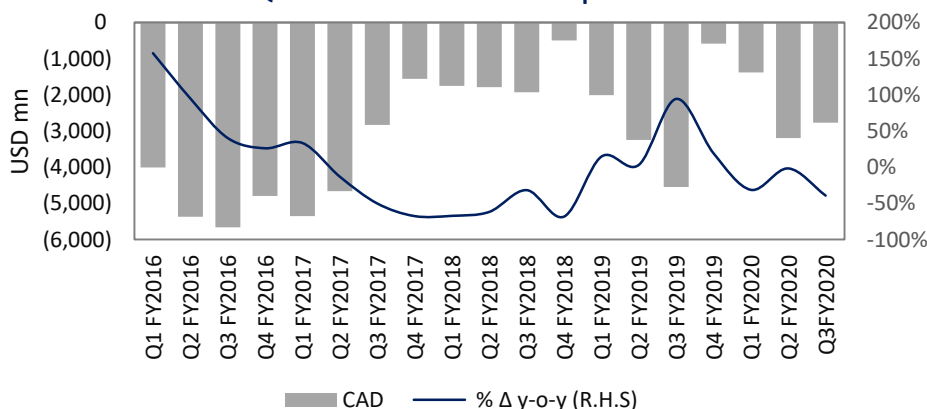
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CAD narrowed by 39% y/y in Q3 FY20, thanks to improved trade deficit and remittances. Egypt's current account deficit shrank in Q3 FY20 to USD2.8bn, helped by a 10.9% y/y decrease in trade deficit and a 27.6% increase in workers' remittances. We note that COVID-19 was only in full swing in the last month of Q3 FY20, when global and domestic lockdown measures and travel bans were first put in place. Thus, we expect the crisis to be apparent the most in Q4 FY20; current Q3 FY20 figures do not fully reflect the impact of the economic fallout of COVID-19 on the external balance. However, the effect of the pandemic turmoil in Q3 FY20 was quite substantial on tourism and the financial account; they both dragged the overall balance to fall into a deficit of USD5.5bn in Q3 FY20 vs. an overall surplus of USD1.4bn in Q3 FY19.

Trade deficit abated on slimmer hydrocarbon and non-hydrocarbon trade deficits. Non-hydrocarbon trade deficit kept its downward trajectory for the fourth consecutive quarter, falling by 7% y/y on 7% y/y growth in exports and a 3.2% y/y decline in imports. The rally in gold prices boosted gold exports, and according the CBE, TV transmitters, drugs, and organic and inorganic compounds led the growth in exports. Despite the 8.9% y/y slide in hydrocarbon exports, the hydrocarbon trade deficit dropped from USD445mn to USD40mn due to a 21.3% y/y decline in hydrocarbon imports.

Chart 1: CAD shrank in Q3 FY20 on both annual and quarter bases

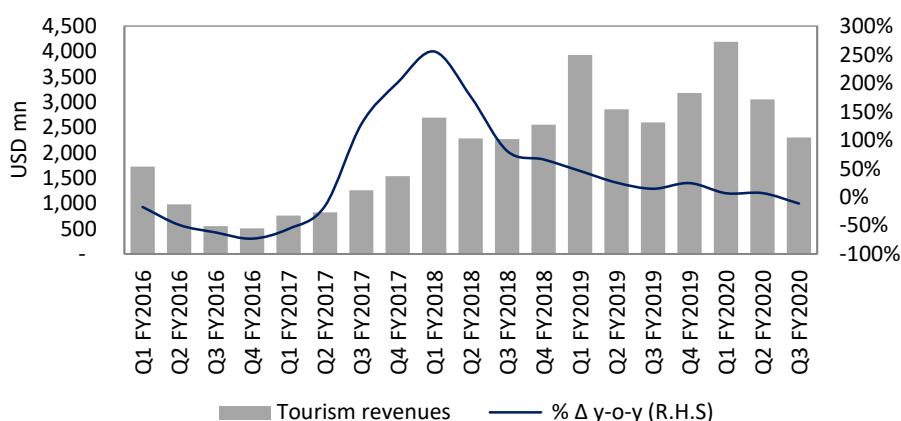


Source: CBE.

Although the health precautionary measures were only tightened up painfully in March, their impact on tourism was tangible. Tourism revenues slipped for the first time on an annual basis since Q2 FY17 (-11.4% y/y to USD2.3bn in Q3 FY20). Taking into account the seasonal pattern of tourists' arrivals in the January-March quarter, a relatively low one compared to the end-of-year and summer months, we still believe the pressures on tourism revenues will be firmer in Q4 FY20.

Remittances are still resilient but may not stay so for long. Workers' remittances grew by 27.6% y/y, the fastest annual growth rate since Q1 FY18, to USD7.9bn in Q3 FY20 vs. USD6.2bn in the same quarter a year earlier. According to the CBE, remittances climbed by 33% to USD5.2bn in the first two months of Q3 FY20. This means remittances in March hovered around USD2.6bn—still around the average monthly figure. However, the significant impact of the COVID-19 shock on GCC countries, the announced austerity measures in Saudi Arabia, and the plunge in oil prices created the perfect storm for remittances outlook.

Chart 2: Tourism revenues sink to their lowest level since Q3 FY18



Source: CBE.

Capital outflows and a surprising slump in FDIs drove overall balance into deficit despite narrowed CAD. The financial account hit net outflows of USD1.06bn in Q3 FY20 vs. net inflows of USD6.5bn a year earlier. The EM sell-off wave triggered by COVID-19 turmoil resulted in net portfolio outflows in excess of USD8bn vs. inflows of USD6.9bn a year earlier. In the space of two months, an overall risk-off mode reduced foreign holdings of local currency-dominated Treasuries by USD17bn before Egypt started to gradually restore some of its lost ground by mid-June 2020. Surprisingly, FDI inflows fell sharply by 58.5% y/y to USD970mn in Q3 FY20, down from USD2.3bn a year earlier. According to the CBE, heightened uncertainty triggered by the pandemic has scuppered foreign investment plans. Nonetheless, we are still puzzled by this substantial fall in FDIs, given that the crisis only peaked in Q4 FY20.

Our Key Takeaways

- (1) *Trade deficit has room to narrow further in Q4 FY20, as 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.*
- (2) *We expect tourism revenues to end the year at around USD10.5bn (vs. An expected USD15bn prior to COVID-19).*
- (3) *We expect the overall balance to turn into surplus in Q4 FY20 due the IMF financial support.*

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