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External Woes vs. Cautious Optimism

In line with our expectations, the effect of COVID-19 on Egypt's external balance drove the CAD deficit to double y/y to USD2.8bn in Q1 FY21. The trade deficit inched up by 0.9% y/y, despite a 12% y/y fall in exports, which was partially offset by a 7% drop in imports. Meanwhile, the service surplus (mainly tourism) remained under the pressures of pandemic-related headwinds, posting another plunge in Q1 FY21 (-78% y/y). Workers' remittances are still a bright spot for Egypt's external position, growing 20% y/y in Q1 FY21.

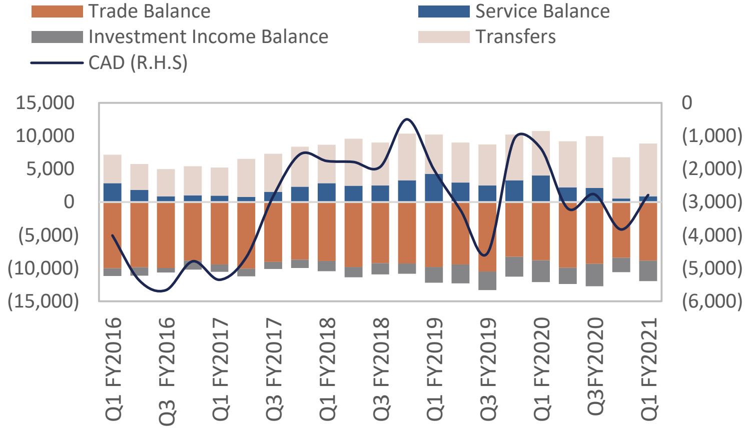
On the whole, the overall balance registered a slight deficit of USD69.2mn, thanks mainly to foreign portfolio inflows. After a sharp fall in foreign portfolio investment (FPI) of 80% y/y to just USD637mn in Q4 FY20, the rebound in carry trade inflows was faster than expected as the country started to receive capital inflows in June, resulting in net capital inflows of USD6.7bn in Q1 FY21. In addition, the net disbursements of medium- and long-term borrowing recorded USD2.2bn, following the disbursement of USD2bn, the first tranche of USD5.2bn IMF's SBA credit facility.

COVID-19 headwinds are still posing structural challenges to the exports sector, tourism, and overall CAD, despite the global rebound in economic activity. The deterioration in CAD in Q1 FY21 was triggered by some temporary factors and more persistent ones, mainly the weaknesses in non-hydrocarbon exports and tenacious trade deficit. **(1)** The temporary halt of LNG exports, due to a slump in energy demand triggered by COVID-19 turmoil, drove hydrocarbon exports to fall by 34% y/y. Yet, the resumption of LNG exports from Idku in October after the shutdown of the terminal in March and the recovery of natural gas global prices will eventually help LNG exports to rebound throughout the course of FY21. However, the hydrocarbon trade balance remained in surplus (USD144mn) in Q1 FY21 due to a 52% y/y decline in imports. **(2)** Non-hydrocarbon trade chronic deficit widened by 6% y/y in Q1 FY21 due to an annual increase of 6% in imports, while exports remained flat. The COVID-19-induced global slowdown and the second wave effect on Egypt's main trade partners weighed on non-hydrocarbon exports. Moreover, the strengthening Egyptian pound (EGP) against the U.S. dollar (USD) and its appreciation in real terms over the last couple of years put further pressure on the export sector's ability to recover fast. **(3)** The significant slippage in service surplus was mainly driven by 81% weaker tourism revenues which registered only USD801mn. This came as Egypt received only 312,000 tourists in July and August 2020 against 2.3mn in the same months in 2019. Also, Suez Canal revenues remained on a downturn path, falling by 8% y/y.

Global flows of foreign direct investment (FDI) are still under severe pressure as a result of the COVID-19 pandemic. Financial distress and liquidity concerns force businesses to avert any funds available for investment to working capital and to increase their retained earnings, which drove FDI inflows to the country to fall by 32% y/y in Q1 FY21.

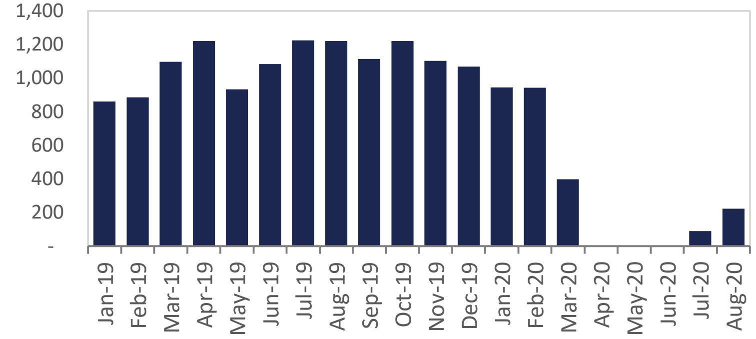
Pressures on main FX revenues will keep the CBE monetary policy on a cautious stance due to the vital role of FPI in financing CAD and stabilizing the local currency.

Figure 1: CAD widened y/y but shrank q/q, following the peak of COVID-19 shock (USDmn)



Source: CBE, Prime Research.

Figure 2: Significant fall in tourist arrival despite the improvement in July and August 2020 (thousands)



Source: UNWTO.

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