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Challenges Remain Daunting

As we had expected, COVID-19 is still casting its shadows on Egypt's external balance. It drove the current account deficit (CAD) to widen further by 52% y/y and 74% q/q in Q2 FY21 ended 31 December 2020, recording USD4.8bn—the biggest deficit since the IMF-backed economic reform program in 2016. The annual widening was the net result of:

(1) Higher trade deficit (+7.3% y/y, +20% q/q).

(2) Lower service surplus (-55% y/y, +16% q/q).

(3) Higher workers' remittances (+7.6% y/y, -7% q/q).

(4) Lower investment income deficit (-3.5% y/y, -22% q/q)

COVID-19-related headwinds are still posing structural challenges to the export sector, tourism, and remittances despite the rebound in global economic activity. The weakness in non-hydrocarbon exports and tenacious trade deficit were amplified by pandemic-driven distortions. The chronic non-hydrocarbon trade deficit widened by 6.7% y/y in Q2 FY21 due to an annual increase of 5% in imports, while exports grew by only 3% y/y. The COVID-19-induced lockdown on Egypt's main trade partners weighed on non-hydrocarbon exports. Moreover, the ongoing real appreciation of the Egyptian pound (EGP) against the U.S. dollar (USD) adds more pressure to the export competitiveness and the sector's ability to recover fast. Despite the 20% y/y decline in hydrocarbon imports, the hydrocarbon trade balance returned back into deficit (USD198mn) due to a 24% y/y decline in hydrocarbon exports. Meanwhile, the 55% y/y plunge in service surplus was mainly driven by 68% weaker tourism revenues which registered only USD987mn. However, tourism revenues began to rebound gradually, increasing by 23% q/q.

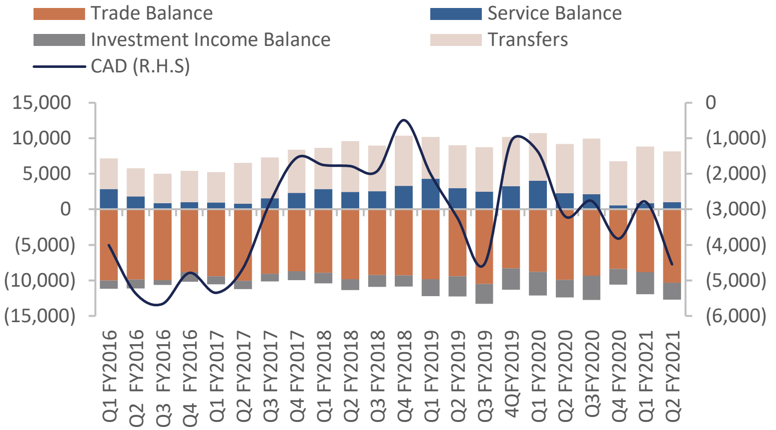
Annual growth in workers' remittances declined to 7.6% y/y, to register USD7.5bn in Q2 FY21 vs. USD7bn in Q2 FY20 and USD8bn in Q1 FY21.

Overall balance was in black, mainly thanks to foreign portfolio inflows. After a sharp fall in foreign portfolio investment (FPI) to just USD637mn (-80% y/y) by the end of FY20, the rebound in carry trade inflows was faster than expected as the country started to receive capital inflows in June. This resulted in net capital inflows of USD3.48bn in Q2 FY21. High lucrative real and nominal yields, a stable currency, and a resilient economy in the face of the pandemic crisis helped Egypt restore foreign appetite for local debt instruments.

Yet, global flows of foreign direct investment (FDI) are on a downward trend on an annual basis. Global financial distress and muted demand are still affecting global investment inflows, thus FDI inflows to the country fell by 33% y/y to USD1.8bn in Q2 FY21. Yet, they have shown some improvement on a quarterly basis (+9% q/q).

Overall, we still believe the pressures on Egypt's main FX revenues are significant, and challenges triggered by pandemic-related distortions in addition to structural weaknesses will keep the CBE's monetary policy on a cautious stance. The recent surge in global commodity prices and U.S yields, in addition to the important role of FPI in financing CAD and stabilizing the local currency, should keep the monetary authority vigilant. Hence, we do not expect the easing cycle to be resumed any time soon.

Figure 1: CAD widened to the highest level since Q2 FY17 (USDmn)



Source: CBE, Prime Research.

Figure 2: Pressures on remittances (USDmn)

Source: CBE, Prime Research.

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