

The Storm Is Gone but the Headwinds Persist

Egypt's current account is still challenged by COVID-19 scars, high global commodity and shipping prices, and concerns over external competitiveness. Much of the changes in the country's external account in FY21 were driven by the normalization of trade patterns post the peak of COVID-19 shock, the relatively slower rebound in tourism, and the effect of economic recovery on imports bills. However, Q4 FY21 results showed a slower pace of deterioration in the current account deficit (CAD), after reaching its highest level since Q1 FY17 in Q3 FY21. CAD widened by 37% y/y to USD5.13bn in Q4 FY21 vs. USD3.82bn in Q4 FY20, albeit narrowing by 9.5% from USD5.67bn in Q3 FY21. Thus, overall CAD hit USD18.4bn in FY21 (4.6% of GDP), the highest deficit since FY16.

CAD dynamics in Q4 FY21 raise a red flag, as the deficit continued to be driven by the deterioration in non-hydrocarbon trade deficit amid a significant rally in global commodity prices. Trade deficit widened by 36.6% y/y to a record high of USD11.5bn in Q4 FY21. This was driven mainly by the deterioration in non-hydrocarbon trade deficit. Non-hydrocarbon exports and imports accelerated sharply in Q4 FY21 (+27.3% y/y and +28.5% y/y, respectively), causing the non-hydrocarbon trade deficit to pile up to USD11.3bn (+29.1% y/y). Despite this acceleration, trade deficit narrowed slightly from the USD11.6bn registered in Q3 FY21. The significant deterioration in the non-hydrocarbon trade deficit came at a time when the Real Effective Exchange Rate (REER) remained on an appreciation trajectory (c.4% ytd). This will add more pressure on the competitiveness of the external sector given the ongoing supply-side headwinds that are affecting the cost of imported inputs and raw materials, especially that c.47% of exports are related to manufacturing which depends on imported raw materials to different degrees.

Despite the recovery in global LNG prices, the hydrocarbon trade balance reverted to a deficit in Q4 FY21. Because of the surge in LNG prices, Egypt's hydrocarbon exports more than doubled to USD2.67bn in Q4 FY21, up from USD1.2bn in Q4 FY20. However, the rise in oil prices and the recovery in demand associated with economic reopening have accelerated the cost of imports, reaching USD2.9bn in Q4 FY21, up from USD801mn in Q4 FY20 and USD2bn in Q3 FY21. As a result, the hydrocarbon trade balance recorded a deficit of USD128mn in Q4 FY21.

Despite the gradual recovery in tourism, it was slower than the acceleration in trade activity. The unfavorable dynamics in Q4 FY21 were also driven by a relatively slower rebound in service surplus to only USD1.2bn despite the ongoing rebound in tourism receipts to USD1.7bn in Q4 FY21 vs. only USD305mn in Q4 FY20, the peak of the COVID-19 crisis on travel activity.

The investment income deficit also widened due to the acceleration in payments. The investment income deficit expanded by 63% y/y to USD3.5bn in Q4 FY21. This came on the back of a 56% y/y increase in investment payments to USD3.8bn due to interest payments and the recovery in multinational companies' (MNCs) earnings, especially in the oil and gas sector.

Remittances remain the bright spot in the country's external balance. Resilient remittances increased by 30% y/y to USD8.1bn in Q4 FY21, reaching a multi-year high, following a slight decline of 0.25% y/y to USD7.85bn in Q3 FY21.

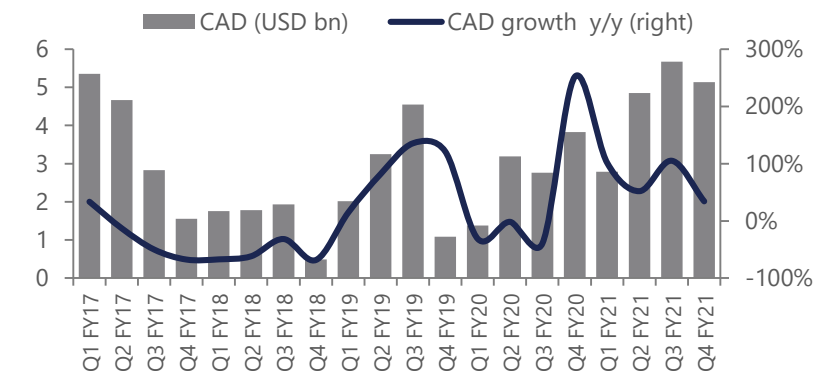
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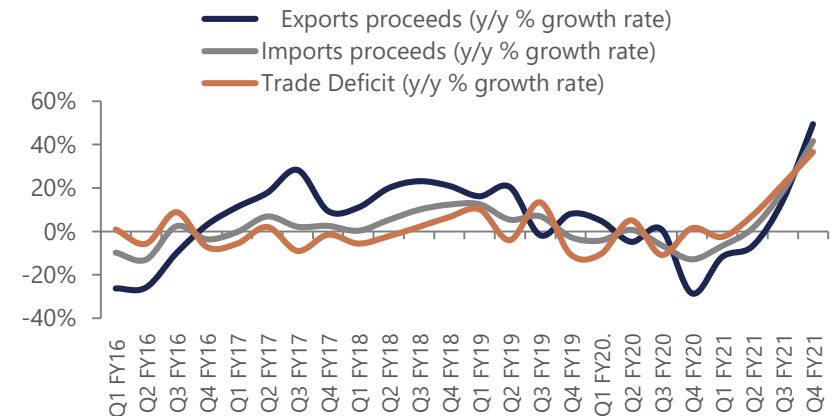
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Figure 1: CAD widened y/y in Q4 but at slower pace



Source: CBE, Prime Research.

Figure 2: Fastest y/y growth in trade deficit since EGP floatation, absent full recovery of tourism receipts



Source: CBE, Prime Research.

The overall balance of payments (BoP) remained in surplus, thanks for the most part to foreign portfolios.

Overall BoP surplus declined in Q4 FY21 to just USD88mn, down from a surplus of USD330mn in Q3 FY21. Such a surplus was mainly driven by net inflows in the financial account of USD6.3bn, which were induced in turn by an increase in foreign portfolio investment (FPIs) inflows of USD2.8bn. Meanwhile, FDIs fell sharply by 72% y/y to a significant low level of only USD427mn, raising a serious concern about the sustainability of private investment recovery given the negative effect of current supply woes on global FDI inflows.

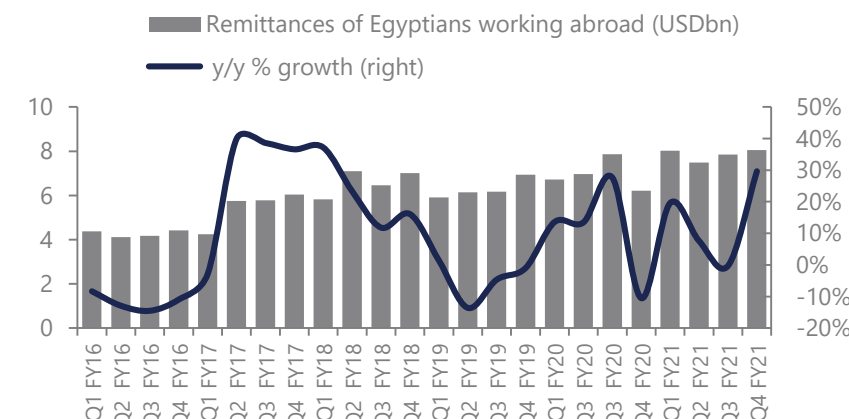
How Q4 FY21 affected CAD's overall performance in FY21:

- 1) **CAD ended the year at USD18.4bn vs. USD11.2bn (4.6% of GDP).** This came 4.5% above our expectations of USD17.6bn (4% of GDP). The larger-than-expected workers' remittances in Q4 FY21, coupled with an improvement in the hydrocarbon trade balance and a gradual recovery in tourism in H2 FY21, all eased the pressure of a widened trade deficit on CAD. The recovery in tourism and travel activity should gain more momentum in FY22, especially from Europe after the end of Russia's travel ban and the removal of Egypt from the UK's red list. This should ease the strains on trade deficit, which is expected to fall under significant pressures due to global supply-driven disruptions. Meanwhile, remittances should gain a further boost from oil and the economic rebound in the GCC countries.
- 2) **Trade balance deficit exceeded our expectations,** widening by 15% y/y in FY21, owing to a 17% y/y increase in non-hydrocarbon trade deficit, while hydrocarbon trade deficit fell sharply by 98% y/y. According to the CBE, the increase in exports could not cope with the acceleration in

imports as the economic recovery fueled demand for imported inputs and raw materials.

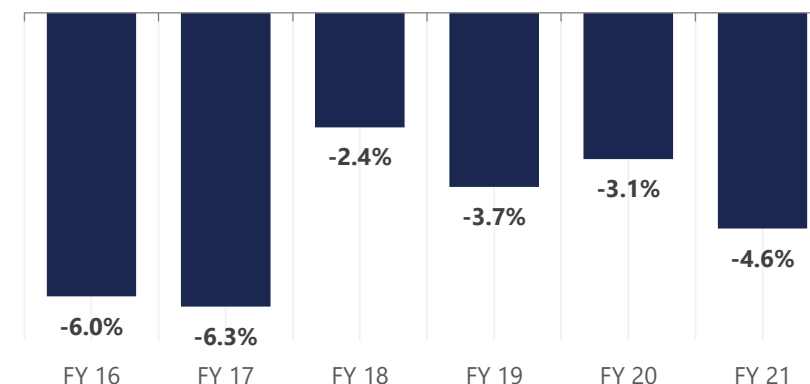
- 3) **Non-hydrocarbon trade deficit will remain vulnerable** and subject to further deterioration due to higher imports bills expected with the economy restoring its lost ground from the COVID-19 crisis.
- 4) **Tourism was still below COVID-19 levels, but remittance remained resilient.** Tourism revenues ended FY21 at USD4.9bn, 51% lower y/y, where most of the decline was concentrated in H1 FY21 before it started to rebound in H2 FY21 onwards. We have a positive outlook for remittances which grew 13% y/y to USD31bn in FY21.
- 5) **Earnings on FDIs put additional pressures on CAD.** At a time when investment income payments, which include earnings of foreign corporates in the country, grew by 5% y/y, FDIs fell to a level not seen since FY14, totaling only USD5.2bn (-30% y/y) in FY21. The drop in FDIs was mainly attributed to the fall in foreign investment inflows in the oil sector due to COVID-19 related disruptions.
- 6) **Reliance on foreign capital inflows to finance CAD makes Egypt's economy vulnerable to external shocks and global financial conditions.** We note that the Egyptian economy is still shielded by the country's current adequate reserves. Yet, we see the CBE between a rock and a hard place in view of the changing global dynamics. However, we do not expect for now any policy change until the end of 2021.

Figure 3: Remittances at a new record high



Source: CBE, Bloomberg.

Figure 4: CAD as a percentage of GDP is widening again



Source: CBE Prime Research.

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