

Underlying Strength, but Gathering Headwinds

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External buffers are still on an upward trajectory, and non-official reserves are at their highest level in more than three years: Egypt's official net international reserves (NIR) inched up by USD24mn, standing at USD40.85bn by end of October (+4% y/y, +0.1% m/m). This was driven mainly by an increase in the stock of gold (+USD146mn) which offset the decline in the stock of foreign currency. Foreign currency fell by USD131mn to USD33.8bn by end of October, having risen USD351mn to USD33.9bn back in September. Non-official reserves grew by USD2.1bn to end the month at USD11.5bn, the highest level since April 2018.

The downside risk to external liquidity is manageable in the short term, but headwinds are accumulating: Thanks to the IMF support, several Eurobond issuances, a new IMF SDR allocation, and more recently the Saudi new deposit at the CBE, foreign-currency liquidity reached an adequate level in 2021. Overall reserves (NIR + non-official reserves) increased significantly by USD2.1bn in October to USD52.35bn, slightly lower than the USD52.5bn early 2020 just before the COVID-19 crisis hit the economy. This is equivalent to more than 7 months of imports of goods and services.

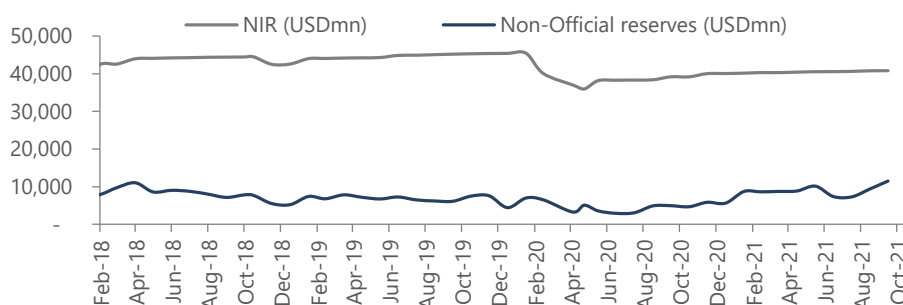
Figure 1: Egypt's main FX liquidity boosters



Source: Prime Research.

The country's downside risks to external liquidity seem manageable in the short-term given the ongoing rebound in tourism revenues, the attractiveness of sovereign debt instruments (the real yield on 1-year T-bill is currently around 4%), and the recovery of LNG exports growth observed since Q2 2021. However, being a net commodity importer with high risk exposure to capital outflows, Egypt's external account vulnerabilities persist. Moreover, the country still has significant external financing needs (including more than USD23bn in projected debt service payments in FY22).

Figure 2: External buffers still growing, despite the pressures



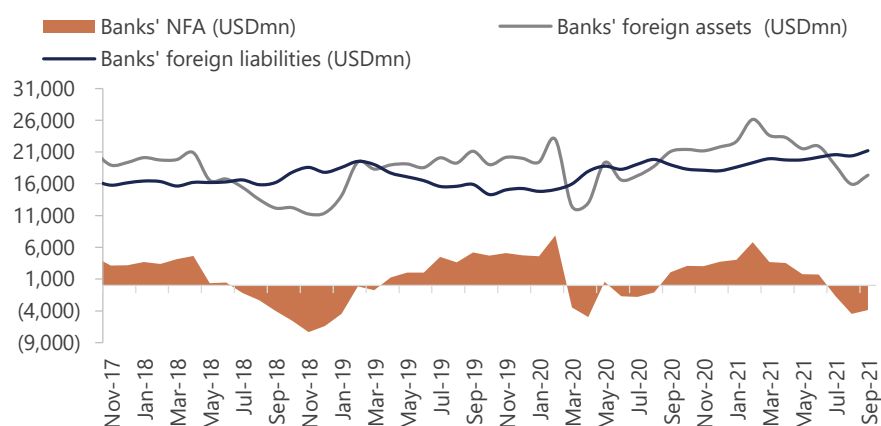
Source: CBE, Prime Research.

Moreover, the current account deficit (CAD) is expected to remain pressured by the stubborn non-oil trade deficit (CAD was at 4.7% of GDP in FY21) due to a significant rally in global commodity prices, amplified by the rigidity of imports and a high concentration of exports. Moreover, the accelerated economic growth should raise the import bill, while foreign direct investment (FDI) is not expected to recover significantly this year, given persistent global supply disruptions.

Foreign assets at commercial banks still reflect the effect of these growing global headwinds: Despite the increase in foreign assets at commercial banks, net foreign assets (NFA) were still in a liability position at the end of September, for the third consecutive month. Commercial banks' foreign assets increased by USD1.4bn to USD17.4bn by end of September, after losing around USD6bn since June 2021. Foreign liabilities also increased by USD811mn to USD21.2bn, which drove overall net foreign assets (NFAs) to a net liability position of USD3.86bn by end of September. We believe the recent figures on foreign assets at commercial banks and the foreign currency component of NIR reflect the accumulation of pressures on financing the external needs of imports and debt repayments. The monetary authorities are racing against time to assess the impact of growing inflationary pressures and global tightening conditions on the economic recovery and external vulnerabilities while preserving an adequate level of external buffers.

For now, we consider the current level of external buffers enough to smooth out the effect of global headwinds on the FX rate and should provide some space for the CBE to keep its monetary stance on hold. However, the risk of maintaining a stable local currency amid growing risks of capital outflows could eventually prove unsustainable. Thus, we should expect a gradual depreciation down the road. However, it will depend largely on how foreign investors react to the Fed's recently-announced tapering of its asset purchases and the effect of growing inflationary pressures on real yields.

Figure 3: NFAs at commercial banks still at a liability position



Source: CBE, Prime Research.

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