Ebb and Flow

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Thanks to a recovery in the services balance, the current account deficit (CAD) in Q1 FY22 improved quarterly, yet was annually pressured by higher global commodity prices which still weighed on its annual reading. CAD widened by 44% y/y (vs. 34% y/y in Q4 FY21), resulting in a USD4bn deficit in Q1 FY22. On a quarterly basis, CAD fell 22% q/q in Q1 FY22, more than double the pace compared to the 9% q/q slide recorded in Q4 FY21**.**

In Q1 FY22, CAD dynamics were driven by the following factors:

(1) **Trade deficit widened 29% y/y in Q1 FY22 to USD11.075bn.** This came against the backdrop of global headwinds affecting imports bills which grew 41% y/y when exports rose only 34% y/y.

(2) **Higher oil prices caused the hydrocarbon trade balance to revert to a deficit of USD101mn against a surplus of USD144mn in Q1 FY21.** However, the country steered its LNG exports back to a strong recovery in Q2 FY22, which should ease the pressure on the hydrocarbon trade deficit in FY22.

(3) **Annual growth in the non-hydrocarbon trade deficit slowed in Q1 FY22 (+26% y/y vs. +29% y/y in Q4 FY21),** primarily owing to 26.5% y/y growth in non-hydrocarbon imports vs. 28.7% y/y in Q4 FY21. Meanwhile, the export growth rate remained flat at 27.3% y/y. The value of both exports and imports gained pace from an increase in commodity prices and shipping costs, in addition to a normalization trend that followed the recovery of international trade activity in the wake of COVID-19 crisis peak in FY21.

(4) **Surplus more than doubled as the tourism sector recovered and Suez Canal revenues hit its highest since 2013.** Service surplus reached USD2.9bn in Q1 FY22 (vs. only USD876mn in Q1 FY21), helped by a strong rebound in the tourism sector which generated USD2.9bn (vs. only USD801mn in Q1 FY21), which is still lower than the average revenues usually achieved in the first quarters of the fiscal year. Also in Q1 FY22, Suez Canal revenues grew by 22.3% y/y to USD1.7bn, its fastest pace since Q4 FY18.

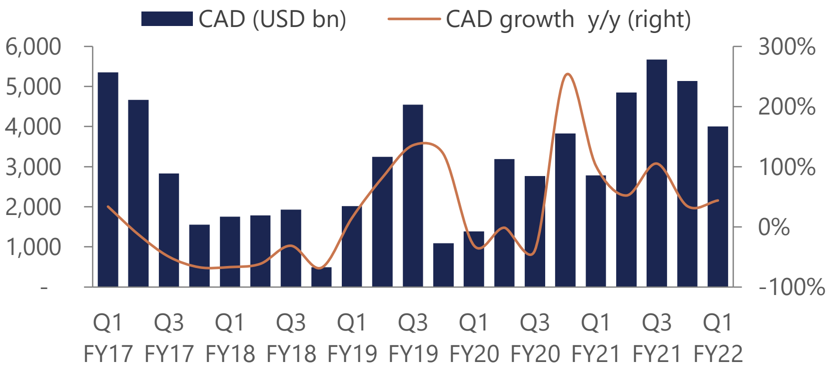
(5) **Investment income deficit continued to weigh on CAD.** Income deficit grew by 26.6% y/y, driven by a 28% increase in investment income payments, including earnings of foreign corporates in the country and interest payments.

(6) **Remittance growth slowed but remained significantly higher than the non-hydrocarbon export proceeds.** Remittances increased by 1.5% y/y to USD8.1bn, a much slower pace compared to the 29.6% y/y recorded in Q4 FY21. We believe growth in remittances will normalize in FY22 after a strong level in FY21.

(7) **Net financial capital account inflows are still funding CAD.** FDI grew by 4% y/y to USD1.4bn (36% of CAD). Meanwhile, net inflows of FPI fell to USD3.5bn from USD6.7bn in Q1 FY21, as the momentum of strong capital inflows to EMs started to ease.

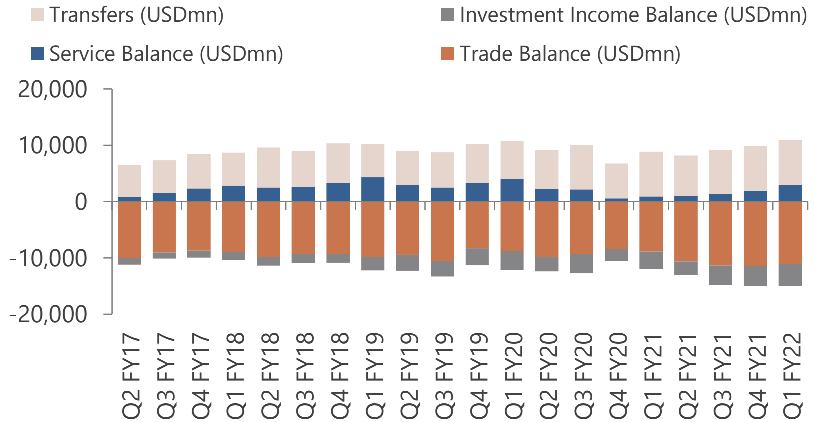
The overall balance of payments (BoP) was in surplus, largely owing to net capital inflows. Overall, the BoP turned to a surplus of USD311mn in Q1 FY22 from a deficit of USD69mn in Q1 FY21 on account of net financial account inflows of USD6bn, up from USD3.9bn in Q1 FY21.

Figure 1: CAD widened y/y but fell q/q



Source: CBE, Prime Research.

Figure 2: Notable recovery on service surplus, yet trade deficit still adding pressure



Source: CBE, Prime Research.

How does Q1 FY22 fit into our projections for CAD dynamics in FY22?

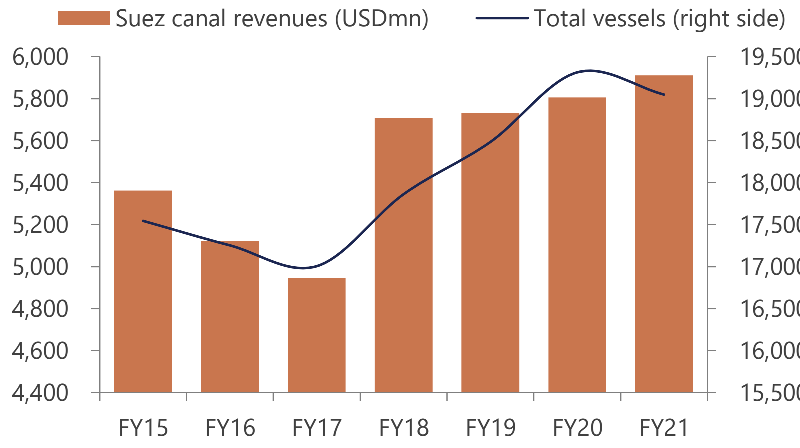
(1) **In line with our forecast, service revenue is set to expand steadily in FY22.** First, tourism is expected to gain traction due to pent-up travel demand and increasing relaxation in travel restrictions. We expect tourism revenues to reach USD11.5bn by end of FY22, slightly lower than the USD12.5bn recorded in FY19, just before the COVID-19 crisis hit the sector. Second, Suez Canal revenues should remain on an upward trajectory on the back of: (1) a 6% toll increase for ships passing through the waterway starting February 2022; (2) the current high LNG price in Europe and Asia will give the waterway a competitive edge; since the canal provides a faster route than the lengthy Cape route and the heavily congested Panama Canal; (3) the southern expansion projects that aim to almost double the capacity of the waterway to 100 ships per day (vs. 50 currently).

(2) **The trade deficit will be influenced by a variety of factors. We expect the hydrocarbon trade deficit to improve over the course of FY22**, resting on a surge in the country's LNG exports and its higher prices, which is set to help the country face the higher cost of imported fuel products. **The non-hydrocarbon trade deficit will remain the main source of weakness.** It will also be subject to further deterioration due to the higher import bills expected with the fast economic growth, as well as the risk of longer global supply disruptions that affect global commodity prices and shipping costs. Global climate change is another major risk that still weighs on the prices of global commodities, mainly food. According to FAO, Egypt's wheat imports for FY22 are estimated to reach 13mn tons, about 7% more than the imports in FY21. Furthermore, the recent acceleration in geopolitical tension between Russia and the West over Ukraine, in addition to the export tariffs imposed by Russia, is mounting the pressure on trade deficit. We note the country's major import markets are currently Russia, Ukraine, and Romania.

(3) **Despite the rise in oil prices, we expect remittances growth to slow. Having posted a strong performance during the COVID-19 crisis, remittances defied expectations in FY21.** However, part of this strong inflow can be attributed to the tendency of some expats to send their families back home in order to cope with the higher living costs in the GCC countries, especially after Saudi Arabia implemented VAT, in addition to the imposition of expat fees since 2018. We expect this tendency to continue, helping remittances inflows stabilize around their current level. Yet, we cannot shrug off the effect of the localization policy in the labor market in GCC countries, which could undermine the positive effect of currently higher oil prices and economic recovery and hence demand for foreign labor.

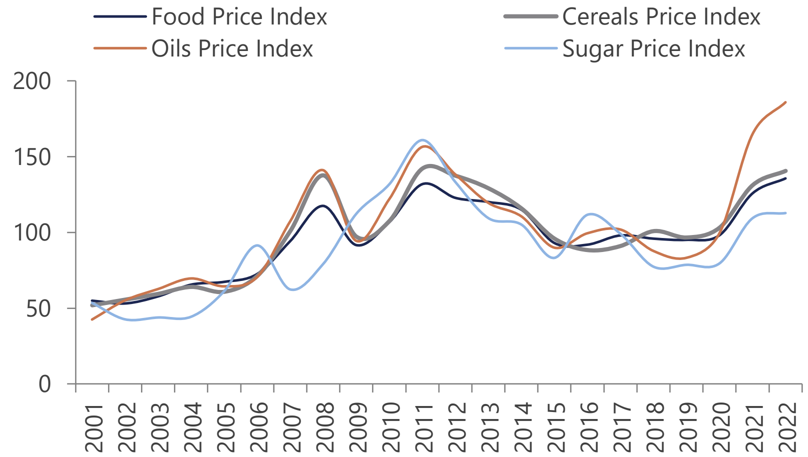
(4) **Egypt's reliance on foreign capital inflows to finance CAD makes it vulnerable to the Fed's tightening policy and global financial conditions.** We note the Egyptian economy is still shielded by its currently adequate reserves. **However, significant external financing needs, including CAD and debt obligations as well as a more hawkish Fed, will make the CBE monetary tightening hard to avoid.**

Figure 3: Suez Canal revenues hits record highs



Source: CBE.

Figure 4: Food price at 10-year highs



Source: FAO.

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