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Views on the Crisis

Impact of the Crisis on Suez Canal Revenues



Introduction

While the whole world shares the broad outlines of the economic and social repercussions of the Coronavirus (COVID-19), which are unprecedented in its recent history, the implications thereof for each country are linked to the nature of each country's economic system, its ability to withstand the entailed repercussions and the speed of its recovery.

In light of the need to study the sectoral implications of these repercussions in order to address the crisis properly, the

Egyptian Center for Economic Studies (ECES), in its initiative, is producing a set of daily reports entitled "Views on Crisis". The reports aim to analyze the implications of the coronavirus crisis for Egypt in relation to a number of vital production and service sectors and to key macroeconomic variables. This ECES initiative comes from the belief that the current critical conditions require directing state's efforts towards achieving two main goals: providing a decent life for Egyptians during the crisis and in the recovery phase, preserving the existing investments- especially domestic investments- and helping to overcome the crisis and prepare for a rapid launch with the gradual decline of the crisis and recovery of the global economy.

The methodology used in these reports is based on an analysis of the supply and demand shocks associated with the crisis cycle in its various stages. Given the lack of detailed data on the sectoral impact of the crisis, the sectoral analysis is based on logical assumptions related to the nature of each sector and the degree of sector vulnerability to previous severe crises that were certainly less severe than the current crisis and different in nature. However, it is a starting point for the urgently required scientific diligence at this stage.

The reports attempt to provide a detailed perception of the magnitude and direction of crisis impact on each sector at present and until the end of the crisis. They aim to propose quick solutions to reduce the adverse impacts of the crisis in a balanced and integrated means that complement the serious efforts made by the state in this regard, and to offer other longer-term solutions to the existing institutional flaws, clearly revealed by the crisis. It is high time that these flaws are radically removed, which will improve post-crisis development efforts.

“A time of crisis is not just a time of anxiety and worry. It gives a chance, an opportunity, to choose well or to choose badly.”

Desmond Tutu

* Reports will be issued in Arabic on a daily basis. An English translation of each report will be sent on the day following its issuance.

First: Brief description of the subject of the report

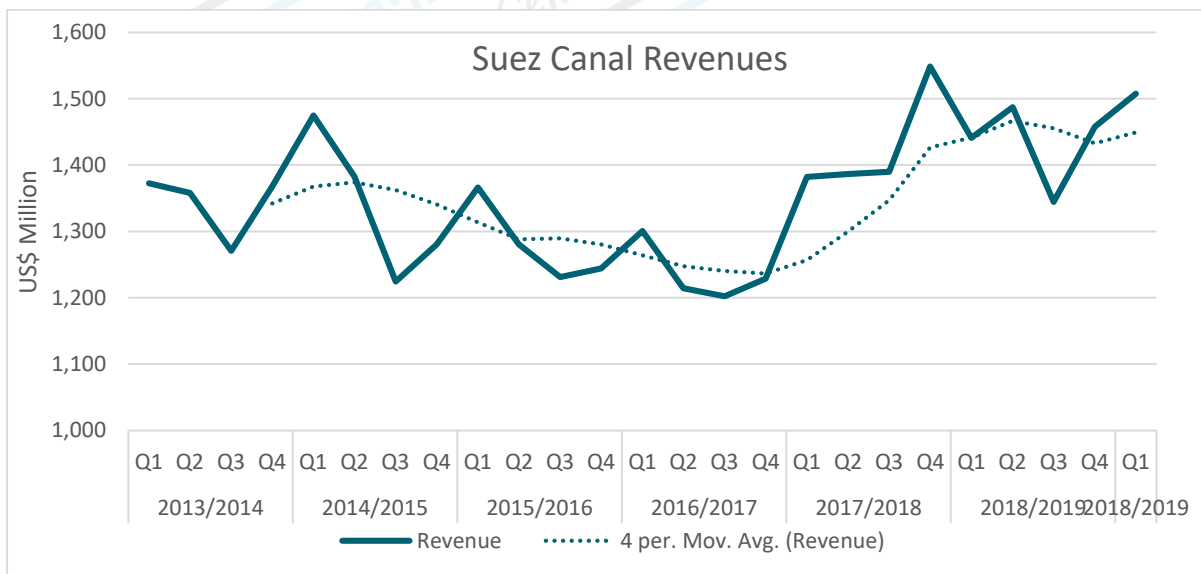
- The Suez Canal is one of the most important pillars of the Egyptian economy. During Fiscal Year (FY) 2018/19, the Canal generated 3.7 percent of public budget revenues. It is also important in stabilizing the Egyptian pound, accounting for 7 percent of current account inflows and 23 percent of service exports during the same fiscal year. In addition to being used as a transit waterway, it also employs 14,000 Egyptian workers and creates several indirect jobs in the trade industry. It is also used as a port, with Egyptian flagged ships are the 6th largest exporters and 10th largest importers.
- While there are several waterways in the world, the Panama Canal in Central America is the only other waterway that is of equal strategic and geographic importance, with significant shipment volumes.
- During FY 2018/19, 18,576 ships passed through the Suez Canal with a total weight of 294 million tons, generating transit revenue of \$5.85 billion. In contrast, the Panama Canal had a lower number of ships and cargo at 13,785 ships and 253 million tons of cargo. Transit figures by tons are more revealing as the pricing is based on cargo weight rather than number of ships.

- We can see there is a clear seasonality in the transit revenues of the Suez Canal. Peak shipping revenues occur during Q1 of each fiscal year while the low season is Q3 of the fiscal year.
- Suez Canal transit fees are higher compared to the Panama Canal. For lighter ships with less than 5000 tons of cargo, the Suez Canal charges between \$7-9 per ton depending on the type of ship while pricing for the Panama Canal is significantly lower and ranges between \$4-6 per ton. Larger cargo above 40,000 tons is between \$2-4 per ton for the Suez Canal and \$1-3 for the Panama Canal, with the range also depending on the type of ship. The Suez Canal being more expensive is justified by the fact that it is wider and can accommodate larger ships, which are more fuel efficient. This makes using the Suez Canal more profitable for shipping companies as they can send one large fuel-efficient ship through the Suez Canal at a lower cost compared to the price of sending a smaller ship through the Panama Canal.¹
- There was a significant annual drop by 9 percent in Canal traffic during FY 2015/16 from \$1.47 to \$1.33 billion the previous year as seen in the graph below. This was due to contraction in

¹ <https://www.etcinternational.com/blog/suez-or-panama-canal-which-route-lowers-your-ocean-shipping-costs/>

international trade and oil prices falling significantly during that time.

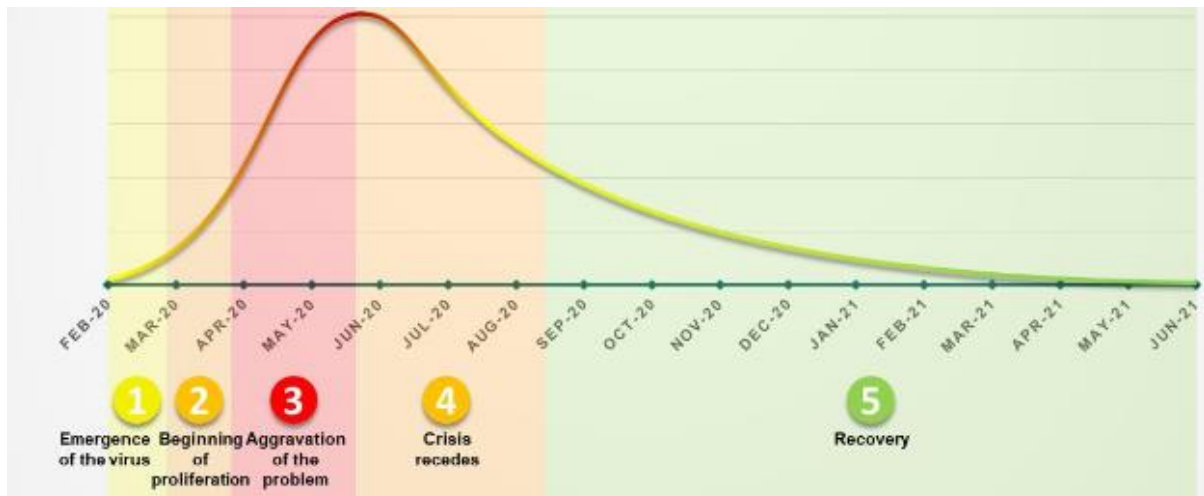
- Construction of the second branch of the Suez Canal was completed by the end of 2016, and full operations started a few months later. During that time oil prices and international trade rebounded. This was reflected by Q4 2017/18 revenues significantly increasing by 25 percent from \$1.2 billion to US\$ 1.5 billion. The new branch also led to a reduction of transit waiting times from 18 hours to 11 hours.
- During the global financial crisis in 2008, monthly revenue in the Canal fell from \$1.23 billion in Q3 2007/2008 to 960 million the following year in Q3 2008/2009, a drop in revenue of 22 percent, which did not recover until years later.



Source: Central Bank of Egypt

Second: Demand and supply shocks in the context of the crisis cycle

- The outbreak of the Coronavirus results in a crisis that goes through five stages.



- **Phase 1: Emergence of the virus** is the beginning of the crisis where the virus was known only in China. Arab, North America and European countries have not been affected yet. Only China has taken precautionary measures against the virus at this stage.
- **Phase 2: Beginning of proliferation** is when the virus started to spread to Europe, Asia and the Middle East. Minor precautionary measures are taken in these countries, while major measures are taken in China such as closing of production facilities.

- **Phase 3: Aggravation of the problem** is when the situation has worsened in Europe and the Middle East and the virus expanded to a full outbreak in Italy and Iran. The virus also starts to spread in the United States and Canada. At this stage, significant precautions are taken that affect the economy such as banning of nearly all international flights and canceling major events. The virus starts to decline in China and South Korea due to preventative measures taken by the government.
- **Phase 4: Crisis recedes** is when the virus starts to decline in Europe and the outbreak is controlled in Italy and Iran. Trade between China and Europe and the Middle East resumes but the United States still has a problem in controlling the virus.
- **Phase 5: Recovery.** The United States and Europe will have a full recovery. Economies in the Middle East have not recovered yet, but their impact on international trade is small, so they will not affect the Suez Canal.
- The table below presents possible scenarios that affect Suez Canal revenues at each stage of the crisis cycle and the different scenarios that lead to supply and demand shocks. We

will see the effects on Suez Canal revenue for the year starting 3Q 2019/20 by comparing it to the previous year. The table below is based on the latest monthly figure of US\$458 million in revenue in February 2020, and annual revenue of US\$5.8 billion.

- The **supply shock** is the possible decrease in the quality of services offered to passing ships due to the decrease of workers. The reduction in the number of workers was dictated by the Suez Canal Authority as a response to the crisis. Since we do not have access to this information, we cannot provide an assessment in this respect.
- The **demand shock** is the number of tons of cargo flowing through the canal. This volume of cargo will change at each stage of the crisis that we are going through.
- The Coronavirus crisis is unprecedented, making it difficult to estimate the drop in Suez Canal revenues in the coming year. However, we can use the 2008 financial crisis as a benchmark in that it will be equal or greater in magnitude. Given that the Coronavirus crisis affects the real economy rather than just the financial sectors it is expected that revenue losses will be equal or even greater.

- The analysis relies on World Bank estimates for the current account deficit as a percentage of GDP at 2.5 percent, i.e., US\$7 billion deficit. Relying on World Bank forecast statistics before the outbreak of Covid-19 means the current account deficit will increase by US\$ 7 billion.

Stage	Demand shock and/or Supply Shock	Analysis	Impact on Suez Canal revenues
1 - Emergence of the virus (December 2019 – January 2020)	Beginning of a slight demand shock and no supply shock.	<p>The observed demand shock is due to the decrease in China’s production activity due to the spread of the disease. It is only a slight shock because the rest of the world is not yet affected.</p> <p>No observed supply shock because at this stage, as no measures have been taken yet to change the</p>	Revenues increased during Q32019/20, yet the impact of the demand shock is still observed in the lower rate of growth of this quarter’s revenue (only 3.3%) in comparison to the (7.3%) rate of growth of the equivalent quarter in the previous year 2018/2019.

		traffic management in the canal.	
2 - The beginning of proliferation Feb. through March 2020	Moderate demand shock in February and sharp demand shock during the first half of March. Supply shock starting from March.	The crisis has reached its peak in China during February, with a serious lockdown of factories. But, on the other hand, the rest of the world remained unaffected thus we perceive the demand shock facing Suez Canal as moderate. During the first half of March, the demand shock was more serious because the rest of world started to seriously suffer from the spreading of the virus. Different levels of lockdowns started to take place in different countries.	The latest data shows that in February 2020 total number of tons transported annually increased by 12.8% compared to February 2019, meaning that revenue will have also increased. However, this is misleading because if we look at the total weight of container ships, it decreased by 13.2 percent due to a decline in international trade. The increase in traffic was thus driven by oil tanker shipments which increased by 25.4%. Irrespective of the pandemic, oil consumption was

		<p>The Suez Canal Authority implemented a decree issued by the cabinet to limit the number of workers in the Suez Canal to reduce worker density. This directive is expected to last until March 31st and may be renewed depending on the circumstances.</p>	<p>expected to decline by 1% in 2020 meaning that oil shipments are not a sustainable source of revenue.</p> <p>As far as the first half of march is concerned, we anticipate a sharp drop in revenues. In March 2019, 97,796 tons were transported—an increase of 10% over previous year same time. Based on a similar drop during the 2008 financial crisis, we expect this March cargo to witness a drop in weight and revenues by almost 15%.</p>
<p>3 - Aggravation of the problem (From mid-March to</p>	<p>An even higher and more severe demand shock and a</p>	<p>Although China will be showing recovery signs during this phase, this is still not likely to be</p>	<p>Scenario 1 (optimistic): Annual revenue losses of \$585 million estimated on the basis of a</p>

<p>mid-May 2020)</p>	<p>moderate supply shock.</p>	<p>translated into a tangible recovery in international trade because the rest of the world would still be badly hit by the virus We predict two possible scenarios: Scenario 1 (optimistic): This scenario assumes that decline in transits by container ships continues at the same rate we witnessed in February. Scenario 2 (pessimistic): This scenario assumes the decline in transits by container ships would be as high as the financial crisis.</p>	<p>10% fall in revenues. Scenario 2 (pessimistic): Annual revenue losses of \$876 million assuming annual transits fall by 15% similar to the situation during the financial crisis.</p>
<p>4 - The crisis recedes (Mid-May-</p>	<p>Gradual recovery of demand.</p>	<p>Gradual recovery will take place thanks to full</p>	<p>We hope the optimistic scenario of phase 3 will prevail, i.e.,</p>

<p>August 2020)</p>	<p>Mild recovery in the supply.</p>	<p>recovery of China and gradual recovery of Europe and North America. This means that the optimistic scenario of the previous phase will prevail.</p> <p>While most of the revenue losses will take place in stage 3, there will still be a tangible drop in revenue at phase 4 during Q3 FY2020/21.</p>	<p>annual revenue losses of \$585 million estimated on the basis of a 10% fall in revenues.</p>
<p>5- Recovery (as of September 2020)</p>	<p>Based on the previous scenario, after a year traffic returns to close to normal. Workers also return to work. Demand recovery and supply recovery.</p>	<p>Workers resume at the SCA and revenues by the end of the year rebound close to pre-crisis levels. Even after the financial crisis traffic did not recover until three years later.</p>	<p>According to most forecasts, international trade is going to recover, and this is not likely to take place before mid-2021. Since the Suez Canal is a channel of trade it is not expected to recover in 2020.</p>

Revenues of the Suez Canal is one of the three components of the trade balance along with tourism and remittances, and is a vital source of foreign exchange. It will also affect the supply chain of manufacturing in Egypt due to shortages of inputs, as we will see in future reports. All these factors will lead to the size of the deficit in the balance of payments growing further.

Fourth: Institutional weaknesses revealed by the crisis²

- One of the major weaknesses observed during the crisis is how the Suez Canal is subject to outside international trade that is out of the control of the government. This weakness was revealed during several global events such as the 2008 financial crisis and the 2015 drop in oil prices. The demand of the Suez Canal is exogenously determined and is very vulnerable, thus the need for an industrial zone in the Canal area, and to develop the Suez Canal as a logistical zone focused on industrial exports. The Suez Canal Area Development Project was launched in 2014 aimed at developing the Suez Canal Region, and the first phase was completed a year later but it is far from

² This report addresses the most important proposed measures to restructure the sector. There is a more comprehensive discussion of these and other measures in the report prepared by the Egyptian Center for Economic Studies in 2018 “Proposed Roadmap for the Development of Tourism in Egypt”. The report can be found at the following link http://www.eces.org.eg/cms/NewsUploads/Pdf/2018_12_15-12_43_91c2e8573.pdf

being fully developed. More efforts to improve its attractiveness to investors and to facilitate industrial development are needed.

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