Research Note

COVID-19 Impacts on Egypt's Transportation Sector

April 2020

This note is part of a series that provides a preliminary assessment of the sudden supply- and demand-side effects of COVID-19 on strategic economic sectors in Egypt.

COVID-19's impacts are being absorbed in every corner of the economy, predominantly global supply chains. With marked declines in manufacturing, exports and overall global commerce, cargo transportation networks are being greatly tested. The slowdown in global trade during 2019 was already impacting the sector as U.S.-China trade tensions continued escalating, but it was poised for a solid recovery when preliminary trade agreements were signed in January 2020. However, air traffic suspensions, virus containment measures, diligent inspections as well as slower global trade have dimmed these prospects.

On April 5, AmCham Egypt's Transport and Logistics Committee hosted a webinar to address the pandemic's impacts on Egypt's transportation sector. The session featured committee chair Marwan El Sammak, chairman and CEO of Ship & Crew - Egypt, and co-chairs Ahmed Elfangary, country manager for DHL Express, and Tarek Fahmy, chairman/CEO of Mediterranean Shipping Company (MSC). The panelists discussed challenges facing different subsectors including air freight, and inland and maritime transportation.

Egypt is a major player in global trade by virtue of its position at the crossroads of Europe, Asia and Africa, with the Nile River and the Suez Canal connecting the three continents. The country has 15 ports along the Mediterranean and 33 on the Red Sea. The overall transportation and storage sector[1] (excluding the Suez Canal) contributes about 5% to annual GDP. It also received 11% of total investments during both FY 2018/19 and Q1 2019/20. The Suez Canal, a key source of foreign currency for Egypt, drew in USD 5.8 billion in 2019 and contributed 2% to FY 2018/19's GDP. Currently, 13% of ships and 20% of container vessels worldwide pass through the Suez Canal, which is the fastest shipping route between Europe and Asia. During FY 2018/19, more than 18,400 vessels passed through the Canal carrying a total of 1.2 billion tons.

Supply and demand shocks

Given their dependence on international trade flows, Egypt's maritime shipping, the Suez Canal and air freight sectors have taken the most direct and sudden demand blows from the COVID-19 outbreak. Almost 90% of Egypt's international trade is conducted through its 48 ports. Demand for the country's inland transportation system has mainly been impacted by the reduced volumes of incoming cargo. Over 94% of total inland cargo transport uses Egypt's road network and thus has been affected by overnight curfews (and accordingly increased daytime congestion) imposed to contain the outbreak. However, curfew exceptions have been granted for transporting food products and other essential commodities needed to supply factories, distributors and retailers. Railways have also seen minimal impact in demand as they carry only about 6% of Egypt's cargo.

[1] Including aviation

1. Maritime trade

The global shipping industry is closely tied to China given its trade importance to almost all countries around the world. Approximately 80% of global goods trade (in volume terms) is transported by sea, and China is home to seven of the world's 10 busiest container ports.[2] The emergence of the coronavirus in China, which coincided with the Chinese Lunar New Year, led to a significant decrease in the number of ships calling at ports such as Shanghai, the world's biggest port handling approximately 43.3 million twenty-foot equivalent units (TEU) in 2019. As COVID-19 spread rapidly across China after the holiday, global shipping was hit from two sides: factory closures and other virus containment measures dried up the supply of goods, while fears of infection slowed demand for Chinese products. Ports worldwide began seeing lower cargo volumes; and freight rates also significantly declined as a result of lower volumes and depressed demand. As the coronavirus spread globally, demand dropped even further, leading to an increase in blank sailings, where scheduled port stops or entire routes are canceled by the carrier.

Global Impacts of COVID-19 on Shipping Markets

	Oil Tanker Shipping	Container Shipping	Dry Bulk Shipping
Impact	▪ Breakdown of OPEC+ alliance saw increased Saudi crude oil exports. ▪ COVID-19 is destroying global oil demand growth for 2020.	▪ Blank sailings have kept spot freight rates artificially high. ▪ Volumes have remained low, but Chinese backlogged exports will increase volumes out of Asia.	▪ Freight rates have been hit hard by COVID-19, seasonality and IMO 2020[3], but smaller carriers are slowly recovering. ▪ Large-sized bulk (capesize) carriers are most affected due to low iron ore demand.
Demand	▪ Short-term: Saudi exports will positively affect demand. ▪ Long-term: Demand is expected to slow due to lower economic activity and air travel suspensions.	▪ Medium-term: Demand will pick up as Chinese manufacturing resumes normal operations. ▪ Long-term: Lockdowns in Europe and North America will dampen container demand.	▪ Short-term: China remains weak, but demand elsewhere can lift rates in the market. ▪ Medium-term: Demand will remain sluggish, but resume to normal in the long-term.
Supply	▪ Slower deliveries due to closures at Chinese ports. ▪ Annual expected fleet growth: Crude oil tanker: 1.8% Oil product tanker: 2%	▪ Slower deliveries due to closures at Chinese ports. ▪ Annual expected fleet growth: 2.5%	▪ Slower deliveries due to closures at Chinese ports. ▪ Annual expected fleet growth: 3.1 %
Outlook	▪ Oil product freight rates will be negatively impacted by poor demand but stay above break-even levels. ▪ Crude oil tanker freight rates remain strong but will decline once geopolitical support eases.	▪ Loss-making average freight rates until 2020's end. ▪ IMO 2020 and deteriorating supply-side fundamentals weaken the outlook.	▪ Fundamentally lower demand will affect earnings. ▪ Freight rates are expected to be lower than 2019.

Source: Baltic and International Maritime Council (BIMCO)[4]

Egypt began feeling the impacts of China's lockdown in the beginning of March. According to MSC's Fahmy, there were notable gaps in volumes coming into Egypt's ports (particularly from China) for a couple of weeks. After Italy, Egypt's third largest export market, went into lockdown, sea freight was rerouted to Germany, Spain, Austria and other European destinations. On March 25, India (which uses Egyptian ports on its shipping routes to Europe and the U.S.) went into a 28-day lockdown, which it extended by another two weeks in early April, also exacerbating supply-side dynamics in Egypt's shipping industry.

Numerous blank sailings have generally reduced Egypt's shipping market capacity, also impacting ocean carriers' balance sheets. Ship & Crew's El Sammak explained that the cost structures for shipping companies

[2] United Nations Conference on Trade and Development (UNCTAD). Review of Maritime Transport. October 2019.
[3] In 2016, the International Maritime Organization announced a global cap on marine fuel sulphur usage to reduce sulphur oxide emissions. As of January 1, 2020, ships are mandated to use marine fuels with a sulphur content of no more than 0.50%S, compared to the previous limit of 3.50%S.
[4] BIMCO. Revised 2020 Forecast for Main Shipping Markets. March 2020

have been completely altered as reductions in the volume of loaded cargo (due to lower supply and depressed demand) have resulted in higher costs per unit.

In early April, Wuhan lifted its 77-day lockdown (January 23-April 8), which induced higher shipping activity albeit with some operating challenges. Egypt's ports are open while implementing precautionary and virus containment measures. The East Port Said terminal is closed, while its west side remains open with limited operations. The Port of Alexandria is only accepting vessels to discharge cargoes, and the Port of Damietta is restricted to container ship activity only. Diligent inspections, disinfection measures and labor shortages are increasing port congestion, but import and export activity is starting to recover, especially with agriculture export season around the corner. In contrast, exports of ready-made garments are seeing considerable delays due to global demand slumps, particularly from the U.S., which is Egypt's biggest market, receiving between 30-40% of annual ready-made garment exports. According to Fahmy, overall export volumes are witnessing minor declines compared to H1 2019.

2. Suez Canal

Given its notable share in global trade, the Canal will also be affected by the global slowdown. The Suez Canal Authority (SCA) reported an overall year-on-year decline in Canal traffic during February 2020: The number of container ships transiting the 193-kilometer waterway fell by 7.3%, while the number of passenger and cargo ships decreased 22.2% and 1.3%, respectively.[5] For Q1 2020, however, the SCA reported moderate year-on-year growth in traffic: the number of passing vessels grew 8.4%, while net tonnage increased 8.5% compared to Q1 2019. Government officials told local media that the growth was a result of shipping backlogs from long-term contracts and the agricultural export season, which helped keep activity up. This may not be the case over the medium term as backlogs are cleared and export season ends. Fewer ships transiting the Canal means fewer tolls paid, which will eat into Egypt's foreign currency liquidity, add to its current account deficit and negatively affect the EGP-USD exchange rate. In H1 2019/20, Suez Canal receipts accounted for 7% of current account inflows and 23% of service receipts.

Despite the Suez Canal's strategic position, competition has been increasing, making it vital for the SCA to provide enough incentives to preserve the corridor's attractiveness. In Q4 2018, the Venta Maersk (a cargo container ship with a gross tonnage of 34,882 tons) conducted a trial voyage from Russia's east coast through the Bering Strait and across the Arctic Ocean to a port in northern Germany. The rival route is 13,300 kilometers long (23 days), compared to the 19,500-kilometer route (34 days) ships from Asia take to get to Europe via Suez Canal. While there are still disputes over territory in Artic-zone countries, Russia is working to develop the Arctic into a year-round route by 2030. Projects to deliver liquified natural gas through that route are already underway, which means Suez Canal receipts could be under threat over the long term.

In the nearer term, alternative routes may gain traction due to their significantly lower transit fares compared to the Canal (especially in light of lower oil prices). The Cape Sea Route, which is about 40% longer than the Suez Route, can save vessels up to USD 235,000 per voyage due to lower transit fares.[6] On April 3, the French container transportation and shipping company CMA CGM announced it was routing a number of ships in both directions between Asia and Europe through the Cape route, bypassing the Suez Canal. While more than 3,000 nautical miles longer (+5 days), the route will save the company USD 200,000-300,000 per ship.[7] El Sammak noted that because usage of the Suez Canal is a factor of fuel and charter cost, lower oil prices have given longer routes more advantage over Suez as companies can save shipping costs at the expense of longer steaming distances. El Sammak forecasted we may see more bypasses in the short term.

Central America's Panama Canal is another rival route. In FY 2018/19, 13,785 vessels carrying a net tonnage of 252.4 million tons passed through the 82-kilometer waterway, drawing in USD 1.8 billion in revenues.[8] Despite significantly lower traffic, the Panama Canal's transit fees are considerably lower than the Suez Canal, which may attract more traffic going forward. Ships carrying less than 5,000 tons of cargo are charged between

[5] Suez Canal Authority.
[6] Ship & Bunker. 2016
[7] CMA CGM Press release.
[8] Panama Canal Authority. Traffic Report. February 2020

USD 7-9 per ton (depending on type of cargo) in the Suez Canal, compared to USD 4-6 in the Panama Canal. Vessels with cargoes above 40,000 tons pay USD 2-4 per ton in the Suez Canal versus USD 1-3 in the Panama Canal.[9] And while the Panama Canal can't handle vessels as large as the Suez Canal, it offers a quicker route.

In November 2019, the SCA renewed discounts for container ships and bulk carriers crossing the Suez Canal in a bid to attract more traffic. Through June 2020, bulk vessels traveling from the U.S. Gulf of Mexico, South America and the Caribbean Islands via the canal will see a 20-75% reduction in passage fees. Container ships en route to South or Southeast Asia from the U.S. East Coast are granted a 45-65% discount. From September 2019 to 2022, vessels passing through the Suez Canal will pay no guidance, lighthouse or docking fees. In July 2019, the SCA also unveiled a comprehensive incentive package with reduced insurance fees, license fees, ship waste purchaser fees as well as extended storage and shipping licenses. Following news of CMA CGM's reroute, the SCA also announced a 6% discount for European vessels.

However, authorities may need to revisit current incentives in light of record low fuel prices, which may persist for longer than anticipated and challenge the Suez Canal's global competitiveness.

3. Air freight

According to the International Air Transport Association (IATA), global revenue losses for passenger airlines are forecasted to reach between USD 63 billion (in the case COVID-19 is contained by 2020's end) and USD 113 billion (should the world see broader spreading of the virus).[10] While IATA has not published forecasts on cargo revenue losses yet, the negative impacts of COVID-19 on the subsector have been visible since February 2020. Seasonally adjusted demand[11] in terms of cargo tonne kilometers (CTK) dropped 9% year-on-year, and cargo capacity—measured in available cargo tonne kilometers (ACTKs)—declined 4% over February 2019 levels.[12] Sharp drops in manufacturing in China due to widespread factory closures and travel restrictions, declines in global export orders, and significant losses in cargo capacity were the primary drivers of reduced global air freight activity. Airlines in Europe suffered the biggest year-on-year decline in total air cargo volumes during February 2020, while North American and Asia-Pacific carriers experienced more moderate falls. The Middle East, Latin America and Africa were the only regions to record growth in air freight demand compared to February 2019, largely due to their minimal exposure to the virus at that time. However, given the Middle East's position connecting trade between China and the rest of the world, the region's carriers have significant exposure to the impact of COVID-19 going forward.

Air Cargo Activity by Region in February 2020 (year-on-year change)

	Share of activity	CTK*	ACTK
Total world	**100%**	**-1.4%**	**-4.4%**
Africa	1.8%	6.2%	3.0%
Asia-Pacific	34.6%	-2.2%	-17.7%
Europe	23.6%	-4.1%	-3.8%
Latin America	2.8%	1.8%	-2.6%
Middle East	13.0%	4.3%	6.0%
North America	24.3%	-1.8%	4.1%

*Source: IATA *not seasonally adjusted*

According to global logistics market analysis company CLIVE Data Services, global cargo volumes fell by 23% during March (compared to March 2019), with the drops in demand accelerating week-on-week by up to 50%. CLIVE Data showed Middle East airlines had taken the hardest hit in volumes, with reported drops of up to 49% by month's end.

[9] The Egyptian Center for Economic Studies (ECES). Views on the Crisis: Impact of the Crisis on Suez Canal Revenues. March 2020

[10] IATA. Updates on COVID-19 Financial Impacts. March 2020

[11] Adjusted for the impact of the Chinese New Year and the leap year in 2020, which meant an additional day of activity.

[12] IATA. Air Cargo Market Analysis: February 2020. April 2020

Egypt reported its first case of COVID-19 on March 8 and amid fears of infection started witnessing significant backlogs of shipments from China, which is the country's top source of imports. The suspension of international passenger flights, which was imposed on March 15 for an open-ended period, has considerably reduced incoming cargo from other countries as well. Due to the backlog, numerous inbound commercial flights were loaded with shipments in the passenger cabin to fulfill orders, with priorities given to medical supplies, factory spare parts, raw materials and other essential imports. Other non-essential shipments such as consumer goods, particularly non-durables, were redirected to sea transport. According to Elfangary, DHL was able to secure a delivery success rate of 95-96% during March despite global supply chain disruptions by increasing shipments on charter and cargo flights through various airlines. The courier services company has also upped the number of flights it uses for shipments from two to five/six weekly flights in order to secure deliveries.

Going forward, Elfangary predicts that as countries abroad gradually reopen, cargo order volumes will grow 50% in the coming weeks, which will continue increasing the backlog and put the sector in further distress.

Air cargo accounts only 1% of global trade by volume, but 35% of global trade in value terms. In addition to high-value goods, perishables, medical supplies and vaccines, and other low-weight products, air cargo also transports inputs for industrial and capital-intensive industries (which account for the bulk of shipped goods in value terms).[13] These types of intermediate and investment goods (which include spare parts, electrical equipment, chemicals and raw materials) make up about 60% of Egypt's non-oil import basket. Accordingly, Egypt's manufacturing sector, which represents roughly 15% of GDP and is heavily dependent these imported production inputs, may bear the brunt of air freight disruptions.

Impacts of oil price cuts on the transport sector

Lower global output and muted demand for transportation resulted in lower global demand for oil, causing oil prices to begin falling in February. An early March OPEC summit saw members agree to cut oil production by 1.5 million barrels per day (bpd) through Q2 2020 (for a total production cut of 3.6 million bpd from an original 2016 agreement), which would be revisited in June. A Saudi-Russia oil price war began a few days later after Russia announced it would not cut oil production. In response, Saudi Arabia boosted production and granted unexpected price discounts to customers in Europe, Asia and the U.S., triggering a free fall in oil prices. As of April 23, Brent Crude stood at a 20-year low of USD 22.26 per barrel, and U.S. crude futures for May had plunged to below zero.

By default, transportation is a direct beneficiary of lower fuel prices. When this is coupled with an uptick in global trade and consequently higher demand for transportation, it results in direct cost savings. The oil price war has resulted in a 33% decline in energy costs, but it comes at a time when business volumes have dwindled across all sectors and operational costs have increased in line with virus containment measures. According to El Sammak, large businesses' cash flows are stifled as their financials remain pegged to higher costs prior to the price war.

Most airlines commit to future fuel shipments at predetermined prices, so they currently have bunkered fuel at higher costs, notes Elfangary, explaining why lower fuel costs will likely have minimal effects until Q3 2020 (despite the fact that 33% of airline costs are fuel-associated[14]). In ports, disinfection protocols and other virus control measures are also weighing on shipping companies' financials, which offsets the potential savings from lower oil prices.

The oil market's fluctuations have been swift, massive and precipitous. Given dual shocks in the global supply- and demand-side dynamics, there remains great uncertainty about the sustainability of these prices and their effects on transportation operators' margins.

[13] IATA
[14] IATA.

The webinar panel recommended the following business continuity strategies to minimize the disruptions COVID-19 has brought upon the transportation sector:

- *Enhance cooperation between the private sector and government and customs authorities to streamline operations and ensure activity runs smoothly.*
- *Integrate digital channels across all subsectors to safeguard economic sectors from future ad hoc disruptions such as COVID-19. (Examples: electronic quotations, e-bills of lading, and electronic receivables/payables)*
- *Adopt agile frameworks to come up with new modes of doing business that focus on maximizing convenience and efficiency rather than only minimizing costs.*

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