Rabobank

Country update **EGYPT**

Summary

After the revolution in the beginning of this year, Egypt's political situation is still unstable, while the country awaits the parliamentary elections in November and December and the presidential elections in April 2012. The main political risks include tensions between the Christian Coptic minority and Islamic parties, as well as the possibility that the military will not hand over power. In either case, protests are likely, which would further disrupt the economy.

As a result of the political crisis especially tourism and investments came to an abrupt halt, thereby reducing foreign exchange (FX) reserves and slowing GDP growth. Consequently, we expect GDP growth to reach a meagre 0.6% in 2011 and a slightly more optimistic 2.5% in 2012. Higher growth rates are needed to create jobs and reduce Egypt's high unemployment rate.

A struggling economy also impairs the government's ability to either raise tax revenues at home, or funds abroad, thereby reducing its ability to finance its large public debt. The public debt is expected to reach 86% of GDP in 2011, from 81% of GDP in 2010.

Things to watch:

- Parliamentary elections in November and December, presidential elections in April 2012
- FX reserves in light of fall in tourism and FDI
- Public debt levels and government's ability to raise funds.

Author: **Anouk Ruhaak**
Country Risk Research
Economic Research Department
Rabobank Nederland

Contact details: P.O.Box 17100, 3500 HG Utrecht, The Netherlands
+31-(0)30-21-64860
A.N.Ruhaak@rn.rabobank.nl

EGYPT

National facts		
Type of government	Republic	
Capital	Cairo	
Surface area (thousand sq km)	997	
Population (millions)	84.5	
Main languages	Arab (100%)	
Main religions	Muslim/Sunnite (90%)	
	Coptic/Christian (10%)	
Head of State (president)	vacant	
Head of Government (PM)	Essam Sharaf	
Monetary unit	EGP (Egyptian pound)	
Economy	**2010**	
Economic size	*bn USD*	*% world total*
Nominal GDP	214	0.34
Nominal GDP at PPP	499	0.67
Export value of goods and services	49	0.26
IMF quotum (in mln SDR)	944	0.43
Economic structure	*2010*	*5-year av.*
Real GDP growth	5.1	6.0
Agriculture (% of GDP)	14	14
Industry (% of GDP)	38	37
Services (% of GDP)	48	49
Standards of living	*USD*	*% world av.*
Nominal GDP per head	2539	26
Nominal GDP per head at PPP	5911	50
Real GDP per head	1489	19

Social and governance indicators			rank / total
Human Development Index (rank)			101 / 169
Ease of doing business (rank)			94 / 183
Economic freedom index (rank)			96 / 179
Corruption perceptions index (rank)			98 / 178
Press freedom index (rank)			127 / 178
Gini index (income distribution)			32
Population below $1.25 per day (PPP)			2%
Foreign trade			**2009**
Main export partners (%)		*Main import partners (%)*	
US	6	US	11
Italy	7	China	9
Spain	7	Germany	8
India	6	Italy	6
Main export products (%)			*2010*
Crude petroleum & -products			43
Finished goods (incl textiles)			41
Semi finished products			7
Iron & steel			2
Main import products (%)			
Semi-finished goods			25
Capital goods			20
Consumer goods			25
Petroleum & products			8
Openness of the economy			
Export value of G&S (% of GDP)			23
Import value of G&S (% of GDP)			28
Inward FDI (% of GDP)			3.0

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

Introduction and update

Months after the revolution that ousted Mubarak, Egypt's political situation remains unstable. While the almost 50 political parties await the parliamentary elections in November and the presidential elections expected in the spring of 2012, the various revolutionary groups remain largely unrepresented. This is explained by the fact that the unorganized youth groups lack a united voice, or agenda. As a result, protests continue to form an important outlet, albeit in a less vivant manner. Moreover, the prospect of having politicians from the old regime returning to power is a further cause for rage, as is the prospect of an enduring military presence (after the military took over upon Mubarak's departure).

The ongoing tensions continue to impact the economy. Especially tourism and foreign investments fell sharply, reducing both FX reserves and GDP growth. As detailed in our last full report (march, 2011), in the first quarter of 2011 tourism fell by 80%, only to pick up slowly thereafter. Similarly, foreign investments are expected to slow to 1% of GDP over 2011 as a whole (from 3% of GDP in 2010). Finally, reduced liquidity in the banking sector has reduced domestic investments.

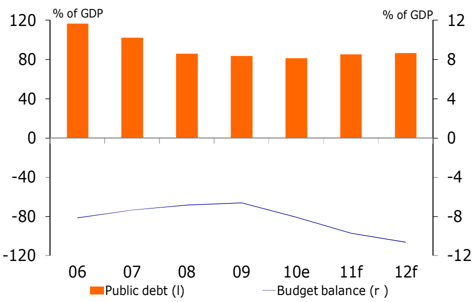
As a result, growth forecasts for 2011 are all but good. While the IMF predicts a meagre 1.5% growth rate, the Economist Intelligence Unit forecasted an even lower 0.6% rate. In either case, the predictions fall far below the 6% needed to guarantee a steady level of employment, given Egypt's high population growth. In contrast, unemployment will remain a significant problem, which is mostly affecting Egypt's youth.

Unsurprisingly, growth forecasts for 2012 are even less informative and will largely depend on election outcomes and any new government's ability to restore political and social stability; both should go a long way in reviving the economy. However, given the lingering instability we do not expect a rapid economic recovery. Instead, for 2012, GDP growth is expected to reach around 2.5%.

The bumpy road ahead

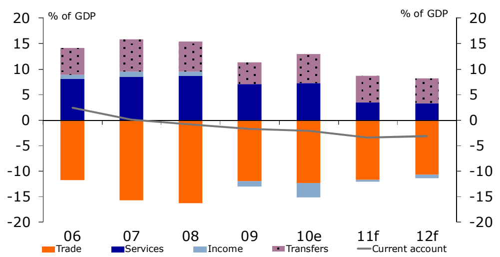
It has been over eight months since president Hosni Mubarak was ousted and Egypt is still awaiting its first elections. Hopes for a better future, which prevailed during and in the aftermath of the revolution, have cooled. The large number of inexperienced and disorganized political parties, combined with continued strikes and protests are creating fears that the revolution will bring chaos rather than prosperity. On the other hand, the military's firm grip on power remains an important source of discontent, especially with the youth that started the revolution. Their discontent is fuelled by the fact that politicians of the old regime will be allowed to participate in the upcoming elections, as well as the military's statement that it will remain in power after the parliamentary elections and until the presidential elections. Whether the presidential elections will indeed take place in the spring of 2012 remains unclear and many fear that they may be postponed until 2013. Meanwhile, the more established Muslim Brotherhood, which is expected to win the elections, has started to employ its popularity to force the regime to create a more democratic framework and speed up the elections. Although this is seen as a positive development, the popularity of the Muslim Brotherhood could cause problems as well, as especially Coptic Christians fear that an Islamic government will not represent their ideals and interests. In fact, tensions between Muslims and Christian Copts have increased over the last few months, culminating in riots last October, which resulted in the death of 27 people. Given the many tensions listed above, timely and fair elections are considered a vital first step for restoring political stability. However, they are only a start. In addition, any new government should take steps to resolve the underlying social crisis that effectively caused the revolution. Especially youth unemployment remains an urgent problem that has not yet been addressed. Given the enormous expectations created by the revolution, any new government will struggle to fulfil the many demands on the table.

Chart 1: Public finances



Source: EIU

Chart 2: Current account balance



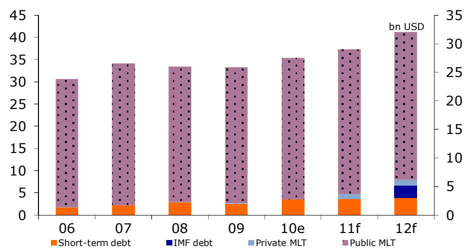
Source: EIU

Increased economic risks

Although slowed economic growth is worrisome, especially in light of Egypt's high unemployment rate, the main risks to the country's short-term economic outlook are a further depletion of FX reserves, as well as the government's ability to reign in spending. During the past eight months an outflow of FDI and a drop in tourism caused FX reserves to fall from USD 36bn in December 2010 (before the revolution), to USD 22.1bn in October 2011. The situation is worrisome, especially because capital flight also resulted in a sharp reduction of unofficial reserves held by private banks. In light of these developments it seems unlikely that the central bank will be able to keep the Egyptian pound stable. Nonetheless, for now, FX reserves still cover roughly 5 months of imports.

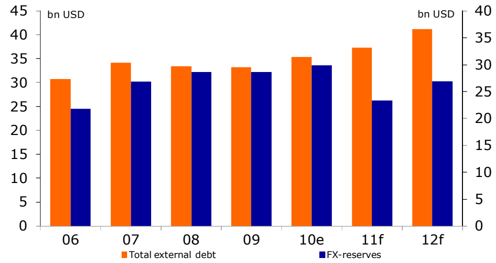
A relatively high public debt level, currently at roughly 81% of GDP (2010), is another cause for concern. During the first half of 2011, the interim regime refused an IMF loan package on the grounds that it would restrain spending and it did not want to saddle any new government with an increasing public debt. However, the regime so far failed to reign in spending. Instead, in light of increased spending on social programs and food and fuel subsidies (which account for 20% of the budget), we expect the budget deficit to increase from 6.6% of GDP in 2010, to 9.1% of GDP in 2011, possibly increasing further in 2012. Aside from an increase in spending, the deficit also mirrors reduced tax revenues, due to slow growth. Consequently, we expect the public debt to rise to 86% of GDP in 2011, with further increases expected in 2012.
Although both falling FX reserves and increasing budget deficits are worrisome, we find some comfort in the fact that various countries already pledged to financially support Egypt, including Saudi Arabia and the US. Although most of the promised funds are still to be disbursed, it appears that, if push comes to shove, the government can count on emergency aid. However, it is not unlikely that low FX reserves and/or high public debt level will eventually force the government to turn to the IMF.

Chart 3: External debt



Source: EIU

Chart 4: Foreign assets



Source: EcoWin

EGYPT

Selection of economic indicators	2006	2007	2008	2009	2010	2011e	2012f
Key country risk indicators							
GDP (% real change pa)	6.8	7.1	7.2	4.7	5.1	0.6	2.9
Consumer prices (average % change pa)	7.6	9.5	18.3	11.8	11.1	13.3	11.0
Current account balance (% of GDP)	2.4	0.1	-0.8	-1.7	-2.1	-3.4	-3.2
Total foreign exchange reserves (mln USD)	24462	30188	32216	32253	33612	26190	30350
Economic growth							
GDP (% real change pa)	6.8	7.1	7.2	4.7	5.1	0.6	2.9
Gross fixed investment (% real change pa)	13.8	23.7	14.8	-10.2	3.9	3.2	5.0
Private consumption (% real change pa)	6.4	8.8	5.7	5.7	5.1	-1.0	3.8
Government consumption (% real change pa)	3.1	0.2	2.1	5.6	4.5	7.0	5.9
Exports of G&S (% real change pa)	21.2	20.2	28.8	-14.5	-3.0	2.9	7.2
Imports of G&S (% real change pa)	21.7	30.5	26.3	-17.9	-3.2	2.1	11.6
Economic policy							
Budget balance (% of GDP)	-8.2	-7.3	-6.8	-6.6	-8.1	-9.7	-10.6
Public debt (% of GDP)	117	103	86	84	81	86	87
Money market interest rate (%)	9.5	6.9	11.6	9.8	9.3	12.0	10.8
M2 growth (% change pa)	15	19	10	9	12	19	10
Consumer prices (average % change pa)	7.6	9.5	18.3	11.8	11.1	13.3	11.0
Exchange rate LCU to USD (average)	5.7	5.6	5.4	5.5	5.6	5.9	5.9
Recorded unemployment (%)	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Balance of payments (mln USD)							
Current account balance	2564	194	-1331	-3195	-4435	-8610	-9180
Trade balance	-12725	-20801	-26774	-22475	-26513	-29460	-31000
Export value of goods	20546	24455	29849	23089	25024	27960	30400
Import value of goods	33271	45256	56623	45564	51537	57410	61400
Services balance	8689	11195	14312	13242	15483	8810	9580
Income balance	831	1478	1373	-1922	-5843	-1110	-1950
Transfer balance	5770	8322	9758	7960	12439	13150	14200
Net direct investment flows	9895	10913	7575	6141	5210	1900	2650
Net portfolio investment flows	-700	-4217	-7650	-527	-3722	-1720	-1830
Net debt flows	-102	2023	-82	-376	2236	1090	4290
Other capital flows (negative is flight)	-7465	-3121	3962	-1960	2570	490	8170
Change in international reserves	4193	5793	2475	84	1859	-6840	4100
External position (mln USD)							
Total foreign debt	30657	34120	33417	33257	35365	37280	41160
Short-term debt	1720	2236	2843	2561	3482	3600	3870
Total debt service due, incl. short-term debt	3435	4261	4983	5787	5806	7100	7710
Total foreign exchange reserves	24462	30188	32216	32253	33612	26190	30350
International investment position	-10810	-8364	-27028	-29739	n.a.	n.a.	n.a.
Total assets	61559	76365	67351	72701	n.a.	n.a.	n.a.
Total liabilities	72369	84729	94379	102439	n.a.	n.a.	n.a.
Key ratios for balance of payments, external solvency and external liquidity							
Trade balance (% of GDP)	-11.8	-15.7	-16.2	-12.0	-12.4	-11.7	-10.7
Current account balance (% of GDP)	2.4	0.1	-0.8	-1.7	-2.1	-3.4	-3.2
Inward FDI (% of GDP)	9.3	8.8	5.8	3.6	3.0	1.0	1.4
Foreign debt (% of GDP)	28	26	20	18	16	15	14
Foreign debt (% of XGSIT)	68	61	49	62	57	62	62
International investment position (% of GDP)	-10.0	-6.3	-16.4	-15.9	n.a.	n.a.	n.a.
Debt service ratio (% of XGSIT)	8	8	7	11	9	12	12
Interest service ratio incl. arrears (% of XGSIT)	2	2	1	2	1	1	2
FX-reserves import cover (months)	6.1	5.4	5.4	7.2	6.5	6.1	4.4
FX-reserves debt service cover (%)	712	709	646	557	579	369	394
Liquidity ratio	176	173	171	166	159	159	141

Source: EIU