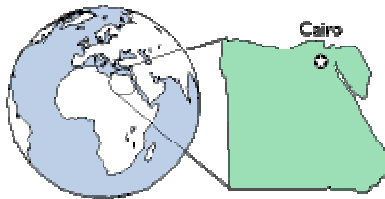


# COUNTRY REVIEW

## Egypt



31 July 2009

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**EULER HERMES COUNTRY RISK GRADE: C**

**Country Risk Grades are on a scale of AA, A, BB, B, C, D  
where AA is the lowest and D the highest risk.**

## Strengths

- Size and strategic importance encourage international financial support, particularly US aid
- President Mubarak's government exercises strong control over the key centres of power
- The government is generally reform-minded in relation to economic policy
- Diversified export and FX-generating economic base
- Economic policy generally pro-market and pro-reform
- Low external debt repayments and comfortable debt ratios, together with FX reserves that provide around six months of import cover
- Improving structural business environment, albeit from a low base

## Weaknesses

- Regional uncertainties, with potential risk of Egypt being drawn into a conflict
- Uncertainties in relation to presidential succession
- Sustained high rates of GDP growth are required to assist with poverty alleviation
- Structural rigidities include a young population, high poverty levels, high unemployment and a large, overstaffed public sector. These present potential sources of domestic unrest
- High (though declining) public debt-GDP ratio...
- ...exacerbated by costly subsidy provision in an attempt to limit the impact of inflationary pressures on the cost of energy and basic foodstuffs
- Inflationary pressures remain high

## Key Risks

- **Collateral damage and adverse economic knock-on effects of a conflict involving Israel and Iran or Israel and Palestinian territories**

## Country Risk Assessment

Ratings	Egypt		Median Grade C	Turkey	Peers	
	Latest	Previous			Libya	Indonesia
<b>Systemic Political Risk:</b>	<b>P3-</b>	<b>P3-</b>	<b>P3+</b>	<b>P3-</b>	<b>P3-</b>	<b>P3+</b>
<b>Systemic Economic Risk:</b>	<b>E4</b>	<b>E4</b>	<b>E5</b>	<b>E5</b>	<b>E4</b>	<b>E5</b>
ME rating:	ME4	ME4	ME5	ME5	ME3	ME5
<i>Structure</i>	5.7	5.7	5.9	3.3	6.0	4.2
<i>Policy</i>	5.2	5.6	5.2	4.6	6.0	4.3
<i>Solvency</i>	2.8	2.8	2.8	4.8	1.0	5.6
<i>External Liquidity</i>	2.9	1.9	4.3	6.0	1.9	4.2
SBE rating:	SBE3	SBE4	SBE4	SBE3	SBE4	SBE5
<b>COUNTRY GRADE:</b>	<b>C</b>	<b>C</b>	<b>C</b>	<b>C</b>	<b>C</b>	<b>B</b>

Nomenclature:  
 Political Risk Ratings are on a scale of P1 (lowest risk), P2+, P2-, P3+, P3-, P4 (highest risk).  
 Economic Risk Ratings are on a scale of E1 (lowest risk), E2, E3, E4, E5, E6 (highest risk).  
 ME (Macro-Economic) ratings are on a scale of ME1 (lowest risk), ME2, ME3, ME4, ME5, ME6 (highest risk).  
 The constituent parts of the ME rating are on a scale of 1.0 (best) to 6.0 (worst).  
 SBE (Structural Business Environment) ratings are on a scale of SBE1 (best), SBE2, SBE3, SBE4, SBE5, SBE6 (worst).  
 Country Grades are on a scale of AA, A, BB, B, C, D where AA is the lowest and D the highest country risk.

Source: Euler Hermes Country Risk Unit

## ECONOMIC STRUCTURE

### Country Profile

Capital city:	Cairo
Population:	81.53 mn (2008)
GDP:	USD 150260 mn (2008)
Currency:	Egyptian pound (EGP)
Form of state:	Republic
Head of government:	President Hosni Mubarak
Next elections:	Legislative by November 2010, presidential in 2011

Major Industries (% of GDP at market prices, 2008)		Global Assumptions	2008	2009f
Agriculture	13.0%	Real GDP grth (% yr/yr) *	0.7	-3.0
Industry	39.0%	Inflation (% , av) *	3.4	1.0
Services	48.0%	Dated Brent (USD/b)	98.0	55.0
		* major economies		

Main Exports (% of total, 2008e)		Main Imports (% of total, 2008e)	
Oil & petroleum products	40.0%	Semi-manufactures	26.0%
Textiles & other manufactures	35.0%	Capital goods	22.0%
Iron & steel	3.0%	Consumer items	14.0%
		Petroleum	8.0%
Lead Export Markets (% of total exports, 2007)		Lead Import Markets (% of total imports, 2007)	
US	9.7%	US	11.7%
Italy	9.5%	China	9.7%
Spain	7.6%	Italy	6.4%
Syria	5.5%	Germany	6.3%

## Basic indicators

Selected economic indicators	2005	2006	2007	2008	2009f
Nominal GDP (USD mn)	93,943	108,300	132,854	150,261	178,571
Population (mn)	77.15	78.60	80.06	81.53	83.20
GDP per capita (USD)	1,218	1,378	1,659	1,843	2,146
Real GDP growth (% yr/yr)	4.5	6.8	7.1	7.2	3.5
Inflation (% , average)	4.8	7.6	9.4	18.3	8.0
Fiscal balance (% of GDP)	-9.6	-8.2	-7.5	-6.6	-7.0
Current account balance (% of GDP)	2.2	2.4	0.3	-0.5	-1.1
External debt/GDP (%)	31.4	26.6	22.9	19.8	15.1
External debt/Exports of goods & services (%)	77.7	63.7	54.1	43.8	51.9
Debt-service ratio (%)	6.1	4.9	4.8	4.3	6.0
Foreign exchange reserves (USD mn)	20,508	24,341	30,054	32,108	30,250
Import cover (months)	6.9	6.9	6.5	5.6	6.6
Exchange rate assumption, EGP:USD (year end)	5.73	5.70	5.50	5.75	5.60
f: CRU central forecast					

Sources: Central Bank, IMF, World Bank, Euler Hermes Country Risk Unit

## Political Stability

Hosni Mubarak has been in power since 1981, following the assassination of President Sadat. He stood for re-election in September 2005 and won a further (fifth) six-year term in office. Following pressure to liberalise from Washington, Mubarak announced in February 2005 that the constitution would be amended to allow multiple candidates to stand in presidential elections, subject to a referendum. The latter was held in May 2005 and, despite some electoral irregularities, 82.9% of the vote was in favour of multi-candidate elections. However, the system is heavily weighted in favour of Mubarak as potential candidates need the support of at least 65 of 444 MPs in **the legislature, which is dominated by the president's National Democratic Party (NDP)**. A measure of democracy has been introduced but, in Middle East fashion, this is highly circumscribed by local conditions.

Acts of terrorism, including bombings in Red Sea resorts such as Sharma al-Shaikh, indicate that Egypt is a natural target for such activity (domestic or global), given its size and geographic position. Although the tourism sector has proved to be resilient against such activity, President Mubarak has used such episodes to crack down on opposition groups. Accordingly, pledges to speed up political reforms, rescind emergency powers and allow greater press freedom appear not to be high priority. Meaningful reforms now appear further distant and **political liberalism off the agenda**. The president's son, Gamal Mubarak, has served a political apprenticeship through several senior positions within the NDP and is a strong candidate for a future presidency. President **Mubarak may yet seek a further term in office, subject to health considerations**, and may even succumb to aspirations of a life presidency. It seems likely that a Mubarak will be head of state for the foreseeable future. In any event, the military will oversee transition to a new leadership—as it smoothly made the way for Mubarak in 1981—so that upheaval is unlikely under almost all perceivable circumstances of regime change.

**Mubarak and the military control all the key centres of power**—including the judiciary and the security services—and are well placed to maintain stability. The legislature's power is limited, as the executive can rule by presidential decree. The main opposition is from Islamic groups, the largest of which is the Muslim Brotherhood (MB). Although the latter is illegal—religious parties are proscribed by the constitution—some of its members hold 'independent' seats in the legislature. Indeed, in parliamentary elections in November-December 2005, the MB won 88 seats, compared with 15 previously. The international community (and the US, in particular) has been urging Egypt to adopt a more-inclusive political framework. However, with uncertain politics throughout the Middle East, the US may be wary of pushing Egypt down the democratisation route too quickly. The danger is that effective opposition will be expressed through popular demonstrations and street violence, which occur periodically. In the absence of a vibrant political opposition and with a young population (35% is aged 15 years or younger) and high poverty levels and unemployment, Egyptian society requires economic benefits to be filtered down to alleviate pressure for violent change. This explains why Mubarak appointed a reform-minded premier, Ahmed Nazif, to initiate economic growth policies and still makes tentative political gestures towards opening up to a more inclusive society. However, while the economic reform agenda has been pushed forward, political changes will be adopted only slowly.

With a **strategic significance in the Middle East and North African region** and a voice of relative moderation, Egypt is an agent with which—and through—the West can negotiate. As a result the country is a **major recipient of US aid**—acting as a counter-balance to US financial disbursements to Israel—and international financial, technical and other support. Relations with its neighbours, including Libya to the west and Israel to the north-east, do not cause concern in the immediate future.

## Economic Stability

Egypt's strategic significance is seen through its dual claims to be the **third-most populous country in Africa (the largest in the Arab world)** and the third largest in area in the Middle East, and it acts as a gateway to both regions. Services now account for almost 50% of GDP, industry (including the important oil sector) for around 40% and agriculture now accounts for only around 10-14%, although it has a greater importance through employment levels in what remains an essentially riparian and, outside the capital, rural society. Tourism, oil and gas, workers' remittances, Suez Canal receipts and cotton and related products provide a fairly diverse resource-base for generating foreign exchange (FX) earnings. According to World Bank classifications, Egypt is a 'lower-middle-income' country. Growth in real GDP averaged an annual 4.4% in 1991-2000 and 5% in 2001-08 (7% 2006-08) but, with a **deteriorating global world economy and associated weakness in Egypt's key economic drivers (see above), we forecast GDP growth will slow to around 3.5% in 2009 and, reflecting a forecast slow global recovery, a below trend 4.5% in 2010**.

Egypt is not a member of OPEC but it remains a net oil exporter and is a significant producer of natural gas. Oil reserves are the sixth highest in Africa and will last for a further 16 years at current

rates of annual extraction of 720,000 barrels per day. Egypt possesses Africa's third largest reserves of natural gas, which will last a further 37 years at current rates of extraction of 58.9bn cubic metres.

**A structural impediment to balanced and sustained growth is the central government deficit**, with subsidies (particularly on energy and foodstuffs) representing the largest single item in the budget. This tends to be equivalent to around 6-10% of GDP but general government deficits are alleviated through allocations from the National Investment Bank, which in turn is financed mainly by surpluses from social security funds, and such deficits are contained at around 3-5% of GDP. The government is actively running down the stock of general government debt as a proportion of GDP (currently around 70%) but a weak domestic and global economic environment has reduced revenue generation through privatisation (USD1.6bn was raised through the sale of an 80% stake in Bank of Alexandria in 2006) and government debt is unlikely to fall in 2009-10.

The thrust of monetary policy is shifting from direct intervention towards **inflation targeting** and interest rate changes are used to help contain inflationary pressures and provide pound support. The central bank is currently in a loosening phase of monetary policy, with the most recent cuts in its two intervention rates effective from 21 June aimed at stimulating growth against a weak global trading environment. The rate of inflation averaged 18.3% in 2008, after 9.4% in 2007 and having peaked at 23.7% in August 2008, reflecting higher domestic fuel prices. Although inflationary pressures are currently easing because of a lagged effect from the earlier period of tightening monetary policy (2008), rigidities will limit the decline to an average increase of 8% in 2009 and around 7% in 2010. One of the rigidities is the **government's concern that reducing energy subsidies and associated increases in fuel prices will result in street demonstrations**. There is now more confidence in the external value of the pound and the working of the official FX market. Indeed, the informal (black) market for currency dealings is now much reduced, representing a radical and positive development. Confidence in economic policy-making and ability to convert the pound resulted in the CBE intervening to slow the pace of pound appreciation in the period 2005 to H1 2008. In the second half of last year, the pound weakened as a result of capital outflows and strengthening USD but **moderate pound depreciation is forecast for 2009-10**.

The current account moved from around balance in 2001 and 2002 to strong surplus (reaching 5% of GDP in 2004) but returned to small deficit in 2008 (0.5%). This year we forecast the deficit will widen to just over 1% of GDP as tourism earnings, receipts from the Suez Canal, workers' remittances and weak energy markets reduce Egypt's export earning capacity. Nevertheless, the government had actively sought to boost FX reserves as an outward sign of economic strength and these had increased from USD13bn in 2000 to over USD32bn at the end of 2008. Accordingly, **we expect import cover to remain a healthy 5-7 months in 2009-10**. Total external debt due (short term plus principal repayments on medium/long term) in 2009 is a comfortable 26% of FX reserves. External debt, after extensive forgiveness in the early 1990s, remains relatively low, at 15-20% of GDP and 40-50% of exports of goods and services. The debt service ratio is a modest 4-6%.

### Structural Business Environment

The **business environment has improved markedly** in recent years but, overall, remains well below average of the countries we assess. The Heritage Foundation's 2009 Index of Economic Freedom (IEF) assigns Egypt a ranking of 97 out of 179 countries, below Tanzania, Lebanon and Ghana but above Tunisia, Morocco and Pakistan. Under the IEF methodology, Egypt had showed the largest improvement of any country in 2007, with fiscal and labour freedoms above the world average. Nevertheless, corruption and protection of property rights are still listed as problem areas. The IEF further indicates that, despite creation of a "one-stop-shop" for investment and less than the world average time to start an enterprise, closing a business can be burdensome. Transparency International's Corruption Perceptions Index 2008 ranks Egypt 115= (with Malawi, Niger and Zambia) out of 180 countries, below Tanzania, Argentina and Armenia but above Nigeria, Togo and Vietnam. According to the World Bank's Doing Business 2009 survey, Egypt ranks 114 out of 181 economies in terms of overall ease of doing business, with enforcement of contracts involving more time and legal costs than the regional average. The time and cost in resolving bankruptcies are higher than the regional average and the rate of recovery is less.

Financial sector reforms are underway but, despite sale of an 80% stake in Bank of Alexandria (the smallest of the largest four banks) to a European operator in 2006, the **pace of privatisation has slowed**. NPLs remain significant.

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## Charts

