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Economic Risk Analysis
Country: Egypt

Egypt on the Brink of Economic Collapse, GCC [Minus Qatar] to the Rescue

Politically, Egypt is in a bad place. Egyptians seem to be given bad choices: either pick brutal dictators, violent conservative-Islamists, or ruthless military. Sometimes, you can combine them so as dictators and military are just the same. The middle path, as in almost every Arab country, is very difficult to find, and that is not likely to get better considering the chaotic state of the economy.

Removed by the citizen rebels of the grassroots Tamarod movement, and following a decisive decision by the military to speed up his departure, Mohamed Morsi can partly link his demise to the poor economic performance of his one year in power, with the same types of challenges facings his replacement Adly Mansour. While Morsi remained focused on pointless social and religious agendas, economic data published by the government and third-party institutions look awful. The nation's GDP has stalled, growing only 2% from 2011 to 2012, and likely to grow even slower in 2013. Although that figure might mean stability in mature economies, it simply means a disaster for a nation like Egypt where the population is in need of everything.

The nation's currency is consistently getting weaker versus the US dollar, and inflation keeps on growing, with some estimating it at 8%, others at 15%. Egypt's economy has been relying on the flow of foreign tourists to keep it afloat. And naturally, when a revolution happens, tourists stay away. In 2011, foreign tourist entries dropped to 10 million, from 14 million in 2010. That's a near 29% loss. To maintain its balance of payment, Egypt will need to find $12 billion, and irocally this is what Saudi Arabia and its anti-Muslim Brotherhood peers of the Gulf have come up with. Meanwhile, Egypt's budget deficit for the period of July 2012 to June 2013 topped $30 billion, or 12% of GDP. As in most, if not all Arab nations ruled by scared regimes, the government of Egypt has earmarked some 75% of the nation's budget to wages, subsidies, and foreign debt repayment, areas that are simply leading that nation into bankruptcy. The foreign debt is now nearing $40 billion. Economic stress in a nation going through such a shock means that whatever currency reserves the country holds are eventually dwindling. In less than one year, Egypt's hard currency reserve dropped by almost 26%, from $13.5 billion in 2012 to about $10 billion today. This reserve is only able to cover three months worth of imports. This fact is a very dramatic event considering that Egypt is a nation that imports most of its fuel and cereal products, which are central to the Egyptian household eating habits. These deteriorating data prompted agencies like Standard and Poor's (S&P) to downgrade Egypt's rating over time, leading to even greater criticism against ultra-conservative president Mohamed Morsi. Both facts and emotions have made foreign investments and financing virtually impossible in the Egyptian context. Now that Morsi is gone, the new executive leadership will have to deal with enormous issues. To do so, it has apparently unlimited powers to enact whatever rules it will deem necessary to stabilize the nation's economy, starting with a fresh round of negotiations with the IMF to

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get loans worth $4.8 billion. This loan was already into a negotiation track some six months ago and an agreement was supposed to be reached in July 2013. But talks with IMF have stalled as the two failed to agree on the issue of subsidies, specifically focused on the price of energy, that would have led to a reduction in the budget deficit, which the IMF wanted to see drop below 10%. It is unclear whether the new leaders will accept IMF terms. Indeed subsidy reductions are often catalysts to more social disruption. Deadly riots took place in 1977 and 2008 precisely as a result of a government reduction of subsidies. Morsi has also been adamant as to not increase taxes on the sale and consumption of many mass products, frustrating his Western partners. At the end, however, the new regime in place will have serious difficulties justifying subsidies reductions, and therefore, given the worries from Washington, Brussels and the GCC about the evolving events in Egypt, it is likely that the IMF will ease its demands for the time being to enable a return to political stability in Egypt.

Massive Financial Needs:

More than ever before, Egypt needs its friends. It is now open warfare with its Muslim Brotherhood, and Qatar, which has given so much money to its ally Mohamed Morsi, is not likely to jump to the rescue. But others in the Gulf region who are in competition with Qatar on buying influence have moved in to pledge billions of dollars in support. The expected reaction from the Muslim Brotherhood in wanting to fight the ousting of Morsi is a scary thought for a great many Sheiks of the Gulf, as well for the US, Israel and so many others who do not want to see Egypt follow the path of Syria.

Support from friends is a necessary step for Egypt, which witnessed foreign direct investment drop from a peak of $10 billion in 2006 to barely $1 billion now. Help from allies will go on supporting some basic economic stabilization. While Qatar has already released $3 billion of the $8 billion pledged, that country is now cutting its losses having bet on the wrong horse when supporting Mohamed Morsi. Libya has already loaned Egypt $2 billion. While Qatar's influence wanes for the time being pending a strategic reassessment, Saudi Arabia, the United Arab Emirates (UAE) and Kuwait are using this opportunity to regain momentum in Egypt. Siding with the Salafists, whose important section was always against Morsi, Saudi Arabia decided to pump $5 billion in aid to Egypt. The Muslim Brotherhood has always had no sympathy to Saudi Arabia, specifically against who they consider illegitimate monarchies. Within 48 hours other GCC donors made their moves. Kuwait followed with an aid package of $4 billion, a donation of $1 billion, with $2 billion immediately deposited into the Egyptian central bank. Kuwait further donated $2 billion worth of oil and gas. Then the UAE followed with its own $3 billion package. This $12 billion package will certainly help the new regime reduce some of the deadly tension, but it is also used by Saudi Arabia and its ideological allies to undermine the Muslim Brotherhood and Qatar's influence. In this context, Saudi Arabia is favoring a more extreme branch of political Islam, the Salafists, which it controls.

Still, Egypt will need much more. It needs some $20 billion, on the low end, to improve its basic infrastructure if wants to rebuild and seek investor commitment to return. In the Sinai region, massive investment will be required to regain the trust of local tribes and communities. Sinai-based Bedouin tribes are said to be influenced by extremist elements, a fact magnified by poverty and lack of resources, and an often suffocating presence of the Egyptian army, which controls the Sinai economy.

The other issue, which the new regime is not likely to economy. The military owns some 30% of the nation's GDP, like a nation within a nation, controlling entire sectors of manufacturing and services, ironically unrelated to defense. There has been a heavy concentration of army-owned economic entities precisely in the heavily contested Sinai region, and given what military leaders get in terms of profits and wealth control, it is unlikely they will agree to relinquish easily, as suggested by many economists.

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