Egypt

Economics

General Political Environment:
The Egyptian political system is dominated by President Hosni Mubarak and most decision-making authority is vested in the president. While several opposition parties exist, they pose little challenge to the ruling National Democratic Party (NDP). Harassment and intimidation by state security forces ensures that they remain weak and fragmented. Although an officially illegal organization, Egypt's Muslim Brotherhood (MB) is the country's main political opposition group.

Succession is a key issue in Egyptian politics. President Mubarak is 79 years old and said to be in poor health. As yet, no successor has been named but analysts are increasingly viewing Gamal Mubarak, the president's son as the heir apparent.

While the ruling NDP retained its parliamentary majority following the October 2005 legislative elections, the MB – which gets around its banned status by running candidates as independents – dramatically increased its representation from 16 to 88 members. The three-round elections were, however, marred by fraud and violence.

The electoral success of the MB prompted a concerted government crackdown on the organisation. Measures include the arrest of more than 1,200 MB members in 2006-7 and asset freezes against 29 MB-connected businessmen. Furthermore, a series of constitutional amendments essentially aimed at ensuring that the MB can never become a legal political force was adopted in March 2007.

Prior to the 2005 elections Egypt adopted a number of political reforms including allowing direct multi-candidate presidential elections for the first time. Ostensibly, the reforms had democratic objectives but altered very little about the political structure and the concentration of power in the NDP.

Investment Environment:
Under Law 8 of 1997, which governs foreign investment in 16 sectors, investors are granted special exemptions and incentives. The Law also guarantees the repatriation of capital, the right to own foreign currency accounts and national treatment. A Prime Ministerial Decree requiring firms operating in the country to surrender 75% of their hard currency earnings was rescinded in 2004.

A number of reforms including a significant reduction in capital needed to start a business, and halving of time required to start a business, led to a top ranking in the World Bank's 2008 *Doing Business* report on national economic reformers in 2007. Reform-minded Prime Minister Ahmed Nazif is thought to have been important to this achievement.

Investors cite a cumbersome bureaucracy and an opaque taxation system as key obstacles to doing business in Egypt. Local court proceedings are reportedly fair but lengthy owing to the severe backlog of cases. Investor difficulties with Egypt's complex customs procedures are being addressed.

Political Violence:

The country's main militant Islamist groups – *Gamaat Islamiya* and *Al Jihad* – declared a cease-fire with the government in 1999 and 2000 respectively. A return to the sustained militant campaign which plagued Egypt in the 1990s remains unlikely.

Local extremists either affiliated or inspired by al-Qaeda have carried out a string of attacks inside Egypt over the past several years: Taba and Ras Shaitan (October 2004), a small-scale attack in the Khan al-Khalili bazaar (April 2005), Sharm El-Sheikh (July 2005), and the attacks on the Red Sea Resort of Dahab (April 2006). The focus of the attacks thus far has been tourist infrastructure, particularly in the Sinai Peninsula. There is a significant risk of further isolated terrorist attacks as Egypt remains an attractive terrorist target due to its pro-Western stance and well-developed tourist infrastructure.

Sectarian violence in Egypt's underdeveloped south remains a problem but has never been directed against foreign investor interests.

Political

Political Structure
Unitary Republic

President
Hosni Mubarak (NDP)

Prime Minister
Ahmed Nazif

Legislative Body
- Majlis al-Shaab (People's Assembly) – 454 members)
- Shura Council (consultative body) – 264 members

Major Parties (seats in Assembly)
- The National Democratic Party (NDP) – 311;
- New Wafd Party – 9;
- Muslim Brotherhood (running as independents) - 88
- National Progressive Unionist Party (Tagammu) – 9;
- the Democratic Arab Nasserist Party – 3;
- Liberal Party – 1;
- Independents – 38

Last Elections
- Presidential: September 7, 2005
- Legislative: October/November 2005

Next Elections
- Presidential: 2011
- Legislative: 2010

Press Freedom Survey:
- 2007 Score: 62 (Not Free)

freedomhouse.org

Control of Corruption Index:
- 2006 Score: -0.41

(-2.5: Worst; +2.5: Best)
worldbank.org

November 2007
Nick Mercer
nmercer@edc.ca

Outlook

The regime's prime focus is on continued political stability and maintaining its own hold on power. As such, change, whether political or economic, will be incremental. While the government's economic reform policy will remain on track, the MB's electoral success will push the government to continue its clampdown on political opposition forces. These tactics will provoke further voter apathy, social unrest and will feed the growth of extremism but not to a sufficient degree to threaten the regime.

Discontent over falling living standards in a country with rapid population growth remains a key government concern. Despite the appointment of a reform-minded cabinet, the regime is likely to remain cautious in moving forward with significant reforms for fear of the short-term social adjustment costs.

Egypt

Economics

Economic

Credit Agencies

Moody's: Ba1

S&P: BB+

Fitch: BB+

Nominal GDP (2006)

US$107.9bn

Population (2006):

75.9 million

Total Trade / GDP:

49.5%

Currency:

Egyptian Pound

Exchange regime:

Flexible exchange rate

Merchandise imports from Canada: 2006

CAD$412.8mn

Main sources of Foreign Exchange (excl. FDI):

Tourism; petroleum

Largest Merchandise Trading Partner:

USA (35%)

EU (30%)

Main imports:

Capital goods (20%)

Semi-finished goods (33%)

Risks to the Outlook

Faster reforms; Higher exports; Lower debt.

Policy slippage; Growing public debt.

March 2007

Jocelyne Lussier

jlussier@edc.ca

Market Spotlight: Egypt's economic liberalization program and wide ranging reforms resulted in strong and broad-based growth. The outlook is equally encouraging. The current five-year plan (for the period 2006/07-10/11) aims to GDP growth rate of 8% a year, which is very ambitious; GDP growth rate of 6% is more realistic. New gas discoveries are encouraging. Investment in infrastructure is set to continue. Confidence has encouraged private spending and has attracted strong FDI inflows from the Gulf countries (GCC). Despite bomb attacks, tourism has been doing well. The sale of state assets has kept the fiscal position in check because any substantial cuts in subsidies would be met by major popular protests. The services industry has not fully met job creation needs. Inflationary pressures have to be addressed in 2007. The Egyptian pound has been stable. The external accounts have strengthened with larger exports and invisibles receipts. But, this outcome could be challenged in future years, as reforms implemented so far, have been designed to ease imports.

Recent performance: Egypt's strong performance has reflected ongoing reforms, strong capital inflows and a surge in gas output. The government is expected to pursue its economic program that has resulted in robust growth, which is in their view, the best course to raise living standards and undercut the Islamists' appeal. Nevertheless, the government is expected to be more cautious about potentially painful reforms, such as streamlining public administration. The government remains concerned about its ability to transform a positive macroeconomic situation into tangible benefits for ordinary Egyptians. Job creation, while starting to have an impact, is still insufficient to curb massive (and under reported) unemployment. The plan that covers the period of 2007 through 2011 is targeting a GDP growth rate of 8% a year. However, GDP growth rate averaging 6% a year is more realistic in view of the country's bottlenecks. High inflation, with prices rising faster than salaries, will be the key socioeconomic challenge.

Fiscal policy: Inflation, which by the end of 2006 had risen to 11.8%, resulted from an outbreak of bird flu and adjustment in some administrated prices. The general government fiscal balance has shown a large deficit of roughly 8% of GDP a year. Nevertheless, the overall fiscal deficit has been reduced to more manageable levels through tax reforms and the sale of state assets – such as Telecom Egypt and Verta Paper Manufacturing Company. Large fiscal deficits led to a (net) public sector debt equivalent to more than 70% of GDP, excluding deposits (blocked accounts) in the central bank for repayments on Paris Club rescheduled debt are excluded. Tariffs have been reduced and interest rates may increase, but it may not be sufficient to keep inflation single digit. Progress has been made towards the introduction of a full inflation-targeting regime.

Banking sector: There has been further rationalization in the banking sector (the number of commercial banks cut from 57 to 39) and Bank Alexandria has been privatized. Even though the Central Bank has implemented a series of reforms, it is not independent. More than 60% of financial sector is controlled by the state. It has suffered from political interference, bad management and an economic slowdown since the late 1990s. Non-performing loans exceed 20-25% of total loans. S&P put the figure at 35-50%, but the sale of Bank Alexandria should improve data. The government has reduced capital requirements in the hope to encourage private sector business.

External sector: Egypt has been benefiting from higher oil and gas prices. External accounts have been strengthening, but are characterized by extremely large merchandise trade deficits offset by equally large surplus in invisibles, typically revenues from tourism and the Suez Canal dues. External debt is manageable equivalent to 25% of GDP. Foreign reserves were at US$23bn at the start of 2007 up from less than US$19.8bn a year earlier.

Outlook: *Egypt is benefiting from oil windfalls and the floating pound, but the fiscal reform remains an outstanding issue. The sale of state assets delays the civil service reform. Over the medium-term, the overriding issue is to achieve strong growth to create employment Moreover, subsidy and bureaucratic reform will remain contentious.*

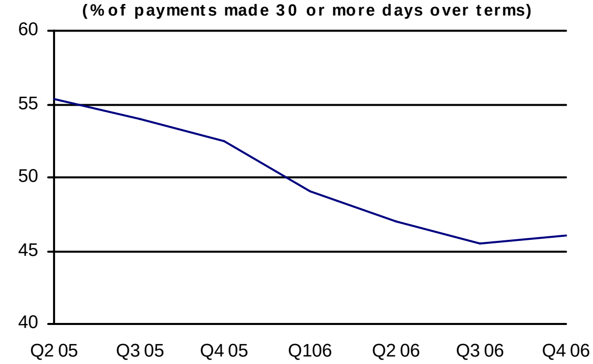
Economic Indicators

	01-05 avg.	2006	2007	2008
GDP (% growth, real)	3,7	6,8	6,7	6,1
Inflation (%chg, pa avg.)	5,1	7,8	10.1	6.5
Fiscal Balance (% of GDP)	-6,5	-8,7	-8.1	-7.5
Exports (%, comp. annual growth)	17,9	30,4	26,9	17,3
Imports (%, comp. annual growth)	9,1	19,2	18,1	13,9
Current Account (% of GDP)	2,5	2.0	1.2	0.1
Reserves (months of imports)	7,2	3,8	6,6	6,5
External Debt (% of GDP)	36,2	28,3	24,6	22,3
Debt Service Ratio (due)	8,7	6,5	7.5	7.8
Exchange Rate (to USD; end of year)	5,5	5,7	5,7	5,7

Source: EIU, EDC Economics

Egypt - Payments Performance

(% of payments made 30 or more days over terms)



Source: D&B. EDC Economics