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The Suez Canal Axis channel will begin operating in August, halving the navigation time for vessels. The new channel will more than double annual canal revenue to \$13.2 billion by 2023. The cabinet approves 2015 budget predicated on 5.0% growth and a budget deficit of 9.9%. The Egyptian Exchange reduces the free float required for new companies to list on its benchmark EGX 30. Security forces foil a suspected Islamist militant attack targeting tourists at Luxor.

New Suez Canal channel to begin operating in August

The **Suez Canal Authority** confirmed on 14 June that the **Suez Canal Axis** channel will begin operating in August.¹ The channel runs parallel to the existing waterway and will increase the volume of maritime trade throughput, a key source of hard currency for Egypt. The Egyptian military started work on the \$9 billion project in August 2014. The majority of financing came from domestic investors. The Suez Canal Axis will also reduce costs for shippers, allowing vessels to pass each other, thereby halving the navigation time from approximately 22 hours to 11 hours.² The government on 11 June also approved legislation increasing the mandate of the Suez Canal Authority. The new legislation permits the Suez Canal Authority to form joint stock companies as the government looks to increase international investment in the **Suez Canal** industrial hub.³ The Suez Canal Authority was previously limited to the management of the Suez Canal and revenue collection.

The Suez Canal Authority estimates that the new canal will increase annual revenues from \$5.3 billion to \$13.2 billion by 2023.⁴ Whether this is feasible will depend on the wider state of the international maritime industry.

“The state of the global shipping industry tends to lag in response to whether the global economy is doing well or badly. Shipping in terms of contracts only feels the benefits of increased economic activity two or three years after other economic sectors recover so any strategy that banks on the availability of vessels is inherently risky at this stage.”⁵

It will also depend on the impact of continued insecurity. Islamist militancy in the **Suez** has largely not affected the Suez Canal and international shipping. In September 2013, security forces disrupted an attack on a **Panama**-flagged vessel passing through the canal. However, while there is concern that militant groups may target shipping, this would not have the same impact on shipping as it would previously.

“Egypt’s relationship with its neighbours has improved substantially since then. The major concern previously from a shipping perspective was that Egypt would blame its neighbours for backing these groups and look to block vessels from certain nations using the Suez Canal which would have violated international agreements leaving Egypt open to sanctions. Now the impact

¹ MENA, 14 Jun 2015.

² MENA, 14 Jun 2015.

³ Al Ahram, 11 Jun 2015.

⁴ MENA, 14 Jun 2015.

⁵ Source, senior maritime arbitrator

of any security incident would be for individual companies on the insurance and contractual side of things rather than international.”⁶

Insecurity further along the shipping lane may have a more significant impact on the shipping industry and therefore Egypt’s access to hard currency. **Yemen** is strategically important for Egypt as it lies at the opening of the Suez Canal shipping route between the **Mediterranean Sea** and the **Indian Ocean**. The deteriorating security situation in Yemen has increased the naval presence in the Indian Ocean with **Arab** states deploying vessels in the **Gulf of Aden**. While the intention is to protect shipping through the **Bab al-Mandab**, the presence of an increased number of warships is likely to disrupt shipping in the region.⁷

*“Shipping companies are considering their options but have little option in terms of rerouting especially with delays to the **Panama Canal** expansion. If shipping companies are bearing increased costs from insurance and security then they will not welcome any attempt by Egypt to increase toll fees on the Suez Canal which I think they will want to ...”⁸*

An insecure Yemen might provide a base for piracy in both the **Red Sea** and the Gulf of Aden in a similar manner to **Somalia** in recent years.⁹

Cabinet approves budget

The cabinet on 18 June approved the 2015 budget predicated on forecast growth of 5% compared to 4.2% in the current financial year.¹⁰ The budget signals the government’s incremental approach to decreasing the budget deficit. President **Abdel Fattah Al-Sisi** (2014- present) is yet to approve the budget. The budget projects a deficit of 9.9% of GDP compared to the forecast 10.8% in the current fiscal year.¹¹ It projects government revenue at Egyptian pounds (EGP) 612 billion (\$80.3 billion), a 26% increase on the current fiscal year.¹² Government expenditure is projected at EGP 885 billion (\$115.9 billion), a 20% increase on the current fiscal year.¹³ The budget projects that domestic tax collection will account for 69% of total revenue, with customs revenues expected to increase 24.8% year on year.¹⁴ The cabinet budget statement said that the government aims to decrease the budget deficit to between 8% and 8.5% of GDP in 2018-2019 and decrease public debt to 85% of GDP.¹⁵ In the budget, state salaries and benefits will increase 14% year on year, approximately 26% of total expenditure.¹⁶ The budget includes an increase in social welfare spending. The draft budget includes social spending commitments of EGP 431 billion (\$56.5 billion).¹⁷ This is approximately 49% of all government expenditure and a 12% increase on the current fiscal year. The draft budget did not include details of spending on politically sensitive fuel subsidies. The **Egyptian General Petroleum Corp (EGPC)** said in a 20 June statement that the full budget includes EGP 61 billion (\$8 billion) provision for fuel product subsidies.¹⁸ The EGPC said this allocation was based on a projected average price of \$70 per barrel of **Brent** crude.¹⁹

⁶ Source, think tank executive, London

⁷ Source, international maritime arbitrator, London

⁸ Source, senior maritime arbitrator

⁹ Source, international maritime arbitrator, London

¹⁰ Cabinet statement, 18 Jun 2015.

¹¹ Cabinet statement, 18 Jun 2015.

¹² Cabinet statement, 18 Jun 2015.

¹³ Cabinet statement, 18 Jun 2015.

¹⁴ Cabinet statement, 18 Jun 2015.

¹⁵ Cabinet statement, 18 Jun 2015.

¹⁶ Cabinet statement, 18 Jun 2015.

¹⁷ Cabinet statement, 18 Jun 2015.

¹⁸ Egyptian Independent, 20 Jun 2015.

¹⁹ Egyptian Independent, 20 Jun 2015.

The budget follows Egypt's return to the international capital markets. The government sold a \$1.5 billion 10-year bond on 4 June.²⁰ Accessing global capital markets will improve Egypt's public finances, and provide access to dollars, which is key to stimulating business activity. The sale attracted investor orders of \$4.5 billion.²¹ The yield on the bond was 6%, tighter than the initial pricing guidance of 6.25%, due to the level of demand.²² Western investors rather than domestic demand accounted for the majority of the bond, which is unusual compared to the majority of debt issues in the **Gulf**.²³ **United States (US)** investors accounted for 45% of the issue, the **United Kingdom** 35%, **European** accounts 11% and **Middle East** investors 7%.²⁴ The investor base was diversified with asset managers taking 72% of the issue, commercial and private banks 13%, hedge funds 9% and insurance and pension funds 6%.²⁵ The bond sale was the first conducted since 2010, as increased political and economic instability deterred foreign portfolio investors. The market price on an outstanding dollar bond which matures in 2020 signals increased investor confidence. The trading yield on the bond was 4.37% on 4 June compared to 11.09% in June 2013.²⁶ However, generous pricing as well as increased political stability attracted investors to the 4 June bond. The bond has a spread of 360 basis points compared to 268.49 for the 2020 bond.²⁷

Egyptian Exchange reduces EXG30 listing requirements

The **Egyptian Exchange** on 28 May announced a series of reforms that it hopes will increase activity and liquidity as it looks to raise investor confidence. The Egyptian Exchange reduced the free float required for new companies to list on its benchmark **EGX 30**.²⁸ Previously, companies required a 15% free float to list on the EGX 30.²⁹ Under the new regulations, companies will only require a minimum 5% free float as long as the market capital of the float is at least EGP 100m (\$13.1m).³⁰ The Egyptian Exchange also amended a previous regulation that a company could only enter the EXG30 if its shares were traded on 50% of trading days within the previous six months.³¹ This prevented newly listed companies from joining the EGX 30 even if actively traded. Under the new regulations, a company's shares need to be traded on 75% of trading days since its listing date.³² The new regulations would notably allow **Orascom Construction Ltd** to list on the EGX 30, having listed on the Egyptian Exchange in April. The Egyptian Exchange additionally announced the launch of a new equal-weighted index for the 50 largest companies in terms of liquidity.³³ The new index will launch on 1 August, following the completion of a scheduled periodic review of the Egyptian Exchange indexes.

Egyptian Exchange chairman **Mohamed Omran** on 1 June also announced changes to its trading mechanisms.³⁴ Omran announced that the Egyptian Exchange would later this month introduce a next-day settlement of trades.³⁵ The Egyptian Exchange currently operates under second-day settlement, increasing counterparty risks. Omran said that the Egyptian Exchange aimed to have three or four preliminary listing proposals in the second half of 2015 and denied media reports that US-based **MSCI** might drop the Egyptian Exchange from its emerging markets index.³⁶ MSCI removed

²⁰ Zawya, 4 Jun 2015.

²¹ Zawya, 4 Jun 2015.

²² Zawya, 4 Jun 2015.

²³ Financial Services Monitor Worldwide, 8 Jun 2015.

²⁴ Financial Services Monitor Worldwide, 8 Jun 2015.

²⁵ Financial Services Monitor Worldwide, 8 Jun 2015.

²⁶ Zawya, 4 Jun 2015.

²⁷ Financial Services Monitor Worldwide, 8 Jun 2015.

²⁸ Zawya, 28 May 2015.

²⁹ Zawya, 28 May 2015.

³⁰ Zawya, 28 May 2015.

³¹ Zawya, 28 May 2015.

³² Zawya, 28 May 2015.

³³ Zawya, 28 May 2015.

³⁴ Reuters, 1 Jun 2015.

³⁵ Reuters, 1 Jun 2015.

³⁶ Reuters, 1 Jun 2015.

Telecom Egypt SAE from its emerging market index, reducing the number of Egyptian stocks in its emerging markets index to only three. The MSCI requires three listings to include an exchange on its emerging markets index.³⁷

Islamist militants attack Luxor

Security forces foiled a suspected attack by the **Islamic State** or an affiliated militant group targeting tourists at **Luxor (Upper Egypt)** on 10 June. The attack potentially signals a new militant strategy of undermining Egypt's economic recovery by switching from security to economic targets. Security forces prevented three militants wearing suicide explosive vests from attacking tourists at the **Karnak Temple** complex in Luxor.³⁸ The militants attempted to target a tourist bus before security forces engaged them.³⁹ Security forces killed two attackers before they could breach the site's security, before the third militant detonated his security vest injuring four people. On 3 June, unidentified gunmen killed two police officers at the **Giza Pyramids** near **Cairo**.⁴⁰

Implications

The completion of the Suez Canal Axis channel ahead of schedule is a positive sign as Egypt embarks on large infrastructure and energy projects following the March investment conference. The strategic location of the Suez Canal and the benefits of shortened navigation time will outweigh shipping companies' security concerns.

The budget shows the government's commitment to fiscal consolidation. Egypt's fiscal position will benefit from increased economic growth and decreased spending on subsidies. However, high social spending obligations – codified in the constitution – will restrict efforts to limit debt. More radical subsidy reform is required, especially if Egypt is to secure **International Monetary Fund (IMF)** assistance, but will be politically contentious. Sisi may rush through subsidy reforms before the parliamentary elections to avoid the need to secure legislative backing.

The level of investor demand for Egypt sovereign bond issuance suggests that the government may return to the international markets as it looks to meet ambitious growth plans while addressing its increasing deficit.

Militants will likely continue to target tourist sites in the Upper Nile and **Sinai**. The heavy security presence at major tourism sites will likely encourage them to prioritise softer targets including tourist buses, hotels and restaurants.

³⁷ Reuters, 1 Jun 2015.

³⁸ Egyptian Independent, 10 Jun 2015.

³⁹ Egyptian Independent, 10 Jun 2015.

⁴⁰ Al Ahram, 3 Jun 2015.

About Africa Risk Consulting:

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