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Foreign minister Sameh Shoukry meets Israeli prime minister Benjamin Netanyahu (2009-present) ostensibly to discuss Palestinian peace talks. The governments discuss the Grand Ethiopian Renaissance Dam (GERD) following Netanyahu's recent visit to Ethiopia. The house of representatives passes the 2016/2017 budget but members of parliament allege that it breaches constitutional spending requirements. Low business confidence and high interest rates suggest the budget's revenue targets are overly ambitious. A major United Kingdom (UK) trade delegation arrives in Cairo on 17 July, with Egypt well placed to benefit from 'Brexit'.

Foreign minister Shoukry visits Israel

Foreign minister **Sameh Shoukry** met **Israeli** prime minister **Benjamin Netanyahu** (2009-present) in **Jerusalem** (Israel) on 10 July.¹ The visit was the first by an Egyptian foreign minister since 2007 and signals improved bilateral relations since the storming of the Israeli embassy in **Cairo** in September 2011. President **Abdel Fattah Al-Sisi** (2014-present) is central to these improved ties.² Sisi has strong ties with senior Israeli security officials from his time as head of Egyptian military intelligence.³ Israel views Sisi as

"...someone they can do business with. They're entirely comfortable with him and, unlike their western counterparts, view him as predictable and dependable. In many ways, the democratically elected former military strongman is an Israeli construct."⁴

Shoukry pledged Egyptian support to revive Israeli-**Palestinian** peace talks, which collapsed in 2014.⁵ Egypt is a significant security partner for Israel as militant group **Hamas** smuggles weapons and fighters through tunnels from Egypt's **Sinai Peninsula**.⁶ There is long-standing speculation that Israeli drones target Islamist militants in the Sinai Peninsula.⁷ Additionally, Egypt has typically acted as a diplomatic back channel between Israel and Palestine.⁸ Shoukry in June held talks with Palestinian president **Mahmoud Abbas** (2005-present) in the occupied **West Bank**.⁹ Sisi is an advocate of the 2002 Arab peace initiative, which offers Israel full recognition in exchange for relinquishing all land seized in the 1967 **Middle East** war and a "just solution" for Palestinian refugees.¹⁰ Netanyahu would countenance using the 2002 plan as a starting point for direct negotiations with Palestinian representatives.¹¹

The secrecy with which Egypt typically engages with Israel due to domestic political and popular sensitivities makes it significant that the agenda of the visit was public. In March, the house of

¹ Al Ahram, 10 Jul 2016.

² Source, retired senior United Nations official, Middle East

³ Source, retired senior United Nations official, Middle East

⁴ Source, retired senior United Nations official, Middle East

⁵ Al Ahram, 10 Jul 2016.

⁶ Al Ahram, 10 Jul 2016.

⁷ Al Monitor, 10 Jul 2016.

⁸ Source, retired senior United Nations official, Middle East

⁹ Al Ahram, 10 Jul 2016.

¹⁰ Source, retired senior United Nations official, Middle East

¹¹ Source, retired senior United Nations official, Middle East

representatives (parliament) expelled member of parliament (MP) **Tawfiq Okasha** after he met in private with Israeli ambassador **Haim Koren**.¹² This highlighted the continued sensitivities of engagement with Israel due to popular solidarity with, and widespread media sympathy for, Palestine:

*“It’s interesting that now steps toward normalisation are being made publicly, unlike under former president **Hosni Mubarak** (1981-2011). Both countries are also under pressure from the **United States (US)** on their domestic policies.”¹³*

Alongside the public agenda, Shoukry discussed **Ethiopia’s** development of the **Grand Ethiopian Renaissance Dam (GERD)**.

“The Palestinian issue was simply a guise for the visit, when in fact the foreign minister is there to seek Netanyahu’s assistance in mediating the GERD dispute.”¹⁴

Egypt is concerned about Ethiopia’s increasingly confrontational stance over the GERD, after Ethiopian communications minister **Getachew Reda** said in May that Ethiopia was not concerned about regional apprehension about the GERD.¹⁵ Netanyahu visited Ethiopia in July as part of a regional tour to secure support to restore Israel’s observer status at the **African Union**.

*“There aren’t many people who think Shoukry’s trip was promoted by a desire to resolve the Israeli-Palestinian conflict. Instead it seems more likely that Sisi wanted to discuss Netanyahu’s recent trip to Africa, and any progress in solving the dam crisis, which is becoming more pressing in light of recent attention on growing water scarcity in Egypt. But then we must ask what is Israel gaining? It could be that with Egypt’s endorsement the Israelis are trying to gain some kind of acceptance or normalisation in relations with their neighbours, and Egypt is playing the role of intermediary, using its close ties with **Saudi Arabia** as the first step.”¹⁶*

There is also speculation that Sisi is looking to restore his authority after the **Administrative Court** in June annulled the transfer of the **Tiran** and **Sanafir** islands to Saudi Arabia.¹⁷ The ruling is a rare constitutional check on Sisi’s power. The court ruled that the transfer contradicted an October 1906 accord between the **United Kingdom (UK)** (Egypt’s then colonial power) and the **Ottoman Empire**.¹⁸ The court additionally ruled that the agreement breached Article 151 of the 2014 constitution, which states that no treaty can involve the concession of land.¹⁹ The court ruled void the border demarcation that placed the **Red Sea** islands under the sovereignty of Saudi Arabia, and ordered them to remain under Egyptian sovereignty.²⁰

“It’s possible that this is the leadership’s way of trying to create a ‘good news’ story. If they succeed in getting the two parties to sit down together, and make some progress, this makes Egypt look strong. It makes sense for them to do this as a way to reassert Egypt’s position as a major player in the region.”²¹

From the Israeli perspective, it is likely that Netanyahu viewed the meeting as an opportunity to show his government’s sincerity about peace with the Palestinians.

*“Speculation on the Israeli motive for the visit is that Netanyahu, under increasing pressure internationally, is using the meeting as an example that the Israelis are serious about coming to an agreement with Abbas. But just before the foreign minister landed in **Tel Aviv**, the Israeli*

¹² www.youm7.com

¹³ Source, columnist, Egypt

¹⁴ Source, regional political expert, Cairo

¹⁵ Asharq al Awsat, 27 May 2016.

¹⁶ Source, diplomat, Cairo

¹⁷ Egyptian Independent, 21 Jun 2016.

¹⁸ Egyptian Independent, 21 Jun 2016.

¹⁹ Egyptian Independent, 21 Jun 2016.

²⁰ Egyptian Independent, 21 Jun 2016.

²¹ Source, journalist, Cairo

*government pledged a large amount of money for expanding one the most controversial settlements in the West Bank... It's clear the visit is mostly about water, but also possibly a step to further economic engagement by the two countries."*²²

Parliament passes 'unconstitutional' budget

The house of representatives on 29 June passed the 2016/2017 budget.²³ Subsequent disputes over its passage and provisions raise concerns that the pro-Sisi **Coalition to Support Egypt (CSE)** is able to ensure the passage of key financial legislation through parliament without adequate opposition scrutiny. The approved budget included a 12.9% increase in government expenditure to 936 billion Egyptian pounds (EGP) (\$106 billion) and a 20.2% increase in revenue to EGP631 billion (\$71.6 billion).²⁴ The budget is predicated on 5.2% growth.²⁵ The deficit is projected to decrease from 11.5% of gross domestic product (GDP) in 2015/2016 to 9.8% of GDP.²⁶ The largest item in the budget is interest payments to service public debt, which accounts for 31% of total spending and 46% of total revenue.²⁷

A large majority of MPs approved the budget without any significant amendments to the draft that the finance ministry published in May.²⁸ However, MPs have subsequently alleged that the government rushed the passage of the budget to avoid proper scrutiny.²⁹ Speaker **Ali Abdel Ali** reportedly ignored the constitutional need for a quorum during a budgetary vote and MPs raised their hands to vote rather than using the electronic voting system.³⁰ This resulted in disputes amongst MPs and the suspension of the session.³¹ When voting eventually did take place, the majority of cabinet members were absent, with only finance minister **Amr el-Garhy** and legal and parliamentary affairs minister **Magdy al-Agaty** present. Each MP was allocated only three minutes to discuss the budget. The **Al Wafd** party, which voted in favour of the budget, has since called on the government to review its expenditure, revenue and fiscal deficit targets on a quarterly basis.³² The opposition **25-30 Alliance** has continued to criticise the budget saying it does not meet constitutional spending requirements in the healthcare and education sectors.³³ According to the draft budget, spending on healthcare and education is on target to reach 1.6% and 3.1% respectively of gross domestic product (GDP).³⁴ The constitution requires the government to spend at least 3% of gross national product (GNP) on healthcare and 4% of GNP on education.³⁵ The difference in calculating GDP and GNP appears to account for the confusion.

MPs have warned that low economic growth and an ongoing shortage of hard currency mean that the budgeted figures are unfeasible.³⁶ Business activity remains depressed, and the downturn in Egypt's non-oil private sector continued through June.³⁷ The foreign exchange liquidity crunch, the result of the overvalued pound, continues to deter investment.³⁸ The **United Arab Emirates**-based banking group **Emirates NBD** purchasing managers index (PMI) revealed that output, new orders and

²² Source, regional political expert, Cairo

²³ www.al-monitor.com

²⁴ www.al-monitor.com

²⁵ www.al-monitor.com

²⁶ www.al-monitor.com

²⁷ www.al-monitor.com

²⁸ www.al-monitor.com

²⁹ www.al-monitor.com

³⁰ www.al-monitor.com

³¹ www.al-monitor.com

³² www.al-monitor.com

³³ www.al-monitor.com

³⁴ Al Ahram, 18 Apr 2016.

³⁵ Al Ahram, 18 Apr 2016.

³⁶ www.al-monitor.com

³⁷ Arab Finance, 10 Jul 2016.

³⁸ Arab Finance, 10 Jul 2016.

employment declined in June.³⁹ Low domestic and international client demand meant that contractions in output and new orders accelerated in June compared to May.⁴⁰ The PMI revealed that the non-oil private sector recorded 47.5 points in June, lower than the 47.6 points recorded in May and lower than the 50-point mark that means growth rather than contraction.⁴¹ This was the ninth consecutive month of worsening business conditions.⁴² However, the rate of contraction has eased slightly throughout the second quarter. The second quarter average was 47.3 compared to 46.9 in the first quarter 2016, and 46.8 in the fourth quarter 2015.⁴³ Non-oil private sector employment declined for the 13th consecutive month increasing pressure on businesses' operating capacity.⁴⁴ Lead times lengthened for the fourth consecutive month.⁴⁵

According to the state **Central Agency for Public Mobilization and Statistics (CAPMAS)**, urban consumer inflation reached 14% year on year in June.⁴⁶ The increase is down to both seasonal factors including increased food prices during Ramadan, but also the devaluation of the Egyptian pound in March. This is the highest monthly inflation rate year on year since August 2009. The index increased 0.8% in June.⁴⁷ This compares to 12.3% year on year and 3% month on month in May.⁴⁸ The average rate of inflation in the second quarter of 2016 was 12.2% year on year, compared to 9.4% in the first quarter signalling the impact of the devaluation.⁴⁹ In June, the **Central Bank of Egypt** increased the benchmark overnight deposit rate 100 basis points to 11.75% to curb inflationary pressures, but this is yet to take effect.

United Kingdom trade delegation arrives following 'Brexit'

A major UK trade delegation arrived in Cairo on 17 July.⁵⁰ The timing of the delegation will reassure Egyptian investors and businesses following the so-called '**Brexit**', the UK referendum to withdraw from the **European Union (EU)**. Any short-term economic downturn from 'Brexit' may not prove substantial as a weak UK pound and euro could benefit Egypt's import-dependent economy. Approximately 16% of Egypt's external debt is denominated in euros.⁵¹ UK trade envoy to Egypt Sir **Jeffrey Donaldson** and UK Export Finance CEO **Louis Taylor** led the mission.⁵² The visit follows the UK government's establishment of a new international trade ministry under minister **Liam Fox**.⁵³ During the delegation, UK Export Finance committed to providing £2.5 billion (\$3.3 billion) to underwrite prospective trade deals of up to £500m (\$659m) for UK companies in Egypt.⁵⁴

The immediate impact on Egypt of the Brexit vote was negative. The **Egyptian Exchange's** benchmark **EGX30** index fell 5.54% to a 14-week low on 26 June following the vote. Credit and margin trading problems on the Egyptian Exchange mean it is especially vulnerable to shifts in global sentiment.⁵⁵ Currency instability has deterred foreign institutional investors from the Egyptian Exchange, increasing the risk of a further slump. This is liable to worsen the hard currency shortage, therefore increasing the possibility of further depreciation of the Egyptian pound.⁵⁶ Notable declines

³⁹ Arab Finance, 10 Jul 2016.

⁴⁰ Arab Finance, 10 Jul 2016.

⁴¹ Arab Finance, 10 Jul 2016.

⁴² Arab Finance, 10 Jul 2016.

⁴³ Arab Finance, 10 Jul 2016.

⁴⁴ Arab Finance, 10 Jul 2016.

⁴⁵ Arab Finance, 10 Jul 2016.

⁴⁶ www.capmas.gov.eg

⁴⁷ www.capmas.gov.eg

⁴⁸ www.capmas.gov.eg

⁴⁹ www.capmas.gov.eg

⁵⁰ British Embassy Cairo, 18 Jul 2016.

⁵¹ Reuters, 26 Jun 2016.

⁵² British Embassy Cairo, 18 Jul 2016.

⁵³ British Embassy Cairo, 18 Jul 2016.

⁵⁴ British Embassy Cairo, 18 Jul 2016.

⁵⁵ Aswat Masriya, 26 Jun 2016.

⁵⁶ Reuters, 26 Jun 2016.

on 26 June include **Commercial International Bank** which fell 4.8%, investment bank **EFG Hermes** 6.55%, car manufacturer **Ghabbour Group** 12.1%, real estate developer **Talaat Mostafa Group** 8.7%, and asset manager **Beltone Financial** 8.8%.⁵⁷

Long-standing business connections mean that Egypt is well placed to benefit following 'Brexit'. The UK is the main source of foreign direct investment (FDI) in Egypt, accounting for almost half of total FDI inflows.⁵⁸ 'Brexit' will not directly impact FDI, which a 1975 bilateral investment promotion and protection agreement covers. The majority of large UK-owned oil and gas and telecommunications companies in Egypt have their holdings in dollars so are benefiting from the current cable, the UK pound/dollar exchange rate. Additionally, Egypt stands to benefit from UK-based companies looking to take advantage of its tariff-free and quota free access to the EU single market under the 2004 economic association agreement (EAA).

Implications

Political and commercial considerations were behind Shoukry's visit to Israel, as much as the Palestine peace process. However, Sisi stands to benefit if either indirect or direct talks resume as it will boost his regional diplomatic credentials. Israel, which has offered to provide technical support to the GERD, is well placed to act as a broker should tensions increase between Egypt and Ethiopia.

The contentious budget vote and subsequent criticism raises concerns about public financial management in Egypt. Low economic growth make the revenue targets unfeasible and will force the government to slow efforts to reform the economy and decrease the deficit.

'Brexit' will not have negative long-term implications for Egypt. International investors are more concerned about currency volatility and capital controls.

⁵⁷ Al Ahram, 26 Jun 2016.

⁵⁸ www.gov.uk

About Africa Risk Consulting:

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