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Egypt turns to the International Monetary Fund (IMF) for a \$12 billion credit line, which, if approved, will take Egypt to its upper IMF borrowing limit. The government also plans to borrow from the World Bank, African Development Bank (AfDB) and international markets to address its worsening current account deficit. Egyptian diplomats block a United Nations Security Council (UNSC) statement condemning the attempted coup in Turkey, ending recent bilateral rapprochement. The government introduces value added tax (VAT) legislation to the House of Representatives. Three international telecommunication companies express an interest in bidding for 4G licences and entering the Egyptian market.

Egypt requests IMF financial support

The **International Monetary Fund (IMF)** on 26 July confirmed that the **Egyptian** government had requested financial support.¹ The request was not a surprise as recent government initiatives were designed to reassure the IMF of the government's commitment to economic reform. Finance minister **Amr El-Garhy** said the government had requested to borrow \$4 billion annually under a three-year credit programme.² The government said each IMF tranche will have an interest rate of 1% or 1.5%, and a five-year repayment period, including a three and a quarter-year grace period.³

The total credit line is, for Egypt, near the IMF's upper limit on member state borrowing. The IMF in February increased Egypt's special drawing rights to \$2.8 billion.⁴ According to IMF regulations, a member state can borrow 145% of its quota per year, up to a total limit of 435%.⁵

An IMF staff team arrived in **Cairo** on 30 July to discuss the request and the specific level of financing.⁶ The IMF expected the talks to last approximately two weeks.⁷ Garhy and **Central Bank of Egypt (CBE)** governor **Tarek Amer** are leading the Egyptian side in the talks.⁸ Once the negotiations are completed, the cabinet will need to approve the preliminary agreement. The government expects to receive a first tranche of \$2 billion within two months of final approval.⁹ The government said external debt will reach \$53.4 billion once it finalises the IMF deal.¹⁰ Reserves stood at \$17.5 billion at the end of June, compared to \$36 billion before the 2011 uprising.¹¹ Egypt has debt obligations this year of \$7-8 billion.¹²

"The approach to taking the IMF loan exemplifies the Egyptian policy mindset: bereft of skilled advisers, Egypt's current government is continuing the trend of 'Band-Aid' solutions. Egypt

¹ Daily News Egypt, 27 Jul 2016.

² Multiple sources: Daily News Egypt, 27 Jul 2016; Reuters, 28 Jul 2016.

³ Al Arabiya, 28 Jul 2016.

⁴ IMF statement, 28 Jul 2016.

⁵ www.imf.org

⁶ Daily News Egypt, 27 Jul 2016.

⁷ IMF statement, 26 Jul 2016.

⁸ IMF statement, 26 Jul 2016.

⁹ Middle East Business News, 28 Jul 2016.

¹⁰ Middle East Business News, 28 Jul 2016.

¹¹ www.aawsat.com

¹² Aswat Masriya, 28 Jul 2016.

operates without any kind of long-term strategy, but rather lurches from crisis to crisis. What happens when they don't have the hard currency to pay back the loan?"¹³

The IMF loan is part of a broader borrowing programme to address the worsened current account deficit and depleted foreign exchange reserves due to a sharp fall in tourist revenue (see previous *ARC Briefing Egypt*). The cabinet in a statement said the government plans to raise \$7 billion a year in financial support over the next three years.¹⁴ According to the statement, of the total \$21 billion, \$3 billion will come from the **World Bank**, \$1.5 billion from the **African Development Bank (AfDB)** and \$3 billion from a planned international bond sale.¹⁵ The statement did not provide details of the source of the remaining funds. Garhy said the government would access international debt markets between September and October.¹⁶ Approval of the second tranche of a \$1.5 billion three-year AfDB loan is expected in September.¹⁷ The statement said recent economic reforms were designed to improve Egypt's standing with international financial institutions and in the market. Egypt is currently rated B- by **S&P Global Ratings**, six levels below investment grade. Relevant reforms include:

- the introduction of value added tax (VAT) legislation (see below);
- ongoing subsidy reform;
- imminent introduction of a fuel smart card system;
- parliamentary approval of the **Civil Service Law**. Parliament passed the Civil Service Law restricting public sector bonuses and remuneration on 24 July;
- planned privatisation of state-owned enterprises. Investment minister **Dalia Khorshid** on 24 July confirmed the government plans initial public offerings (IPOs) before the end of the fiscal year on both the **Egyptian Exchange** and international markets.¹⁸ Possible oil sector IPOs or partial sales include **Middle East Oil Refinery**, **Egyptian Ethylene and Derivatives Co**, **Petrojet**, **Engineering for the Petroleum & Process Industries**, **Alexandria Mineral Oils Co** and **Misr Fertilizers Production Co**.¹⁹ The government has previously discussed listing the state-owned **Arab African International Bank** and **Banque du Caire**, and selling a stake in **United Bank** to a strategic investor.²⁰

The talks with the IMF are likely to be politically contentious and face domestic opposition. Egypt has held intermittent talks with the IMF since 2011 but instability and political opposition to fiscal reforms have derailed previous negotiations.

"The IMF is right to demand reform, but it is about how the reform is enacted. A large percentage of Egyptians fall into the category of impoverished and are already struggling with the high cost of food because of inflation; electricity prices are being raised, so on the Egyptian side there is fear about austerity measures raising already bubbling public anger. That's why the subsidy discussions continue to stall the deal being finalised."²¹

There is increasing popular anger over a perception that the government is unwilling to challenge structural economic bottlenecks that benefit the political and economic elite.

"The IMF deal is a necessary evil, but it has to involve some self-reflection. This loan is set to fill the gaps of the budget deficit. But what about the armed forces budget? What about the millions that the state is losing to corruption? What about the lack of job prospects for educated youth? What about the subsidy systems that barely serve the poor, but help line the pockets of the rich,

¹³ Source, senior banker, Cairo

¹⁴ CBC TV, 27 Jul 2016.

¹⁵ CBC TV, 27 Jul 2016.

¹⁶ IMF statement, 26 Jul 2016.

¹⁷ Al Arabiya, 28 Jul 2016.

¹⁸ Daily News Egypt, 24 Jul 2016.

¹⁹ Daily News Egypt, 24 Jul 2016.

²⁰ Daily News Egypt, 27 Jul 2016.

²¹ Source, policy analyst, Cairo

who keep their profits overseas? Until there is an honest conversation about the very real structural problems in the economy, a situation like this will only repeat itself.”²²

The IMF may insist that the CBE adopt a more flexible exchange mechanism and cuts government lending to reduce inflation.²³ In order to address the current account deficit, the IMF may insist that the government reduce its budget deficit, which would include subsidy reform, increased fees for government services, reductions in public sector salaries, and more effective private sector engagement in capital projects.²⁴

“The beginning of the negotiations has shown the Egyptians unwilling to admit publicly to any pre-conditions for the loan. But the VAT tax, civil service law and reductions in subsidies clearly show that is not the case, and those behind-the-scenes concessions are being made. These reforms are necessary, but proper attention must be given to how they will be implemented and timing is everything. This is where the potential fallout could be huge.”²⁵

Investors welcomed the news of the potential IMF deal, citing its positive impact on the foreign currency shortage and business confidence, and the increased likelihood of a currency devaluation.²⁶ The Egyptian Exchange’s benchmark **EGX30** index rallied 5% and the yield on the 2015-issued Eurobonds due in 2025 fell 70 basis points to 6.92% on 27 July.²⁷ However, unless the government enacts meaningful economic reform, the effect on investor sentiment may prove short-lived.

“Egypt expects that the loan will renew confidence of foreign investors, but that does not acknowledge the core reasons for investors’ reluctance in the first place. They [investors] watch the news: they see a country still faced by economic and political challenges and the government, which often responds woefully to such challenges. In short, it is a scary pond to dip their feet into. Until the government makes the country a more appealing prospect, and looks less hostile itself, investors will stay away. The loan is a temporary distraction, it is needed, but it’s not enough. There are other measures that would help: floating the currency, helping exporters with incentives, slowly cutting down on the civil service.”²⁸

Egypt blocks United Nations Turkey coup statement

Egyptian diplomats on 16 July blocked a **United Nations Security Council (UNSC)** statement condemning the attempted coup in **Turkey** the previous day.²⁹ The dispute may derail diplomatic efforts to improve bilateral relations strained since the ousting of former President **Mohamed Morsi** (2012-2013). On 15 July, factions of the Turkish military launched an unsuccessful attempt to oust President **Recep Tayyip Erdoğan** (2014-present). The proposed **United States (US)**-drafted UNSC statement called on all parties to “*respect the democratically elected government of Turkey*”.³⁰ UNSC statements require the consensus of all permanent and non-permanent members. Egypt is a non-permanent member state. Egyptian diplomats questioned the authority of the UNSC to declare any government democratically elected.³¹

While the coup was underway, a number of privately owned Egyptian media channels praised it.³² On 20 July, Erdoğan used an international media interview to criticise the democratic credentials of President **Abdel Fattah Al-Sisi** (2014-present), noting increased authoritarianism under his

²² Source, economist, Cairo

²³ Bloomberg, 5 Aug 2016.

²⁴ Bloomberg, 5 Aug 2016.

²⁵ Source, economic journalist, Cairo

²⁶ Reuters, 28 Jul 2016.

²⁷ Al Ahram, 27 Jul 2016.

²⁸ Source, senior banker, Cairo

²⁹ Al Ahram, 16 Jul 2016.

³⁰ Al Ahram, 16 Jul 2016.

³¹ Reuters, 16 Jul 2016.

³² Daily News Egypt, 17 Jul 2016.

administration.³³ The Egyptian foreign ministry responded to Erdoğan's comments claiming he was unable to distinguish between a coup and a popularly-backed military intervention.³⁴ Sisi was head of the **Egyptian Armed Forces** during the coup that ousted Morsi in July 2013. Turkey provided diplomatic and financial support to Morsi, with Erdoğan's **Adalet ve Kalkınma Partisi (AKP)** maintaining links with the now proscribed **Muslim Brotherhood**.

The dispute may derail recent political efforts to improve bilateral relations. Turkey, since the appointment of **Binali Yıldırım** as prime minister in May, has adopted a conciliatory foreign policy, securing rapprochement with **Israel** and **Russia**.³⁵ **Saudi Arabia**, a key backer of Sisi and close ally of Turkey, is pushing for improved bilateral relations. Egyptian parliamentary speaker **Ali Abdel Ali** on 14 July said Egypt would cooperate with Turkey as long as it did not interfere in Egyptian internal affairs.³⁶ Ali's comments came after Turkish deputy prime minister **Numan Kurtulmus** said Turkey is looking to normalise relations as long as Egypt stays the execution of Morsi and implements democratic reforms.³⁷

Government introduces VAT legislation

The government on 19 July introduced long-overdue value added tax (VAT) legislation to the **House of Representatives** (parliament).³⁸ The introduction of VAT will increase government revenue and reduce pressure on the fiscal deficit. Successive governments have failed to introduce VAT amid political and popular opposition.³⁹ The draft legislation proposes replacing the current 10% sales tax with an average VAT of 14%.⁴⁰ The finance ministry expects this will result in additional annual revenue of 15-20 billion Egyptian pounds (EGP) (\$1.7-\$2.3 billion).⁴¹ Parliament has started to deliberate the proposed VAT rates, but the date of its implementation is uncertain.⁴²

The government has attempted to decrease sensitivities around VAT by targeting high-end consumers.⁴³ The draft legislation proposes:

- 8% VAT on domestic appliances including televisions and refrigerators;
- a similar level of VAT on soft drinks and mobile telecommunication;
- 1.6% VAT on cars with a 1.6 litre engine, 15% on 1.5-2 litre engines, and 30% on imported cars with engines over 2 litres;
- the introduction of a 5% VAT on private education.⁴⁴

The government has excluded most food products from VAT in an attempt to shield lower-income households from its impact.⁴⁵ Garhy said on 19 July that the introduction of VAT will result in a price inflation spike of 0.5% for low income households and 2.3% for high income households.⁴⁶

In the business sector, the draft legislation proposes 10% VAT on technical and legal consulting services.⁴⁷ The legislation exempts from VAT crude oil, natural gas, and liquefied petroleum gas (LPG) as well as the sale and leasing of land.⁴⁸ The **Federation of Egyptian Industries** has called on the

³³ Al Jazeera, 20 Jul 2016.

³⁴ Al Jazeera, 20 Jul 2016.

³⁵ Hurriyet, 13 Jul.

³⁶ Al Ahram, 14 Jul 2016.

³⁷ Al Ahram, 14 Jul 2016.

³⁸ www.madamasr.com

³⁹ www.madamasr.com

⁴⁰ www.madamasr.com

⁴¹ www.madamasr.com

⁴² Alborsa News, 19 Jul 2016.

⁴³ Alborsa News, 19 Jul 2016.

⁴⁴ Alborsa News, 19 Jul 2016.

⁴⁵ Alborsa News, 19 Jul 2016.

⁴⁶ Al Ahram, 20 Jul 2016.

⁴⁷ www.madamasr.com

⁴⁸ www.madamasr.com

Egyptian Tax Authority to ensure greater registration of businesses to facilitate the effective and equal implementation of VAT.⁴⁹

International companies interested in 4G licences

Three international telecommunication companies not currently operating in Egypt have expressed an interest in bidding for 4G licences.⁵⁰ Despite concerns about currency volatility, the size of the Egyptian market continues to make it attractive to investors. The deadline for incumbent telecommunication companies **Vodafone Egypt**, **Orange Egypt** and **Etisalat Egypt** to agree on terms for 4G licences was the first week of August.⁵¹ State-owned fixed-line monopoly **Telecom Egypt**, a 45% shareholder in Vodafone Egypt is also reportedly interested in directly acquiring a 4G licence as it looks to enter the mobile market.⁵²

If the **National Telecom Regulatory Authority** cannot agree terms with incumbent companies, it will extend the bidding to new market entrants. **China's** state-owned **China Telecommunications Corp**, **Kuwait-based Zain Group**, and **Saudi Arabia-based Saudi Telecom Co** have all reportedly expressed an interest in securing a licence.⁵³ The total value of the licences is reportedly \$2.5 billion, with the government demanding investors pay half in dollars as it looks to improve the banking sector's dollar liquidity.⁵⁴

Implications

The IMF deal, if approved, will allow the government to remove the restrictions on hard currency and facilitate currency devaluation, encouraging increased manufacturing activity and reducing investor concerns about profit repatriation. There are implementation risks due to likely domestic opposition, but the government is better placed than its predecessors to successfully reach agreement with the IMF. The Sisi administration has completed Egypt's formal political transition and the CBE is committed to monetary reform. However, multilateral assistance alone will likely be insufficient to meet Egypt's total financing needs. Sufficient growth will require economic reform, which is dependent on effective policy implementation as well as an influx of new funds.

Turkey is unlikely to resume financial support to Egypt as it did under Morsi. However, the diplomatic dispute with Turkey will have little long-term regional implications. Saudi Arabia and Israel both have sufficient political, economic and commercial influence over Turkey and Egypt to mitigate the risk of the situation escalating.

If implemented effectively, the VAT legislation will help the government narrow its fiscal deficit. However, significantly improving tax revenue will require increased economic growth and the inclusion of the informal economic sector.

Better access to high-speed telecoms services will increase the ease of doing business in Egypt. It is, however, unclear when 4G services will become available. 3G and 4G subscriptions are expected to increase steadily.

⁴⁹ Al Borsa News, 19 Jul 2016.

⁵⁰ Gulf News, 19 Jul 2016.

⁵¹ Gulf News, 19 Jul 2016.

⁵² Gulf News, 19 Jul 2016.

⁵³ Gulf News, 19 Jul 2016.

⁵⁴ Reuters, 6 Jul 2016.

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