

## AFRICA RISK CONSULTING

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#### Egypt Summary 1 March 2017

**Parliament approves prime minister Sherif Ismail's new cabinet without a roll call vote. Key ministers including finance minister Amr El Garhy and electricity minister Mohamed Shaker remain in office. Ismail merges investment and international cooperation ministries to align government economic approach with that of international financial institutions. State-owned Egyptian Natural Gas Holding Co (EGAS) says that Egypt will begin natural gas exports in the second half of 2017. Central Agency for Public Mobilization and Statistics (CAPMAS) data show that year-on-year inflation reached 29.6% in January.**

#### Parliament approves new cabinet

The house of representatives (parliament) approved prime minister **Sherif Ismail's** government reshuffle with a substantial majority on 14 February.<sup>1</sup> The reshuffle signals the precedence that president **Abdel Fattah Al-Sisi** (2014-present) gives to increased economic growth. As broadly expected, the so-called "sovereign ministers", whom Sisi unilaterally appoints, retained their posts: defence minister **Sedki Sobhi**, foreign minister **Sameh Shoukry**, interior minister **Magdy Abdel Ghaffar**, and justice minister **Hossam Abdel-Reheim**.<sup>2</sup>

*"There were rumours that Ghaffar might be removed, but none of the key sovereign portfolios, whom the president has sole authority to appoint, has been altered. Could it be that Sisi is not in a strong position to make changes? The performance of the others is debatable, but the police, and their lack of discipline continue to be a thorn in the president's side. It's said he is mistrustful, and views them as major distractions from his programme of reforms. So why not change the minister? Possibly because his [Sisi's] strategy continues to be containment rather than risking any moves that could fracture his hold of this beast."*<sup>3</sup>

Incumbent finance minister **Amr El Garhy**, largely responsible for securing the \$12 billion **International Monetary Fund (IMF)** extended fund facility (EFF), and electricity minister **Mohamed Shaker** also remain in office.<sup>4</sup>

In the most notable development, Ismail merged the investment and international cooperation ministries.<sup>5</sup> Current international cooperation minister **Sahar Nasr** has assumed responsibility for the newly merged ministry.<sup>6</sup> El Garhy justified the merger of the ministries, noting that international financial institutions have made private sector growth and investment a central plank of their strategies.<sup>7</sup> Nasr's first responsibility is to implement the new investment law, which former investment minister **Dalia Khurshid** drafted and which parliament is currently discussing.<sup>8</sup> Nasr is a member of the presidential advisory economic council.<sup>9</sup> Prior to joining the government in September

<sup>1</sup> Al Ahram, 14 Feb 2017.

<sup>2</sup> Al Ahram, 14 Feb 2017.

<sup>3</sup> Source, Political science professor, Cairo

<sup>4</sup> Al Ahram, 14 Feb 2017.

<sup>5</sup> Al Ahram, 14 Feb 2017.

<sup>6</sup> Al Ahram, 14 Feb 2017.

<sup>7</sup> Al Hayah Al Youm, 14 Feb 2017.

<sup>8</sup> Youm7, 14 Feb 2017.

<sup>9</sup> Al Ahram, 14 Feb 2017.

2015, Nasr was lead economist in the **World Bank's** finance and private sector development department for the **Middle East and North Africa (MENA)**.<sup>10</sup>

Ismail unbundled the trade and industry ministry, transferring responsibility for internal trade to the supply ministry.<sup>11</sup> **Ali Museilhi** heads the new supply and internal trade ministry.<sup>12</sup> Museilhi replaces **Mohammed Ali el-Sheikh**, the former quartermaster-general of the armed forces, whose appointment expanded the military's commercial interests. Sheikh's failure to curb escalating prices and profiteering amid continued shortages made him unpopular,

*"He had no plan or experience to be able to control the prices of basic commodities. He's gone."*<sup>13</sup>

Museilhi's first priorities are especially politically sensitive: to ensure sufficient supplies of staple commodities and moderate inflationary pressures. Following his appointment, Museilhi criticised the transition from commodity to cash subsidies, a central policy of Ismail's reform of government expenditures.<sup>14</sup> Member of parliament (MP) for his hometown **Abu Kabir** in the **Sharqiya Governorate**, Museilhi has chaired the parliamentary economic committee since January 2016.<sup>15</sup> Museilhi was social solidarity minister between 2004 and 2011 under former president **Hosni Mubarak** (1981-2011) and was CEO of state-owned **EgyptPost**.<sup>16</sup> Museilhi is co-founder of the **Egyptian Patriotic Movement Party**.<sup>17</sup>

The restructuring of the ministries is unlikely to have a significant impact on government operations or direction.

*"Investment and international co-operation have been merged, as have trade and supply, nothing major here, this was for budgetary reasons."*<sup>18</sup>

The reshuffle resulted in the departure of long-serving planning minister **Ashraf al-Araby**.<sup>19</sup> His successor is **Hala Helmi El Said**, the current dean of the economics and political sciences at **Cairo University** and the former executive director of the **Egyptian Banking Institute**.<sup>20</sup> Ismail named **Salah Abdel Rahman** as El Said's deputy, responsible for administrative reform.<sup>21</sup> Other new appointments include:

- **Abdel Moneim Al Banna**, new agriculture and land reclamation minister.<sup>22</sup> Al Banna was formerly president of the state **Agriculture Research Center**, where he faced unspecified but outstanding corruption allegations.<sup>23</sup>
- **Hisham Arafat**, new transport minister, who has pledged to introduce a new strategic plan for the sector that prioritises river transport.<sup>24</sup> Arafat heads the structural engineering & construction management department at **Future University**, and served as a transport infrastructure adviser to the Mubarak administration.<sup>25</sup>

<sup>10</sup> www.worldbank.org

<sup>11</sup> Al Ahram, 14 Feb 2017.

<sup>12</sup> Al Ahram, 14 Feb 2017.

<sup>13</sup> Source, Arabic newspaper columnist, Cairo

<sup>14</sup> Youm7, 14 Feb 2017.

<sup>15</sup> Al Ahram, 14 Feb 2017.

<sup>16</sup> Al Ahram, 14 Feb 2017.

<sup>17</sup> Al Ahram, 14 Feb 2017.

<sup>18</sup> Source, Arabic newspaper columnist, Cairo

<sup>19</sup> Al Ahram, 14 Feb 2017.

<sup>20</sup> Al Ahram, 14 Feb 2017.

<sup>21</sup> Al Ahram, 14 Feb 2017.

<sup>22</sup> Al Ahram, 14 Feb 2017.

<sup>23</sup> Al Ahram, 14 Feb 2017.

<sup>24</sup> Al Ahram, 14 Feb 2017.

<sup>25</sup> Al Ahram, 14 Feb 2017.

- **Omar Marwan**, new legal and parliamentary affairs minister, having previously served as assistant minister, and general secretary for the **Supreme Elections Committee** during the 2015 parliamentary election.<sup>26</sup>
- **Hisham El Sherif**, new local development state minister. El Sherif is currently the chairman of the **Regional Information Technology & Software Engineering Center**.<sup>27</sup>
- **Khaled Abdel Ghaffar**, new higher education minister.<sup>28</sup>
- **Tarek Shawki**, new education minister.<sup>29</sup>

The cabinet reshuffle was repeatedly delayed, reportedly due to tensions between Ismail and Sisi over the appointments.

*“The government has been delayed because no-one wanted these jobs, little pay and even less of a budget to actually undergo their duties mean that these are not appealing positions. To be in the cabinet at such a time in Egypt is precarious at best, and has not been helped by Ismail’s recent proposal to up his salary and those of his deputies and the cabinet. It was expected that civil service workers would be receiving a pay boost to help them cope with spiraling inflation after the float, many of them earn 1,500 Egyptian pounds (EGP) (\$90) a month, and support an entire family on what is \$90. Ismail wants to raise his own salary – currently EGP 30,000 (\$1,900) by EGP 12,000 (\$761) a month... so as you can see taking up a cabinet position [and facing criticism over pay] is simply not a smart move.”<sup>30</sup>*

Parliament approved the cabinet without a roll call vote. Estimates suggest only 20 to 30 members from the opposition **25-30 Coalition** voted against the government.<sup>31</sup> Sources indicate that speaker **Ali Abdel Aal Sayyed Ahmed** was key in ensuring approval of the cabinet.

*“The cabinet changes are not very interesting, but the current lack of confidence in Ismail’s government that gets quickly brushed under the carpet by the speaker, who’s really the government’s gatekeeper, represents one of the major flaws of the president: which is that he doesn’t hire good people. Whether they are in the parliament or hired as consultants on specific issues or projects, it doesn’t matter. But it hasn’t happened... Possibly their most fatal mistake has been to recruit on the basis of sycophantic obedience rather than finding the right people, who know what they are doing, who have had experience solving the issues Egypt is facing before.”<sup>32</sup>*

Sisi is expected to continue to dominate decision-making, with little parliamentary oversight over the government.

*“All of this is ‘window dressing’ anyway, it’s not a traditional cabinet. Everyone takes their cues from above, so the extent to which a minor shuffle like this has impact is debatable. Ismail himself dodges parliament and the cabinet has followed suit. They prefer to act alone.”<sup>33</sup>*

Parliament, however, said it would review the performance of the new government at the end of the financial year on 30 June.<sup>34</sup>

The new cabinet will not mark a significant change in policy direction for the Sisi administration. The reshuffle will do little to curb popular anger about the increased cost of living. The most notable element of the reshuffle was parliament’s passive role in the scrutiny and approval of the nominees. This will further undermine its credibility as an effective check over the government.

<sup>26</sup> Al Ahram, 14 Feb 2017.

<sup>27</sup> Al Ahram, 14 Feb 2017.

<sup>28</sup> Al Ahram, 14 Feb 2017.

<sup>29</sup> Al Ahram, 14 Feb 2017.

<sup>30</sup> Source, government official, Cairo

<sup>31</sup> Al Borsa, 15 Feb 2017.

<sup>32</sup> Source, investment banker, Cairo

<sup>33</sup> Source, journalist, Cairo

<sup>34</sup> Al Mal, 14 Feb 2017.

## Egypt to become natural gas exporter

State-owned **Egyptian Natural Gas Holding Co (EGAS)** chairman **Mohamed El Masry** said on 4 February that Egypt will begin natural gas exports in the second half of 2017.<sup>35</sup> Gas exports, once they begin, will provide a regular source of hard currency. Egypt is currently a net gas importer, with a generous subsidy programme driving consumption upwards. Under interim president **Adly Mansour** (2013-2014) and then Sisi, consumption has decreased and production has increased due to the introduction of more attractive upstream contractual terms, and the incremental lifting of subsidies. According to El Masry, Egypt produces 4.2 billion cubic feet per day, but consumes 5.2 billion.<sup>36</sup> To bridge the deficit, El Masry confirmed that Egypt plans to import 108 cargoes of liquefied natural gas (LNG) this year under a \$1 billion contract.<sup>37</sup> Of the total, up to 45 cargoes will arrive under government-to-government contracts with **Oman** state-owned **Oman Trading International Co (OTI)**, **Russia**-state owned **Rosneft PJSC**, and **France**-based **Engie SA**.<sup>38</sup> Payments under the contract have a six-month grace period.<sup>39</sup> A tender, scheduled for November, will secure the remaining imports.<sup>40</sup>

El Masry said that Egypt will become less reliant on imports in 2018.<sup>41</sup> **United Kingdom (UK)**-based **BP Plc's North Alexandria** concession is due to begin production in April, and **Italy**-based **Eni SpA's** offshore **Zohr** gas field before the end of 2017.<sup>42</sup> This will increase production to 5 billion cubic feet per day by the start of 2018.<sup>43</sup> Production will then increase to 7.5 billion cubic feet in 2020.<sup>44</sup> El Masry said that Egypt has the necessary infrastructure to distribute 9 billion cubic feet per day, and export 1.88 billion cubic feet by 2020.<sup>45</sup> On the same day as El Masry set out the LNG development timeframe, oil minister **Tarek El-Molla** said the government may announce new gas discoveries in the second half of this year.<sup>46</sup>

Egypt was a net LNG exporter until 2014, when depressed output and increased power shortages resulted in the diversion of output to meet domestic requirement. El Masry confirmed that EGAS is currently meeting the gas requirements of all industrial and manufacturing sites, and the **Beni Suef**, **Borolo** and **New Administrative Capital** power plants.<sup>47</sup> El Masry called on companies to clear their EGAS arrears. The state-owned **Egyptian LNG** began to export minimal amounts of LNG from its **Idku** plant in September 2016 to keep the terminal's equipment operational.<sup>48</sup> Egyptian LNG expects to run the Idku plant at full capacity for export in 2020 or 2021.<sup>49</sup>

In a reminder, however, of the operating challenges facing international energy companies in Egypt, **United Arab Emirates**-based **Dana Gas PJSC** said on 9 February that it is freezing capital investments in the country due to government arrears.<sup>50</sup> As Egypt secures dollars from multilateral institutions and international markets, international oil companies are likely to increase pressure on the government to clear its arrears. Dana Gas CEO **Patrick Allman-Ward** said the government owed the company \$265m at the end of 2016, compared to \$221m at the end of 2015.<sup>51</sup> The recovery rate in

<sup>35</sup> Daily News Egypt, 4 Feb 2017.

<sup>36</sup> Daily News Egypt, 4 Feb 2017.

<sup>37</sup> Al Ahram, 4 Feb 2017.

<sup>38</sup> Daily News Egypt, 4 Feb 2017.

<sup>39</sup> Al Ahram, 4 Feb 2017.

<sup>40</sup> Bloomberg, 4 Feb 2017.

<sup>41</sup> Daily News Egypt, 4 Feb 2017.

<sup>42</sup> Daily News Egypt, 4 Feb 2017.

<sup>43</sup> Daily News Egypt, 4 Feb 2017.

<sup>44</sup> Daily News Egypt, 4 Feb 2017.

<sup>45</sup> Daily News Egypt, 4 Feb 2017.

<sup>46</sup> Bloomberg, 4 Feb 2017.

<sup>47</sup> Daily News Egypt, 4 Feb 2017.

<sup>48</sup> Daily News Egypt, 4 Feb 2017.

<sup>49</sup> Bloomberg, 4 Feb 2017.

<sup>50</sup> The Gulf, 9 Feb 2017.

<sup>51</sup> The Gulf, 9 Feb 2017.

Egypt was only 64% of billings, the lowest level since 2010.<sup>52</sup> Despite higher output, Dana Gas posted a \$33m profit for 2016, compared to \$144m in 2015.<sup>53</sup> Dana Gas said that output increased 5%, mostly due to increase in production in Egypt, but profits fell 77%.<sup>54</sup> Dana Gas will now suspend its development programme, including new well drilling, in Egypt until it is able to secure additional payments from the government.<sup>55</sup> Dana Gas subsidiary **Dana Gas Egypt** owns a 100% interest in three onshore concessions in the **Nile Delta (El Manzala, West El Manzala and West El Qantarab)**, a 100% interest in two offshore concessions in the Nile Delta (**North El Arish and North El Salhiya**), and a 50% interest in an onshore concession in the Nile Delta (**El Mataria**).<sup>56</sup> Dana Gas also indirectly holds a 26.4% interest in the **Egyptian Bahrain Gas Derivatives Co** joint venture to build a liquefied petroleum gas (LPG) extraction plant at **Ras Shukhier** on the **Gulf of Suez**.<sup>57</sup>

Dana Gas is, however, the exception rather than the rule. In November 2016, BP agreed to pay Eni \$375m, and \$150m to cover past expenditures, to acquire a 10% stake in the **Shorouk** gas concession.<sup>58</sup> The Shorouk gas concession includes the “*world class*”<sup>59</sup> Zohr gas field, discovered in August 2015 and which contains an estimated 850 billion cubic metres of gas. The deal is dependent on regulatory approval, but is expected to complete in the second quarter.<sup>60</sup> Under the agreement, BP can purchase an additional 5% stake before the end of 2017.<sup>61</sup>

The government can cite the energy sector as evidence of its ability to deliver tangible benefits to the Egyptian economy. A more effective upstream regulatory environment has increased production, while subsidy cuts are beginning to decrease consumption. A decrease in petroleum product imports will result in an improved balance of payments. Egypt’s strong domestic gas demand market will offset international oil company concerns about inconsistent government payments, currency volatility, policy slippage and backlog of underdeveloped projects.

### Inflation reaches 29.6%

The **Central Agency for Public Mobilization and Statistics (CAPMAS)** published data on 12 February showing that year-on-year inflation reached 29.6% in January.<sup>62</sup> Increased pressure on household spending will make it harder for the government to cut expenditure in line with the IMF EFF. The inflation increase compares to the 24.3% year-on-year in December, which was the highest level since January 2011.<sup>63</sup> The price of food and beverages increased 38.6% year-on-year in January.<sup>64</sup> According to CAPMAS figures, core inflation, which guides **Central Bank of Egypt (CBE)** monetary policy, reached 30.9% year-on-year in January.<sup>65</sup> This compares to 25.9% in December, and is the highest since the CBE started recording the data in January 2005.<sup>66</sup> The CBE monetary policy committee is due to meet on 16 February.<sup>67</sup> The increase in core inflation will increase pressure on the CBE to increase its rates. The introduction of value added tax (VAT) in September, the currency devaluation in November, and the tariff increases on imported goods in December have also resulted in upward inflationary pressures in Egypt’s import-dependent economy. The currency devaluation has, to some extent, distorted the picture and the value of year-on-year comparative data.

<sup>52</sup> The Gulf, 9 Feb 2017.

<sup>53</sup> The Gulf, 9 Feb 2017.

<sup>54</sup> The Gulf, 9 Feb 2017.

<sup>55</sup> The Gulf, 9 Feb 2017.

<sup>56</sup> www.danagas.com

<sup>57</sup> www.danagas.com

<sup>58</sup> Egyptian Independent, 27 Nov 2016.

<sup>59</sup> BMI, 1 Jan 2016.

<sup>60</sup> www.energyvoice.com

<sup>61</sup> Al Shorouk, 27 Nov 2016.

<sup>62</sup> Al Ahram, 12 Feb 2017.

<sup>63</sup> Al Ahram, 12 Feb 2017.

<sup>64</sup> Al Ahram, 12 Feb 2017.

<sup>65</sup> Al Ahram, 12 Feb 2017.

<sup>66</sup> Al Ahram, 12 Feb 2017.

<sup>67</sup> Al Ahram, 12 Feb 2017.

Finance minister El Garhy said on 13 February that the government expects inflation to peak at the end of the first quarter.<sup>68</sup> El Garhy blamed supply shocks rather than demand for the inflation.<sup>69</sup>

Inflation will undermine the government's obtainment of the IMF EFF conditions. The house of representatives energy committee, on 13 February, used the spike in inflation to petition electricity minister Shaker to postpone a hike in electricity prices slotted for July 2017 to July 2018.<sup>70</sup> The house economics committee, on the same day, forced then supply minister Sheikh to reconsider price increases of subsidised goods.<sup>71</sup>

Analysts broadly agree with El Garhy's timeframe, forecasting inflation to peak during the first half of 2017, before moderating towards the end of the year.<sup>72</sup> This would allow the CBE to cut interest rates to facilitate credit recovery during the second half of the year.<sup>73</sup> This, however, is dependent on oil prices, and the government's continued commitment to cutting subsidies.<sup>74</sup>

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<sup>68</sup> Bloomberg, 13 Feb 2017.

<sup>69</sup> Al Ahram, 12 Dec 2017.

<sup>70</sup> Al Borsa, 13 Feb 2017.

<sup>71</sup> Al Mal, 13 Feb 2017.

<sup>72</sup> Reuters, 13 Feb 2017.

<sup>73</sup> Bloomberg, 13 Feb 2017.

<sup>74</sup> Enterprise, 13 Feb 2017.

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