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Egypt’s hopes for Gulf aid

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Summary

The latest economic conference is a good opportunity for the Egyptian government to showcase its economic reform efforts and its roadmap for economic growth. It’s also a chance to present projects to potential investors.

- Gulf support to Egypt has been critical lately with a shift from aid to investment.
- Investment expectations from the conference have been downgraded to around $US15-20billion.
- Gulf investors, they are expected to focus positively on the energy sector, while their focus on the real estate sector won’t necessarily help.
- Gulf investments will depend on crucial macro issues: the decrease in oil prices, the war on ISIS, the overall geopolitical situation in the region as well as the capability of the government to achieve local stability and sustainability.

Background

Egypt’s turbulent last four years have seen the economy significantly retreat compared to pre-revolution levels. Slow growth of around 2% has resulted in high unemployment, exceeding 13%.[1] To survive such difficult times, with the budget deficit mounting and current account deficit significantly widening, it became critical for Egypt to seek external support for its currency and to decrease pressure on local borrowing. Most of the support came from the Gulf countries in the form of direct aid rather than investments during President Morsi’s era and this support increased after he was forced to step down.

Timeline of Gulf Support to Egypt

Before the 25th January revolution, it was rare to hear about large grants or direct aid, apart from after the Gulf war when Egypt got rewarded with billions of dollars in debt forgiveness as well as a US$5billion deposit in its Central Bank for its role in the war.

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[1] Central Bank of Egypt Official Website 2014

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2011 The Supreme Council of Armed Forces (SCAF) took power in February 2011 and capitalized on the accumulated reserves at the Central Bank which stood at US$35billion. Yet, as months passed, reserves eroded and the government needed support, though the situation was still manageable.[2] Saudi and Qatar both offered direct if limited aid during SCAF era.

2012 When President Morsi took office in June, the economic situation was critical, reserves were at low levels (around 15 BN USD) and the budget deficit was too high to finance solely from the local market.[3] Seeking external support was critical, yet the International Monetary Fund's (IMF) conditions were too hard to implement, so Egypt had to go for bilateral support from its close allies namely Qatar, Turkey and Libya. They offered US$12billion, mainly in the form of grants, low interest loans and petroleum products.

Contrary to common belief, investments by the Gulf states in Egypt were less than 15% of total Foreign Direct Investments (FDIs) in the decade before the revolution and amounted to less than US$10billion.

Such support was generous and helped protect the economy from collapse. Yet it didn't foster significant growth as the economy grew just 2.1% that fiscal year. The Egyptian pound was under severe pressure and it was officially devalued by more than 10% during that tough year. The critical aspect in such generous economic support was that it was purely politically driven and was not tied to any required reform initiatives.

2013 Another phase of instability and violence which left Egypt on the verge of collapse- if it had not been for the quick and extra generous aid from the Gulf. Immediately after the start of the transitional phase on the 3rd July 2013, Saudi Arabia, Kuwait and the Emirates offered a US$12 billion aid package, which increased in the following months to reach around US$20 billion divided between grants, low interest loans and petroleum products.

This aid protected the economy again from collapse, but it only grew at 2.2% and unemployment exceeded 13% during this fiscal year.[4] The Egyptian pound was significantly supported during the year and the Central Bank didn't have to devalue it.

2014 When President Sisi took office in June, the general perception was that Gulf aid would continue so analysts were surprised when no new aid package was announced. But senior Gulf officials had said that aid would only be during the transitional period, and would then convert into investments in economically feasible projects.

The Abu Dhabi government provided two international consultants to help the Egyptian government plan its way out of the recession. They estimated the need for US$120billion of foreign cash inflows between aid and investments to stimulate growth at 5% annually and help support the Egyptian pound.[5]

Importance of Gulf Investment

[2] Ministry of Finance, Annual report 2014.
[3] Al-Ghitany Ibrahim, Egypt Independent, "The performance of the Egyptian economy under Morsy" 2013
[4] Ministry of Finance, Annual Report 2013.
[5] Reuters, "Consultants say Egypt needs 120 BN USD inflow over 4 years"

Western investors (European and American) represented around 85% of FDIs in the period of 2000-2010, most of which came in the oil and gas sector. Now Western oil companies that have been operating in Egypt for years might still be interested, yet some issues have to be resolved - such as having Parliament sign off on strategic petroleum excavation contracts together with the full repayment of their outstanding arrears. If this was done they might invest further - even if this takes a long time for disbursement, as with British Petroleum announcing US$12billion over 5 years, starting in 2017.[6]

With the recent political turmoil, Western investors view Egypt as high risk and so investment will be slow and short term. More than this is the catalogue of other factors that are impacting on investors.

- Oil prices have dropped by 50% during the last year.[7] So the revenues of Gulf countries have significantly decreased and some are even running a deficit. Despite the fact that Gulf countries are rich from high oil prices for years, they are now less willing and able to support Egypt.
- The rising threat of ISIS and the international coalition formed to fight it is being mainly financed by the Gulf. So the war bill will drain Gulf reserves and could come at the expense of supporting Egypt.
- The overall political situation in the region has become complicated with threats from Yemen, Iraq, Iran and Syria that need addressing.
- The stability of the country and its sustainability are an issue, with the last few weeks witnessing daily bombings.

Prospects of Gulf Support

The economic conference has around 850 investors from Gulf countries and 170 from Saudi Arabia attending.[8] The most likely sectors for investment will be energy: especially electricity generation with its various types; and real estate. The latter is a comfort zone for many Gulf investors, with a new capital for the country to be launched soon and an upscale real estate development in Sheikh Zayed city to be announced during the conference as well.[9]

Unresolved disputes with the Egyptian government due to bureaucratic procedures will complicate things for investors.[10] Some efforts have been made to resolve these but the backlog is quite high.

Solutions for Egypt's economy

It is critical for the Egyptian government to rethink the importance of FDIs as well as rethink the strategy in attracting them.

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[6] Daily News Egypt, "BP will invest 12 BN USD in Egypt over 5 years", December 2014.
[7] Ministry of Petroleum Official Website.
[8] Youm 7 Journal, February 2015
[9] Egyptian Streets, "Egypt's tallest building to be revealed" 2015
[10] Al-Arabyia News Website, "Egypt prevents Saudi investors from transferring their money" 2015

Fostering local market consumption would be a more reasonable strategy as local market consumption has always been a solid economic pillar. It contributed more than two thirds of the growth that happened in the last two quarters, and will remain a sustainable source of growth - given local consumption is mainly for basic goods that are not expected to erode through turbulence.[11]

Still FDIs will be important to push growth, support the launch of mega projects and provide foreign currency to boost the Egyptian pound .

The government needs to have a focused strategy where they create large employment opportunities, promote other local industries and expand Egyptian exports. In this regard, industrial and agricultural projects would be more suitable than real estate investments, which have limited impact on creating sustainable growth and employment.

The days of unlimited and unconditional Gulf aid to Egypt are gone but some aid can still be relied upon in times of emergency.

Overall, to revive the economy, the government would be better focusing on fostering local consumption- while at the same time attracting FDIs.

[11] Ministry of Planning, Press Releases 2015

About the author

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