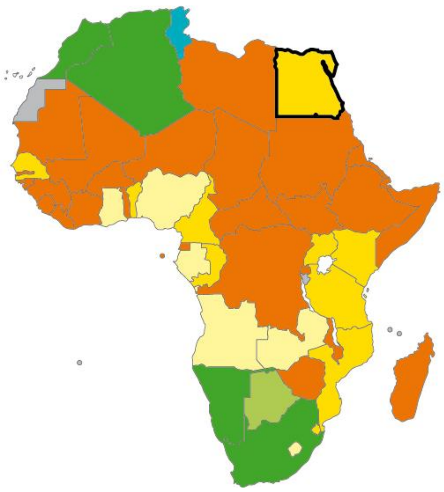
COUNTRY RISK ANALYSIS

Egypt

CREATING CONFIDENCE IN YOUR EXPORTS



COUNTRY RISK CATEGORY

6/7

The country risk categories range from 0 to 7. The lower the number the better the credit rating the country has.

0 1 2 3 4 5 6 7

EKN'S OUTSTANDING GUARANTEES IN THE COUNTRY

Short-term transactions: SEK 305 million

Medium and long-term transactions: SEK 1,702 million

EKN'S POLICY

Sovereign risks: Normal risk assessment.

Other public risks: Restrictive risk assessment.

Bank risks: Restrictive risk assessment.

Corporate risks: Restrictive risk assessment.

See “EKN'S POLICY” section

DATE

15/5/2014

Egypt back to square one

Just over three years have passed since President Mubarak was deposed by the military following popular protests. History repeated itself in the middle of 2013. Massive demonstrations against the democratically elected president and Islamist Morsi and his government led the military to take power once again. Egypt is thus back where it was before the Arabic Spring, with military rule under a civilian facade. The economy is much weaker after three years of turbulence. A collapse has only been avoided via financial support from other countries. The economic prospects going forward are linked to the political process. The most probable scenario is political and economic normalisation after the elections this year, characterised by authoritarian rule and continuing support from outside the country. But the splits between the secular and religious populations of Egypt will lead to new conflicts sooner or later.

STRENGTHS

- Continuing financial support from the Gulf countries.
- Low external debt and debt service ratio.
- EKN's positive payment experiences over the past decade.

WEAKNESSES

- Deep split between Islamists and the military, which risks leading to new conflicts.
- Weak external balance with a sizable trade balance deficit and low international reserves.
- Weak business climate with a lack of financing and an unpredictable legal system.

POLITICS

Military back in the driver's seat

The ousting of Islamist President Mohammed Morsi in July 2013 has restored Egypt's traditional power structure with authoritarian rule by the military and the ministry of interior with the support of elements in the judiciary and the business community. The military's crackdown on the Muslim Brotherhood has been followed by more authoritarian measures. New laws that give military tribunals the right to try civilians and restrictions on protest activities have been adopted. These measures risk leading to new protests and countermeasures from the police. The Gulf states have taken the lead in supporting Egypt's return to military rule, while the western world has lost its influence after the military took power.

The military, Egypt's dominant power centre, has strong popular backing and will implement its plans for a rapid transition to rule with a civilian facade. The referendum on the new constitution showed that the military's roadmap is moving forward. Relatively high voter participation and strong approval has convinced Abdul Fattah al-Sisi, head of the armed forces and defence minister, to run in the presidential election which will likely be held in the end of May. This would make it possible for parliamentary elections to be held in the beginning of the second half of 2014, which will complete the political transition.

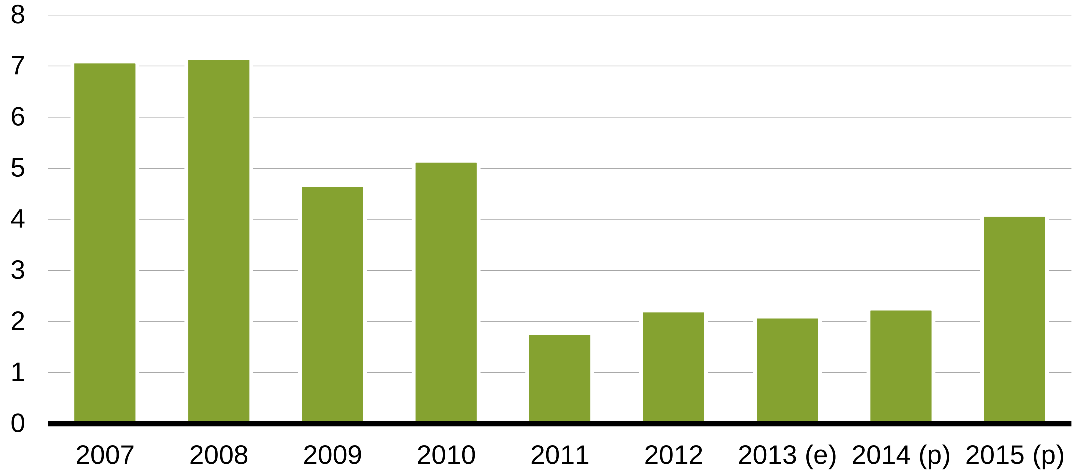
All indications are that Sisi will win the presidential election, especially since there are no serious challengers. The coming parliament is however expected to be split between several parties. This would mean that a coalition government must be formed, a result which probably will lead to additional power for the president. With the Muslim Brotherhood excluded from the political process, the parliament will be dominated by secular and liberal parties that support Sisi and the military. Although Egypt's new constitution gives the parliament greater control over the president, the president will continue to have a lot of power.

ECONOMY

Public finances continuing to worsen

The uncertain security situation and political climate will bring down Egypt's growth in 2014 as well. Growth is forecast at just over three percent this year, with a slight increase thereafter, provided that the political and security situation will be stabilised following the elections. The economic situation has not improved significantly since the military took power in July last year. There has been a stabilisation, but indebtedness, unemployment and the budget deficit are all at record-high levels. Ordinary Egyptians have not seen improvements, which has put the government under pressure and led to the government being reshuffled in February. The economy has been kept running thanks to support from Saudi Arabia, the United Arab Emirates and Kuwait.

GDP GROWTH (% PER YEAR)



Growth is still being kept down by the political turbulence. Data: IMF.

The transition government has launched an investment programme that is supposed to stimulate growth and increase employment. It is clear that the government is prioritising growth ahead of budgetary discipline. Politically sensitive measures to reduce public spending and increase revenues have been postponed. The salaries and pensions of public employees, food and energy subsidies and interest payments have increased in recent years. The budget deficit continues to be over ten percent of GDP and would be even higher without the support of the Gulf countries. Without fiscal reforms, the public debt will soon be equal to 100 percent of GDP. The government's dependence on temporary solutions and bilateral support creates uncertainty concerning its ability to finance its debt. The central bank is expected to continue financing the public debt, the majority of which is in local currency.

Achieving sustainable public finances will be an enormous task for the new president and government. Egypt will need additional support from the Gulf states, and will get it, but not forever. Cutting the budget deficit will not be possible without tax increases, reduced subsidies, lower salary increases in the public sector and reduced military expenses. These measures will be difficult to implement, with effects only seen in the long run. The country's public finances will remain a weakness of the economy.

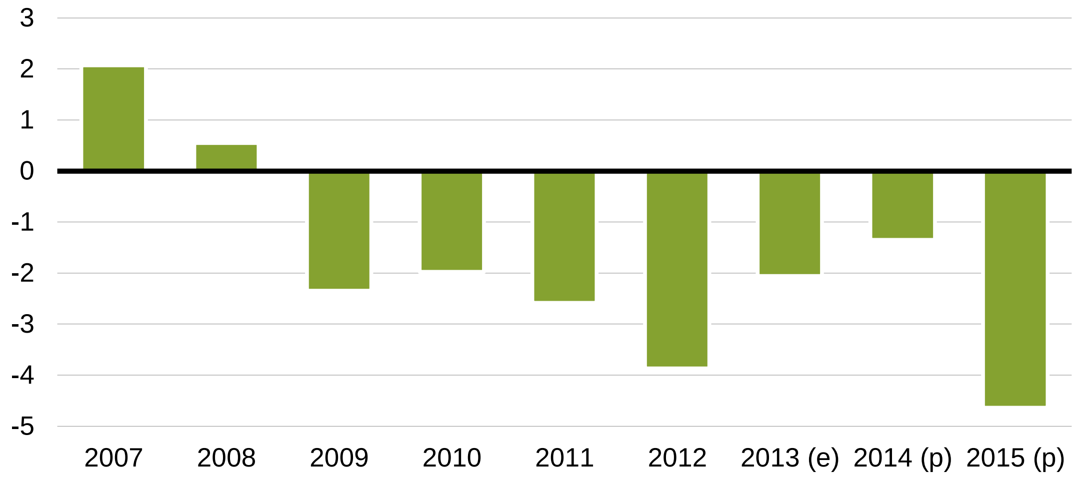
Sisi has given mixed messages about his future economic agenda. He called attention in his statements to the high budget deficit and the record-high debt, which may indicate that he will prioritise dealing with the country's public finances. At the same time, he has shown his support for the poor with respect to healthcare, housing and subsidies. It seems highly probable that he is trying to lower expectations in the run-up to his presidency in light of the economy's weak condition. Sisi will probably open up the country to foreign investors, especially from the Gulf states.

BALANCE OF PAYMENTS AND DEBT ISSUES

Current account deficit and low international reserves in spite of support

Egypt's main sources of hard currency earnings are tourism, remittances and revenues from the Suez Canal. The balance of payments is still weak, in spite of a temporary improvement in the current account balance. The current account deficit was reduced in 2013 and is expected to further decrease this year, thanks to the support from the Gulf states. The trade balance deficit is expected to remain considerable, caused by a combination of rising expenses for imported oil and foodstuffs and generally higher import costs due to a lower exchange rate. With weak tourism and low inflows of foreign investments, there will continue to be a balance of payments deficit. However, the country's external debt is low and consists mainly of soft loans. The loans from the Gulf countries have very favourable terms and do not increase Egypt's low debt service. The risk of a balance of payments crisis is therefore low in the next few years.

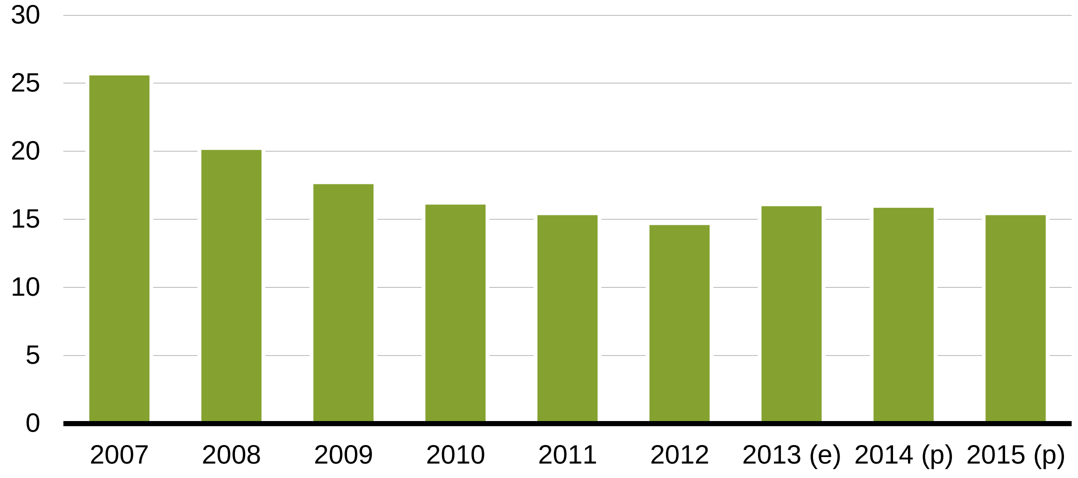
CURRENT ACCOUNT BALANCE (% OF GDP)



The trade deficit is the main reason for the weak current account balance. Data: IMF.

Capital flight and the central bank's attempts to keep the currency stable drained the country's international reserves in 2011 and 2012. After the military took power in 2013 and the financial support from the Gulf countries, the international reserves were stabilised and access to hard currency in the economy has improved. The international reserves are small, equal to three months of imports, but are expected to rise in 2014 as additional support from the Gulf countries is deposited in Egypt's central bank. In addition, the US is expected to resume its economic and military support for Egypt as the interim government paves the way for a return to civilian rule. Given Egypt's strategic significance, in particular the peace treaty with Israel and control over the Suez Canal, the US will want to have a certain degree of influence over the coming regime.

EXTERNAL DEBT (% OF GDP)



The external debt is low and has a favourable interest rate. Data: Datastream.

CURRENCY POLICY

Currency temporarily stabilised

Officially, the Egyptian pound is floating, but the central bank intervenes in the foreign exchange market to keep it stable against the euro and the US dollar. The exchange rate has been under close watch since the popular uprisings in the beginning of 2011, when confidence in the Egyptian pound took a hit and use of the US dollar increased. The central bank's attempts to strengthen the pound via foreign exchange interventions have slowed down the depreciation rate, but also led to a sharp drop in international reserves. Access to foreign currency is rationed by the central bank via an auction system, which led to a parallel currency market.

The pressure on the pound has eased since the inflow of currency from the Gulf countries in mid-2013 and the currency has been somewhat stable after that. The black currency market has almost disappeared, which is indicative of greater Egyptian confidence in the economy and currency. The risk of heavy depreciation or the government implementing stricter capital controls to stop capital outflows has thus been reduced, at least for the time being. In April 2014, the central bank was able to transfer outstanding amounts to foreign investors who wished to bring home money from Egypt. EKN's ability to guarantee transactions in local currency has not been tested, but the lacking convertibility of the Egyptian pound and transfer obstacles rule this out at the present time.

FINANCIAL SECTOR

Bank exposure to sovereign main risk

The stabilisation of Egypt's economic and political situation has had positive effects on the country's banking sector. After a couple of years without growth in either borrowing or lending, an expansion is expected starting in 2014. The prospects for the banking sector are likewise weighed down by continuing political and social tensions and the government’s strained economy, which continue to undermine investor and consumer confidence. Since foreign lenders have been unwilling to lend money to Egypt, the government has relied on the local banking sector to finance its growing budget deficit. The banks have simultaneously become less willing to lend to the private sector due to the uncertain domestic conditions. Their main function is currently to finance the public budget deficit instead of lending to the private sector, in spite of high demand from SMEs for loans. The exposure to the Egyptian government is the single largest credit risk for the banking system and links the credit rating of the banks to the sovereign’s credit rating. The banks' capital buffers are insufficient to withstand the government potentially defaulting on its payments.

Since the banks have restructured a large amount of loans, their reported proportion of bad loans is underestimated and profitability overestimated. The banking sector's deposit to lending ratio has been on a downward trend since 2010 and has resulted in improved liquidity. The sector also runs the risk of a liquidity crisis in hard currency due to the falling international reserves, which has led to currency regulations. One positive point is that the Egyptian banks are expected to remain well-financed thanks to their large customer deposits, supported by remittances from Egyptians working abroad.

BUSINESS ENVIRONMENT

Weak business climate

Egypt's economy is dominated by public enterprises and the public sector. The government’s growing dependence of the banking sector to finance the budget deficit is also impacting the private sector and impairing its access to credit. The lack of financing has led to underinvestment, especially in infrastructure. Power failures are common and disrupt industries. Foreign investments have been reduced as a result of political instability and poor payment experience in certain sectors, especially oil and gas.

Bureaucracy and corruption are widespread. These weaknesses lead to difficulties for creditors in enforcing judicial decisions and recovery in the event of bankruptcy. In EKN's experience, it takes a long time to register securities. At the same time, litigation processes pertaining to corruption against companies and company executives who were allied with the former regime are being undertaken. A variety of past privatisations of state enterprises are also being questioned, and these are under threat of renationalisation. The rule of law is weak and the outcome of litigation proceedings is unpredictable. When assessing the credit risk of companies, importance must be given to investigating the ownership structure and assessing the currency exposure.

The World Bank rates the Egyptian business climate 128th out of 189 countries, which is behind comparable countries in the region such as Tunisia, Morocco and Jordan. No significant changes to the business environment are to be expected in the immediate future.

EKN'S EXPOSURE

A few guarantees dominate

In the period between 2009 and 2013, EKN has issued guarantees for 149 transactions totalling SEK 7.8 billion for Swedish companies exporting to Egypt. Exports have gone to sectors such as transport, telecommunications and manufacturing. In 2011, exposure grew sharply due to a few major offers and guarantees. One investment guarantee dominates exposure. Other offers and guarantees are spread among a dozen exporters. EKN's claims of almost SEK 100 million mainly consist of older political claims. The flow of new guarantees is limited but has increased since 2012 as a result of the deteriorating risk situation in Egypt.

EXPOSURE AT 31 DECEMBER (SEK MILLION)

A few large guarantees and offers dominate the exposure.

PAYMENT EXPERIENCE

Positive experience in recent years

EKN's payment experience in Egypt in recent years has been positive. No indemnifications have been made over the past ten years. Despite the past problems with foreign exchange allocation for international payments, few delays have occurred in EKN guaranteed transactions. The delays that have occurred are of a commercial nature. The Paris Club claims, with renegotiated public and publicly guaranteed loans from the beginning of the 1990s, are being paid according to plan. The claims mainly relate to exports in the telecommunications and transport sectors and just below SEK 100 million remains to be paid.

EKN'S POLICY

Downgrades and tighter policy

EKN has downgraded Egypt twice since 2012, an assessment undertaken in collaboration with the OECD. The most recent downgrade was in May 2013 and Egypt has been in country risk category 6 since then. EKN applies a restrictive risk assessment for all buyer categories except pure sovereign risks. Payment guarantees is required for risks related to other public buyers. The policy stipulates restrictive provision of guarantees for short-term corporate risks, but payment guarantees is also sought for these transactions.

For bank and corporate risks, EKN particularly takes into account counterparty currency exposure. Adequate transparency of ownership and financial conditions are important aspects for corporate risks. Emphasis is placed on the exporter having experience in doing business in the country and being familiar with the operating environment.

The extended waiting period, the period from the maturity date of the claim until the guarantee holder can demand indemnification, has been removed in light of the fact that the economy's liquidity problems have eased up and the risk of foreign payments being delayed has been reduced.

NORMAL RISK ASSESSMENT
There are not any limitations to the risk assessment or preconditions for risk assessment stipulated in advance.

RESTRICTIVE RISK ASSESSMENT
EKN places higher demands on the risk assessment to guarantee a transaction. EKN may have specified special criteria that are central to the risk assessment of the debtor category in question.

OFFICIAL COUNTRY DATA AND CREDIT RATINGS

OFFICIAL COUNTRY DATA

Area: 1,001,450 km² (2.2 times Sweden)
Population: 85.3 million (2013)
Population growth: 1.9% (2013)
GDP: USD 257 billion in 2012 (Sweden USD 523 billion in 2012)
GDP/capita: USD 3,112 per capita in 2012 (Sweden USD 54,815 in 2012)

CREDIT RATINGS

	COUNTRY CEILING	SOVEREIGN RATING
Moody's:	B3	Caa1/neg
S&P:	B-	B-/stable
Fitch:	B-	B-/stable

COUNTRY ANALYST

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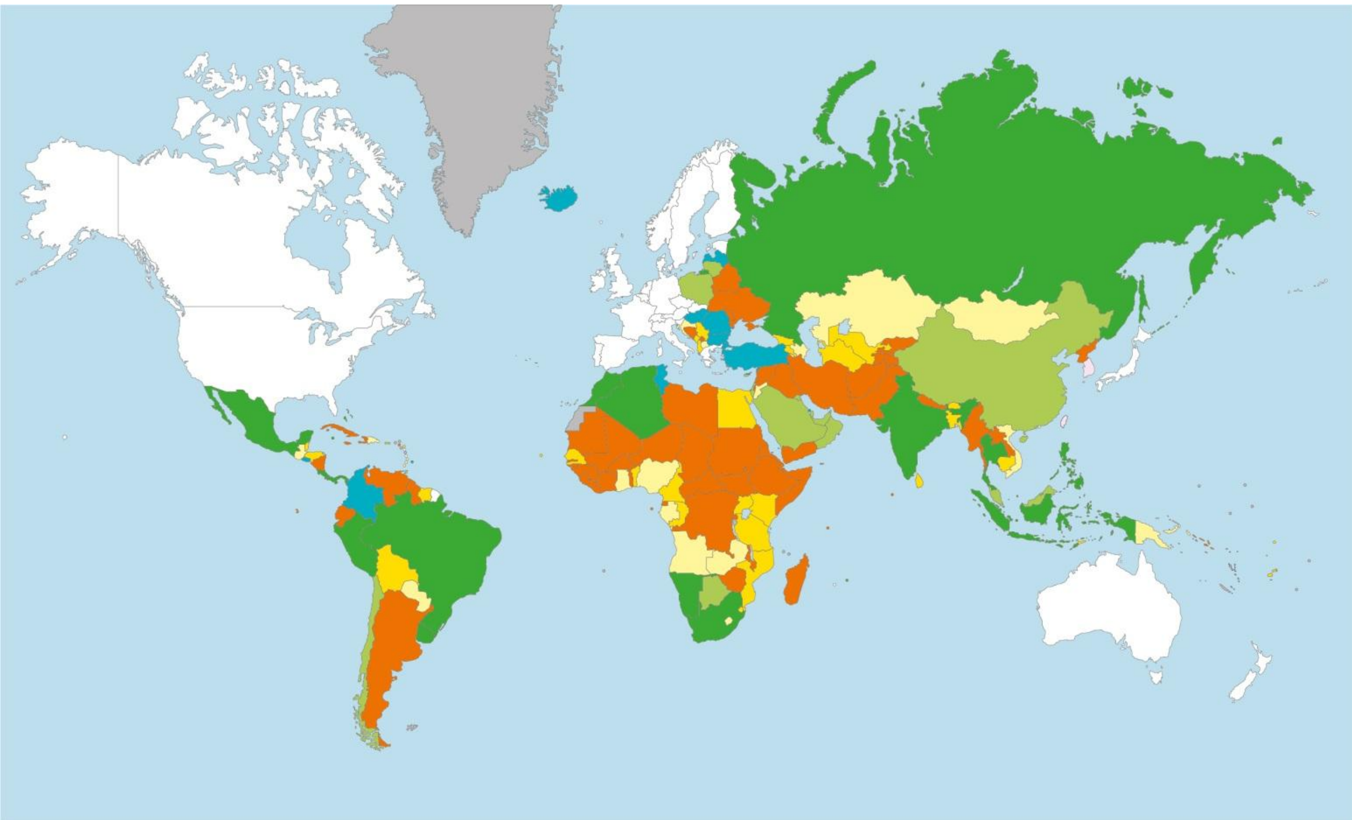
EKN's country analyst for Egypt:
Victor Carstenius
Telephone: +46 (0)8-788 00 65
E-mail: victor.carstenius@ekn.se

EKN'S VIEW OF THE WORLD



The country risk categories range from 0 to 7.
The lower the number the better the credit rating the country has.

EKN – CREATING CONFIDENCE IN YOUR EXPORTS

EKN is a government agency that supports Swedish exports and the internationalisation of Swedish industry. This we do by offering exporting companies and banks guarantees for payment and financing, together with advice on business structure and risk management.
Our services provide an extra level of confidence, increased competitiveness and more opportunities for successful export transactions.

The Swedish Export Credits Guarantee Board
Kungsgatan 36, PO Box 3064, SE-10361 Stockholm, Sweden | Tel +46 (0)8-7880000 | www.ekn.se | email info@ekn.se