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SUBJECT: Egypt's Economic Prospects: An Update

NESA M# 86-20051

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Central Intelligence Agency

Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

9 April 1986

Egypt's Economic Prospects: An Update

Summary

We remain pessimistic about Egypt's economic prospects, both short-term and beyond. During 1986 the Egyptian government will likely confront a liquidity crisis severe enough to force the regime to adopt hastily conceived austerity measures which could lead to political disorder. We see nothing in macro-economic trends or in the recent reform measures announced by Cairo that makes us more sanguine about the economic outlook. To the contrary, basic economic indicators point to a worsening of Egypt's financial position, while regime efforts to deal with the problems are weak or inappropriate. [redacted] 25X1

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The Plunge in Foreign Earnings Accelerates

Egypt's primary sources of foreign exchange are in trouble and earnings are falling at an alarming rate. Petroleum revenues are likely to decline to $1.2 billion, or roughly one-half of 1985's estimated $2.4 billion earnings, largely as a result of the continuing slide in world oil prices. (Our oil revenue estimates are projected on the assumption that prices will stabilize and average $15 per barrel for the year.) If average prices fall to $10 per barrel, Egyptian earnings would drop an additional $400 million. [redacted] 25X1

This memorandum was prepared by [redacted] the Arab-Israeli Division, Office of Near Eastern and South Asian Analysis. Information as of 9 April 1986 was used in its preparation. Questions or comments should be addressed to Chief, Arab-Israeli Division, [redacted] 25X1 25X1 25X1

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Egyptian officials can do very little over the near term to compensate for lower oil prices. Egypt possesses very little surplus production capacity. Current production has been averaging around 870,000 barrels per day (b/d) and can be increased only marginally to perhaps 900,000-950,000 b/d. Over the next year or so large increases in domestic energy prices could conceivably cut oil consumption, thereby increasing the exportable surplus, but the regime remains wedded to low energy prices for domestic consumers. Moreover, price hikes probably would do little more than reduce the rate of growth of energy consumption. [redacted] 25X1

Remittances and other major sources of foreign exchange appear to be in worse shape than our analysis in March indicated. Baghdad, as a result of financial pressures associated with the Gulf War, has decided to reduce the large expatriate labor force in Iraq. Official Egyptian projections show as many as 300,000 Egyptian workers, or about 40 percent of the Egyptian work force in Iraq, returning home over the next several months. Many of those remaining will face substantial wage cuts and restrictions on exporting capital. Returning Egyptian expatriate workers may boost remittances initially as they bring with them accumulated savings, but the overall implications of this exodus are extremely negative and will depress remittance earnings over the year. [redacted] 25X1

Tourism also appears unlikely to recover from the combined effects of renewed terrorism in the Middle East, the February police riots, and growing US/Libyan tension. According to recent press reports, many tourists are avoiding Egypt and bookings at major Cairo hotels are slumping. The impact of reduced tourist earnings goes far beyond the relatively small receipts recorded in the balance of payments accounts; much of tourist spending finds its way through the unofficial economy and provides major unrecorded earnings for important segments of the middle and lower class. [redacted] 25X1

We see no other major elements of Egypt's balance of payments likely to offset the deterioration in foreign exchange earnings caused by falling oil prices, remittances, and tourism. Lower interest rates for the small portion of Egyptian debt that is interest-sensitive are far outweighed by the much larger drop in interest earnings of banking system assets invested overseas. We have optimistically assumed that private capital flows will increase during 1986, largely as a result of the GM deal and associated spin-offs. We have further built into our projections an assumed ten percent cut in imports. Nevertheless, this far from worst case scenario still shows Egypt with a financing gap of at least $1.2 billion during 1986. 25X1
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Reform Efforts to Date

The reform measures announced by the government in late March fall considerably short of what is required to deal with the economic crisis. Most of the proposed changes--largely tax increases directed at the middle class and some customs reforms--will, at best, restrain somewhat the growth of already large budget deficits. They will not effectively address the more serious balance of payments problem. Among the glaring omissions of this reform package are:

-- no mention of any progress toward a unified exchange rate,

-- no specific measures to curb imports or boost exports by undertaking structural reform of the subsidy system or revamping the inefficient public sector industries,

-- no significant energy price increases. [redacted] 25X1

The proposed actions in no way represent what we suggested is most needed--an integrated package of reforms designed to stimulate the economy and mobilize public opinion in support of the program. Instead, the same cautious and piecemeal approach to reform that has proven unsuccessful in the past is being trundled out one more time and packaged by Egyptian officials as a significant step forward. Prime Minister Lotfy has left open the door for additional reforms in coming months, but the current tenor of Cairo's thinking on economic reform is not encouraging. [redacted] 25X1

Prologue to Crisis

Mubarak's refusal to enter into a serious dialogue with the IMF/IBRD represents, in our opinion, a mistake that could spark a financial crisis in the near term. A key indicator of impending crisis would be the unwillingness of foreign commercial banks to hold short-term credit tranches, primarily supplier credits, at current levels. [redacted] The lack of any significant progress toward developing an effective adjustment program and the absence of movement toward a rescheduling of official debt, could erode banking community confidence in Egypt's ability to service debt and trigger foreign banks into cutting their short-term lending to Egypt. If this occurs, Cairo will be hard pressed to finance immediate import needs and a full blown economic crisis could be at hand. [redacted] 25X1 25X1 25X1 25X1

The Mubarak regime is, we believe, unprepared to deal effectively with the consequences of such an emergency and would likely react by imposing drastic and ill-advised austerity measures which could heighten the risk of civil unrest and

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political instability. In our opinion, comprehensive and orderly reforms at the present time, linked to careful public opinion preparation, are less likely to lead to turmoil than hurried measures at the last minute. We believe that the regime must pursue an adjustment program that, however it is packaged, is in substantial agreement with the IMF and includes a Paris Club rescheduling of official debt. Further delays can only add to the severity of the adjustment process. 25X1

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Egypt: Balance of Payments

Billion US $

	1985 [1]	1986 [2]
Current Account Balance	-1.6	-2.7
Trade Balance	-6.1	-6.2
Exports (f.o.b)	3.9	2.8
Oil	2.4	1.2
Non Oil	1.5	1.6
Imports	-10.0	-9.0
Service Balance	3.3	2.3
Receipts	7.0	5.9
Remittances	2.8	2.0
Suez Canal	.9	.9
Tourism	.4	.3
Other	2.9	2.7
Payments	-3.7	-3.6
Official Transfers	1.2	1.2
Capital Account	1.2	1.5
Financing Gap	- .4	-1.2

[1] Estimated
[2] Projected