SACE

FOCUS ON
Egypt: Return to Business Between Revolution and Restoration

Produced by the Economic Analysis and Research

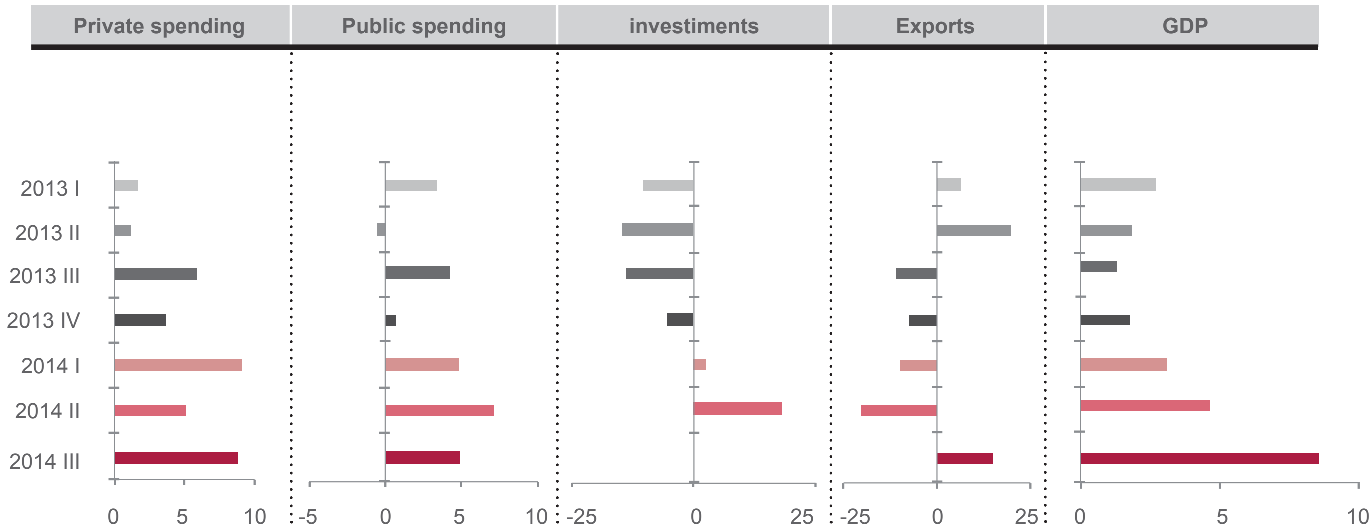
EXECUTIVE SUMMARY

- ***The Egyptian economy has begun to register the first signs of recovery.*** *Renewed optimism has rekindled consumer spending, remittances and tourism and, for the first time, has restored growth to levels unknown for some time.*
- ***The Italian presence in the country is important****, and the role that Italy has played too. Despite the disorder of recent years, Italy continues to rank as the country's no. 4 trading partner, with exports equal to € 2.8 billion in 2013.*
- *Major opportunities are expected when the government unveils its development plan for the country at Sharm El Sheikh in March.* ***Numerous projects are expected (estimated value close to 10 billion dollars) in which Italian companies can play an important role.***
- ***Facilitated financing and free trade zones*** *also offer significant opportunities for our SMEs.*
- ***The country risk remains high, especially operating risk and currency transfer risk.*** *The presence of SACE in the area and its products for hedging the credit and political risks may prove strategic in approaching and developing the market.*

FROM SPRING TO EARLY SUMMER…

The election of Al Sisi in May 2014 seems to have brought Egypt back on the path to normalization and a return to the international scene. Following a three-year transition, the response of the economic was not long in coming. **This climate of greater optimism has stimulated consumption, both private (+ 4.9% the trend in the third quarter of 2014; Fig. 1) and public (+ 8.8%) and has given impetus to exports (+15.0%)**, returning growth to stronger rates, with GDP increasing by 6.8% in the third quarter (versus a 2.1% average in 2013).

FIGURE 1. *Trend in GDP components (% chg vs same period the previous year)*



Source: SACE processing of EIU data.

Tourism, revenues from the Suez Canal and remittances, which contribute 10% of exports and 3% of GDP, have regained momentum. **International aid from partners in the Gulf**, especially Saudi Arabia, the UAE and Kuwait, have been essential.

Much remains to be done, of course, to remedy the **shortage of strong currency** in the country, the **energy crunch**, and the **persistent bureaucracy**, but there has been an obvious leap forward by the Egyptian economy and the reformist initiatives of the government, which particularly favors **infrastructural development** and **foreign investments**.

ITALY-EGYPT: A LONG-STANDING RELATIONSHIP

Between 2009 and 2013, despite the turbulence caused by the revolution in January 2011, **€ 22 billion in direct investments flowed into Egypt, € 3.7 billion of them from Italy.**

The Italian presence in the country is well-established with 130 companies currently active in various sectors: services, plant design, transport, logistics, tourism and energy. The no. 1 Italian group is **ENI**, the leading foreign petroleum company, followed by **Edison**, partner in a joint venture with Egyptian Petroleum Company to exploit the gas and oil deposits at Abu Qir. **Intesa San Paolo** has been present since 2006 with the acquisition of Bank of Alexandria. **Pirelli, Italgen, Danieli, Techint and Calatagirone Group** have also made significant investments.

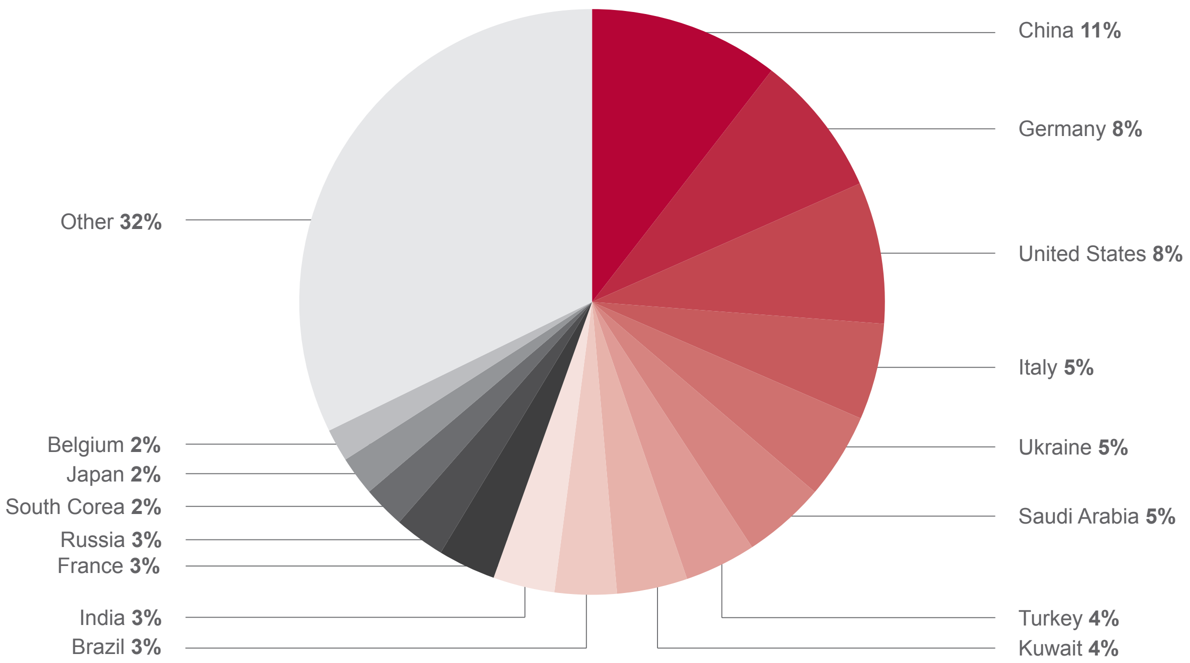
The economic slowdown of the country in the past three years has had a negative impact on trade volumes. It is estimated that Italy has "lost" over € 5.5 billion in exports[01] in this period. In fact, the healthy growth rates of the 2005-08 period (+ 27.9% annual average) were followed by much lower increases, on the order of 2.2% (average).

Over time, however, Italy has established an important role among the suppliers to Egypt. In 2013, with total exports of € 2.8 billion, Italy was the no. 4 supplier with a 5.3% market share (Fig. 2), second in Europe only to Germany (7.9%).

An analysis of Egypt's imports reveals a strong prevalence of refined petroleum products (11.9% of the total), demonstrating the country's structural energy gap. **Next comes mechanical engineering**, the no. 2 sector with a 6.9% share.

[01] *The estimate of lost exports compares the level of exports that might have obtained if growth in the demand for Italian goods in 2011-13 had remained the same as in 2005 and 2007-8: a "loss" occurs when the exports that could have been obtained without the events causing instability are greater than those actually obtained.*

FIGURE 2. *Source of Egyptian imports (2013; in % of total)*

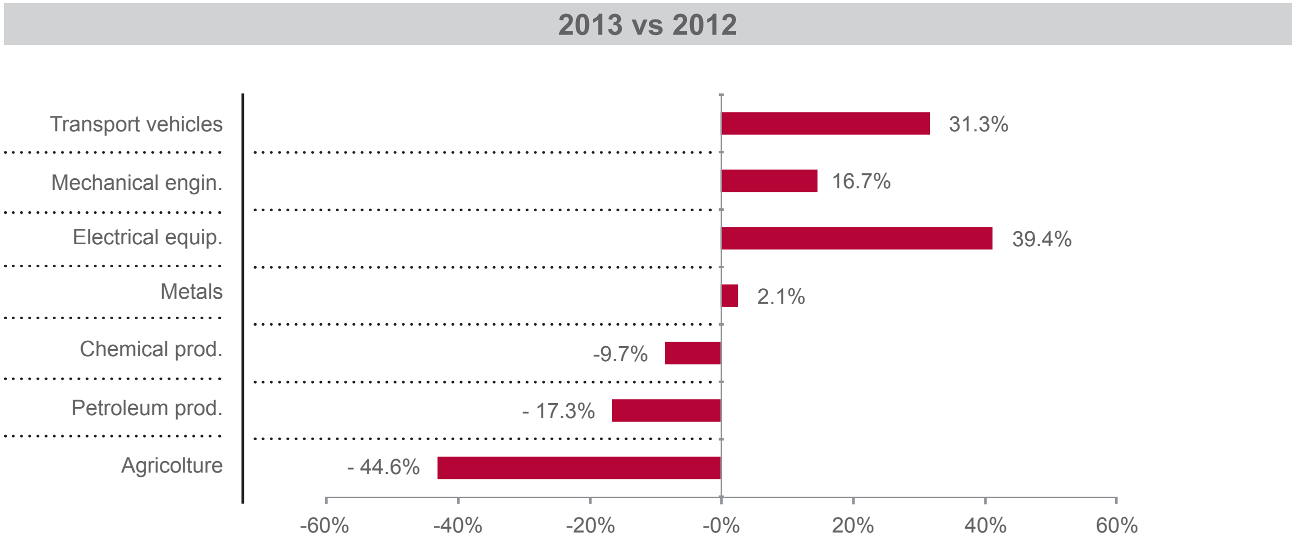


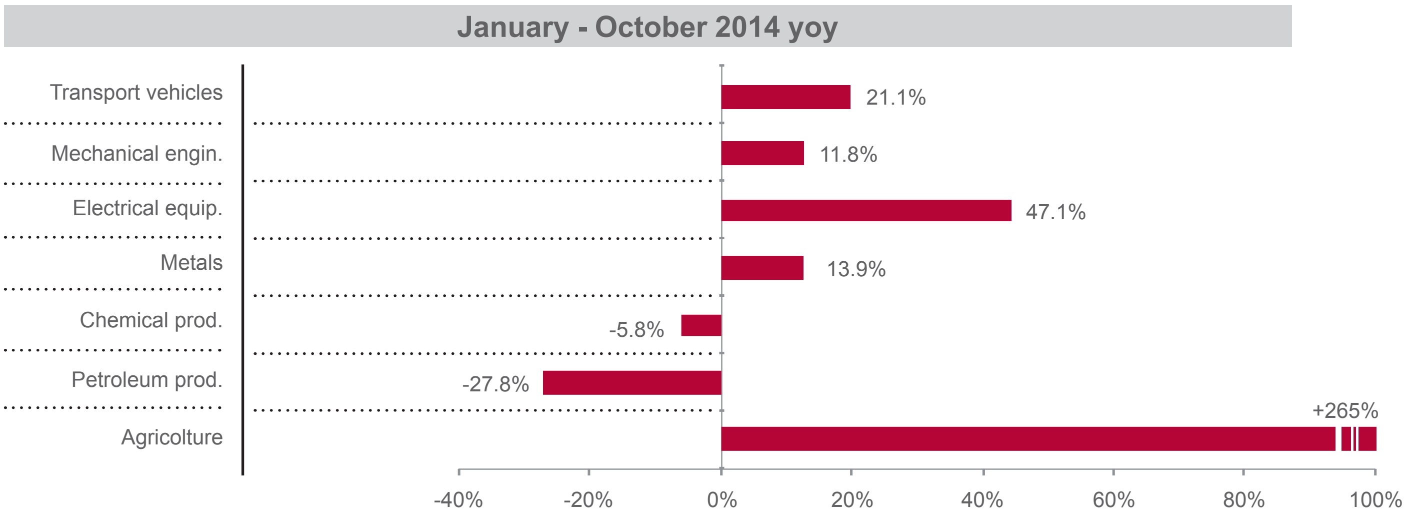
Source: SACE processing of UN Comtrade data

The strongest sector of Italian exports is mechanical engineering, which alone accounts for 32% of the total. Specifically, Italy has exported internal combustion and turbine engines, machinery for the chemical and petrochemical industry, and robotic systems for manufacturing. **Trade in crude oil and derivatives is also important**. In 2013, 52% of Egyptian exports to Italy consisted of crude oil, shipped back to its origin in the form of refined energy and chemical products (€ 706 million and € 260 million, respectively).

In the first ten months of 2014, Italian exports to the country grew by 4.9% versus the same period of 2013. There was a sharp decline in the sales of refined products and chemicals: -33% (Fig. 3) and -10%, respectively. Performance was positive for agricultural products (+265%), electrical and electronic equipment (+ 47%) and transport vehicles (+ 21%) and, among the principal sectors, mechanical engineering (+12%).

FIGURE 3. *Performance of exports to Egypt in the principal sectors (Chg. %)* [02]





Source: SACE processing of ISTAT data

If our exports grew at the same rate as Egyptian imports (projected at 5.9% over the next five years), they would reach € 4 billion by 2019. Then, if we could regain the growth rates of the 2005-2008 period (assuming an increase of 10% a year), **exports could reach € 5 billion**. The sectors that could make the greatest contribution are those related to residential construction and major infrastructure projects, **including wood, metals, and furniture**, but also **mechanical engineering**, thanks to demand from fast-growing industries in the country like ceramics.

[02] *The bar "food sector" was cut for reasons of scale.*

NEW OPPORTUNITIES FOR ITALIAN COMPANIES

An essential moment in the country's recovery process will be the international conference at Sharm el Sheikh in March 2015, when the Egyptian Government will present its development strategy. The target is to jump-start growth with a massive investment plan that will attract foreign capital. The most active countries include Saudi Arabia, Kuwait, the UAE and Russia.

The greatest opportunities fall into five areas:

- **Major infrastructure projects.** Of the 15 mega-initiatives (worth a total of 100 billion dollars), the principal project is **development of the Suez region**. In addition to the widening of the waterway, the project will include the construction of ports, industrial zones and logistical centers all along the canal area. The objective is to make the canal not just a transit point but an important center of world trade. Italian companies might play an important role in this project, thanks to their know-how;

- **Mining industry, especially in the so-called "Golden Triangle"**, the area encompassed by the ports of Safaga and El Quseir and the city of Qena (Fig. 4). The initiative contemplates the creation of a mining district on an area of more than 6,000 km2;

FIGURE 4. *The Golden Triangle*

Source: Google Maps

- **Housing construction.** The government plan calls for the construction of **1 million housing units** in the next five years for the low and middle income classes of the population, with resources provided by donors of the Gulf and the Egyptian Central Bank;

- **Energy**. There are **17 projects in the pipeline to increase the country's capacity by 8.3 GW**. Achieving the government's objective of reaching 20% green energy by 2020 will require investments of over € 1 billion. Most of these projects should involve the Mediterranean coast between El Alamein and El Salloum;

- **Rail transport**. The Egyptian Government, in partnership with Italy's Ferrovie dello Stato in an advisory role, is renewing a rail transport system now regarded as outdated by international standards.

There may also be good opportunities for small and midsize Italian companies interested in the Egyptian market. Numerous initiatives are promoting the creation of a diversified private industrial system that will create new jobs. These include **facilitated financing** initiatives promoted by the Egyptian Central Bank and the **ten free trade zones created in the country** in recent years to attract new foreign investment through tax incentives and exemptions. **The principal zones are in Alexandria, Damietta, Ismailia and Nasr City.**

CONCLUSIONS

Italy and its companies can play an important role in the revitalization of the country. Favored by geo**graphical-cultural proximity** and a **long-standing presence in Egyptian industry**, Italian companies cannot miss the opportunity to enter and consolidate their positions in a market of almost 90 million people.

The risks remain high, however. Operating risk, linked primarily to the country's bureaucracy and its shortage of energy; transfer risk, aggravated in recent years by a shortage of strong currency and the quota system introduced in the auctions managed by the central bank; and payment default risk especially for corporate counterparties.

For these reasons, SACE assigns a high risk to the country, indicating as principal risks those of transfer (85/100) and payment default by corporate counterparties (85/100).

Export credit insurance may therefore be a strategic instrument for Italian companies by hedging risks but also providing knowledge of the market.

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