



February 2011

Egypt's Crisis Will Not Last Long

International financial markets were hit hard by the news as the implications of political uncertainty in Egypt rippled across the region and the world. The price of oil rose and major stock markets fell. Egypt's benchmark index – EGX 30 stock index had a two-day drop of 16% through Jan 27. Spreads on Egyptian credit-default swaps, or CDS, widened and the nation's currency traded sharply lower against the U.S. dollar.

The “Day of Anger”

The aftershocks of Tunisia's Jasmine Revolution continue to reverberate across the Arab world. On January 25, Egyptians began an unprecedented revolt against poverty, corruption and thirty years of rule by President Hosni Mubarak, launching massive protests on the streets of Cairo and other cities. The protests began peacefully, but turned violent when the police began using batons, and firing tear gas and rubber bullets to disperse the demonstrators.

The Tunisian revolution, a historic first in the Arab world, has emboldened people across the Middle East and North Africa to rise against their leaders and their fossilized autocratic regimes. It sparked other smaller but ongoing protests in Algeria, Jordan and Yemen. After decades of dictatorship, corruption and nepotism, Arab political, social and economic frustration is extremely high, and it is becoming a time bomb for the stability of the region.

Meanwhile, Fitch Rating revised down its outlook for Egypt on Jan 22, dropping it to “negative” as mass protests in the country turned violent, engulfing the capital and other cities in the most serious challenge to President Hosni Mubarak's regime in years.

UN Should Step In

Many investors are increasingly are worrying that the next market crisis will emerge from the Middle East. Like last year's fears that the debt crisis in Europe would have a domino effect across the continent, the uprising in Egypt raises fears among investors that markets are at risk as the crisis spreads to other countries. The fear is grounded in geopolitical risk.

Egypt's economy is relatively small—the fourth-largest in the Mideast, with a gross domestic product last year of just under \$217 billion, according to International Monetary Fund estimates. But the country plays an outsize economic role as home to one of the world's most important trade and energy thoroughfares, the Suez Canal.

About a million barrels a day of crude and refined products are shipped northward on the Suez Canal, according to estimates from the U.S. Department of Energy. A separate pipeline linking the Red Sea and the Mediterranean carries another 1.1 million barrels a day. Together, that is roughly 2% of global oil production.

So, it's critical that the Suez Canal remains open. The Mubarak regime should try everything to cling to power. They must make sure that the Canal is well protected as well. Otherwise, food and energy prices would sky rocket in the world shortly and the world economy can't handle such an exogenous shock. A wave of political upheaval would sweep the Mideast and then the world.

Mubarak should not step down and flee Egypt like Ben Ali did in Tunisia. He needs to declare a transition to democracy and free elections under United Nations supervision. Otherwise the Muslim Brotherhood, the only well-organized opposition group in Egypt, will control of Egypt and the Suez Canal within a few months. They will have no qualms about using unbounded violence to seize and hold power. With the Muslim Brotherhood in power, they will have access to the huge arsenal of weapons that the United States has provided Egypt over the past thirty years. A war might start under this circumstance.

Consequently and immediately, with the support of the international community and the full military backing of the United States, Mubarak needs to declare a transition to democracy. This transition needs to be supervised by the United Nations and will take years to accomplish given the radical elements in Egyptian society. UN will need to stay involved for a long time. ¹

Strategy & Action

Fitch said that while it doesn't expect Egypt's macroeconomic outlook to be seriously affected as a result of the protests, it noted that serious challenges remain, such as high youth unemployment and food inflation running at about 17% per year. While Egypt has enjoyed respectable economic growth figures, even during the global financial meltdown, the rallies have centered on the inequality in income distribution, allegations of corruption, and the grinding unemployment some analysts have put as high as 25%.

We expect that oil and cotton prices will remain strong, but we do not worry that the Egypt's crisis will last long and spread to neighbor countries. The recent corrections in emerging markets would continue, but it should be treated as another buying opportunity for the long term investors.

1. Reference: "Egypt's Second Suez Canal Crisis" – Paul Sterne

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