

The Egypt crisis

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Overview

The Egypt crisis is probably the first global 'big story' of the year. What was essentially an internal political issue that has social and economic consequences appears now to have the power to spook global markets and provoke a new set of conjectures. An analysis shows that while Egypt on its own will find it hard to get back on its feet, the rest of the world will continue to worry about crude oil, which has once again broken the \$ 100 mark. The timing is unfortunate as the western countries do appear to be witnessing stable growth and would demand typically more oil thus bringing in the 'demand factor' too.

Turmoil in Egypt

The turmoil in Egypt is against the rule of president, Hosni Mubarak. While the underlying factors leading to this protest is political, the economic condition of the country is disturbing. Unemployment is at 25% while food inflation is 17%. Government deficit is around 8% of GDP and over 40% of the population is below the poverty line defined as \$ 2 a day by the World Bank.

Foreign investment and tourism have been two important sectors responsible for growth which will be impacted now.

How does it affect the world?

Two consequences have been at the forefront in the last few days. The first is an increase in the price of crude oil and the second relates to movements in foreign capital flows and hence stock markets.

How critical is Egypt for the oil economy?

Egypt is not a major producer of oil as such. But it controls the 120-mile Suez Canal and the 200-mile Suez-Mediterranean pipeline which together carry 2.5-4.5% of demand globally. While any short-term disruption would probably have a marginal impact on underlying oil output, the impact will magnify through changes in the pattern of world trade on regional crude prices and differentials, with the currently oversupplied tanker market potentially finding some temporary strength. Although the Suez Canal and the pipeline linking the Red Sea with the Mediterranean continues to operate, the present round of protests has brought most of the economy to a halt.

Analysts have pointed out that just like what happened in the sixties crude exports earmarked for certain destinations could find their way to different parts of the world. For instance, African crude can get pulled back into the Mediterranean rather than going to Asia, while the Sumed

and Northbound Suez volumes would head to Asia, as the pattern of economic advantage into different regions changes. This will create distortions in the short run even in terms of physical supplies being available even under normal production conditions.

Can the canal close down?

An outright closure of the canal would need a formal decision based on consensus between the Egyptian government and armed forces. It does appear that the Egyptian military would be reluctant to close the canal under the current circumstances. However, if a radical, anti-western government emerges, there is a chance that the Canal could become hostage to international power politics and then this possibility cannot be ruled out. But, this situation is still only a conjecture.

The worst case scenario probably will not materialize

Price impact

Since August, oil prices have been steadily increasing from around \$70 on the back of higher demand as the global economy recovered thus fuelling inflation. Prices are now at their highest since September 2008. Brent crude did go through the \$100 barrier for the first time in over two years. Analysts believe that oil prices were rising on concerns that the turmoil could spread into neighboring countries or even major oil producers including Saudi Arabia.

Oil price will remain volatile

The unrest in Egypt follows the recent overthrow of the regime in Tunisia, adding to the nervousness that more chaos could engulf the Middle East, which accounts for almost a third of the world's oil production. Beyond Egypt and its direct impact, there is concern that this can spread to Yemen, Algeria, Morocco, Jordan and Libya and have a cascading effect much like the dismantling of communism in the late eighties and early nineties.

A contagion cannot be ruled out

OPEC has stated that it would not increase production on the back of the surge in prices as there is no shortage of oil.

OPEC not to relent

Future of Egypt, economically speaking

The sustainability of Egypt's growth and spending hinges significantly on the confidence of foreign investors and tourists who come to Egypt's resorts; and the companies who send their cargo through the strategically important Suez Canal. The immediate reaction of overseas companies and investors to the crisis has been to run for cover. Tourists are being advised either to leave the country or at least to avoid major cities. The picture is hence fairly grim and does not bode well for the economy.

Future growth in jeopardy and 5% GDP mark will be hard to maintain

Impact on India

As a trading partner, Egypt is not very significant with a share of 0.60% in imports and 0.79% in exports. However, given that India is in inflationary times, higher crude prices will have an impact on inflation considering that aviation fuel and petrol, which are important components of the WPI, are market driven.

The subsidy bill on diesel and other administered petro products would also be pressurized and have to be taken into account by the government when presenting the Budget this month.

Impact on stock markets

While the Indian market was spooked, the reaction was varied across the globe. The recovery in US economy has been more important in the west, while the Asian markets gave more importance to the possible oil crisis following from the Egypt disharmony. Airline and oil companies would be keenly watched in the coming days. However, escalation of this crisis could lead to investors leaving riskier markets to traditional safe-haven investments like precious metals and US Treasury bonds.

Not our trading partner, but oil price the concern

Are our markets over-reacting?

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