

Egypt Risks Include Hoarding

Developments in Egypt are a major risk factor in the global outlook. They include conflict with Israel, tensions in Saudi Arabia, an impact on world oil and unrest in other countries in the region (see Background on Egypt on January 28.)

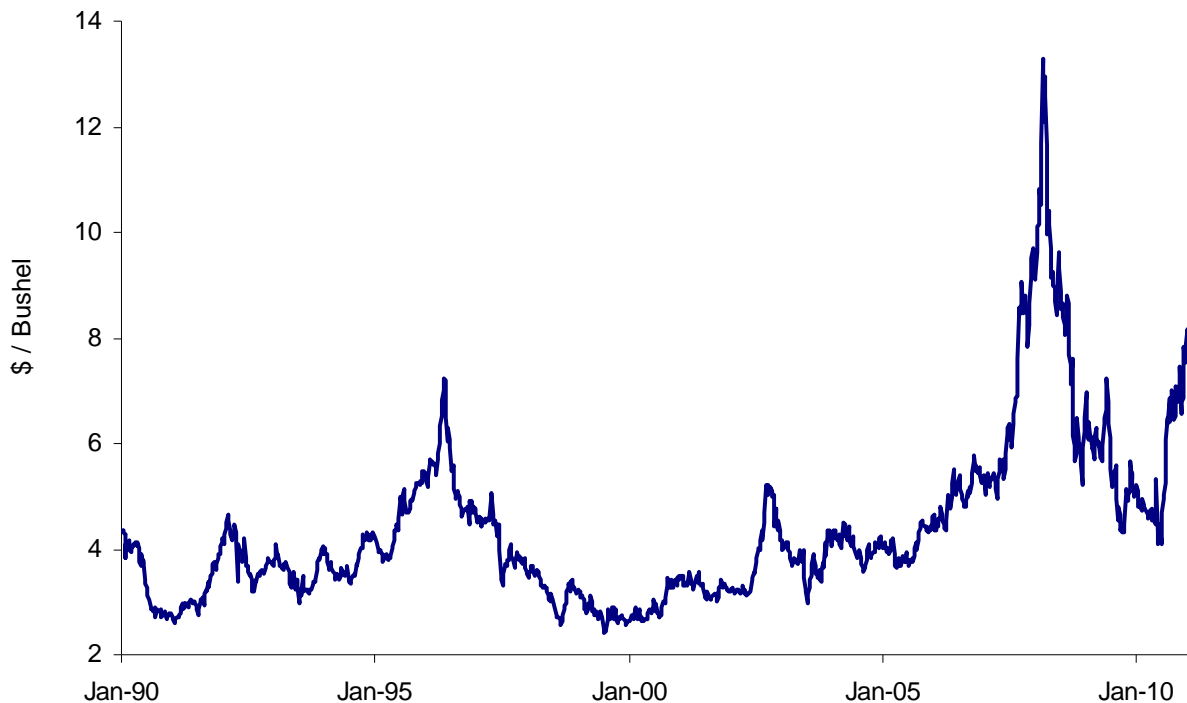
- We're not sure when President Mubarak will step down. The U.S. originally seemed to be encouraging his immediate departure. Around February 3, the U.S. seemed to switch to a policy of encouraging a gradual departure, as conveyed by envoy Frank Wizner.
- Saudi Arabia has been fully committed to President Mubarak and has asked for U.S. support. If Mubarak is forced out abruptly, it probably adds to U.S.-Saudi tensions and weakens both U.S. and Saudi influence in the region.
- Some in the government opposition have said they would walk away from the March 1979 Egypt-Israel peace treaty. Among its many provisions is a guarantee of Israel's free passage through the Suez Canal. This is more fragile than it sounds – currently only 120 Egyptian ship pilots are trained to move ships single file through the canal, alternating between north and south flows. While the Canal doesn't move that much of the world's oil (maybe 1%), its closure either by a walk-out of the pilots or a breakdown of the Egyptian military's control of the waterway, would be a negative global development given the importance of world seaways and treaties related to seaways.

World markets fell hard on Friday, January 28 on concerns that Egypt was moving into revolution. They rebounded strongly in the week beginning January 31 on the evidence that **Egypt's military was playing a stabilizing role**. This works in the short run, but the military's ability and self-interest to control events is declining.

- **As the conflict in Egypt drags on, hard currency, gasoline, medicine and food will begin to run out. The Cairo stock exchange has been closed since January 27.**
- Egypt has 80 million people. Many are dependent on grain imports – the U.S. helped achieve this in the 1980s with massive subsidized PL480 grain shipments that converted many Egyptians to urbanized bread eaters (from dispersed growers and eaters of local crops including rice.)

- **U.S. food aid to Egypt is limited by a budget that covers the price of wheat and the total landed cost in getting grain from Gulf ports to Alexandria.** Roughly a third of the grain is required to be shipped on expensive Jones Act carriers. Combined with very high wheat prices, this reduces the tonnage going into Egypt.

Wheat Prices (last obs. February 10, 2011)

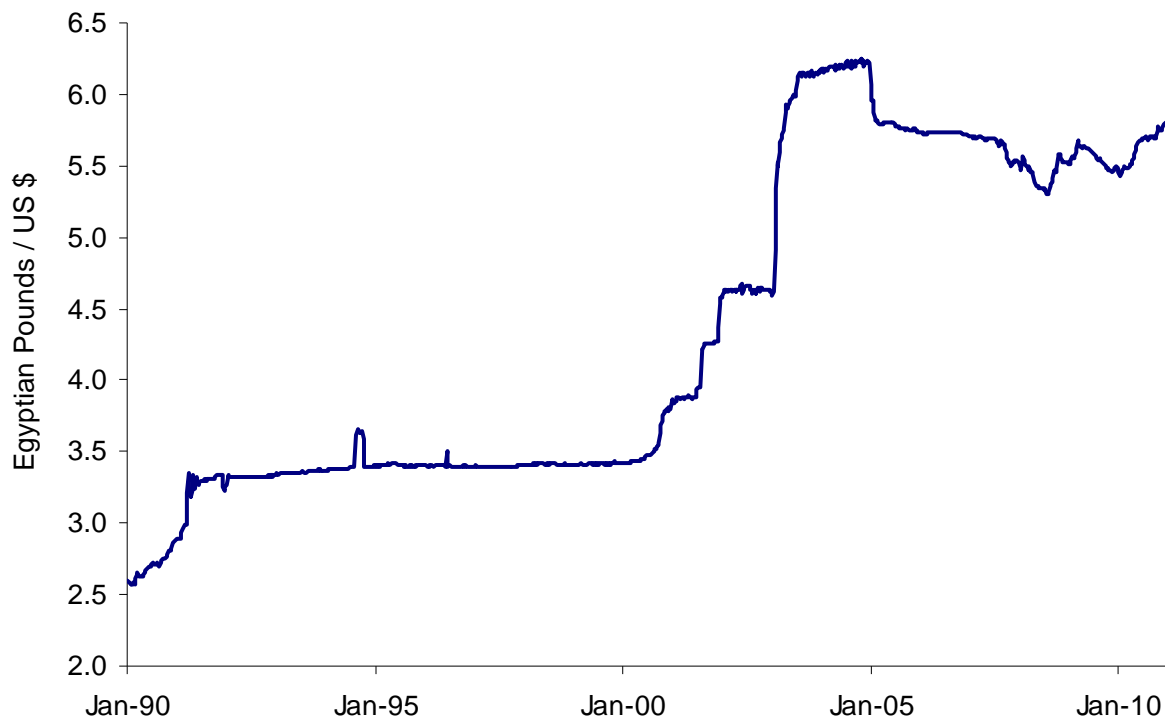


Source: Wall Street Journal; Encima Global

- **Adding to the problem, the Egyptian pound will probably weaken sharply. This creates urgency for Egyptians to buy goods, dollars and euros.** This is an explosive combination – a dwindling stock of goods in a country where the currency may soon drop in value.

- Egypt has been intervening in the exchange rate to maintain it at 5.9 Egyptian pounds per U.S. dollar. Egypt's reserves were reported at USD \$36 billion at the end of January. The M1 money supply stood at 224 billion Egyptian pounds at the end of December, slightly more than total reserves. As turmoil mounts, large pound-denominated loans to those with clout have probably increased substantially, lifting M1 in February well above total reserves. In the likely event of a devaluation, those with loans in Egyptian pounds will have some protection while already-low Egyptian living standards will decline further.

Egypt Pound (last obs. February 10, 2011)



Source: Wall Street Journal; Encima Global

Notes: This email and attachment are confidential and intended solely for the use of the individual to whom they are addressed. Encima Global LLC does not accept liability for the content, or for the consequences of any actions taken on the basis of the information provided. The information is not necessarily complete, and we make no warranty as to its accuracy.