RISK IN EGYPT: A FIXED PRICE ON UNCERTAINTY

By Dante Disparte, US managing director, Clements Worldwide

It is hard to ignore Egypt. Not only is it the heart and cultural centre of the Arab world, it is also its most populous country, with 86 million people, and a key North African market that cannot be overlooked – locally, regionally or internationally. While the recent headlines have been dominated by grim scenes of popular uprisings, a military coup and, most recently, a resurgence of terrorism in the Sinai Peninsula at the hands of Ansar Bait al-Maqdis, Egypt's long-term prospects remain hopeful. The first step, however, depends on how the administration of the newly elected Abdel Fattah al-Sisi stabilises risk and uncertainty.

Egypt's long-term geo-strategic relations with the US have been strained. The detente with Israel remains in balance and so many investors, local and international, remain skittish about near-term prospects for stability. Even with an electoral outcome favouring al-Sisi, his prospects to remain in power and Egypt's prospects to return to growth depend on one thing – jobs. With youth unemployment at 33% and general unemployment at 13%, the Egyptian economy has to grow between 6% and 7% to absorb the 700,000 new entrants in the labour force each year, targeting 8% unemployment according to economists at The Arab Stabilisation Plan.

The difference between risk and uncertainty is that risk can be measured and factored into most investment decisions. Indeed, without risk, there would be no so-called 'upside'. This holds true for investing in stock markets as for investing in countries. Uncertainty, on the other hand, cannot be measured and it is what causes panics, flights of capital, bank runs and general paralysis. The same is true for local and international investment into Egypt, according to recent figures. Post-revolution foreign direct investment inflows of $1.5bn were nearly netted out entirely by capital outflows, in a flight to safety, of $1.2bn. Similarly, domestic investments by Egypt's largest firms were halved from their pre-revolution levels down to $18.3bn between 2011 and 2012, according to regional experts Ibrahim Saif and Ahmed Farouk Ghoneim. Add a young, urban and jobless population and you have an incendiary mix that is both Egypt's greatest asset and liability.

Yet, all is not lost. Internationally backed Egyptian firms are leading by example and, critically, capitalising on these uncertain times by investing heavily in a down market. According to The World Bank, Gazelles, the moniker used to describe fast-growing, high-impact entrepreneurs, are a major part of the solution for both job creation and raising living standards in Egypt. Approximately 5% to 10% of these firms deliver between 50% and 80% of job creation. Similarly, these Gazelles are keenly aware of risks and how to hedge them. Agencies such as the Overseas Private Investment Corporation (OPIC) and private insurers offer a range of solutions to put a fixed price on uncertainty. Against this standard, many developing and frontier markets move from being too risky to investment grade with the advent of solutions such as political risk insurance, which can offer a vital hedge against a host of worst-case scenarios.

For practical purposes, international firms operating in Egypt will need to consider insuring their tangible assets with property insurance valued in the same currency as their operating income. For example, a European firm denominated in euros will not only have an exposure to country risk in Egypt, but will also face certain risks relating to a currency mismatch. This pernicious effect often renders many insurance policies of little value at the time of a claim and subject asset valuations to currency volatility. Additionally, firms will want to ensure that they are covered for the range of worst-case scenarios outlined above. Political risk insurance covering the investments, forced abandonment of property, currency inconvertibility and various forms of contract frustration are available from private insurers or agencies. Covering the 'people behind the P&L' is of course of paramount importance, but less common but highly advised forms of coverage include political evacuation and salary continuation insurance. This policy class not only affords international staff the semblance of stability by guaranteeing that a portion of their earnings continues, they also afford insured firms the peace of mind of having professional assistance with the evacuation process. While the toll of Egypt's revolution is still being tallied, remaining on the sidelines as an investor, domestically and internationally, may only compound Egypt's woes and translate into lost opportunities in a competitive global market. ■