Egyptian government resignation signals fear of a 'Ukraine Effect'

The Egyptian government has resigned. On Monday morning, Prime Minister Hazem el- Beblawi presented his resignation to interim President Adly Mansour, who replaced the deposed President Morsi – now under trial for treason among other things – and heralded the crackdown against the Muslim Brotherhood. Egypt has been in turmoil for some time and long before the de-facto military coup (even if Morsi's approval rating was abysmal and less than 11%) against Morsi; indeed, that event merely deepened the crisis situation that started with the so-called Spring in February 2011. Yet, there is something rather sudden about e-Beblawi's timing and in Egypt's continued instability, nothing should be taken at face value.

What does the resignation mean, then? The troubled post-Morsi transition, which has already seen the passing of a new Constitution (passed by over 90% of the votes but in the context of a very low turnout of less than 45%), has as its next and crucial step the presidential election next April. In fact, the government's resignation was expected because the current Minister of Defense, Abdel Fattah el-Sisi, is widely expected to throw his decorated General's hat into the race for the Presidency, formally restoring military rule in Egypt.

Rumors of el-Sisi’s presidential ambitions have been spreading ever since the coup against Morsi. There is no el-Sisi surprise then. The announcement has been in the air for months, yet there are rumors that senior officers are not entirely convinced that el-Sisi should run. Egypt is in the midst of deep economic collapse; the transportation sector has been on strike for over a month, paralyzing such cities as Cairo and Alexandria; pharmacists and dentists have also joined the protests by going on strike. In other words, the timing is inauspicious and some in the Army leadership see a Gen. el-Sisi victory – likely in the current political climate – as a risk: that is it would cement public opinion against the armed forces, eroding their power base and interests rather than enhancing them.

El-Sisi has few competitors. Some like Hamdeen Sabbahi, something of a socialist or ‘Nasserite’, who decided to run, could have a chance if el-Sisi were not in the race. Others, portraying themselves as Liberal, and in the absence of notable Liberal figures like Mohammed el-Baradei, who is in exile, have very little chance, as they appeal to a privileged and limited section of Egyptian society. Meanwhile, the climate of insecurity – terrorists have resumed campaigns targeting tourists – six Koreans were killed a few weeks ago – favors the authoritarians. El-Sisi will surely exploit the tensions with the Muslim Brotherhood. Moreover, in the event that el-Sisi decided to remain as Defense minister or head of the armed forces, most Egyptians would still be suspicious of his likely involvement behind the scenes – as in the present situation – such that they would rather have him clearly in charge instead of behind the curtain in a reverse of the ‘Wizard of Oz’ adage “pay no attention to the man behind the curtain”. However, uncertainty and instability in post-Mubarak Egypt prevail and even the careful calculus of a crafty manipulator such as el-Sisi, who forced a coup against the very President who put him in charge of Defense, suggest that the General still fears the ‘street’. The events in Ukraine, their timing and progression, and President Yanukovich’s sudden if unofficial resignation, will certainly have reminded officers like el-Sisi of the protests that brought down Mubarak exactly three years ago. The streets of Kiev inherited the legacy of the Egyptian ‘spring’ and the Army fears that the Egyptian street could erupt at any time to reclaim that mantle and that legacy.

El-Sisi and his backers in the military have asked Ibrahim Mahleb to replace the resigning Prime Minister el-Beblawi. Interestingly, Mahleb is a figure with few friends among the Tahrir Square crowd, who brought down two presidents because of his close ties to the Mubarak family.

Perhaps, el-Sisi is preparing the Egyptian people for a full reversal of the political and social turmoil of the past three years. Adding to speculation that el-Sisi has been suffering a case of Ukraine fever is the fact that, yesterday, the Courts re-authorized police control in universities. The problem is that now, the youth and many older Egyptians no longer believe in the omnipotence of their President. The street has brought down two (in both cases with the tacit and overt backing of the armed forces, who piloted the crises to their ultimate benefit), two presidents. It will not be afraid to attempt to take down another. However, in the case of Mubarak and Morsi, the armed forces helped the protesters; they managed the situation and had their own agendas for getting rid of those same leaders. Morsi was ruining the country through mismanagement and Mubarak was seen as planning a dynasty, encouraging his non-military and pro-private sector business son as his successor. The Egyptian army wants to continue to control the massive aid flow and the most productive sectors of the economy. If the street protesters attempt another ‘Spring’ as in 2011, they will face the full wrath of the armed forces, which could plunge Egypt in a scenario more in line with Syria than with Ukraine.

Why should this matter to the West and even to the markets?

Egypt is the barometer of the Arab Middle East; it is its moral and intellectual pillar. What happens in Egypt doesn't stay in Egypt; it spreads and amplifies throughout North Africa and the Levant. The presidential transition, likely to see el-Sisi in charge, will have to be successful along three factors: promoting the economy, re-establishing security and re-integrating society. The first six months of 2014 will be crucial. If those elements are not addressed, Egypt would descend further down the path of anarchy, leaving the armed forces adopting a more authoritarian stance while radical Islamists, re-establish themselves as the main – and non political – opposition. Tourism would collapse, western aid might be replaced by Russian or Chinese support, but those governments are also concerned by the potential for religious radicalism. Surely, oil prices would rise as prolonged tensions would translate to instability in the Suez Canal area, impacting the world economy. There is still a chance to salvage Egypt and el-Sisi, may turn out to be as practical as he has been crafty, leading a more democratic transition and shifting away from the recent turn toward authoritarianism. Egypt is wealthy in resources, human and natural. They need to be better managed.

Geopolitical risk from Egypt may prompt a major oil price increase

Oil prices have been rising and could increase further in response to the fast rising tensions in Egypt, tensions which could spread beyond its borders to other Arab countries. Brent crude oil futures have risen to their highest level in four months and the escalation of violence in Egypt will disrupt supplies from the Middle East. Brent North Sea for September delivery gained 76 cents to 110.96 dollars a barrel in midday trading in London, after reaching 111.53 dollars, its highest level since early April.

Egypt’s military is facing increasing international condemnation of the bloody crackdown against protesters conduct of the Muslim Brotherhood. Should the situation deteriorate further, the United States will be under pressure to extend its condemnation beyond the cancellation of military exercises and possibly cut off US aid of over a billion dollars, making Egypt even more vulnerable to unrest, causing an even higher spike in oil prices. General unrest would seriously risk reaching shipments of crude from the Suez Canal and the SUMED pipeline, which provides a link between Europe and Asia and allows ships safer and faster travel between the regions without having to navigate around Africa. Although Egypt is not a major oil producer, about 2.5 million barrels pass through the Suez Canal every day, or roughly 8% of OPEC production or about two million barrels per day (bpd).

Egypt is the most populous Arab country and it has the power of launching a domino effect, especially in terms of risk perception for the region. If Egypt collapses, analysts and observers immediately wonder who will fall next. The Muslim Brotherhood, while rooted in Egypt, has inspired a number of Islamist political movements and parties throughout North Africa and the Middle East. The ‘Arab Spring’ has spread their influence as many of these parties have former parliamentary majorities in Morocco, Tunisia and Libya; Jordan has also an important Muslim Brotherhood parliamentary group and Hamas, in Gaza, is a direct ally of ousted Egyptian president Morsi. Evidently, the region has all the ingredients needed for an explosion and all that is needed is the trigger mechanism. Egypt is unique, and this suggests that it is unlikely to experience a sectarian civil war on the scale of Syria;

however, the ‘Arab spring’ has released a ‘genie’ of revolt that has been very difficult to repress and given the levels of unemployment and social disparity, civil war cannot be entirely discounted. Civil war in Egypt would be disastrous and it would be difficult to prevent international intervention, especially where the Suez Canal is concerned. Oil exports would be at huge risk as would be international trade in general.

2013 has been a year of higher oil prices. Libyan exports have fallen by at least half and in June they fell to a seventh of its average output. Political unrest has been the main reason to account for those increases. Since January, the oil traded in a range 87-109 dollars per barrel (one barrel = 159 liters); the North Sea Brent crude hovered around a range of 97-119 dollars. Concern about the supply situation has prompted high anxiety. Unrest in Libya, attacks on pipelines, security concerns in Algeria and Nigeria – the geopolitics is currently a major factor in oil price formation. The geopolitical situation in the Middle East will keep prices at a high level, especially now that some EU countries need to replenish their stocks before winter, he says. The Libyan drop is significant in this regard; because oil exports from have been halved to less than 500,000 barrels of oil daily. Back in June, exports had stood at 1.3 million barrels. Traders justified the price increase with the closure of two major oil export terminals in Libya as a result of a labor dispute. In addition, the Iraqi-Turkish oil pipeline was closed after a bomb attack. This makes oil being delivered through the Suez Canal all the more necessary and all the more valuable, especially as there are signs that the EU has started to see a pattern of economic growth that has prompted analysts to suggest the recession is over.

Political unrest in the Middle East has generally been characterized by acts of ‘terrorism’ and sabotage. Both carry dire consequences for energy prices and the current price of oil does not take such risks into account yet. The Syrian civil war has not affected oil prices because Syria's role in the energy game was just starting to develop with a proposed Iran-Iraq-Syria pipeline, which remains a distant prospect. The economic weakness of the industrial nations during the most intense periods of the 'Arab Spring' mitigated sharp rises in oil price related to political risk. Now, with economic outlooks improving in most or all OECD countries (including parts of southern Europe, Japan and the United States), political risk will take its toll and some long overdue dividends with it.

One immediate consequence in Europe is that Russia will become an even more important supplier, especially as far as the EU's economic powerhouse, Germany, is concerned. That is, however, a small consolation for political risk. Relations between Russia and the West have fallen to their worse levels since the end of the Cold War. Some might say that a new Cold War is in the making. Threats of western boycotts of the Sochi 2013 Winter Olympics over controversial Russian anti-Gay legislation are not helping and Russia could take advantage of the fact it has some better cards to play in the situation that is taking shape thanks to the growing tension in Egypt. Oh, it should also be noted that there has been a sharp decline in US inventories of crude oil by 2.81 million barrels – rather than an expected 1.5 million barrels. Oil hunger is back and this may also prompt an increase in commodity prices in general.

Africa holds the Key to

Higher Potash Prices

Potash prices are bouncing back. The first sign of a 'renaissance' came after the Russian-Belarusian Potash Company the Belarusian Potash Company (BPC) signed a deal to supply a million tons of potash to India earlier in the week at a price of two on February 6 at a price of USD 427/ton. While the price is not as high as the 2012 contract (USD 490/ton) it is significant because it is higher than breakthrough contract with China that Canpotex (representing Potash Corp, Mosaic and Agrium Inc) signed on New Year's Eve 2012 at USD 400/ton. The Indian contract price has validated K+S's CEO Norbert Steiner's prediction that potash prices would not sink below a ceiling of USD 400/ton. Steiner has also predicted that potash demand would increase slightly this year as well compared to 2012.

Not a day later, Canpotex also signed a contract for 1.1 million tons with Indian customers at USD 427/ton (timing and pricing the same as the BPC/IPL contract. While the price per ton is lower than the previous contract, Canpotex has garnered a larger slice of the Indian potash market pie as the previous one was for 950,000 tons. The Indian contract and the fact that Brazilian demand (and prices) are increasing further suggest that potash prices have reached their lows and that and global potash shipments should start to increase. As optimistic as this scenario may be, there are geopolitical factors that will help to sustain, or increase further, the high potash prices – and those of other mineral fertilizers. The special factor to consider is Sub-Saharan Africa.

Sub-Saharan was second only to South East Asia in the intensity of economic growth over the past decade. Even in the face of the past five years economic stagnation in the rich countries, Africa has continued to experience growth: "I cannot help but be impressed by the continent's resilience … in the face of the most serious disturbances seen by the world’s economy since the Great Depression,” said the head of the International Monetary Fund, Christine Lagarde. The IMF meanwhile expects African economic growth to continue at over 5% in 2013. Resources, mining, oil and gas explorations have fueled Africa’s growth, but agriculture has also emerged as an important factor. While in Europe, the gross domestic product shrank by 11% in the last five years, it rose by 29 percent in Africa.

Many investors still do not care; they think of Africa as ‘hunger and war’, even while it has earned the statistics as one of the world’s most dynamic and fastest growing regions in the world. AGCO, a large Agricultural equipment manufacturer, recently held its second annual Summit held in Berlin. The summit focused on Africa, its unfulfilled agricultural potential and the need. Soil productivity is the priority. It is estimated that more than 60 percent of the potential agricultural land has not yet been cultivated. Such an undeveloped farmland reserve is the key to ensuring a sustainable food supply. Increased mechanization and better soil fertilization are the two essential ingredients to boost agriculture. African farmers need more modern mechanized farming methods to increase the level of productivity. Through greater productivity and efficiency, the dependence of African countries on imported crops and food self-sufficiency decreases increases.

Africa holds more than half of the world’s unexploited agricultural resources. Africa’s agricultural industry has lagged but it will inevitably have to improve as Africa’s population is expected to reach over two billion people by 2050. This will require Africa’s food production to improve considerably in order to meet the inevitable surge in food demand. Most of the growth and additional food supply needs will be concentrated in sub-Saharan Africa, where, on average, women have 5.1 children – more than twice the world average of 2.5 children. Even if birth rates drop as a result of education and changes in culture, Africa’s food needs will still be enormous and its agricultural sector will be under increasing pressure to meet this challenge, especially as far as the production of such staples as cereals and rice are concerned.

The drive to improve agricultural production means that demand for fertilizers such as potash and phosphate will increase in Africa, especially considering that crop yields are far from allowing the continent to reduce its dependence on food imports. The UN notes that agricultural output in sub-Saharan Africa has actually dropped by 10% on a pro-capita basis since 1970, having risen 40% worldwide in the same period. This is reflected in a considerable disparity in fertilizer consumption, which can be as low as 10% of the world average. Africa’s soil itself needs more mineral fertilizer in order to be productive as it is often rusty and deficient in the very nutrients, nitrogen and phosphorous, that phosphate and potash based mineral fertilizers can replace. The difficulty for African farmers is that a limited supply of such products has made them economically inaccessible, which means that after an intense agricultural season, an African farmer is less able to replenish the soil with nutrients.

A return to subsidies for mineral fertilizers may be the solution as indicated by Malawi’s recent experience. In 2005, the recently deceased president Mutharika’s government started to subsidize fertilizers, the resulting boost to agriculture became known as the ‘Malawi Miracle’ such was its success. This success has helped change attitudes in the large international lending institutions, reducing financial barriers to demand for phosphates and potash in Africa. The Norwegian fertilizer company Yara International ASA (‘Yara’, OL: YAR) has set an ambitious growth plan in Africa as a medium term growth market. The company noted that the main obstacle to the African market is far less an issue of demand, of which there is plenty, than one of limited logistical

capacity.
Africa needs more and larger ports, railways and roads to accommodate the market requirements.

Finally, while Africa’s growing demand alone will add demand for fertilizers, the high price of petroleum will also contribute to this trend. The ‘Arab Spring’, far from having set a course for gradual democratization and stability, has actually raised regional instability. The ‘Spring’ is far from over and a new season of protest has arrived as the secular opposition in Tunisia and Egypt is trying to shift the course back in line with the original aspirations of the movement. The instability will be reflected by high oil prices and by potential shortages of phosphate given that Tunisia is one of the main producers and that production has been severely cut by strikes and social disruptions.

Morocco and Jordan (respectively the number one and number six ranked producers in the world) are not immune to the political pressure, especially if the secular ideals manage to overcome the current Islamist trend. Jordan also supplies potash to some of its Arab neighbors; any disruption in supply would best be filled locally. High oil prices and political instability in the Middle East will raise demand for bio-fuels. Bio-fuels tend to be produced from potash and phosphate intensive crops such as soybean and corn, which will stimulate mineral fertilizer demand worldwide in the short and medium term.

African governments are also being encouraged to develop autochthonous commercial agricultural practices. Ethiopia, Sudan, Mozambique, Angola and Uganda have already indicated an interest in pursuing this path and some, like Ethiopia, are already on the way to becoming potash producers (Allana Potash, TSX: AAA). Africa could to see consumption of potash increase by 200-1000 percent over the next decade. Some of this potash will be mined in Africa itself; however, Brazil and even Argentina could also become large suppliers. Fears of a food crisis have forced African governments to recognize the urgency of addressing their food production deficiencies. The continent now has the choice and the means to become one of the main food producing and exporting regions in the world thanks to an effort in which potash and phosphate will play a key role.

A potential rapprochement between the two key Middle Eastern States?

A historic visit to Cairo: On Tuesday, Mahmoud Ahmadinejad became the first Iranian head of state to visit Egypt since the 1979 Islamic revolution. Ahmadinejad received a warm welcome at the airport but the cordial reception masked the tensions that still exist between two of the most important powers in the Middle East, despite some improvements in diplomatic relations since the election of the Islamist president Morsi in Egypt.

The subject of Syria dominated the talks; however, the world was most concerned by what sort of bilateral relations might emerge after this meeting and what that would mean for the region. In fact, there is little room for improvement. Formally, Iran and Egypt have diplomatic relations. Iran broke off ties in 1979 after President Sadat signed the peace treaty between Egypt and Israel; presumably, Ahmadinejad expected Morsi to do the same, but the Treaty is too entrenched in Egyptian politics for it to falter on ideological grounds. The United States offers Cairo over a billion dollars in aid every year and the deal would be compromised should Egypt’s president threaten to repeal it. Certainly, since the Muslim Brotherhood (the ‘Islamists’) have taken power in Egypt, Iran had sent clear signs of a desire to strengthen ties but Cairo but showed restraint so far. Apart from the Peace Treaty, the two countries differ strongly on Syria. While Tehran supports the government of President Bashar al-Assad, Cairo has openly called for his resignation and supports the Syrian opposition, which has ties to the Muslim Brotherhood.

Ahmadinejad, who received an ‘unpleasant’ welcome to the Egyptian capital after a Syrian pro-opposition protester launched a shoe in his general direction, arrived in a country in turmoil; Egypt has not found peace yet: Protests against police brutality continued throughout the week; there were violent clashes and riots in various cities. The Culture minister resigned. The United States and the Arab Gulf States, including Saudi Arabia and the UAE, which invested heavily in Egypt under Mubarak, are very concerned about any sign of Egypt and Iran becoming closer. The Gulf States have an ‘ideological’ problem with Iran’s Shiite influenced political structure and faith and want to see Iran weakened. Iran, for its part needs more allies in the region. It is diplomatically weaker as a result of the war in Syria and more isolation for Hezbollah in Lebanon. This geopolitical tension is bound to help maintain high oil and, by extension, commodity prices. The tensions are increasingly being driven by a nascent secular opposition movement, a ‘paradigm shift’ in the making: indeed, whereas, the opposition in the past 30-40 years in Egypt has had an Islamist character; barely a year after Islamist governments have swept the region from Egypt to Tunisia (with some pressure on Morocco as well), the population’s grievances and economic problems have only exacerbated. The ‘Arab Spring’ is not over; it will be a long process marked by more turmoil before a true stability is established.

Then there are the deep divisions between Sunni and Shiite communities in the Middle East that are contributing to tensions in Syria, of course as well as Lebanon, Bahrain, Iraq and Yemen. The divisions have a religious veneer but they are also tied to political and economic interests. Morsi is caught in this cauldron trying to play both sides, perhaps even attempting to pursue a non-ideological and "pragmatic" foreign policy dictated by economic concerns. Morsi has visited Saudi Arabia, China and Iran, trying to play all sides against each other. China was a signal to the United States and an attempt to force a more 'US independent' policy; however, Egypt has little to offer China apart from cheaper access to the Suez Canal. Iran could offer Egypt oil, but it is facing tremendous internal challenges: numerous internal problems, a grave economic crisis, a debatable Constitution, issues related to security and public order, respect for human rights and freedom of the press and expression.

The following is a clip from a recent interview on CTV Newschannel on this topic:

Egypt's Revolution Conspires for Change

Egypt is suffering a deep economic crisis and needs tough reforms to climb its way out of it; large sums of foreign capital are crucial for short term survival and structural changes for the long run. Since being elected as the first President of Egypt post-Mubarak, Morsi has had to confront a fragile economy, an unemployment rate of at least 20% (the actual one could be considerably higher given the preponderance of the informal sector and the decline in tourism) while more than one fifth of the population is living below the poverty line. Morsi cannot afford the luxury of ignoring the mood of the ‘street’. Inasmuch as Morsi would like to take a more populist stance, he will eventually have to launch the kind of reform that in Egypt has typically led to ‘bread riots’. Morsi has never gained the support of secular reformists – those who share the outlook of the original Tahrir Square protests of 2011. He has also lost some of his Muslim Brotherhood base after failing to uphold a tough stance in the wake of the latest Israeli-Palestinian dispute. Morsi will have to swallow the Camp David Accords and continue to block militants filtering in the Sinai to attack Israel.

Morsi’s concentration of powers has essentially exonerated Morsi from having to abide by any popular sentiment; he has the ultimate authority and can as such take decisions that might be unpopular with the so called ‘Arab Street’. In other words it allows him to act like Mubarak when necessary. Even as Washington and western capitals will surely criticize Morsi’s actions in public; in private, they will prefer having the luxury of dealing with one strong voice in Cairo rather than a multitude of these. A more democratic Egypt would have been less amenable to accommodating Tel Aviv, were it truly to express the dominant Party’s position. Morsi’s foreign policy, in fact, has remained very pragmatic. He has not indulged in grand gestures that would indicate any significant change from the Mubarak years. This is not surprising, because if anything at all, after decades of repression, the Muslim Brotherhood has survived because of its deep pragmatism.

The 60 dead and hundreds injured in this week’s clashes in Egypt suggest that, on the second anniversary of the revolution that toppled Hosni Mubarak, the Egyptian people have yet to achieve democracy; they are also paying a high price towards achieving this goal. The crowded streets of Cairo, Alexandria, Port Said and Suez have made it clear that the revolution is not over – perhaps, in fact, the revolution has not even started yet. Surely, the external attributes of power have changed and there is an elected government with a majority party (even if Parliament has been dissolved for now), the Muslim Brotherhood, which has represented the unofficial opposition since 1928. The tables have turned now and the old Islamist opposition has had to confront secular protesters, much closer in spirit and aspirations to those who launched the Tahrir Square protests in 2011. Yet, even the masses appear to have lost confidence in Morsi and the army may be waiting in the wings to take back some of the power that the new president tried to reduce when he came to office last June.

The Muslim Brotherhood has failed to take a path leading to a just democracy. The movement is in fact divided and as happens in many parties, there are both reformers and radicals within its ranks. Such a split, barely a month before another parliamentary election, cannot facilitate any effective government action in the direction desired by the people. The army's long shadow, as noted above has not gone away; it is still there and not only will it work to ensure stability; it will seek to protect its interests and search for ways to take a more active role in the power structure. Egypt is also in dire need of financial aid. The economy is collapsing and the recent tensions – which seem to be merely the start of a wider and longer season of protests-will hurt the tourism industry, which is the largest employer in the private sector. The currency has been devalued by 50% and unemployment is easily above 20%. The two possible short term solutions have some thorns. The IMF will lend Egypt some USD 4.8 billion but only on the condition that it adopts structural reforms, which in Egypt would necessarily, include a repeal of food subsidies – one of the most sensitive political issues in the country for decades and Egypt currently imports 40% of its food needs.

Qatar, an ally of the Muslim Brotherhood, also has a loan of

USD 2 billion (it lent Egypt $2.5 billion last year) in store but is waiting for the situation to stabilize in Egypt and for the IMF to lend its money first as a sign of confidence, if any is even left. Nevertheless, without this aid, Egypt will continue to sink deeper in the climate of protest. The secular opposition has never stopped protesting and even the soccer riots in Port Said are related to the youth who originally took part in the Tahrir Square protests two years ago. At the same time, the Islamists could radicalize further, blaming Morsi of having made too many compromises and of failing to embrace a program that is truly in the spirit and practice of the Shari ‘a. Egypt and the rest of the Arab countries that have undergone significant changes in the past 24 months will need many years to fully emerge from the turmoil, just as it took ten years for the former Soviet Block countries to see some true reforms and/or progress. The problem is that for Egypt – and even for Tunisia and others – ten years is too long a period. The risk of implosion and regional contagion of unrest is too high.