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Egypt: Mubarak on the brink, but what next?

Contributing Analysts

Alastair Newton

+44 20 710 23940

alastair.newton@nomura.com

Ann Wyman

+44 20 710 28792

ann.wyman@nomura.com

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- Egyptian President Hosni Mubarak's 1 February announcement that he will not stand for re-election in September marks a potential step forward but is unlikely, in our view, to be enough to satisfy demonstrators calling for his immediate resignation.
- We therefore expect protests to continue and believe that the longer Mr Mubarak hangs on the more difficult it will be for authorities in Egypt to engineer a relatively orderly transition – which, nevertheless, we still see as the most likely way forward.
- Moreover, the current impasse is exacerbating economic and financial conditions on the ground, with banks now to remain closed through the end of the work week (tomorrow), limiting access to cash. And government financing operations have come to a halt.
- Markets have responded positively to the news, with equity markets rallying and CDS spreads tightening. However, this relief rally may be premature given that further steps will be needed to reach a political resolution, and concerns may still increase about the shape of future governments in a post-Mubarak era.
- Elsewhere in the region, Egyptians' success in forcing things this far may well fuel further unrest, for example in Jordan where the king fired the government yesterday to try to defuse tensions.
- Any early up-tick in market sentiment over the MENA region as a whole following Mr Mubarak's announcement yesterday may therefore prove to be premature.

A potential step forward...

"Egypt's army...may now be developing a new vision of how the state's interests ought to be preserved – one that need not include Mr Mubarak." Bassma Kodmani, 31 January 2011¹

Although President Hosni Mubarak's 1 February announcement that he will not stand for re-election in September's presidential election was greeted as a partial victory by thousands of protestors in Cairo and Egypt's other major cities, it does not appear to have been enough to fully meet their demands. The decision was not unexpected, but the timing probably reflects the army's view that, (a) even though peaceful protests have been continuing, a sufficient measure of calm (relative to the end of last week, at least) has been restored for the move not to be perceived as flowing from weakness; and/or (b) dragging out the status quo would only mean that ultimately the authorities would have to make even more concessions to keep order. Nonetheless, such calculations look increasingly reactive, rather than getting ahead of the protestors demands.

Moreover, relative to point (b) above, although we see Mr Mubarak's announcement as a potential step forward, we are concerned that it may not go far enough to bring calm back to the streets. Indeed, we judge that one of the lessons from the

¹ "Army will craft a post-Mubarak era" by Bassma Kodmani, Financial Times, 31 January 2010

overthrow of the regime in Tunisia earlier this month is that his attempt to stay in office until the presidential election scheduled for September may inflame tensions on the street and lead to protestors intensifying their efforts to force an early removal. Early media reports following the announcement (e.g., on the BBC News website www.bbc.co.uk) suggest that a similar trend is already evident in Egypt.

...but protests are likely to continue...

In other words, we see a high probability that protests will continue and possibly escalate. This appears unlikely, as things stand, to precipitate a major military crackdown (following the army's announcement on 31 January that it would not use force to prevent orderly demonstrations). So, further concessions by Egypt's authorities appear to us to be not only likely but inevitable – to the point where Mr Mubarak does indeed step down in favour of an interim administration of some sort.

Furthermore, external pressure is being brought to bear on Mr Mubarak to quit early. Notably, the White House press office has reported that President Barack Obama spoke to Mr Mubarak by phone after last night's announcement, and subsequently issued a statement on the former's behalf stating that the US believed that "an orderly transition must be meaningful, it must be peaceful, and it must begin now".

...and even an early exit would probably not be the last word

Assuming that Mr Mubarak does step down in the next few days, which now looks increasingly likely, key questions relating to Egypt's future trajectory may still need to be answered. Notably:

- **Who will the army (which remains the ultimate arbiter in Egypt) want/be willing to accept as Mr Mubarak's successor**, given that Vice President Omar Suleiman may not be acceptable to Egypt's electorate?

Lieutenant General Suleiman has been the head of Egypt's internal security since the 1990s and, as we have previously noted, is widely believed to have been the army's top choice to succeed Mr Mubarak (see [Egypt: Winds of change still in the air?](#) Nomura Fixed Income Research, 28 January 2011). But at least some demonstrators on the streets have been openly bracketing him with Mr Mubarak. At most, therefore, we currently see Mr Suleiman as a possible leader or leading participant in transitional arrangements.

Other senior members of the military, such as Chief of Staff General Sami Enan, may face similar objections.

Among non-military figures, two Nobel Prize winners – Mohamed ElBaradei and Ahmed Zewail – are frequently mentioned. But it is far from clear how much support either enjoys among Egypt's electorate at large as opposed to the young urban middle classes who appear to be at the forefront of the protests.

One further leading figure who could play a key role is Amr Moussa, currently Secretary General of the Arab League and a former Egyptian foreign minister.

- **Can the authorities bring in sufficient constitutional/legislative reform to satisfy the protestors without opening the door to the Muslim Brotherhood?**

The Muslim Brotherhood is widely considered to be a broad church with a conservative older generation leadership and a more liberal younger element. The resultant divisions of view in its ranks (strategic and tactical) are clearly visible to external observers². Despite that, in the absence of any other credible opposition group, the Brotherhood does enjoy widespread support. In the 2005 parliamentary election its candidates (standing as independents) secured 86 out of 454 seats despite innumerable hurdles³.

Expert opinion is therefore that the Brotherhood could realistically win a plurality in a genuinely free and fair election unless a credible alternative were to emerge between now and such an event. In our view, the army, which is staunchly secular, as well as some external powers, including the US, will likely strongly resist this. Indeed, the US, EU and Israel would likely find the prospect of a strong Muslim Brotherhood influence in any future government unpalatable, particularly given the Brotherhood's close association with Hamas. Nonetheless, it is not clear that any of them may be in a position to prevent its ascent.

² (Ibid)

³ One consequence of this success was that the Brotherhood found even more obstacles in its way in the 2010 election and withdrew from the second round of voting.

- **Will there have to be early legislative elections in addition to the presidential election?**

The conduct of legislative elections which took place at the end of last year has been widely criticised, and we judge that there are likely to be persistent demands for the dissolution of the legislature and significant changes in the electoral rules and processes before early fresh elections.

At least one of these questions is likely to require an early answer, i.e., who should lead and who should participate in an interim administration – although even that may not become clear for some days yet (and possibly longer to judge, again, from Tunisia's experience). But others, notably relating to constitutional and legislative changes, are likely to take time to resolve and therefore perpetuate political – and market – uncertainty for weeks if not months through to the presidential election and, possibly, beyond.

Economic and financial market backdrop: time is of the essence

With political uncertainty lingering, the Egyptian economy and financial markets are grinding to a halt, presenting a host of problems for the newly-appointed government (as well as potentially having a bearing on the political outlook). Banks will remain closed for the remainder of the work week (i.e., through tomorrow), though the authorities have indicated that they will make efforts to reopen on Sunday (though even if this were to happen, it would only be a partial opening given the likely extension of the curfew). Cash is becoming scarce, particularly as many workers have not been able to collect their salaries at from the end of January, and concerns are growing about access to food supply in certain areas.

The extended bank closure has begun to raise concerns about the potential for deposit runs and extensive demand for foreign exchange, once they do eventually open. And the risk of the imposition of capital controls, at least temporarily, has increased. Regular government financing operations have also been interrupted, with the cancellation of a regularly-scheduled treasury-bill yesterday. Thus far, there has been no indication of how that financing will be replaced (redemptions will remain at the banks and will pay interest until banks reopen). Auctions occur once a week, for relatively similar amounts (Figure 1).

With each passing day, the consequences of these disruptions are likely to deepen, running the risk of a more protracted economic downturn. Both Moody's and S&P have downgraded Egypt's debt ratings (to Ba2 and BB, respectively) and further downgrades in coming weeks and months cannot be ruled out.

Markets, meanwhile, have responded *positively* to the news that Mubarak has begun to cede ground to the protestors, expecting that further concessions can eventually lead to a solution that may be amenable to the protestors. Egyptian GDRs and equity markets around the region have rallied, with most regional indices up by more than 1% and Saudi Arabia rallying 2.2%. Sovereign spreads also appear to be staging a recovery, and prices of Egyptian bonds are rising. We would exercise caution on the positive market response, as there are many ongoing political challenges to be met before a path toward resolution looks more assured.

Wider Implications

The success of Egypt's protestors in forcing Mr Mubarak's/the army's hand this far may well encourage protestors in other parts of the region – much of which appears to have been awaiting developments in Egypt these recent days before deciding what route to take. Top of the list at present looks to be **Jordan** where protests led by the opposition Islamic Action Front (IAF) persuaded King Abdullah to sack the government yesterday. However, his appointment of a senior general and former prime minister, Marouf Bakhit, to head a new government looks unlikely to see an end to protests⁴.

That said, King Abdullah himself does not look to be under threat – important because if that were to change it would, in our view, mark a serious escalation in another state in the region that is geopolitically pivotal.

Figure 1. Planned government auctions (EGPmn)

Feb-11	Amount	Mar-11	Amount
01/02/2011	10000	01/02/2011	10500
08/02/2011	11000	08/02/2011	10500
15/02/2011	10000	15/02/2011	10000
22/02/2011	10000	22/02/2011	10500
		01/03/2011	10500
Total	41000		52000

Source: Bloomberg, Nomura

⁴ See, eg, "Jordan protests: King Abdullah names Marouf Bakhit PM", BBC News, 1 February 2011 – available at <http://www.bbc.co.uk/news/world-middle-east-12336960>.

Other countries in the region also merit a continuing watching eye. Consider:

- **Algeria** has already seen food price-triggered unrest. Steps, including the purchase of 800,000 tonnes of wheat from France, have been taken to counter this. But similar challenges to those confronting Egypt persist;
- **Bahrain** is characterised by persistent tensions between its Sunni-dominated authorities and the Shia majority which could be exacerbated by unrest elsewhere in the region. Bahrain's CDS spreads widened by more than the regional average at the start of this week (but still remain more modest than eurozone peripherals);
- **Iran** has a similar socio-economic and demographic profile to Tunisia. But the opposition appears to be cowed by the suppression which followed the June 2009 election and a popular uprising there looks very unlikely;
- **Oman** is the only GCC member so far to have reported unrest following the regime collapse in Tunisia although, to date at least, this has been minor;
- **Yemen**, in which there has been considerable turbulence throughout the past two years or so, has already seen considerable unrest following the regime collapse in Tunisia. If this persists it could create more space for al Qa'ida in the Arabian Peninsula (AQAP) which already poses a significant regional terrorist threat.

Disclosure Appendix A1

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