



Rising socio-economic instability and its tail risks impacting Egypt

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NSSG[®]

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Our analysis covers the events happening until May 30, 2022.

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Executive summary

NSSG's Intelligence team has focused their attention on the upcoming challenges Egypt will face concerning socio-economic stability, food security, and terrorism, which have been compounded by the global supply chain disruptions generated by the war in Ukraine.

Here we list some of the key focus points this report follows:

- The Russian invasion of Ukraine has led to severe grain shortages, highlighting the vulnerability of Egypt, which is the world's largest wheat importer. Food security is likely to remain a significant concern in the medium term.
- The economic challenges brought by rising commodity prices and the remaining fallout from the CoVid-19 pandemic led Egypt to ask for support from the International Monetary Fund (IMF), which in the past has pushed the government to cut bread subsidies—a highly sensitive topic in the country. If the government were to agree to halting price controls on staple goods, a significant wave of public unrest would likely ensue, as large parts of the population would find themselves in the position not be able to afford food.
- The deteriorating socio-economic conditions within the country may provide a fertile ground for recruitment and propaganda efforts by terrorist organizations such as the Islamic State-Wilayat Sinai (IS-WS).
- IS-WS has, in recent months, increased the pace of its operations in North Sinai and beyond, even performing on May 7 an attack in the vicinity of the Suez Canal. As the government focuses on internal stability in mainland Egypt, the group may exploit this window of opportunity to step up its operations.

This report will outline the above mentioned points into brief analysis with the aim to offer a planning perspective for business operatives in the area as well as to help raise the awareness regarding the tail risks that could emerge due to the analysed context.

Introduction

Ever since Russia's invasion of Ukraine, Egypt has been facing a series of economic challenges that raise significant concerns over internal instability, both from an economic and political perspective. The massive inflation surge, food insecurity, and an unstable national currency have become significant contributors to black market trade, crime, and social tensions that seem to be deteriorating as the country's ability to tackle the crisis is hanging in the balance.

At the same time, since the start of 2022, Egypt has witnessed significantly more terrorist violence in the northern parts of the Sinai Peninsula, where insurgents affiliated with the Islamic State (IS) terrorist organization have been operating for years. The situation in the upper peninsula has deteriorated, especially over the past two months, punctuated by the deadliest IS attacks in recent years that targeted Egyptian military elements and pro-government militias, who play a significant security role in anti-IS operations in the peninsula. **The risk to commercial shipping and trade was highlighted on the evening of May 7, during an IS attack in el Qantara, which is relatively close to the Suez Canal.**



Rising terrorist activity in North Sinai

The North Sinai has been subjected to nearly constant insurgent-led violence for almost the past decade, undermining the security in the region. Armed militant groups have been actively operating there, despite losing most of their former strongholds following the counter-terrorism campaign dubbed **Comprehensive Operation Sinai 2018**. The operation was launched after Egypt suffered one of the deadliest terrorist attacks in the country's history in 2017, which left dozens of civilians dead in Tanta and Alexandria. As a result, Egyptian security forces managed to push away militant forces from mainland Egypt and to contain their activities to low-intensity sporadic attacks against the security forces and the civilian population in North Sinai.

However, **since pledging allegiance to the new IS caliph Abu al-Hassan al-Hashemi al-Quraishi in March 2022, the Islamic State's Egyptian affiliate, Islamic State-Wilayat Sinai (IS-WS), has become significantly more active throughout the central and northern parts of the Sinai Peninsula.** In terms of the frequency and severity of attacks in the past year, the month of April has been the most intense, with the highest number of fatal attacks that primarily targeted civilians and the Sinai Tribal Union (STU)—a tribal militia which regularly conducts counter-insurgency operations throughout North Sinai in cooperation with the Egyptian army. The attacks resulted in the killing and wounding of more than 50 militiamen in a matter of weeks, dealing a significant blow to the anti-IS campaign.

It is also **worth noting that the insurgents in the past months have increased their operations targeting civilians, assaulting villages to abduct those suspected of feeding intelligence to the military about their whereabouts.** During the past weeks, IS-WS released several videos showing the execution of these alleged spies, as part of a fairly common propaganda effort aimed at undermining state authority.

While the frequency of insurgent kinetic activities has shown a marked uptick, tactics have also evolved. Previously, standoff attacks, particularly improvised explosive device (IED) variants, were common as they effectively used the economy of force principle. IED attacks minimized the risk of exposure for IS-WS elements as well as increased the potential for maximum casualties. More recently, IS-WS have levelled up their direct engagement operations against the security forces with firearms attacks and ambushes.

Furthermore, critical infrastructure in the region was also targeted by IS-WS militants, who were responsible for blowing up a natural gas pipeline running through the city of Bir al-Abd at the end of April. Although there were no casualties in the attack, it underscores the terrorist group's willingness and ability to cause significant damage to infrastructure, which is considered an attractive target due to its economic relevance to the Egyptian state.

After this intense period in North Sinai during April, the security situation deteriorated further in May. **In what has become the deadliest terrorist attack carried out in recent years against the Egyptian military, on May 7, a group of IS-WS militants attacked troops guarding a water pumping station in El Qantara, located in the Ismailia Governorate, near the strategically important Suez Canal.** The attack resulted in the killing of 11 Egyptian soldiers and the wounding of five others. It was notable because it occurred outside of North Sinai Governorate, highlighting the risk of a potential spread of militant activities outside of their usual areas of operations and close to critical logistics infrastructures.

Just a few days later, IS-WS militants carried out another targeted attack against Egyptian security forces at a military checkpoint near the recently rebuilt city of Rafah. A heavy shootout between the two sides resulted in the killing of five military personnel and the wounding of four others. The Egyptian Armed Forces intensified counter-terrorism operations across North Sinai in response to the attack. During these operations, IS-WS attempted another attack during the second half of the month with a suicide bomber. Fortunately, the police forces at a checkpoint near the Gaza Strip were able to foil it. Nevertheless, the attempt highlighted the group's keenness to maintain pressure on the Egyptian military and to keep it off-balance.



Economic challenges triggered by Russia's invasion of Ukraine

While the repercussions of the Russian invasion of Ukraine that started at the end of February can still be felt in global markets, the Egyptian economy's exceptional vulnerability to the crisis became very clear immediately. Before the invasion, Egypt had inflationary pressures due to the pandemic and associated hikes in energy and commodities prices, which were compounded by the conflict as investment halted or vacated the Egyptian market. **In the case of Egypt, warnings were almost imminent given that the conflict would severely impact the country's food security—Egypt is Russia and Ukraine's largest wheat export market—and accelerate inflation due to the supply-chain disruption.**

On March 21, the Egyptian pound depreciated by 14% in 24 hours and slipped by an additional 1% the next day, which had been the steepest drop in the currency's value in nearly five years. In order to safeguard the country's financial resources and maintain currency liquidity amid the sudden financial crisis, the government introduced a set of key monetary policy changes. In a move that the Central Bank of Egypt (CBE) has not made since 2017, key interest rates were raised by 100 basis points. Despite the implementation of several monetary policy changes, however, the skyrocketing inflation rate has led to the raising of key interest rates for the second time. Accordingly, in mid-May, the CBE confirmed that an additional 2% raised interest rates in a bid to fight inflation and maintain price stability.

On top of battling the negative economic impacts that the coronavirus pandemic brought during the past two years, the massive inflation spike pushed commodity prices, including the price of fuel and grains (of which Egypt is one of the world's largest importers), to unprecedented levels. Thus, considering the impact the war in Ukraine has had on the Egyptian economy – particularly the fact that it threatens the country's access to strategic commodities – Egypt was forced to introduce additional measures to avoid a massive economic and food crisis. Therefore, despite receiving economic assistance from the EU and several Gulf countries to maintain stability and prevent an immediate financial collapse, Egypt was forced to request support from the International Monetary Fund (IMF) again, in a bid to shield its economy from further external and internal shocks. This decision, however, left many fearing whether the economic struggles that followed a similar decision in 2016 would appear in Egypt again, which would disproportionately affect the most vulnerable groups of society.



However, the Egyptian government argues that the IMF's support is critical to mitigate the extensive repercussions of the war in Ukraine effectively. In order to keep the economy running and maintain an acceptable level of economic growth, economic stability must be achieved. However, given the volatility of the markets and that of the national currency, implementing a comprehensive economic program without outside help is not viable in the current situation. Thus, negotiations are underway, and an agreement with the IMF is expected to be finalized within months, including allocating further financial assistance to Egypt.

However, to implement an amended economic reform plan, the country must be ready to effectively respond to external shocks, which requires exchange rate flexibility. Six years ago, the consequences of allowing the Egyptian pound to fluctuate following years of fighting a stagnant economy resulted in a wave of major street protests. The demonstrations were primarily led by those citizens who were most affected by the unstable economic conditions. They demanded a right to food, which was triggered by an IMF-requested cut to subsidized bread – a particularly sensitive issue in Egypt –one that most previous presidencies left untouched even despite economic hardships, due to the risk of triggering popular unrest. Furthermore, socio-economic instability generates also a favourable environment for terrorist propaganda and recruitment, something that IS-Ws will likely try to exploit to destabilize the Egyptian state further and, possibly, perform attacks within mainland Egypt.

Food security

Egypt is the world's largest wheat importer, with more than 80% of its supplies coming from Russia and Ukraine. Since the invasion, supply chain disruptions caused by the Russian blockade of Ukrainian Black Sea ports resulted in a halt to grain shipments bound for Egypt. Thus, in response to the new challenges, the government provided additional support and incentives to local farmers and accelerated domestic wheat harvesting. In addition, it also reached out to new prospective international partners to make up for the lost wheat stocks to ensure it can secure the needed strategic grain reserves in the short-to-medium term. Accordingly, apart from signing deals with countries such as Romania, Egypt finalized negotiations with India regarding purchasing 1 million tonnes of wheat. While these agreements have been a significant step towards ensuring Egypt's strategic wheat reserves, celebrations were short-lived after India announced weeks later that it needed to introduce an export ban on wheat due to potential food shortages within its own domestic market. Although New Delhi later clarified those contracts with Egypt would not be affected, the threat of a ban once again highlighted the country's vulnerability to global supply-chain disruption.

As mentioned in the section above, if the Egyptian government were to be unable to maintain bread subsidies in place due to the global supply chain disruptions and pressure from the IMF, a significant wave of public unrest could ensue, potentially threatening the regime's stability. So far, even though the Egyptian population is growing more concerned about the economic situation, the government was able to avoid the eruption of demonstrations by implementing enhanced public security measures and increasing repression to deter protests. However, the current situation is precarious at best since—absent a significant change in the deteriorating socio-economic conditions—repression may only delay the outbreak of protests in the country rather than prevent it.

Additionally, the gravity of the crisis was also highlighted when unexpectedly, at the end of May, several pro-government parties proposed halting national megaprojects until the political and economic situations stabilized. It is essential to highlight that large-scale national development projects in Egypt have been key drivers of the economy and investments for the past years and a significant part of the economic reform plan.

Nevertheless, the argument behind the temporary pausing of projects is that the government should refocus strategic resources on securing critical food reserves and ensuring that key government-funded programs can continue without disruption. While ensuring economic stability is indeed key to avoiding intensifying social tensions, it is curious that such a proposal was raised by pro-regime figures considering how large part development projects have played in the country's economic plan in the past years. Although it remains rather unlikely that such projects would be halted completely, it is possible that, given the deepening of the crisis in the country, some projects that are not considered essential would eventually be forced to be rescheduled.



Implications and conclusions

Despite the Egyptian government's efforts to mitigate the impact of the war in Ukraine, the economy is under increased pressure from rising inflation and food insecurity, creating conducive conditions for the propagation of large-scale social unrest. The first signs of tensions growing more intense emerged in March when citizens dissatisfied with the government's handling of the crisis inundated social media platforms by calling for protests to demand the restoration of stability in the country. At the same time, increased black-market activity has also challenged security forces, which put more pressure on authorities to maintain price stability and counter illegal trafficking in strategic commodities. However, merchants directly affected by the new price controls in place still attempt to sell products at different prices to secure revenues, which has regularly led to violent quarrels and fights among citizens over the past months.

These events clearly portray how economic instability has contributed to an unstable security environment. Thus, given that the financial and food security crises are unlikely to achieve any kind of resolution over the medium-term, there is a significant risk that Egypt could witness large-scale nationwide demonstrations akin to the events in 2016 and the 2011 "Arab spring" uprising.

Regarding the latest series of terrorist attacks in North Sinai, the developments reflect the extremists' commitment to further destabilizing the region as part of a grand strategy to unseat apostate governments. Given continued support under the new IS leadership, this level of IS-WS activity could significantly raise the threat of terrorism across the country, as larger portions of the population risk being radicalized due to the upcoming economic hardship and the government crackdown on dissent. While the enhanced counter-terrorism operations that are currently underway are expected to inflict heavy losses on the group, there is a strong possibility that it will only be a temporary setback, and by time IS-WS will have the needed support to regroup and reinforce its capabilities.

Under all scenarios, monitoring the development of events in the region is of paramount importance for any multinational company with a significant presence in the region.

If you are interested in monitoring political risks affecting your company, reach us at support@nssg.global