

WILL SUEZ CANAL EXPANSION LIVE UP TO EXPECTATIONS?

The speed with which Egypt completed its Suez Canal expansion has given observers confidence that the country's ambitious SCZone plan really could become the economic powerhouse the government envisions. WRITER James King

Senior figures in Egypt's private sector liken the country's president, Abdel Fattah al-Sisi, to a demanding chief executive. Take stock of the sweeping fiscal reforms and major infrastructure projects announced since his inauguration and it is easy to see why. Since June 2014, the Egyptian government has introduced improvements to the energy subsidy and income tax regimes, enacted a new foreign investment law, liberalised the electricity sector and embarked upon a number of high-profile mega-projects.

While these achievements have been accompanied by concerning political developments, there is little doubt that the government is serious about economic reform. Sitting at the heart of this process has been the redevelopment of the Suez Canal. In early August 2014, the president unveiled the historic expansion of the 145-year-old trading artery, which included the construction of a parallel waterway 35 kilometres in length to accommodate two-way traffic, as well as the expansion and deepening of the existing canal.

Remarkably, this feat was achieved in just 12 months, despite estimations the project would take three years to complete. To accomplish this, the authorities hired 80% of the world's dredging equipment and employed crews to work around the clock. The expansion has nearly doubled the canal's daily shipping capacity from 49 to 97, while estimated ship waiting times have fallen from about 11 hours to three hours. These improvements will be important for a commercial conduit that sees about 10% of all global maritime trade pass through its waters each year.

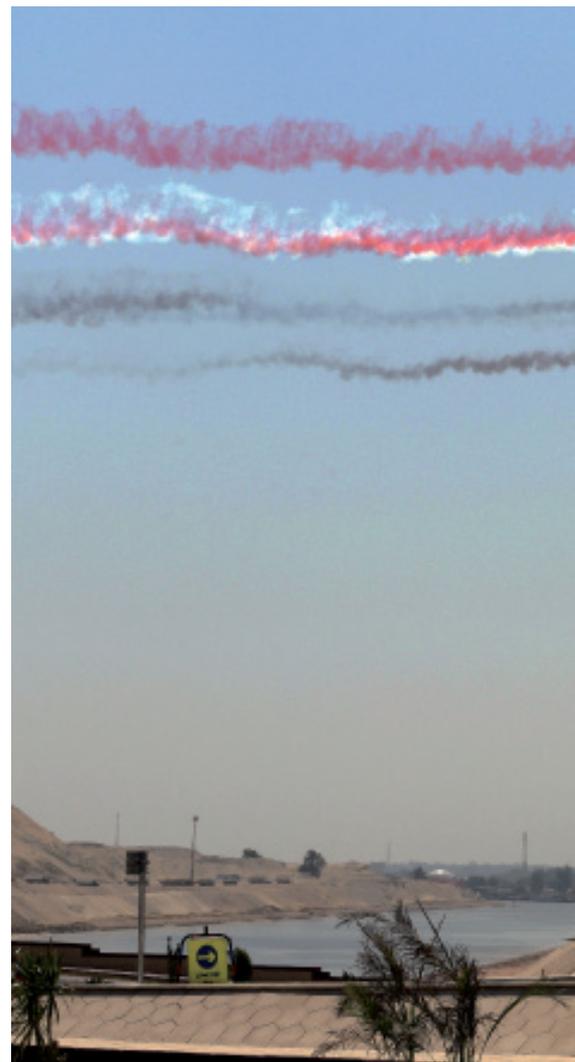
To finance these developments, the government issued \$8.6bn worth of five-year investment certificates to the Egyptian pub-

lic, with a 12% interest rate. Tellingly, the certificates sold out in just eight working days. According to a number of sources on the ground, the success of the investment certificate scheme reflects not only of the high returns on offer but also popular support for the redevelopment. For its part, the government defended the high interest rate on the basis that future returns from the development will be sizeable.

The authorities expect to see a corresponding jump in shipping receipts, from \$5.4bn in 2014 to a projected \$13.2bn by 2023. Yet, these projections are widely regarded as optimistic. Based on these assumptions and in light of the close relationship between global trade and Suez Canal receipts, world trade would have to grow by 10% per year between 2016 and 2023, according to research from Moody's. This compares with an average of 5.3% between 1993 and 2013, based on figures from the World Trade Organisation. Moreover, the fact that the canal was operating marginally below capacity prior to the upgrade has led some analysts to question the need for the investment.

Despite the validity of these criticisms, other factors were in play regarding the redevelopment. Crucially, the upgrade will allow the world's largest ships to make use of the canal. According to the Baltic and International Maritime Council, the average size of a newbuild container ship in 2014 was 7400 TEUs (20-foot equivalent unit), an increase on 6600 TEUs the previous year. This number is expected to reach 8000 TEUs in 2015. Moreover, mega-ships operated by the largest shipping lines now dominate global maritime trade. The CSCL Globe, launched in November 2014 with a capacity of 19,000 TEUs, is the latest in this trend.

"Unless you keep upgrading and developing, clients will look at other opportuni-



ties," says Hisham Ezz Al-Arab, chief executive of Commercial International Bank, Egypt's largest private lender. "It's an issue of client retention. Over the past month, the number and diversity of ships using the Suez Canal has increased."

LOGISTICS HUB

More importantly, the Egyptian government is forging ahead with plans to develop a specialised transport, logistics and industrial area around the canal. The Suez Canal Area Development Project, launched in August 2014, will create a network of integrated economic centres and world-class ports in a global logistics hub and industrial processing centre. Collectively, these developments will make up the Suez Canal Zone (SCZone), established by presidential decree in August this year.

"The government is looking to capitalise on the additional shipping traffic by developing extensive transit, storage and logistics facilities across the SCZone. This is where I expect real revenue generation for the country to occur," says Anis Aclimandos, president of the American Chamber of Commerce in Egypt.

Egyptian army planes fly overhead during a ceremony to mark the expansion of the Suez Canal



CIB'S GLOBAL TRANSACTION SERVICES TEAM HAS DESIGNED AN APPLICATION TO ALLOW AUTOMATED PAYMENTS BY SHIPS PASSING THROUGH THE CANAL, SAVING ABOUT 48 HOURS *Hisham Ezz Al-Arab* ●●

The SCZone will be based around three primary development nodes. These include the development of East Port Said into a major transshipment hub and gateway logistics facility; the regeneration of the Ismailia area to include the headquarters for the SCZone, various urban centres and research and development, agri-processing and information and communications technology clusters; as well as the creation of a massive

industrial and port complex at Ain Sukhna and Adabiya along the Gulf of Suez.

"The SCZone is underpinned by a transparent legal framework with efficient customs and tax procedures. As a result, we are already seeing a lot of early interest from investors in Europe and Asia," says Dr Hani Sarie-Eldin, founder and chairman of Sarie-Eldin & Partners, the law firm responsible for structuring the framework of the SCZone.

AMBITIOUS PLANS

In the long term, the Egyptian government has even greater ambitions for the area. During a press conference in March, minister of investment Ashraf Salman claimed that the zone would ultimately account for 30% to 35% of the country's economy. In addition, the authorities expect the zone to create about 1 million jobs over the next 15 years.

"While some of the government's projected figures for revenue generation and employment around the canal appear optimistic, they are certainly achievable, provided the investment climate heads in the right direction," says Mr Aclimandos.

This anticipated economic windfall will provide significant opportunities for the country's banks. Commercial International Bank (CIB), the country's third largest lender by both Tier 1 capital and total assets, has already transformed the way business is conducted by ships using the canal. As part of a wider effort to reduce waiting times for maritime traffic, the lender overhauled the canal's ageing payments system.

"The old payment process involved shipping traffic depositing an actual bank draft with the canal's administration office. CIB's global transaction services team has designed an application to allow automated, simultaneous payments by ships passing through the canal. This system saves about 48 hours," says Mr Ezz Al-Arab.

LENDING OPPORTUNITIES

As developments around the canal gather pace, the country's banks are preparing for corporate credit demand to grow, while the size of projects associated with the SCZone is also expected to lead to an uptick in syndicated lending. For their part, the banks have the necessary firepower to handle this expected jump in activity with the sector's loan-to-deposit ratio sitting at just over 40% in 2014. With the zone's initial infrastructure costs expected to be in the region of \$15bn, and a further \$25bn scheduled for port upgrades, the country's lenders will not be short of opportunities, particularly as foreign investment increases.

"The biggest challenge facing any international investor entering a new market relates to the sophistication of local currency funding and transaction banking structures. In Egypt, both of these are well developed. The Egyptian banking sector is ready to finance projects in local currency," says Mr Ezz Al-Arab.

Nevertheless, at this stage opaque figures and uncertainties over global trade and shipping trends means it is difficult to assess the potential impact of developments around the Suez Canal. While government numbers might appear optimistic, it seems likely that sizeable economic gains can be expected in the coming years if the authorities stick to their current plan. Yet, more importantly, these developments speak to the wider process of reform and investment taking place across the country.

"If you really want to appreciate where Egypt is today, you have to look at the region," says Mr Aclimandos. "The country is now enjoying a period of renewed growth and stability, while most of our neighbours are paralysed by violent turmoil." **TB**