



Helping Egypt Weather the Gaza War's Impact

The Egyptian economy is under increasing strain, with the Gaza war's effects adding to the pressure. In this excerpt from the Watch List 2024, Crisis Group identifies ways the EU can support Egypt in coping with its economic woes.

Even before the Gaza war sent Middle Eastern economies reeling, Egypt was facing an economic crisis that risked fuelling unrest and destabilising the region. Cairo is paying the price for over-dependency on food and fuel imports that it can scarcely afford, as well as over-reliance on expensive short-term financing. Now the shock waves generated by the conflict in Gaza have augmented those already emanating from Russia's war in Ukraine. Among other things, Cairo has lost several months of revenue from the re-export of Israeli gas and had to curtail domestic consumption when Israel stopped extracting from Tamar gas field for a time; it has seen the cancellation of tourist visits to the Sinai Peninsula because of its proximity to war-torn Gaza; and it is losing fees paid by cargo vessels passing through the Suez Canal, with traffic slowing dramatically since Houthi insurgents sympathetic to Hamas began attacking commercial shipping in the waters around Yemen. These events have compounded Egypt's pre-existing troubles, such as an unsustainable debt burden and a cost-of-living crisis that has been worsening since 2022. They are also of concern to European leaders, who worry that any Egyptian unrest could heighten regional instability and

render Cairo an unreliable partner in maintaining the Suez Canal trade route to Asia.

The Gaza war poses other challenges for Egypt. From the start of the conflict, Cairo has been worried about spillover, particularly the possibility that Israel will force Palestinians out of the strip into the Sinai. Concern is mounting as displacement within Gaza accelerates further and humanitarian conditions continue to deteriorate. From President Abdelfattah al-Sisi on down, Egyptian authorities flatly reject the scenario reportedly mooted by Israeli leaders that would see "voluntary emigration" of Palestinians from the decimated enclave. Moreover, they worry that uprooting people from Gaza and forcing them into Egypt could trigger protests and mass mobilisation, particularly if the Palestinian refugees were to perceive the authorities as responsible for their displacement.

To support Egypt's stability, the EU and its member states should:

- Provide financial assistance to Egypt beyond addressing concerns that its economic woes might trigger a spike in irregular migration to Europe. The EU should put a priority on budget support and economic development, including green and digital transition projects, to enhance Egypt's political and economic resilience.

- Make some of this funding conditional on economic and governance reforms, aimed at shoring up the country's long-term stability and protecting human rights, ideally including benchmarks to be used in gauging progress.
- Continue to amplify Egypt's message that displacement of Palestinians from Gaza is unacceptable. The EU should also remind Israel of its humanitarian international law obligations, which forbid any action to relocate the residents of occupied territory.

The Gaza War's Economic Blows

As Crisis Group has previously described, Egypt's economy has been struggling for several years, but the Gaza conflict has thrown its vulnerability to external shocks into especially sharp relief. The war hit Cairo's main sources of much-needed foreign currency and threatens to trigger a major debt crisis, with potentially destabilising effects.

The loss of foreign currency owes to several war-related developments. First, Israel stopped extracting natural gas from the Tamar field in its territorial waters for a period, fearing that rockets fired from Gaza could hit these facilities. It switched off the pipeline that carries liquefied natural gas to Egypt for re-export and domestic consumption. As a result, Cairo had to export less gas and to extend daily rolling blackouts from one to two hours. Israel later resumed piping gas to Egypt, but in small volumes, meaning that the power outages persist. Meanwhile, a significant number of tourists dropped plans to visit Egypt, particularly its beaches and diving spots in southern Sinai, with early November cancellations reaching 25 per cent. Then, when Yemen's Houthi rebels started attacking vessels in the Red Sea, demanding that Israel end its offensive, shipping insurance costs climbed, pushing firms to steer their gargantuan boats elsewhere. As a result, traffic through the Suez Canal – a key source of hard currency for Egypt – fell by 30 per cent in the first ten days of January from what it was the previous year.

These blows come on top of the enormous problems already besetting Egypt's economy. It suffered a severe setback with Russia's war in Ukraine and the ensuing spike in commodity prices, followed by the global increase in interest rates. These events widened the current

account deficit, depleted foreign reserves and inflated external debt, pushing the country to the brink of default. The crisis intensified in 2023, marked by a significant devaluation of the exchange rate, causing food prices to rise sharply. As a result, many Egyptians, especially in the middle and working classes, some of whom already were already working two or more jobs to make ends meet, saw a dramatic erosion of their standard of living. These economic troubles also have roots in President Sisi's governance since 2013, which has emphasised government-led infrastructure projects funded by external debt, often through military-owned companies. This approach led to the army's dominance in various industries, at the expense of the local private sector.

Despite the deteriorating economic outlook, Egyptian authorities avoided adopting several necessary measures for fear of destabilising the country. To help make debt payments, Egypt secured a \$3 billion loan from the International Monetary Fund (IMF) in late 2022, but the IMF suspended disbursement in 2023 because Cairo, citing political sensitivities, was reluctant to make all the agreed-upon reforms. Notably, the government did not curb the military's control of large parts of the economy. It also continued to prop up the Egyptian pound, because it feared that floating the exchange rate – ie, exposing it to market forces – could further boost inflation, which reached a record high of 40.3 per cent in September 2023. The Egyptian authorities tried to stay clear of currency devaluation, with the pound hovering at around 30 to the dollar, while on the black market the rate stabilised at around 35-40 pounds to the dollar. But with the Gaza war's effects, the

black-market rate jumped to 60 pounds to the dollar in January, ratcheting up pressure on the authorities to alter the official exchange rate.

Amid these economic woes, and despite Egypt's failure to carry out the IMF-mandated reforms, Gulf and Western partners (including the EU and member states) appear willing to help Cairo weather the storm. The U.S. is ready to provide financial support to Egypt, as Treasury Secretary Janet Yellen signalled after meeting her Egyptian counterpart in January. Gulf countries, though not openly committed to financial aid, seem inclined to boost Egypt's economy through increased private investment and asset purchases. In October, the EU began working on its own support package for Egypt. The EU reportedly followed the example of a two-fold deal struck with Tunisia. First, it provided a smaller yet significant amount of unconditional aid to fund measures to lower irregular migration departures, and secondly, it offered larger sums in macro-financial assistance conditioned on a deal with the IMF.

Most importantly, the IMF is renegotiating its loan with Egypt and has declared that it is ready to increase the loan amount in view of the

challenging circumstances. While talks are still under way, news reports suggest that the IMF is willing to soften its conditions and reach a compromise, such as pegging the pound to a basket of currencies instead of a floating exchange rate. These steps would help Cairo manage the domestic politics around the loan, because they would reduce the inflationary impact of a devaluation.

This flow of external credit is likely to provide short-term relief, even though it may not address long-term structural imbalances, including addressing the dominance of military-owned companies in the economy. Yet supporting Egypt at this delicate time is essential, in view of the possible repercussions for regional as well as European stability. As the largest country in the Arab world, sitting atop a key waterway for global trade and hosting millions of refugees from Sudan, Syria and elsewhere, Egypt continues to play an important, constructive role in regional affairs, despite the decline in its geopolitical influence. The destabilisation of Egypt could have dramatic consequences for trade, migration and regional politics.

Pre-empting an Influx of Palestinian Refugees

Ever since Israel launched its military campaign in Gaza, Egypt has shared the worries of the Palestinians living there that Israel might try to forcibly relocate them to the Sinai. It strongly opposes this prospect. On 23 November, President al-Sisi unequivocally affirmed Egypt's stance in this regard, emphasising its commitment to the Palestinian cause and to safeguarding its own national security. With the widespread destruction of civilian infrastructure in Gaza, Egyptian diplomats tell Crisis Group they continue to suspect that Israel's hidden objective is to push Palestinians toward the Egyptian border. Palestinians might even try to enter the Sinai of their own accord if Israel's actions make Gaza uninhabitable.

Egyptian officials fear a recurrence of the

Nakba (Arabic for "catastrophe", referring to the Palestinians' mass displacement in the 1948 war), which would burden Egypt with offering permanent shelter to a substantial number of exiles from Gaza. A long-running jihadist insurgency in the Sinai exacerbates their concerns, as does the spectre of linkages between militants in the peninsula and those staying behind in the strip to fight Israel. Finally, militancy might well arise among a large, aggrieved Palestinian population in Egypt, leading to cross-border attacks on Israel, exposing the country to Israeli retaliation and forcing Cairo to police those actors on its territory.

The situation at the Gaza-Egypt border has, if anything, grown more nerve-racking with Israeli military operations now concentrated in

the southern part of the enclave. Netanyahu has called for the army to occupy the Philadelphi corridor (a narrow strip of land running along the border on the Palestinian side) to regain full control of Gaza's boundaries. Humanitarian conditions continue to deteriorate, with more and more Palestinians crammed into Rafah and al-Mawasi, two areas in the strip's far south.

Amid Israel's military operations, as well as talk by politicians including Prime Minister Benjamin Netanyahu of "voluntary emigration" of the Palestinian population from Gaza, Egyptian authorities struggle to conceal their powerlessness. Egypt's regional influence has diminished over the decades. For the last

several years, it has seen conflicts break out in neighbouring countries – before the Gaza conflagration, it was Libya's civil war starting in 2014 and Sudan's in April 2023 – that threaten to reverberate inside its borders. Its recurrent meddling in the latter two conflicts, however ill advised, is an attempt to protect Egypt from spillover. Because of its loss of economic and military strength, Cairo finds itself in the position of having to appeal to external actors, such as the EU and its member states, to convey the message to Israel that a refugee influx would breach a red line not just for Egypt but for them as well.

What the EU and Its Member States Can Do

EU officials are worried that the difficult economic outlook could destabilise Egypt and push Egyptians and refugees currently in Egypt (Prime Minister Mostafa Madbouly estimates the number at 9 million) to attempt to reach Europe, where political forces have arrayed against accepting large numbers of migrants. Initial indications are that the partnership with Egypt will not be limited to migration but will include a broader economic approach. In December 2023, EU Commission President Ursula von der Leyen indicated that the EU wants to reach an agreement with Egypt similar to the deal struck with Tunisia in 2023, which mobilised funds to support economic development and stem irregular migration. In January, EU Commissioner Olivér Várhelyi specified that the agreement will focus on investment by mobilising 3.2 billion euros, in addition to 5.8 billion that the EU had already earmarked for Egypt, in areas such as food, water and energy, as well as migration. Such external credit may provide short-term support for the Egyptian economy, alleviating fiscal and external pressures until 2027, when loan repayments are expected to decline.

While the apparent shift away from narrow concern with migration is positive, the

EU should go further, tying at least some of its future financial assistance to progress with much needed economic and governance reforms. On the economic front, the EU partnership offered to Egypt should make priorities of budget support and economic development, such as green transition and digital projects, that can bolster the country's political and economic resilience. The time is also ripe to press for steps to loosen the military's grip on the private sector. On the governance front, Brussels should push Cairo to release political prisoners, issue guarantees to protect opposition political parties from repression and take measures safeguarding respect for migrants' human rights, ideally setting clear benchmarks that it can use to assess progress.

In addition, Egypt will need European help in allaying and managing the plight of the Palestinians who live on its border, both because of the humanitarian imperative and because of the risk of a major inflow of people from Gaza, which could in turn jeopardise its national security and trigger domestic backlash. An incident leading to the forcible or "voluntary" exodus of part of the Palestinian population cannot be ruled out. As noted in the Israel-Palestine entry below, Europe should exert continuing pressure

on Israel to seek an immediate ceasefire with Hamas and to enable greater volumes of aid to reach the strip. At the same time, Egypt needs the EU and its member states to keep stressing the message that displacement of Palestinians from Gaza, in any numbers, is out of bounds – as some leaders are already doing. On 17 November, EU High Representative Josep Borrell declared his firm stance against the forcible removal of Palestinians from Gaza. On 19

November, it was von der Leyen who, in a meeting with Sisi, stated that she opposed this scenario, despite her initial unconditional support for Israel's actions. The EU should continue to remind Israel of its obligations under international humanitarian law, which strictly forbid any action to relocate the residents of occupied territory. European leaders should likewise tell Israel that Gaza's future will remain its (and not Egypt's) responsibility. ■

