

The Roots of Egypt's Market Crash

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Al Jazeera Net



Egypt's Cairo and Alexandria Stock Exchange lost more than 16 per cent on Tuesday [EPA]

When brokers at Egypt's Cairo and Alexandria Stock Exchange (CASE) returned from their weeklong holiday on Tuesday, they found themselves in a mess.

By a coincidence of the shifting Islamic calendar, the end of Ramadan this year nearly overlapped with Egypt's celebration of its victories during the 1973 war with Israel, giving traders seven days off.

For the CASE, this seemed like lucky timing. The break gave skittish investors time to parse through the \$700 billion bailout plan scuttled through US Congress last week before they had a chance to yank their cash out of Egypt.

But despite the bailout, Middle Eastern markets dived on Tuesday amid sinking oil prices and chatter that the Gulf's half-decade, superlative-laden property boom may be nearing its end.

Exchanges even tumbled in Indonesia, Brazil and Russia - markets isolated from the subprime mortgage mess, but not from a global lending freeze-up. Egypt's bourse was not spared the thrashing.

By the end of trading on Tuesday, the benchmark CASE30 index had sunk more than 16 percent, bulldozing every gain the young and ambitious exchange has made since mid-2006.

This was vexing for some analysts, who noted that Egypt's cash-driven, highly liquid economy should be secluded from outside credit problems.

Why was an exchange so apparently isolated so hard struck? Wael Ziada, head of Egypt research at EFG-Hermes, an investment bank whose own stock fell 8.6 per cent during the drop, spoke with Al Jazeera in Cairo after markets closed on Tuesday.

Al Jazeera: What were the roots of Tuesday's crash, and how much of this had to do with troubles in the Gulf?

Wael Ziada: I think basically today's crash was just the Egyptian market catching up with the rest of the markets. We had a long Eid el-Fitr break which extended over a week, and this week was one of the most volatile for global markets.

We've seen some markets, like the Russian market, coming down on Monday in excess of, I think, 15 per cent and some other major markets coming down today. You have the Gulf market trading since Sunday and we just started in Egypt today.

To what extent did the long break for Eid el-Fitr and Armed Forces Day affect the losses on Tuesday?

At the end of the day what happened is that we had a more than 16 per cent decline in the stock market. This basically means that if we had a longer period the market might have fallen 7 per cent, 8 per cent, 10 percent, something like that. It would have been more gradual.

Which sectors were hardest hit and why?

I think the hardest hit today was the financial sector. That one went down around 22.5 per cent. It was followed by construction materials, which went down by 20 per cent. The whole market went down by 17.5 based on the Hermes Financial Index (HFI).

Then again, some of these stocks like CIB, which is the biggest commercial bank here in Egypt, went down significantly. It went down by almost 40 per cent, but it was on extremely low volumes, which to a great extent does not reflect how much it will really come down, or the true investor's appetite.

Did authorities intervene to try to staunch the losses?

When the decline exceeded 10 per cent, the session was halted and then resumed trading. Again, on the HFI it went down by 17.5 per cent. On the CASE30 index, the official Egypt exchange index, it went down by around 16.5 per cent.

Over the past few weeks, foreign investors have pulled out of the CASE in order to recoup losses at home. Did this trend continue on Tuesday or did we see a different kind of selling?

To a great extent it was a continuation of that trend. At the end of the day foreign investors were net sellers, institutional investors were net sellers, while retail investors and local investors were net buyers. So, yes, to a great extent, this is a continuation of that trend that started earlier this year.



Foreign investors have pulled out of the Egyptian stock market [EPA]

Did anyone see this coming?

I think the stock market continued to reveal unexpected trends. We expected, and I think the investor community at large expected, that the global equity market would suffer this year, and emerging markets, which are to a great extent exposed to the developed market, would come down in the context of global recession.

I'm not sure if anybody saw this magnitude coming, but I don't think anyone differed on the direction. Definitely you have the more optimistic and pessimistic investors looking at things differently, but I think both were looking a decline in the global equity market.

What is it going to take to revive the Egyptian market, and where is the money for that going to come from?

First of all, volatility in developed markets has to decrease tremendously. And you should see some kind of stabilization before this spreads into other emerging markets.

I think that will be initiated by institutional investors. But for this to happen, we need to reach the bottom. And if you look at the US and European markets today, it shows that we have not reached the bottom yet.

Obviously liquidity is not going to be the same while the whole world is recovering from a crisis in the financial markets. This time, unlike other crises that we've seen before, the financial sector is affecting liquidity, the balance sheets of banks, and everybody who can buy into the market.

We need to see some stabilisation, some positive economic data across the world. I think just before seeing this positive data we should see some appreciation in global equity pricing. Normally equity prices are a leading indicator of the status of the economy.

Egypt's central bank has repeatedly raised interest rates to curb record inflation over the past year. Will this slow the market's recovery?

Not really, because the correlation between interest rates and the local equity market has not been that strong. Equity - stocks - have not really reacted to increases or decreases in interest rates by the central bank. The lending-deposit ratio is still quite low and still you have plenty of liquidity in the system.

I don't think interest rates will necessarily impact recovery. I think what's more important is the global economic picture and the ability of the government to tackle issues of high inflation and budget deficit, which obviously weighs on sentiment on the economy as a whole.

What advice do you have for people with money in the Egyptian market or for people interested in investing in the region?

For those who are already invested in the market, my advice is, first of all, don't panic. That's what we normally tell investors: Don't panic, just wait and watch the trends, invest based on fundamentals.

For those who are into the market for a quick buck, to play the market, it might not be the right time to do so. You should be in the market looking for long-term gains and perhaps generous yields that compensate for waiting for a long time.

I would really relay the importance of investing based on fundamentals as opposed to speculative trading. In times of extreme volatility, like the time we're living in today, it would be very difficult - almost impossible - to make money over a short period.

How does this situation compare to the crash of 1987? Are there other precedents for a crash of this scale?

If you really want to compare it, maybe you can compare it to 1929. In 1987, a recession started before the world realised that, yeah, hey, we've got a recession on hand and then the global equity market starts coming down. It still did not impact all the asset classes. And again, with the dot.com bubble, it just impacted a certain asset class, but other classes were good and performed well.

In 1929, there was a debate - and there still is today - about what happened to bring about the recession that led to the Great Depression.

Today, the situation is basically that the world has taken more debt than it can digest. So the main reason for that is overstretching the borrowing capacity and excessively leveraging the system. This is the era of easy and loose finances coming to an end. We definitely are living history and we are going to see dramatic changes.

You have a lot of people with views like, could this be the end of the US dollar as the backing reserve currency for the rest of the world? We now know that it's just started.

The Egyptian exchange is now down 4,650 points, or 44 per cent, for the year. Do you expect we will see any long-term changes in the way the CSE operates as a result of the crashes?

It's important to understand that the CASE is just a regulatory entity. It facilitates the trade, but it cannot have a direct intervention in the trade or impact investor sentiment. It can help shape the financial trade by putting proper regulations in place.

There are some initiatives, like short-selling, derivative markets - with what's happening today, and people all over the globe putting holds on short-selling or banning short-selling, some of these initiatives maybe see a setback.

But it's not about CASE. It's not about Egypt. It's about the world as a whole, and it's about investors worldwide reassessing risk.

What does the crash say about the way emerging exchanges interact with developed markets?

The way it should be properly portrayed is that you generally have healthy capital markets, and these capital markets help mobilise funds throughout the world. So in the event of a severe problem in financial markets, this definitely will have an impact on investors' decisions worldwide.

So the way developed and developing economies work, the basic tie, is investment flows between both countries, between both markets, between both economies. But if you have a situation where there is paralysis in the global financial markets, this will definitely impact investments, especially if you have redemptions taking place at the level of emerging markets funds. This whole mess in the financial markets has to be cleaned up before business returns to normal.

Many Egyptians are poor, and the proportion invested in the CASE is still relatively small. What does the crash mean for the average Egyptian?

The history of the stock market in Egypt is pretty recent.

At the end of this, there are obviously winners and losers. It will have an impact on savings, on low-income earners who have few investments in the stock market. You find lots of them investing in speculative ideas because they lack the understanding of how to invest. I think this the time that they will want to re-approach this market in a more conscious, educated manner, and I think mutual funds and other funds will offer a solution for them.

Of course, those Egyptians who have found their fortunes slashed by 40, 50 or 60 per cent, may consider not coming back to the market. But we've seen it before: You always have the exuberance at the level of the retail investors extending the cycle toward the peak. That will continue to happen.

It's just a process of maturing taking place in the market with all these cycles. And of course media coverage of what's happening is something that did not exist here maybe 10 years ago.