Capital Market Development in North Africa: Current Status and Future Potential

Key Messages
- Overall the laws and regulations governing the stock markets of North Africa seem adequate, although in the case of the Egyptian exchange the minimum capital requirements for listing could be perhaps revised upwards.
- Many of the components for successful stock markets are absent in North Africa.
- There are few private pension funds in North Africa given the dominance of pensions for state employees that are largely financed by current contributions from governments and employees rather than returns from the invested funds.
- An examination of North African stock markets shows that the number of listed companies is adequate for a degree of portfolio diversification. However market capitalisation is low compared to other markets in the Middle East region.
- The ease of doing business indicators are also unfavourable for North Africa compared to the GCC, and the resultant uncertainty is damaging for the development of capital markets.
- Market indicators however present a more encouraging picture.

1. Introduction

Capital markets in North Africa have a long history but have been marginal to the region’s development. For the private sector to expand and flourish there is strong evidence which shows that the ability to raise equity finance is indispensable. However this investigation reveals the limited breadth and depth of the North African markets. Markets in sovereign and corporate bonds complement equity financing, but these are also underdeveloped in North Africa.

The study finds that legal and regulatory provision is for the most part adequate, but there has been an absence of confidence by both domestic and foreign investors. Transparency and corruption perceptions have been unhelpful, as have been the bureaucratic obstacles to doing business. Nevertheless market performance is encouraging despite the negative impact of the global financial crisis and the Arab Spring.

There is reason to be optimistic about future stock prices as markets have started to recover. Alternative markets with lower listing requirements for medium and small sized businesses already exist. A policy priority should be to get these markets working effectively as smaller businesses can contribute substantially to the employment generation the region so badly needs.

If priority is to be given to capital market development corporate and transaction tax issues should be reviewed. Currency convertibility and controls over capital movements are also matters for consideration. Much of the policy debate in North Africa has focused on foreign direct investment rather than portfolio investment flows. There is a strong case for the debate being widened.

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The following are thanked for their contribution: Diabaté Alassane (Principal Country Economist, ORNB), Kevin Lumbila (Senior Economist, OSGE) and Kaouther Abderrahim (Economist, ORNA). Traduction by CLSD.

The analysis and findings of this report reflects the opinions of the authors and not those of the African Development Bank Group, its Board of Directors or the countries they represent.
2. The context

Although the Alexandria Stock Market was the pioneering exchange in the Mediterranean dating from 1883, developments in North Africa during the twentieth century lagged well behind those in Europe. This mattered as the absence of equity and bond markets with depth and breadth restricted corporate financing possibilities and limited business development. The inability to raise equity capital and stable long term funding through bond issuance has arguably been a serious impediment to the development of the private sector in North Africa.

The academic literature on whether stock markets are helpful for development is generally supportive. Ajit Singh found that stock markets contributed significantly to both internal and external liberalisation in successful developing countries. They also provided a vital source of capital in countries where high interest rates resulted in financial repression, the evidence suggesting that stock markets could offset such repression. With bank credit interest is invariably priced to reflect the possibility of default, the paradox being that high interest makes default more likely. In contract with equity finance it is the investors who are taking the risk, but also benefiting from superior returns if the company is performing well through dividends and ultimately capital gains. Ross Levine and Sara Zervos found that stock markets complemented bank finance, market liquidity being an important factor in promoting economic growth, capital accumulation and productivity improvement. Market size and price volatility appeared not to be significant, an encouraging finding for North Africa given the volatility of stock prices and limited size of markets in the region.

Equity market growth is seen by Geert Bekaert, Campbell Harvey and Christian Lundblad as an outcome of economic liberalisation policies which helps development, provided other preconditions such as a well educated population are present. These facilitating factors have prompted researchers to look at the relationship between stock market growth and economic development from a wider perspective to understand its complexities. Given this Arestis, Demetriades and Luintel questioned how significant stock markets are in facilitating economic development arguing that banks are more important. They argued that the highly aggregated time series data used in these earlier studies may have resulted in findings that exaggerated the role of stock markets in development. There is insufficient data in North Africa to take this work forward in a regional context, but this wider literature suggests some of the factors that should be taken into account in determining the parameters for the study. Those studies that have been conducted on the Middle East do not attempt to question the link between stock market growth and economic development, but rather focus on how the link can be improved through smarter policies. Mohammed Omran and Ali Bolbol argued that for the Arab World domestic liberalisation should precede measures to attract foreign investors and that the aim of financial reforms should be to create a level playing field for both domestic and foreign investors.

2.1. Research questions

The aim of this project is to examine the listing criteria and regulation of the stock exchanges in Cairo, Casablanca, Tunis and Tripoli and to analyse trading volumes and price trends. Are the criteria for listing too strict, discouraging new listings or are they too lax, permitting shares which are little traded to be listed and raising doubts over market liquidity? Is there a sufficient choice of stock to facilitate portfolio diversification within each North African market or across all three markets? Is there too much stock concentration in a few segments such as construction and insufficient industrial and agricultural stock?

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2.2. Implications

These issues are of particular interest to fund managers and institutional investors such as insurance providers and pension funds both within the region and outside. The capital markets of North Africa are open to outside investors and there have been portfolio investment flows from the Gulf Cooperation Council countries as well as from Europe. Local brokerage firms such as EGF Hermes in Cairo manage some of these flows but others are managed externally, examples being the Riyadh based Jadwa Arab Markets Fund and the Bahrain based Global Egypt Fund.


There has been increased investor interest in more rapidly growing emerging markets than in the sluggish or flat developed markets since the global financial crisis of 2008. Unfortunately despite its geographical proximity to Europe, and the common language and culture with the oil rich Gulf economies, North Africa has attracted little private capital, and has been viewed as rather marginal by many investors. The uncertainty since the Arab Spring has adversely affected stock prices in North Africa and further damaged investor confidence. Nevertheless with North African listed stock arguably undervalued it is a good time to consider prospects. With political risk and the current weak economic fundamentals already reflected in stock prices, there is a reasonable possibility of gains as normal economic conditions are restored. Stock markets in North Africa functioned well before the Arab Spring, but although there was audited financial reporting, corporate governance in many of the companies listed could have been of a higher standard. The rankings of agencies such as Transparency International affect foreign investor perceptions. In this research consideration is given to transparency issues and how improvements can be made so that North Africa can attract a greater share of emergent market investment.

3.1. International comparisons

The proposed study also has a comparative dimension, as the development and role of stock markets in North Africa is compared with that of the Istanbul Stock Exchange, the most active in the Mediterranean region, and the Saudi Arabian Stock Exchange, the largest in the Arab World in relation to the economy it serves. What can the exchanges in North Africa learn from the experiences of Turkey, a country with a comparable population size to Egypt, Saudi Arabia, the largest Arab stock market, and Jordan, a frontier capital market comparable in some respects with Tunisia?

The market capitalisation of stock exchanges in North Africa is shown in table 1 which provides time series data for the December 2004 – December 2011 period which includes the Arab Spring. The data includes Egypt and Morocco which are full members of the World Federation of Exchanges and data from Tunisia which is not a member. The Tunisian figures were taken from the Bourse de Tunis and converted into US dollars at the exchange rate prevailing in December of each year. Libya is also not a member of the World Federation of Exchanges, as its stock market was only established in 2006 and only limited data is available. Its market capitalisation on the eve of the revolution in January 2011 was $31,112 million, higher than that of Tunisia and comparable to Jordan. The Libyan market was largely illiquid however, with little trading and only 12 companies listed. There is insufficient data to examine its capitalisation since inception and hence Libya is not included in table 1.

Table 1: Comparative market capitalisation of North African exchanges, $ million, end of year

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Egypt</td>
<td>38,533</td>
<td>79,509</td>
<td>93,496</td>
<td>139,274</td>
<td>85,978</td>
<td>91,207</td>
<td>84,277</td>
<td>48,602</td>
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<tr>
<td>Morocco</td>
<td>25,064</td>
<td>27,220</td>
<td>49,360</td>
<td>75,494</td>
<td>65,854</td>
<td>64,478</td>
<td>69,152</td>
<td>60,087</td>
</tr>
<tr>
<td>Tunisia</td>
<td>2,365</td>
<td>2,944</td>
<td>4,091</td>
<td>4,046</td>
<td>5,146</td>
<td>7,580</td>
<td>9,435</td>
<td>8,960</td>
</tr>
<tr>
<td>Jordan</td>
<td>18,383</td>
<td>37,644</td>
<td>20,729</td>
<td>41,216</td>
<td>35,895</td>
<td>31,826</td>
<td>30,864</td>
<td>27,183</td>
</tr>
<tr>
<td>Turkey</td>
<td>98,799</td>
<td>161,538</td>
<td>162,398</td>
<td>266,571</td>
<td>118,329</td>
<td>233,996</td>
<td>307,012</td>
<td>197,074</td>
</tr>
</tbody>
</table>

financial crisis of 2008. Subsequently the Casablanca market largely recovered, but for Egypt the decline was greater and the subsequent recovery weaker in the period leading up to the revolution which brought an even greater fall. The smaller Tunisian market was only marginally affected by the global financial crisis and enjoyed six years of growth prior to its revolution.

The stock markets of North Africa are very small compared to the two largest markets in the Middle East, those of Turkey and Saudi Arabia. Egypt before the 1952 revolution had the largest stock market in the Arab World, but the nationalisation of most of the listed companies under Nasser’s rule resulted in its demise. Meanwhile the rise of Saudi Arabia as the world’s largest oil exporter, with much more supportive policies towards the private sector, encouraged stock market development, which has contributed significantly to the diversification of the Kingdom’s economy. This is also the case in Turkey, whose economic success many in Egypt seek to emulate. The ability to raise equity capital has facilitated the development of its vibrant industrial sector, with 174 manufacturing companies listed.

### 3.2. Market breadth

The number of companies listed provides a measure of the breadth of a stock market, the larger the number the greater the breadth. This facilitates investors being able to have a more diversified portfolio to mitigate risk, which is especially important for institutional investors such as insurance companies, mutual funds and pension providers. The number of companies listed is also affected by the strictness of the listing requirements, as very demanding requirements may result in private companies being unwilling to enter the market, or those already listed to leave the market. This is what happened in Egypt as table 2 shows, as there was little secondary trading in the shares of many of the almost 800 companies listed in 2004. This resulted in the value of a listing being reduced, as the market could not be tapped for new capital. Once financial reporting requirements were increased, many companies decided to delist rather than incurring further costs for little possibility of benefits. This occurred especially with the companies privatised after 1990 in Egypt as the artificially low prices of the initial public offerings resulted in favourable price earnings ratios and high yields, but over time these declined once the initial offer effect wore off, resulting in investors losing interest in the stock.

**Table 2: Number of companies listed on North African exchanges in comparative perspective**

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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Egypt</td>
<td>795</td>
<td>744</td>
<td>595</td>
<td>435</td>
<td>373</td>
<td>313</td>
<td>228</td>
<td>234</td>
</tr>
<tr>
<td>Morocco</td>
<td>53</td>
<td>54</td>
<td>63</td>
<td>73</td>
<td>77</td>
<td>76</td>
<td>74</td>
<td>75</td>
</tr>
<tr>
<td>Tunisia</td>
<td>44</td>
<td>45</td>
<td>48</td>
<td>51</td>
<td>50</td>
<td>52</td>
<td>56</td>
<td>57</td>
</tr>
<tr>
<td>Jordan</td>
<td>192</td>
<td>201</td>
<td>227</td>
<td>245</td>
<td>262</td>
<td>272</td>
<td>277</td>
<td>247</td>
</tr>
<tr>
<td>Turkey</td>
<td>297</td>
<td>304</td>
<td>316</td>
<td>319</td>
<td>317</td>
<td>315</td>
<td>339</td>
<td>264</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>73</td>
<td>77</td>
<td>86</td>
<td>111</td>
<td>127</td>
<td>135</td>
<td>146</td>
<td>149</td>
</tr>
</tbody>
</table>


Despite the reduction in the number of companies listed in Egypt, with over 200 remaining there is sufficient stock available for institutional investors to build diversified portfolios. The average size of company listed in 2010 was only $370 million in terms of market capitalisation compared with $934 million in Morocco, although this was higher than the average for Tunisia of $189 million. Smaller companies with lower market capitalisation are usually regarded as more risky than large companies. In the case of Tunisia the market was also excessively concentrated, with over 70 per cent of market capitalisation accounted for by banks, insurance and investment companies whereas only 7.4 per cent was accounted for by manufacturing. The market was better balanced in Morocco, as although the banks accounted for almost one third of market capitalisation the other two thirds was diversified with telecommunications accounting for 23 per cent of market capitalisation, property developers 13 per cent and industry 4 per cent, admittedly a disappointingly low number. Egypt’s market is less dominated by banks, largely because the major banks remain in state ownership. There are 17 industrial stock listed, including engineering companies, an Egyptian strength, 4 telecommunications companies, including the Cairo based multinational company Orascom, and 3 technology companies.

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9 The 2010 figures are used for this comparison as the 2011 figures were distorted by the fall in stock values with the Arab Spring and are arguably less representative.
3.3. Market depth

The depth and liquidity of a stock market can be measured by the value of transactions, a low value indicating little buying and selling activity and therefore difficulty in disposing of significant amounts of stock without an adverse effect on prices\textsuperscript{13}. Egypt is by far the most active market in North Africa in terms of buying and selling activity as table 3 shows, indeed transactions peaked in 2008 during the global financial crisis, although much of the activity was instigated by sellers. In 2010 trading was more subdued, despite a substantial improvement in market conditions. The following year trading fell dramatically with the Arab Spring. Transactions were well below those in the largest regional markets in Istanbul and Riyadh. On the positive side transactions volatility was much less marked than in Saudi Arabia where a major speculative bubble burst in 2007 despite the continuing strength of the oil market which should have helped the Kingdom.

Table 3: Relative value of market transactions of North African exchanges, $ million

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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Egypt</td>
<td>6,513</td>
<td>26,241</td>
<td>48,084</td>
<td>60,196</td>
<td>93,476</td>
<td>73,474</td>
<td>38,210</td>
<td>16,132</td>
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<tr>
<td>Morocco</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>4,445</td>
<td>6,146</td>
<td>4,914</td>
</tr>
<tr>
<td>Tunisia</td>
<td>529</td>
<td>1,274</td>
<td>3,431</td>
<td>1,348</td>
<td>3,318</td>
<td>2,671</td>
<td>2,898</td>
<td>1,163</td>
</tr>
<tr>
<td>Jordan</td>
<td>5,350</td>
<td>23,816</td>
<td>20,054</td>
<td>17,427</td>
<td>28,960</td>
<td>12,897</td>
<td>8,599</td>
<td>3,898</td>
</tr>
<tr>
<td>Turkey</td>
<td>146,605</td>
<td>200,858</td>
<td>222,724</td>
<td>294,295</td>
<td>247,833</td>
<td>301,122</td>
<td>410,609</td>
<td>412,911</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>472,941</td>
<td>1,103,534</td>
<td>1,403,048</td>
<td>681,948</td>
<td>523,327</td>
<td>335,146</td>
<td>201,212</td>
<td>291,432</td>
</tr>
</tbody>
</table>


3.4. Performance measures

The two most important metrics for listed shares are price earnings ratios and yields, the latter providing a measure of performance. Investors pay particular attention to price earnings ratios, a low ratio indicating that the shares are good value for those interested in earnings and a high ratio indicating that the management has been successful in adding to shareholder value through significant capital gains. There has long been debate about what determines price earnings ratios and their relationship with share performance\textsuperscript{13}. Table 4 shows that price earnings ratios are moderate for Egypt and Morocco, with no discernible trend in the case of the former. They are broadly in line with the ratios for Turkey and Saudi Arabia, and are certainly not as stretched as those in Jordan which are unlikely to be sustainable.

Table 4: Comparative Price Earnings Ratios of stock listed on North African exchanges

<table>
<thead>
<tr>
<th>Country</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Egypt</td>
<td>13.0</td>
<td>22.0</td>
<td>13.6</td>
<td>15.7</td>
<td>9.3</td>
<td>11.0</td>
<td>14.7</td>
</tr>
<tr>
<td>Morocco</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>15.1</td>
<td>N/A</td>
</tr>
<tr>
<td>Jordan</td>
<td>N/A</td>
<td>N/A</td>
<td>16.7</td>
<td>28.0</td>
<td>18.8</td>
<td>14.4</td>
<td>26.3</td>
</tr>
<tr>
<td>Turkey</td>
<td>13.3</td>
<td>19.4</td>
<td>14.9</td>
<td>12.0</td>
<td>5.8</td>
<td>17.9</td>
<td>13.4</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>17.3</td>
<td>15.3</td>
</tr>
</tbody>
</table>


The dividend yield measures the dividend divided by the price per share, usually expressed as a percentage. Companies pay dividends to provide a return to investors, especially where capital gains are minimal or zero, as this helps placate shareholders and encourages them not to sell their shares. Often rapidly expanding companies do not pay dividends as profits are retained to finance investment, whereas mature companies with predictable income streams, such as utility providers, focus on dividends. The relationship between dividend yields and expected stock returns has long been a subject of debate with most researchers finding that the relationship is long term\textsuperscript{14}, although there are disagreements on what are the best techniques to use for predictions\textsuperscript{15}.

Limited data is available for stock yields for the markets of the Middle East and North Africa. Table 5 shows that yields are higher for Egypt and Morocco than for Jordan, Turkey and Saudi Arabia, the differences perhaps being explained by the need to compensate for relative risk perceptions. Yields in Egypt have been even higher historically, peaking in 2007, just before the global financial crisis\textsuperscript{16}.

Table 5: Comparative stock yields on North African exchanges, %

<table>
<thead>
<tr>
<th>Country</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
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</thead>
<tbody>
<tr>
<td>Egypt</td>
<td>6.9</td>
<td>3.8</td>
<td>14.8</td>
<td>17.0</td>
<td>14.7</td>
<td>4.4</td>
<td>3.7</td>
</tr>
<tr>
<td>Morocco</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>4.2</td>
<td>3.6</td>
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<tr>
<td>Jordan</td>
<td>N/A</td>
<td>N/A</td>
<td>2.3</td>
<td>1.8</td>
<td>2.5</td>
<td>2.7</td>
<td>2.6</td>
</tr>
<tr>
<td>Turkey</td>
<td>1.4</td>
<td>1.7</td>
<td>2.1</td>
<td>1.9</td>
<td>4.9</td>
<td>2.7</td>
<td>2.1</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>3.9</td>
<td>2.3</td>
<td>2.7</td>
</tr>
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</table>


The revolutions in Egypt and Tunisia not surprisingly had an adverse effect on stock prices as uncertainty resulted in investor panic. The stock market in Egypt was closed for business from 27th January until 23rd March 2011 in a pre-emptive move by the authorities following a sudden fall of 15 percent in the EGX30. In Libya the uprising and virtual civil war also resulted in the closure of the market, although as the exchange was in the very early stages of development the suspension of secondary market activity had little impact on what was in any case an illiquid market.

The performance of the EGX300 and the TUNINDEX following the revolutions is shown in figure 1. Initially both indices fell, the decline being more marked and rapid in Egypt. It can be debated whether the temporary closure of the market in Egypt worsened the decline in Egypt as overnight investors stock holdings became illiquid. However in the circumstances the authorities arguably had little choice.

**Figure 1: Performance of the Egyptian and Tunisian stock markets following the Arab Spring**

![Performance of the Egyptian and Tunisian stock markets following the Arab Spring](image)

Source: Egypt Exchange and Bourse de Tunis

One year after the revolution in Tunisia the all share index was only marginally below its level of December 2010 indicating that market sentiment had recovered and there was more optimism for the future with the democratic election of a new government with a legitimate mandate. In Egypt the political movement was slower with the military running the country provisionally and an unelected technocratic government appointed following the fall of the Mubarak regime. However once the parliamentary elections were satisfactorily concluded with a decisive popular mandate for the successful parties, market confidence started to return. The smooth outcome from the presidential election was also viewed positively, although concerns remain about the role of the military, the drafting of the constitution and the role of the judiciary. It is apparent, but not surprising, that political developments have largely shaped market sentiment following the revolutions rather than economic fundamentals. It is likely, indeed inevitable, that it will be economic fundamentals that once again drive the markets once the political situation settles and the new governments focus on the difficult economic policy choices. Encouragingly, the parties who fared best in the elections, including the Islamist parties, favour market solutions to revive the economies.

### Table 6: Relative index performance of leading stock listed on North African exchanges, end of year data

<table>
<thead>
<tr>
<th>Country</th>
<th>Index</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
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<td>Egypt</td>
<td>EGX30</td>
<td>2,567</td>
<td>6,324</td>
<td>6,973</td>
<td>10,550</td>
<td>4,596</td>
<td>6,208</td>
<td>7,142</td>
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<td>MASI</td>
<td>4,522</td>
<td>5,539</td>
<td>9,479</td>
<td>12,695</td>
<td>10,984</td>
<td>10,444</td>
<td>12,655</td>
</tr>
<tr>
<td>Tunisia</td>
<td>Tunindex</td>
<td>1,332</td>
<td>1,615</td>
<td>2,331</td>
<td>2,614</td>
<td>2,892</td>
<td>4,292</td>
<td>5,112</td>
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<tr>
<td>Jordan</td>
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<td>N/A</td>
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<td>3,675</td>
<td>2,758</td>
<td>2,533</td>
<td>2,373</td>
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<td>Turkey</td>
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<td>39,117</td>
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<td>26,864</td>
<td>52,825</td>
<td>66,004</td>
</tr>
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<td>Saudi Arabia</td>
<td>TASI</td>
<td>8,206</td>
<td>16,712</td>
<td>7,933</td>
<td>11,039</td>
<td>4,803</td>
<td>6,122</td>
<td>6,621</td>
</tr>
</tbody>
</table>


The movement of the indices shown in table 6 are of course consistent with the market capitalisations shown in table 1. The EGX30 index peaked in 2007 prior to the global financial crisis as did the MASI index for Morocco the ASE for Jordan and the TASI for Saudi Arabia. The latter had recovered somewhat from the bursting of the asset price bubble the previous year but has never recovered its 2005 value despite the buoyancy of oil revenues and the resultant government spending which has stimulated the Kingdom’s economy. Generally the relationship between how the stock market indices are performing and domestic economic activity appears to be weak for the markets of North Africa and the Middle East. External factors in the global economy are arguably more important, and the performance of the Egyptian and Moroccan markets appears to have been highly correlated with stock market developments in the nearby European Union. Turkey’s strong recovery during a period of much poorer performance in the European Union, from the global financial crisis reflected its high GDP growth however once the parliamentary elections were satisfactorily concluded with a decisive popular mandate for the successful parties, market confidence started to return. The smooth outcome from the presidential election was also viewed positively, although concerns remain about the role of the military, the drafting of the constitution and the role of the judiciary. It is apparent, but not surprising, that political developments have largely shaped market sentiment following the revolutions rather than economic fundamentals. It is likely, indeed inevitable, that it will be economic fundamentals that once again drive the markets once the political situation settles and the new governments focus on the difficult economic policy choices. Encouragingly, the parties who fared best in the elections, including the Islamist parties, favour market solutions to revive the economies.

### 3.5. The impact of the Arab Spring

The revolutions in Egypt and Tunisia not surprisingly had an adverse effect on stock prices as uncertainty resulted in investor panic. The stock market in Egypt was closed for business from 27th January until 23rd March 2011 in a pre-emptive move by the authorities following a sudden fall of 15 percent in the EGX30. In Libya the uprising and virtual civil war also resulted in the closure of the market, although as the exchange was in the very early stages of development the suspension of secondary market activity had little impact on what was in any case an illiquid market.

The performance of the EGX300 and the TUNINDEX following the revolutions is shown in figure 1. Initially both indices fell, the decline being more marked and rapid in Egypt. It can be debated whether the temporary closure of the market in Egypt worsened the decline in Egypt as overnight investors stock holdings became illiquid. However in the circumstances the authorities arguably had little choice.

The extent to which the issuance and trading of bonds facilitates economic development has long been a matter of debate. New issuance can aid productive investment, but many express doubts about how far secondary and tertiary market activity helps development. Others see a link between market liquidity and economic development as liquidity can be used to take advantage of investment opportunities and improve resource allocation.

Bond issuance has been very limited in North Africa apart from in Egypt where bonds have a long history and increasing amounts of funds were raised by local currency issuance from 2008 onwards as Table 7 shows. There has only been one corporate bond issuance in Egypt and two from state owned entities. The others are all government issues, with 41 treasury bonds, 49 government housing bonds and 59 development bonds outstanding 2012.

Table 7: Relative value of bonds listed on North African exchanges, $ million, end of year

<table>
<thead>
<tr>
<th>Country</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Egypt</td>
<td>4,793</td>
<td>9,063</td>
<td>11,269</td>
<td>0</td>
<td>14,310</td>
<td>24,471</td>
<td>37,350</td>
</tr>
<tr>
<td>Morocco</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>1,807</td>
<td>1,762</td>
<td></td>
</tr>
<tr>
<td>Jordan</td>
<td>0</td>
<td>0</td>
<td>3,510</td>
<td>4,964</td>
<td>6,260</td>
<td>8,303</td>
<td>8,924</td>
</tr>
<tr>
<td>Turkey</td>
<td>135,162</td>
<td>187,537</td>
<td>190,985</td>
<td>254,351</td>
<td>219,389</td>
<td>263,608</td>
<td>280,882</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>7</td>
<td>116</td>
<td></td>
</tr>
</tbody>
</table>


Some of the development bonds have very long maturities extending to 2019, but perhaps surprisingly one of the treasury issues extends even longer to 2025, and it is clear from the maturities that these financing instruments are not short term treasury bills as might be expected. There is no secondary trading in Egyptian bonds most been held by the state owned banks and other financial institutions. To a considerable extent increasing bank holdings of treasury bonds resulted in reduced advances to the private sector as is apparent from the balance sheets of the leading Egyptian banks. Hence it could be argued there was a crowding out effect with government debt issuance being at the expense of resources being allocated to the private sector, an undesirable outcome.

Unlike in Egypt where virtually all bonds are sovereign issuances, in Tunisia the market has been wholly corporate bonds. Most of these bonds have been issued by banks and leasing companies, with 13 issues in 2010 worth $345 million. There is little bond trading, 356 transactions being recorded in 2010 worth $50 million, and the market became largely illiquid in 2011 following the revolution. As Tunisia has only observer status with the World Federation of Exchanges no time series data is available for bond issuance and trading. Morocco is included as Table 7 shows, but bond issuance only started in 2009 and is only a minute proportion of the issuance in Egypt with no trading or market liquidity. It is apparent that bond markets are underdeveloped in North Africa in comparison to Turkey with Tunisia and Morocco needing sovereign issuances to provide local currency pricing benchmarks and Egypt needing corporate issuances.

The Egyptian authorities are planning a sukuk issuance worth $2 billion to augment IMF assistance which is being sought for $3.2 billion. Since the revolution the government deficit has increased substantially and it is estimated that additional borrowing of $10 to $12 billion is required. While much of the borrowing is financed through treasury bills and bond issuance the cost of this has increased.

20 Bank Misr, Annual Report, Cairo, 2010, p. 37
22 Ibid., p. 55.
23 Mirna Sleiman and Andrew Torchio, “Egypt prepares to sell $2 billion Islamic bonds”, Reuters, Dubai, 14th February 2012
24 Reem Abdellatif, “Budget deficit widens as analysts blame lack of political will”, Daily News Egypt, Cairo, 25th December 2011.
as interest rates and inflation have risen. The issuance of sukuk can widen financing possibilities by tapping new funding sources, including both local investors seeking to have Sharī'ah compliant portfolios and Egypt’s Islamic banks, which cannot hold interest yielding bonds or treasury bills. Another aim is to attract Islamic funding from the Gulf countries where there are much larger Islamic financial institutions potentially willing to take on North African exposure provided the expected returns are sufficient to compensate for the perceived risks.

Islamic finance should not be seen as a cheaper alternative to IMF funding, indeed it is more expensive, but on the other hand it is less intrusive as Islamic banks do not seek to impose structural adjustment measures or otherwise interfere with domestic macroeconomic policy. If Egypt does proceed with the sukuk issuance it could set a precedent for Tunisia and possibly Morocco. Tunisia has already had discussions about offering a sovereign sukuk with an issuance likely in 201325.

25 Mirna Sleiman, “Tunisia planning to issue Islamic bond”, Reuters, Bahrain, 29th February 2012.
5. Mutual Funds

Much of the investment in the stock exchanges is by individuals of high net worth as institutional investment is less developed, with insurance companies and pension funds, the most significant sources for such investment, remaining underdeveloped. Mutual funds are a potentially important means of bringing investors of more modest means to the market\(^{26}\). This can involve both equity based funds and those providing portfolios of corporate or sovereign bonds. In some Arab countries, notably Saudi Arabia and Kuwait, mutual funds have become very popular investment vehicles for millions of middle class families, but in North Africa there is less awareness of mutual funds and the financial benefits they can bring while keeping risk to acceptable levels.

In Morocco major banks offer mutual funds as savings products to their clients, including expatriate local citizens who have significant funds to invest. Banque Populaire, the country’s second largest bank, offers four closed ended funds, which are branded Al Iddikhar Chaabil, with maturities of 3 to 7 years. Attijariwafa Bank, the leading bank in Morocco and seventh largest in Africa, also offers a five year investment plan for its retail and private bank clients in Morocco and Mauritania\(^{27}\). Although the funds are placed in equity and bonds through these schemes in Morocco, they lack the flexibility of open ended mutual funds and there is no standardised and transparent reporting of historical investment performance.

Tunisia has few local funds but Amen Bank, the largest private bank in the country, offers a fund that invests in equities and bonds. However the fund lacks a detailed prospectus and there is no information on historical performance. Fidelity, the world’s largest fund management group, established an office in Tunisia in July 2010, one of a global network of 24 countries from which the group operates. Over 60 staff were recruited to work on back office operational processes, supporting primarily the United Kingdom’s mutual funds business and providing IT support for Fidelity’s global employee base\(^{28}\). This is exactly the type of employment that Tunisia needs for its young well educated workforce and Fidelity has plans to create 500 jobs, but the timetable will depend on the new government maintaining stability. Part of the value of having mutual funds is that it educates investors on how to manage market risk and encourages a culture where there is greater interest in business performance and the private sector more generally.

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6. Alternative Markets

Many small businesses find the reporting requirements of being listed in stock markets too onerous and costly. This results in family businesses often remaining private and only able to access debt capital or private equity. Although the latter can help business development it is illiquid and inflexible, and there is no market valuation of the enterprise. Many stock exchanges have encouraged the development of alternative markets as a type of half-way house to a full listing on the major exchange. Firms listed on alternative investment markets tend to have better corporate governance than wholly private companies and become more aware of principal agency and moral hazard issues. Hence being listed on an alternative market is a valuable learning experience, in addition to the market being a welcome source for risk capital.

The first mid and small cap market established in the Middle East and North Africa region was Nilex, the Nile Exchange, which opened for business in 2007. By 2012 there were 19 companies listed on the market, with the first two listed in 2008 followed by four in 2009, eight in 2010 and four in 2011. The annual listing fees levied on medium and small enterprises are reduced to L.E. 0.5 per L.E. 1,000 of the capital with a minimum of L.E 500 and a maximum of L.E 30,000. Not surprisingly the Arab Spring and its aftermath undermined market confidence, but by 2012 there was active trading in seven of the companies listed including information technology, medical and investment companies. There are 35 nominated advisors who can guide companies through the listing process.

An alternative market is also being established in Tunisia. There is no minimum capital requirement for listing but companies should have a clear business plan and be able to demonstrate that they have secure management reporting systems in place. Companies approved for listing should have at least one hundred shareholders and ownership should not be concentrated. Firms which successfully list are subject to a reduced rate of corporation tax of 20 per cent for a five year period.

There are two alternative exchanges in Morocco, the Development Market, where medium sized companies can seek a listing, and the Growth Market, designed for small companies. There are 18 companies listed on the Development Market and 12 listed on the Growth Market. Details of the listing requirements for these markets are discussed in the section on listing. To date none of the alternative markets in North Africa has achieved viability in terms of liquidity and trading, although if Nilex and the Casablanca markets become more active, and the Tunisian market actually open for business, there will be widening options for investors.

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30 LE = $0.166
7. Stock market liberalisation

All the North African stock markets are state owned but the key stakeholders are the brokerage firms which are members of the exchanges and the regulatory authorities which are represented on the boards of directors. In practice ownership has not been an issue as there is no direct government involvement and there has not been much debate about whether the stock markets should be privatised. The example of NASDEQ Dubai provides an alternative model as this involves partial foreign ownership and branding. The ambitious aim was to rebrand the Dubai International Financial Exchange to make it the leading market between Europe and East Asia, but the amount of business attracted was limited, partly because its launch coincided with the global financial crisis. NASDEQ Dubai has subsequently outsourced its trading and operational functions to the Dubai Financial Exchange, the local market.

This illustrates the difficulties with the internationalisation of financial markets and why in the case of North Africa it is unlikely that any of the markets could become global, or even regional, hubs.

Empirical studies of emerging markets show that the liberalisation of stock exchanges lowers the costs of capital if foreign inflows are allowed. The markets of North Africa have no restrictions on foreign capital inflows, but in practice these have been limited partly because outside investors, including those from the Arab surplus capital countries of the Gulf, know comparatively little about the markets. In addition it is suggested that Arab investors focus on making capital gains from equity holdings rather than income. Consequently income from Arab listed companies is often not related to investment which reduces the pressure to pay dividends. One source of potential capital is expatriates from North Africa working in professional occupations in the Gulf as doctors, dentists or in the financial services sector. There is little evidence however that such professionals are investing in their home countries apart from in real estate.

The sovereign wealth funds in the Gulf have broadened their investment horizons in recent years and are now less conservative than in the past when a high proportion of their funds were in United States treasury bills and Western government bonds. For over a decade they have invested in equities but little of this investment has been into North Africa. Sovereign wealth funds are potentially interested in their own regions given cultural similarities. This does not seem however to have benefited the Cairo or Casablanca markets with greater outflows of Gulf capital to Asian markets such as Hong Kong and Singapore.

There has been more direct rather than portfolio investment from the Gulf to North Africa, much of this involving real estate and tourist developments. The real estate company Emaar, which is listed on the Dubai stock market, has invested heavily in its subsidiaries, Emaar Misr in Egypt and Emaar Morocco. There has been no attempt to raise local capital however by seeking cross listings on the Cairo or Casablanca stock exchanges. The institutional capacity exists to facilitate such listings, with firms such EGF Hermes, the leading regional investment bank, very interested in this type of business opportunity. EGF Hermes itself has listings on both the Egyptian and London stock exchanges.

7.1. The legal and Regulatory Environment

There is comprehensive legal provision governing stock market activity in North Africa and detailed regulatory requirements. In Egypt the rules for listing and de-listing were substantially revised in 2002 by the Capital Market Authority, the regulatory body. As in the norm internationally all listed securities must be lodged in the Central Depository and there can be no restrictions on the securities being traded. The penalty under Article 3 for non-disclosure of information that could damage the interests

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39 http://www.efg-hermes.com/English/AboutUs.aspx?PageID=41&h=1
40 Capital Market Authority, Securities Listing and De-Listing Rules of the Cairo and Alexandria Stock Exchanges, Decree Number 30, Cairo, June 18th 2002.
of shareholders, L.E. 5,000, seems rather modest, as is also the case with the fine of L.E. 500 for late disclosure of up to 5 working days and the subsequent fine of L.E. 100 per day. Under Article 4 the names, nationality, private and business addresses and qualifications and experiences of all members of the Board of Directors have to be disclosed, as is also the case for any shareholder owning more than 5 per cent of the total capital of the company and all senior executives. In order to obtain a listing in Egypt the firm must supply details of the major business contracts it has signed in the two years prior to the listing application. The company must appoint an Audit Committee responsible to the Board of Directors whose responsibilities are spelt out under Article 7 of Listing Rules. A major responsibility is to ensure that any recommendations of the independent auditors are implemented by the company management. Article 9 stipulates that any company seeking a listing shall offer a minimum of 30 per cent of its shares for public subscription, with this percentage also applying to investment certificates and bonds offered. Any bonds issued should have a minimum credit rating of BBB-. The minimum issued capital for listed companies is L.E. 20 million, a relatively modest amount by international standards. Net profits for the fiscal year prior to the listing application should not be less than 5 per cent of the paid-in capital. Detailed disclosure requirements are stipulated in the Egyptian Listing Rules. A copy of the audited annual financial statement should be lodged with the Stock Exchange within 10 days of it being approved by the company’s General Assembly. Quarterly financial statements should be lodged with the Stock Exchange in conformity to Capital Market Authority requirements within 45 days of the end of the quarter. Under Article 24 any change in investment policies involving the opening or closure of the company’s branches or switches from ownership to leasing should be disclosed. New purchases of company shares in Egypt by strategic investors seeking to acquire a degree of control should also be declared. Article 27 provides for the announcement of news which could be detrimental to shareholders interests, which should be announced in cooperation with the Stock Exchange outside trading hours so that investor panic is avoided. Article 30 covers the announcement of dividends in the form of cash or bonus shares which should follow immediately after the payments are authorised by the company’s general assembly. De-listing is covered in Article 34, with suspension occurring if incorrect or misleading information is provided or if there is no trading in the company’s shares over a six month period.

The conditions for being listed on the Tunisian Exchange are similar to those in Egypt with the major legislation passed in 1994 with substantial amendments in 1999, 2005 and 2009. Audited accounts must be submitted for the two years prior to the listing being sought and at least 10 per cent of the capital should be offered to the public, a much smaller proportion than in Egypt. A prospectus must be produced together with a report on business activity and a business plan for the next five year period. This is not required in Egypt, but there is merit in looking to the future rather than only recording the past. The minimum capital required for a listing is TD 3 million, a much higher threshold than in Egypt.

The listing requirements for the markets in Morocco are shown in Table 8 where, as already indicated, there are two alternatives to the Main Market: the Development Market and the Growth Market, the latter designed for small companies who seek to move beyond having funding from private equity investors and venture capitalists. The financial reporting requirements for listing are less for the Development and Growth Markets with fewer statements demanded and less detailed financial information. There is no minimum equity requirement, a lower number of listed shares stipulated and a much lesser value for the shares. For the Main Market the minimum capital requirement is much higher than in Cairo but less than one third of the requirements in Tunisia.

Table 8: Listing requirements in Morocco

<table>
<thead>
<tr>
<th>Company profile</th>
<th>Main Market</th>
<th>Development Market</th>
<th>Growth Market</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minimum equity</td>
<td>MAD 50 million</td>
<td>No limit</td>
<td>No limit</td>
</tr>
<tr>
<td>Minimum sales</td>
<td>None</td>
<td>MAD 50 million</td>
<td>None</td>
</tr>
<tr>
<td>Years of certified accounts</td>
<td>3</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Consolidated financial statement</td>
<td>Yes</td>
<td>Optional</td>
<td>Optional</td>
</tr>
<tr>
<td>Minimum number of shares issued</td>
<td>250,000</td>
<td>100,000</td>
<td>30,000</td>
</tr>
<tr>
<td>Minimum value of listed shares</td>
<td>MAD 75 million</td>
<td>MAD 25 million</td>
<td>MAD 10 million</td>
</tr>
</tbody>
</table>

Source: Casablanca Stock Exchange
Note: 1 MAD = $0.12

Regulatory best practice is a central concern of the International Organisation of Securities Commissions (IOSCO) which is based in Madrid. The exchanges of North Africa are all members of IOSCO and participate in its deliberations and the work of its emerging markets committee. In 2010 IOSCO organised a conference in Cairo on Rebuilding the Trust of the Global Investing Public and in 2011 a seminar in Marrakesh on New Financial Products and their Regulatory Implications. There was much debate on what should be the agenda
of IOSCO and its North African members in the coming years. Derivatives and products markets and products such as exchange traded funds are not yet found in North Africa, but it is far from clear such innovations can contribute much to the region’s development. Arguably such innovations would only be a distraction. Regulatory bodies should instead focus on the main markets and strengthening the alternative markets that provide funding for small and medium sized companies. Furthermore trading in derivatives is questionable from a Shari’ah perspective, whereas the risk sharing associated with equity finance is viewed with favour.

The work of the OECD Task Force on Corporate Governance of MENA Stock Exchanges is also of relevance and can help restore investor confidence in North Africa. It had its inaugural meeting in Paris in July 2011 and their work is on-going. Its Middle Eastern affiliate, the Dubai based Institute for Corporate Governance, Hawkmah, has established task forces on state owned enterprises, private equity, banks and insurance companies. The remits cover North Africa, but as yet there has been no work on corporate governance of companies listed on the main stock exchanges or alternative markets. There is much evidence to suggest that sound corporate governance is positively associated with share price gains and solid company earnings whereas corporate scandals and rumours of misdeeds by company directors increases uncertainty and undermines the confidence of investors.

7.2. Transparency and Corruption Perceptions

Investor confidence in North Africa has also been adversely affected by perceptions of corruption by both local and international investors. This increases the cost of doing business and causes additional uncertainties which add to risk. Although corruption perceptions primarily involve government practices in relation to activities such as state procurement and the granting of licences, these clearly affect the local business climate and add to costs.

The corruption perceptions scores and rankings compiled by Transparency International for the economies of North Africa are shown in table 9. The possible scores range from zero to ten with New Zealand being perceived as having the least corruption in the world in 2011 with a score of 9.5. In contrast Somalia was perceived as the most corrupt business environment with a score of only one. All of the North African countries obtained low scores in 2011, Tunisia and Morocco being perceived as the least corrupt, and Libya and Mauritania as the most corrupt. Even worse, all the corruption perception scores for North Africa deteriorated over the 2005-2011 period, apart from those for Morocco and Algeria, and in the case of Algeria there was minimal improvement. The deterioration was greatest in Tunisia, and although the perception remained that it was the least corrupt country in the region, the gap between it and Morocco narrowed significantly. The deterioration in Tunisia and Egypt appeared to be part of a longer term trend. Data for these two countries was available for these two countries for 2001, although not for the other countries. The scores for 2001 for Tunisia and Egypt were 5.3 and 3.6 respectively, which means that the Tunisian score declined by 1.5 over the decade, an indictment of the old regime.

Table 9: Corruption Perceptions Index

<table>
<thead>
<tr>
<th>Country</th>
<th>2005 Score</th>
<th>2011 Score</th>
<th>2005 Rank</th>
<th>2011 Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Algeria</td>
<td>2.8</td>
<td>3.8</td>
<td>97</td>
<td>43</td>
</tr>
<tr>
<td>Egypt</td>
<td>3.4</td>
<td>2.4</td>
<td>70</td>
<td>112</td>
</tr>
<tr>
<td>Libya</td>
<td>2.5</td>
<td>2.0</td>
<td>117</td>
<td>168</td>
</tr>
<tr>
<td>Morocco</td>
<td>3.2</td>
<td>3.4</td>
<td>78</td>
<td>80</td>
</tr>
<tr>
<td>Mauritania</td>
<td>N/A</td>
<td>2.4</td>
<td>N/A</td>
<td>143</td>
</tr>
<tr>
<td>Tunisia</td>
<td>4.9</td>
<td>3.8</td>
<td>43</td>
<td>73</td>
</tr>
</tbody>
</table>


The position of North African countries in the global corruption perception rankings is also shown in table 9. There were 182 countries included in 2011 and 158 in 2005, all of the new inclusions being for countries where corruption perceptions were high, but in some cases less than those for Libya. This addition of new countries negatively affected the ranking of Libya, though only very marginally, but not the other North African countries. The substantial falls in the global rankings of Egypt by over 40 places between 2005 and 2011 and Tunisia by 30 places therefore reflected decreasing transparency and higher perceptions of corruption in both countries.

Stock market performance and investor confidence is undermined if there are legal uncertainties, cumbersome planning regulations and excessively bureaucratic procedures facing those who seek to establish new businesses or expand existing enterprises. The International Development Association, an affiliate of the World Bank, publishes an

43 http://www.oecd.org/document/39/0,3746,en_2649_34813_47929319_1_1_1_1,00.html
44 http://www.hawkmah.org/sectors/taskforces/index.html
annual “ease of doing business” report. The ranking from this for the North Africa economies are shown in table 10. All the countries were in an unfavourable position in 2007, but with the exception of Mauritania, rankings improved over the 2007-2012 period. Tunisia has the highest rank followed a long way behind by Morocco and Egypt. The countries of the GCC fare much better in the rankings, with Saudi Arabia the twelfth in the world ranking, UAE ranked at 33 and Qatar at 36. Construction permits and the cost of registering companies are especially problematic in the economies of North Africa where all too often in the past governments have hindered rather than helped business development. Obtaining credit is also difficult in North Africa compared with the GCC. Raising equity finance through stock market listings and rights issues should not be seen as an alternative to bank loans but rather as complementary. Having a solid equity base for levering can help business expansion but only if the banking system is accommodating to requests for financing.

Table 10: Ease of Doing Business Rank

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Algeria</td>
<td>175</td>
<td>148</td>
<td>153</td>
<td>150</td>
</tr>
<tr>
<td>Egypt</td>
<td>165</td>
<td>110</td>
<td>21</td>
<td>78</td>
</tr>
<tr>
<td>Morocco</td>
<td>115</td>
<td>94</td>
<td>93</td>
<td>98</td>
</tr>
<tr>
<td>Mauritania</td>
<td>148</td>
<td>159</td>
<td>159</td>
<td>166</td>
</tr>
<tr>
<td>Tunisia</td>
<td>80</td>
<td>46</td>
<td>56</td>
<td>98</td>
</tr>
</tbody>
</table>

The economies of North Africa are caught in a bind as the mobilisation of domestic resources remains limited and financial intermediation is relatively weak, especially for the funding of small and medium sized enterprises (SMEs). Banking remains relatively underdeveloped in comparison with other emerging markets, with retail banking catering only for the middle classes while the majority of the population relies on cash transactions and faces exclusion from the financial system\(^{46}\). Consequently most domestic savings are not harnessed by the banks resulting in a shortage of funds for SMEs. Furthermore as the banks are substantial holders of government bonds and much funding is directed to the public sector, private sector financing is crowded out as table 11 shows, the position being worst in Algeria and Libya. There was a significant improvement in Morocco over the period from 2006 to 2009 as a result of economic reforms and privatisations and there SMEs account for almost one quarter of total lending. The situation is less satisfactory in Tunisia where SME lending accounts for 15% of the total and in Egypt where it is a mere 5%\(^{47}\).

### Table 11: Bank Credit to the Private Sector as % GDP

<table>
<thead>
<tr>
<th>Country</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Algeria</td>
<td>13</td>
<td>14</td>
<td>12</td>
<td>16</td>
</tr>
<tr>
<td>Egypt</td>
<td>29</td>
<td>27</td>
<td>32</td>
<td>37</td>
</tr>
<tr>
<td>Libya</td>
<td>10</td>
<td>9</td>
<td>9</td>
<td>16</td>
</tr>
<tr>
<td>Morocco</td>
<td>54</td>
<td>56</td>
<td>66</td>
<td>73</td>
</tr>
<tr>
<td>Tunisia</td>
<td>58</td>
<td>59</td>
<td>56</td>
<td>62</td>
</tr>
</tbody>
</table>

Source: Credit data from Central Bank reports and GDP data from the World Bank.

In North Africa it is not only retail and commercial banking that is underdeveloped but also investment banking which is critical for the successful development of capital markets. The leading international investment banks have established offices in Riyadh where the capital market is more developed but North Africa is largely served from London, there being insufficient new equity listings, rights issues or corporate bond offerings to justify a local presence. Cairo based EGF Hermes is the major local investment bank in the North Africa region but it has no offices in Tunis or Casablanca, its activities being confined to Egypt.


9. Future Potential

Should policy makers in North Africa encourage capital market development and if so what type of policy framework would be most appropriate? The popular perception of some in the region is that capital markets are speculative, the focus being on short term trading gains rather than facilitating long term economic development. Such views are held by those suspicious of the private sector and who prefer to see the state playing the major role in resource allocation. This approach to development was tried throughout North Africa in the post independence period, but with limited success in terms of employment creation given the constraints on public finance and its lack of sustainability.

The subsequent economic liberalisation policies tended to stress the role of foreign direct investment as a potential engine for growth rather than portfolio investment inflows into local capital markets. Hence the policy debate was concerned with whether multinational corporations should be offered incentives to establish subsidiaries in North Africa or if state owned corporations should continue to dominate in the extractive and manufacturing sectors. Little consideration was given to how local SMEs could obtain capital for expansion so that the more successful could become major national or even international businesses.

The merit of having domestic capital market is that it enables local companies to raise equity and debt capital in their own currencies, thus reducing foreign exchange exposure risk. Raising capital in foreign markets can be costly if domestic currencies depreciate, as has been the experience in North Africa. As there is limited convertibility of North African currencies for capital purposes, this also inhibits the ability of local firms to access international capital markets, as they may be unable to get permission to pay dividends in foreign currencies or service debt and make repayments. It is only businesses that have secure earnings in US dollars or euro rather than Egyptian pounds or Tunisian dinar that can viably access international capital markets.

The development of local capital markets facilitates the financial valuation of the companies listed and increases transparency and disclosure. The financial reporting requirements of listed companies are usually much more comprehensive than those of state owned enterprises. Furthermore the development of local capital markets encourages the emergence of a financial intelligence infrastructure to keep investors better informed, from financial journalism to more formal assessment of risk by ratings agencies. Capital markets are a prerequisite for the establishment and growth of private pension funds and insurance companies serving local markets as they provides opportunities for investment in local currencies to cover local currency liabilities. In North Africa the main pension provider is the state which can only afford limited payments and is unsustainable in the long run. The insurance industry remains very underdeveloped as individuals and companies bear most risk. The growth of institutional investors such as pension funds and insurance companies would increase employment opportunities, including potentially well paid jobs in asset management.

The development of local capital markets encourages inflows of portfolio investment. Table 12 shows the value of these inflows for Turkey, the most successful economy in the region. Although inflows fell in 2008 because of the global financial crisis they remained positive and soon revived. In contrast Egypt has experienced significant capital flight, although there was a significant inflow in 2010, the year before the revolution. Inflows into Morocco and Tunisia were insignificant, reflecting the minimal size of their capital markets.

Table 12: Portfolio Equity Net Inflows, $US million

<table>
<thead>
<tr>
<th>Country</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Egypt</td>
<td>-3,199</td>
<td>-673</td>
<td>393</td>
<td>1,724</td>
</tr>
<tr>
<td>Morocco</td>
<td>-64</td>
<td>148</td>
<td>-4</td>
<td>132</td>
</tr>
<tr>
<td>Tunisia</td>
<td>29</td>
<td>-39</td>
<td>-89</td>
<td>-26</td>
</tr>
<tr>
<td>Turkey</td>
<td>5,138</td>
<td>716</td>
<td>2,827</td>
<td>3,468</td>
</tr>
</tbody>
</table>


It is investors, not governments, who ensure the success of capital markets. However government policy makers can adopt measures to facilitate capital market investment. These include passing legislation if necessary to ensure the sound regulation of capital markets as well as further liberalisation of capital transactions. Prudent macroeconomic policies are also desirable by keeping inflation under control and ensuring currency stability. Low rates of corporate taxation are also helpful, as this makes listed companies more profitable and enhances dividend payments to investors. Hence it is not merely a matter of policy makers focusing on capital market measures, but in creating a business climate which is attractive for portfolio investors, both local and foreign.
Overall the laws and regulations governing the stock markets of North Africa seem adequate, although in the case of the Egyptian exchange the minimum capital requirements for listing could be perhaps revised upwards. Any firms excluded could perhaps apply for re-listing on Nilex, which would give a boost to the alternative market. The fact that alternative markets have been established in Cairo, Tunis and Casablanca demonstrates that most of the structures are in place to facilitate access to equity market finance for small and medium sized enterprises. There is in other words a gateway to widening financing sources for enterprises which want to expand from the constraints facing family businesses. For suppliers of private equity a market listing provides an exit route, indeed it may have been the possibility of an eventual listing that motivated the private equity investors in the first place.

Many of the components for successful stock markets are absent in North Africa, not least the lack of a market in corporate bonds or sukuk, the Shari’ah compliant substitute for fixed income securities. This complements equity market development as it enables investors to switch between stocks and fixed income instruments and ensures that liquidity can be parked profitability. It provides a liquidity source of capital which equity investors can draw on when stock market opportunities arise. In the absence of bond markets the funds are simply withdrawn from the exchange in times of stress and are less likely to return when conditions improve. The bank deposits in which the funds are placed as an alternative to bonds are often less liquid, as to get higher returns investors use time deposits or deposits which are subject to minimum notice periods for withdrawals.

Institutional investment tends to stabilise stock markets as pension funds and insurance companies take a long term view and are less likely to engage in speculative behaviour. There are few private pension funds in North Africa given the dominance of pensions for state employees that are largely financed by current contributions from governments and employees rather than returns from the invested funds. The insurance industry is also underdeveloped, especially life insurance including family takaful, which can serve as a source of long term capital. The number of mutual funds, an important component of long term investments in mature stock markets, has increased significantly in North Africa, especially in Egypt. The size of the funds is however small, reducing their significance for stock market development.

An examination of North African stock markets shows that the number of listed companies is adequate for a degree of portfolio diversification. However market capitalisation is low compared to other markets in the Middle East region such as Istanbul and the Tadawul in Saudi Arabia. In relation to emerging markets in Asia the size of the North African markets is even more limited. In other words the market width is adequate, but not the depth. It is investor confidence that is needed to expand the market and achieve depth. The problem is not the stock markets themselves which are viewed as well governed, but rather the wider business environment. Perceptions of corruption illustrate the challenges as investors have seen the problem increasing during the last decade and North African countries compare unfavourably with other emerging markets in the region, notably those of the GCC. The ease of doing business indicators are also unfavourable for North Africa compared to the GCC, and the resultant uncertainty is damaging for the development of capital markets.

Market indicators however present a more encouraging picture. Price earnings ratios in Egypt are much less inflated than in Jordan and are in line with those of Saudi Arabia and Turkey. Stock yields during the decade up to 2010 were higher in Egypt and Morocco than in Jordan, Turkey and Saudi Arabia. Morocco’s MASI index has kept near its 2007 highs and Tunisia’s was at a record high in 2010. Egypt’s EGX30 suffered a fall after 2007, but this was much less than that for Saudi Arabia. Even more encouragingly although not surprisingly the stock market indices fell substantially in Egypt and Tunisia during the Arab Spring, they have since rebounded\(^{48}\). They remain however attractively priced in relation to many other emerging markets, and arguably this is a good time for investors to enter the markets in North Africa before values become more stretched.

\(^{48}\) Nadia Saleem, “Money pours back into Mideast stock markets”, Reuters, Dubai, 16th February 2012.
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