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COMMENTARY

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Mixed Signals Derail Investor Confidence in Egypt's Economy

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The Egyptian economy seems stuck in a long, dark tunnel, with little hope of rescue by the country's political and economic actors. The closing weeks of 2012 demonstrated just how bad the situation has become, with politicians burying their heads in the sand, insisting that "circumstances" were not as bad as they appeared.

But the facts tell a different story. During the last week of 2012, the Egyptian pound fell to its lowest level compared to the US dollar since the fall of Hosni Mubarak. At the end of December 2010, the dollar was trading at 5.82 Egyptian pounds; in the last week of 2012, it hit 6.24 pounds before the Central Bank enacted a new currency system in an attempt to halt the worsening economic situation.

Meanwhile, the credit agency Standard & Poor's has downgraded Egypt's credit rating from B to B- due to civil unrest, which it notes has "weakened Egypt's institutional framework". The agency goes on to say that "the increasingly polarized political discourse could diminish the effectiveness of policy-making". Egypt's rating was also revised in 2011, sliding from B+ to B. S&P commented at the time that "Egypt's external position has deteriorated and is likely to weaken further, absent stabilization in the domestic political situation alongside external financial support".

Restoring growth in Egypt will not be an easy task. As more time elapses without a clear economic vision or efforts to build trust among economic and political actors, the economy's performance is bound to further deteriorate. There are several key reasons why things became so bad.

Political point-scoring has taken primacy over actually coming to grips with the economic challenges. Thus, each administration that has taken office since Mubarak's fall has chosen to make cosmetic changes rather than put forward a strategic vision to address the economy's structural deficiencies. These deficiencies include cumbersome investment procedures, low productivity, a huge and inefficient public sector, and declining levels of exports. Instead, the governments of the transition period have simply increased public spending and hired more people.

This approach has had two major implications. First, it has expanded Egypt's budget deficit, which has reached almost 10 per cent of GDP. Second, foreign currency reserves have been significantly depleted. Reserves stood at about US$15 billion (Dh55 billion) in September 2012 - the equivalent of around 2.6 months of imports - compared to US$24.1 billion in September 2011.

The increase in public spending and the avoidance of material reforms of Egypt's public sector and subsidy policies reflect that politicians are not firmly committed to correcting the decline in macroeconomic indicators.

The international community has been equally dissatisfied with the Egyptian government's management of its economic affairs. For the most part, donor countries have been reluctant to extend unconditional financial assistance to Egypt.

With the arrival of Muslim Brotherhood-backed President Mohammad Morsi, the international community faced uncertainty about the Islamists' economic agenda and approach to the rest of the world. Thus the country has seen limited capital inflows over the past two years, making it ever more difficult to regain momentum toward economic growth.

Moreover, there has been no clear commitment from this government about the nature of the economic policy it will adopt. Although it was announced in November that an IMF agreement was imminent, political controversy surrounding Egypt's new constitution delayed its signing.

Morsi also suspended some of the decisions made by Prime Minister Hesham Qandil - who was appointed by Morsi - one week before the constitutional referendum. The decisions involve tax increases and changes, which deserve further deliberations according to the Egyptian president.

Such inconsistency deepens the scepticism of the private sector, as some of the policies appear designed to deliver short-term political gains for the president rather than long-term economic benefits.

Political inconsistency deters local investment and keeps away foreign investors seeking to enter the Egyptian market. Foreign investors are looking for clear terms and an economic vision. Morsi's visits to China and Turkey last year to encourage investors appeared to have fallen on deaf ears, underscoring that international investors are more interested in credit agency assessments than the president's promises.

Although the tunnel seems long and bad decisions have been made, it is still possible to build confidence gradually. The government must engage in a serious dialogue with the private sector. It cannot limit itself to figures close to the Brotherhood, as has apparently been the case.

At the same time, media and civil organizations need to stop the public shaming of the private sector. They have focused on the sins of the past and blamed the private sector for the current economic slowdown and gloomy forecast. A more positive environment is a precondition for significant investment.

In addition, the government borrowing from the domestic market to fund expenditures increases the cost of funding and crowds out the private sector. This has to stop to give businesses - small and medium enterprises, in particular - access to the credit market.

Successful management of Egypt's economic transition begins with sending the right signals to investors at home and abroad. To do so, the Egyptian government must adopt a clear economic vision and avoid inconsistency in its policies.

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