

*M.P. Huehn, C. Kalhoefer, German University in Cairo, Egypt*

## **MODERNISATION OF EGYPT'S BANKING SYSTEM THROUGH FOREIGN BANKS**

The Egyptian economy is growing strongly. How much exactly, is – like the inflation figures – not quite clear. Different sources cite growth rates for the past two years between 5 % and 6 %. In such a fast growing economy one should expect a healthy banking system with good availability of credits, low default rates, the usual range of financing instruments and central bank rates acting as the interest benchmark. The reality, however, is quite different. The IMF gauges the availability of financing as low, as for example indicated by a sharp decrease of the ratio between loans to customers and assets; the default rates are still quite high (the government had to offload the massive 44 % share of non-performing loans (NPL) of Bank of Alexandria, before it could be sold to San Paolo IMI); private loan practices are sometimes bizarre (to get an overdraft facility customers have to deposit the equivalent amount in their account, despite a massive building boom there are almost no mortgage loans), while the corporate bond market is almost non-existent and a derivatives market still does not exist; and the private banks “are not necessarily responsive to central bank interest rate policies” as EFG Hermes analyst Reham el-Desoki delicately puts it. All this hints at major problems in the banking sector which necessarily have a negative impact on economic growth, inflation and the effectiveness of the central bank.

Like many other developing countries, and the Eastern European economies in particular, Egypt is struggling to marry its centralised, largely planned system with a market economy. There seem to be two factions in Egypt's government, one trying to keep control over the economy (and their fiefdoms) and one trying to modernise the economy. The latter group seems to believe that this can only happen if Egypt has a modern and functioning banking system. They use foreign banks to achieve this goal, but until recently they fought an uphill battle. Not only do they have to fight against the conservatives and their vested interests. They also struggle with an extremely distrustful attitude of the public towards banks, a consequence of major financial scandals in the 1990s, which is expressed for instance in the different interest paid by banks: foreign banks like HSBC only pay about half the interest on deposits than Egyptian banks. In addition, the few state-owned banks still dominate the market in terms of market share.

No new banking licence was granted in the past 10 years. This measure is aimed mainly at foreign banks because it forces foreign banks to take over or buy a stake in a local bank. Since all local banks are dramatically overstaffed with underperforming not-motivated employees, and have a considerable portfolio of NPLs, the hurdle is rather too high for many potential investors. The take-over of one of the four stateowned banks, Bank of Alexandria, in 2006 by San Paolo IMI is augured to chime in an effort of the reformers to raise Egypt's banking system quickly to international standards. With a sharp decline in the number of banks from 57 to 37 in recent years and the aim to decrease the number as low as 22, a

progressing privatisation, and a new banking law, the race is on. Thus, the concerted reform efforts of the Central Bank of Egypt, the IMF and the ECB may prove far less important than the selfhealing forces of the market. The parallels between the Egyptian and especially the Ukrainian situation are so obvious that one could think that the Egyptian policy makers have learnt from the beneficial role that foreign (in the Ukraine predominantly Austrian) banks can play in reforming a banking system and with it the economy.

Among other things, foreign banks strengthen competition, import talent and train local employees, introduce modern banking instruments, strengthen trust (essential in any market), fast-forward the development of a modern banking culture, reduce bribes and inflation, strengthen cash-flow and the central bank. Taken together they have a fast and very positive impact on a developing country's economy if introduced with a little foresight.

Huehn, M.P. Modernisation of Egypt's banking system through foreign banks [Текст] / M.P. Huehn, C. Kalhoefer // Міжнародна банківська конкуренція: теорія і практика: збірник тез доповідей II Міжнародної науково-практичної конференції (31 травня – 1 червня 2007 р.). – Суми: УАБС НБУ, 2007. – С. 146-148.