MENA Crisis: The Key Risk to Global Recovery and Stability

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Abstracts

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A Pivotal Moment History In The Making

The wave of popular protests that has swept across the Middle East and North Africa (MENA) since January constitutes the biggest shake-up to the region for at least a generation, and its impact will be felt for many years to come. The unrest also poses the biggest risk to the global economic recovery this year, not least because it is causing oil prices to spike higher.

Although it is still too early to determine whether the unrest will lead to genuine democratisation or renewed authoritarianism, it is clear that most countries' political risk profiles will remain elevated for the foreseeable future. The countries that have already seen regimes ousted are entering uncharted territory, as they transition to a new political order, while the states that have yet to see change will be bracing themselves for all eventualities.

Democratisation is now a realistic possibility, but the path will not be easy, and any attempt to hold back the tide will risk greater unrest.

Although rising inflation has fuelled discontent, the protests are being driven by more fundamental issues, such as a lack of democracy, high unemployment, poor opportunities for social advancement, anger at perceived government corruption and high inequalities, significant demographic youth bulges, and in some cases, ethnic and sectarian strife.

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We deem Algeria, Bahrain, Iran, and Yemen to be most at risk of further unrest, although we emphasise that virtually no state will be completely immune to public protests. Egypt will remain in a delicate transition to democracy, and if the people's hopes are dashed, further protests could erupt. In Bahrain, the growing demands of the Shi'a majority could transform the polity, with major implications for Saudi Arabia, which fears unrest among its own Shi'a minority in the oil-rich Eastern Province. Saudi Arabia also fears that Iran may be instigating unrest in Bahrain to increase its geopolitical influence. Ironically, Iran itself is at risk of severe political upheaval, due to its deteriorating economy and tighter international sanctions, and we see scope for regime change in both Saudi Arabia and Iran by the end of this decade.

Libya's descent into civil war represents the most immediate risk to the region and Europe. The country's oil supplies are of key significance to the EU, but southern European countries also fear a massive influx of refugees from the country. Even if Colonel Qadhafi is formally removed from power, Libya's wounds will take a long time to heal, and the ensuing power vacuum could necessitate Western military intervention. In addition, chaos and lawlessness in Libya could allow Islamist extremists to establish a greater presence in the country.

More broadly, the crisis in MENA has served notice to authoritarian regimes around the world that they are not immune from popular uprisings. Governments in Venezuela, Belarus, several African countries, Central Asia, North Korea, Myanmar, and even China will become ever more vigilant to the possibility of public unrest, although idiosyncratic factors mean that a domino effect will not necessarily ensue.

As far as global financial markets are concerned, the combination of supply-side risks to oil and massive political uncertainty in a strategically important region is bad news for risk trades. As investors re-price for higher oil prices and political volatility, equities and emerging market (EM) currencies are likely to suffer while the dollar and G7 fixed-income instruments should benefit. The implications for the medium-term global macroeconomic outlook are much more difficult to ascertain at this stage. These will ultimately depend on key political developments, the extent to which the situation in Libya deteriorates and whether the key oil-producing states Algeria and Saudi Arabia are affected. The risk scenarios are becoming much clearer - indeed, we see the potential for oil to exceed US$120/bbl in the short term. In our view, global markets have underestimated the potential risks stemming from MENA and this will result in a tactical re-pricing, especially in risk-dependent 8 Business Monitor International Ltd mena crisis: the key risk to global recovery and stability assets in emerging markets. Nonetheless, we maintain that as yet, the core factors underpinning our global recovery

view (banking sector stabilisation, accommodative monetary policy and mitigation of treasury crisis risks in Europe) remain in play. There is thus a potential for markets to overreact on the downside, in the event that dire political risk scenarios do not play out.

Our global macro team has modeled a 'worst-case scenario' in which oil prices spike to US$200/bbl.

This showed that a move to US$200/bbl followed by a sharp drop that left prices at an average US$90/bbl in Q1 2012 would shave about 0.5pp from our 3.1% US growth forecast in 2011. In the eurozone, growth would be trimmed by around 0.8pp from 1.8%. Unsurprisingly, on a global basis, net oil importers would be harder hit in the near term, with Turkey (where growth would be cut by 1.6pp in 2011), South Africa (1.4pp), Singapore (1.7pp) and India (1.2pp) among the worst off. The hit to real GDP growth in 2012 could potentially be worse if oil prices do not subside, but suffice to say that a period of US$200/bbl oil, even if only brief, would pose severe risks to global growth, inflation and policymaking.

Asia's economic growth is particularly vulnerable to high oil prices, because most countries in the region import more than 90% of their oil needs. India, Vietnam, Indonesia, and South Korea are among the most vulnerable countries, with the former two already suffering from high inflation and oil import bills.

European economies are also likely to be hit by high oil prices, and policymakers in the continent will also be wary of the security risks of Libya's descent into chaos. However, one relative beneficiary is likely to be Russia. Although there are several Russian oil firms with stakes in the Libyan oil industry, high oil prices are generally positive for the Russian economy, provided that any price surge does not tip the global economy back into recession.

For Latin America, higher oil prices are a doubledegded sword. Venezuela is the most notable beneficiary, although high oil prices may exacerbate structural deficiencies. Mexico and Colombia are also likely to see higher exports, but oil importers such as Chile and Peru could be major losers. Indeed, the latter two countries will also suffer from lower copper prices brought on by global risk aversion. On the other hand, Chile and Peru also have strong fiscal positions, allowing them to weather the storm.

The impact of higher oil prices on sub-Saharan African (SSA) economies will vary widely. Production is concentrated in a few key countries including Nigeria, Angola and Sudan, with most other nations being net importers. Measuring the impact on individual

economies is also complicated by the fact that many countries are exporters of crude and importers of refined oil (or vice versa), not to mention that various governments will have in place different policies on subsidies at the pump. On balance, though, the impact of higher oil prices is likely to be negative for headline growth: consumers' budgets are already tight; governments' finances are still recovering from the last downturn; and inflation, having hit a cyclical trough in H2 2010, is now clearly on the rise.

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