

Economic Watch

Cross-Country Emerging Markets Analysis

Madrid, 18th November 2011
Economic Analysis

Cross-Country Emerging
Markets Analysis

Middle East woes and potential risk scenarios

- **Social unrest risks remains**

After Ramadan's break, social unrest climate remains high in some of the countries in North African countries. In Libya, where Gaddafi's death provided some relief, security will remain a serious concern for at least the next year as militias refuse to disarm. Minor social and labour demand protests have persisted in Algeria and to a lesser extent in Morocco. Tensions remain in Egypt, where religious clashes and a lengthy electoral timetable combined with a series of missteps by the interim rulers is paving the way for a tense political transition. Yemen's situation is still at limbo and the risk of civil war in Syria remains high.

- **Geopolitical risk is moving to a more worrisome area**

The risk is moving to a more problematic area both in terms of world geopolitical and economic implications:

- **Confrontation in Syria goes an step further:** This week, defectors under the Free Syrian Army attacked a military base near the capital, what has been considered as the first reported assault on a major security facility since the protests began. Furthermore, the Arab League said diplomatic efforts are "close to the end of the road" and called Syria to allow a team of observers.
- **Kuwait, the first GCC oil player to register loud protests:** Demonstrators stormed the Parliament after weeks of protests over alleged corruption and called for the Primer Minister resignation. This has been the first political violence since December in one of the main oil producers in the area (2.3 mbd).
- **Iranian tensions on the rise:** Several events have prompted fears about the Iranian situation. First, Saudi Arabia hinted Iran was after clashes in an Eastern province in which fourteen people were injured. A week later, the GCC condemned an alleged plot to kill the Saudi Arabia's ambassador in Washington. And, finally, rumours that a report from the International Atomic Energy Agency was stating that Iran is developing nuclear arms capability led to escalating tensions with Israel, whose President said an attack on the Persian country was "more and more likely".

- **Social tensions and the European crisis can undermine a peaceful transition to democracy**

- **Economic situation in affected countries will not help:** In Syria, the regime's weak point is the economy, which is shrinking due to sanctions and ongoing instability. Libya's oil production recovery will take time and tourism receipts in the rest of the countries will remain subdued.
- **The Eurozone crisis will have a negative impact:** North African countries will be affected by lower exports and tourism receipts due to the economic situation in Europe.
- Despite a recent moderation **Food prices remains elevated (specially cereals):** with the potential to reinforce the protest climate.

- **Risk scenarios: Still low probability but with serious implications**

Although still low probabilities scenarios, there is the potential for geopolitical tensions to escalate in the region, maintaining or accelerating the oil price risk premium. Some of the potential risk scenarios and probabilities are the following:

- **A revival of Social unrest in Northern African countries (35%):** This is a still possible scenario. Difficulties to find the new paradigm, after decades of autocratic regimes, makes the transition process highly unstable. The political fragmentation and economic situation will prove important obstacles to overcome. This will have a limited impact for the world economy as oil production and spare capacity of the area are relatively low. However, it has still the potential to maintain volatility in oil prices.
- **A spread of unrest to EAU and Saudi Arabia (10%):** The social unrest process has proved to be highly reinforcing. Tensions in North African can spread rapidly to the Gulf countries. As oil prices remain high, this scenario is less likely in GCC countries as the potential to tap economic demands are still quite high (despite the increases in fiscal break even oil prices). However, recent events in Kuwait show us again that social demands are beyond the economic situation.
- **A military confrontation with Iran (10%):** A confrontation between Israel (and its allies) with Iran is very unlikely today, given its invaluable consequences for both sides. A more probable scenario is an intensification of Iran and Saudi Arabia chess game in the region, confronting Persian support to rebels in some countries with oil monarchies low-level concessions. A further deterioration in Syria (likely) could reinforce tensions in the Israel-Iran-Saudi Arabia.

These two last scenarios would have serious implications for the global economy as the potential of serious oil production disruptions will arise. Besides, most of the oil spare capacity is in hands of the GCC countries (especially in Saudi Arabia), limiting the ability to cope with the disruptions and making the oil price shock more permanent.

Table 1

Middle East Social Unrest Tracker

		Dec			Jan			Feb			Mar			Apr			May			Jun			Jul			Aug			Sep			Oct			Nov.		
		1w	2w	3w	4w	1w	2w	3w	4w	1w	2w	3w	4w	1w	2w	3w	4w	1w	2w	3w	4w	1w	2w	3w	4w	1w	2w	3w	4w	1w	2w	3w	4w	1w	2w	3w	4w
North Africa	Morocco																																				
	Tunisia																																				
	Egypt																																				
	Algeria																																				
	Libya																																				
Others	Lebanon																																				
	Jordan																																				
	Syria																																				
Gulf Countries	Bahrain																																				
	Yemen																																				
	Oman																																				
	Qatar																																				
	Kuwait																																				
	EAU																																				
	Iran																																				
	Saudi Arabia																																				

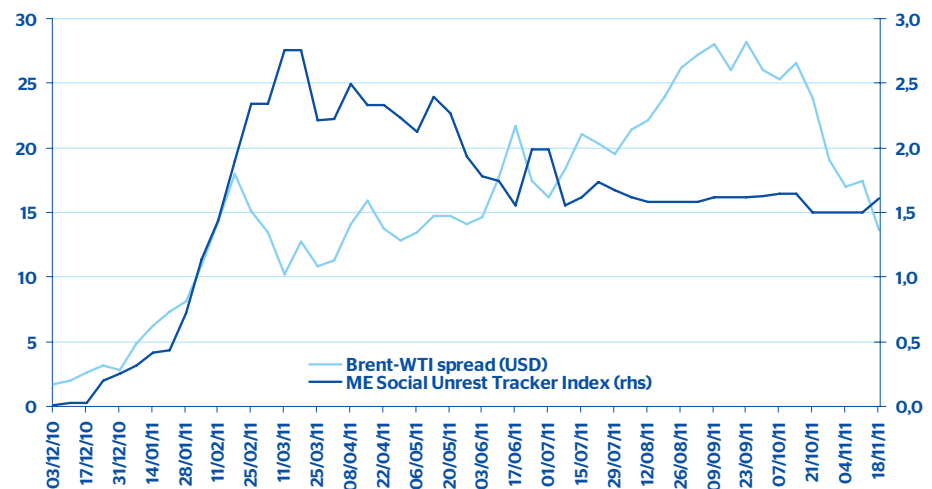
Social Tension Scale

	No protests
	Isolated Labor and Social Demand
	General Social & Anti Governments demands
	Restrained protests (military presence, communications Shutdowns, Curfew, Arrests.)
	Protest escalates +Military Repression (tear gas, mass detentions, attacks to gov and police buildings, shots, deaths.)
	Military Repression + Risk of social confrontation + Civil war

Source: BBVA Research through international news agencies and SOS International

Chart 1

Oil risk premium and Middle East Social Unrest Tracker Index*

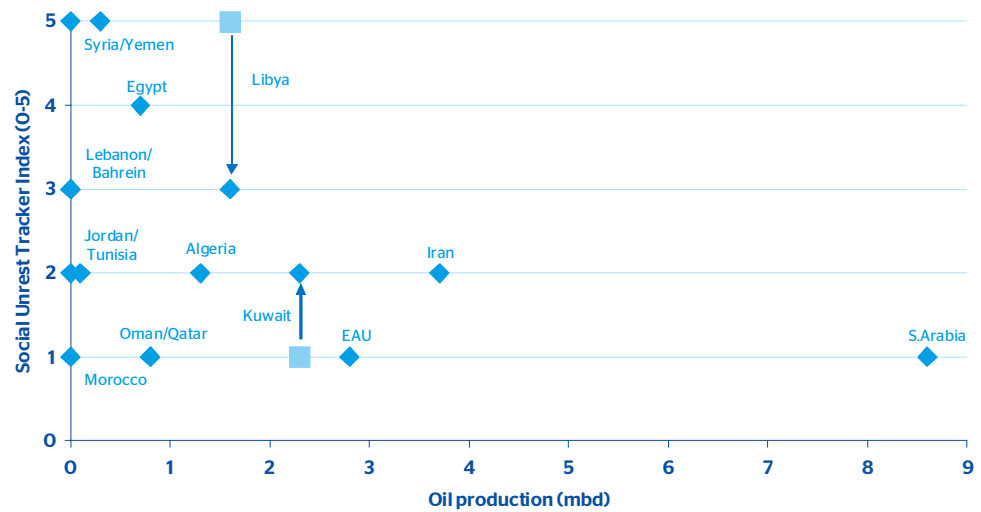


*Weighted average by oil production Middle East share

Source: BBVA Research and Haver

Chart 2

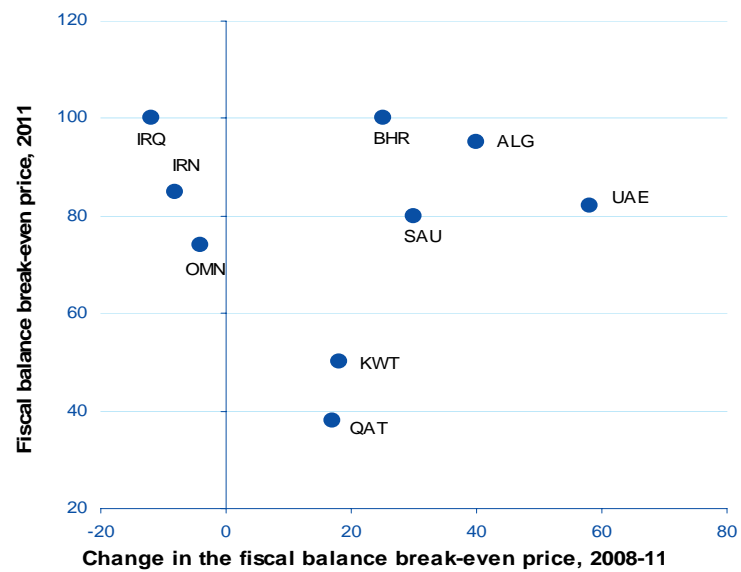
Middle East oil supply disruption risks stemming from social unrest (recent changes)



Source: BBVA Research and International Energy Agency

Chart 3

Fiscal break-even oil prices (USD)



Source: IMF

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