The Global Fallout from the Middle East Crisis

Risk Insights

• Political instability in the Middle East and North Africa is likely to affect companies that have a significant exposure to this area, such as European agri-food and textile businesses and Asian exporters.

• As a result, supply chain disruptions and increased payment risks are liable to impact on companies globally.

• In the long term, lenders and insurers are likely to re-price political risk in several emerging markets, thus leading to higher credit and insurance costs for foreign and local companies.

• Unrest in oil-exporting countries will also affect hydrocarbon prices and raise business costs.

• There are likely to be natural gas supply disruptions, particularly for companies in energy-dependent Southern Europe.

• As political risk rises, country risk information is set to become even more essential to companies dealing with foreign counterparties.

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Unrest will have a major effect on business risk

Recommendations

The wave of uprisings sweeping across the Middle East and North Africa (MENA) is set to have a major impact on the risk of doing business. As political instability rises in the region, companies around the world need to prepare for the knock-on effects on supply chains and business costs across most sectors.

1. In the short term, political instability and economic breakdown in affected countries are likely to impact on supply chains around the world; agri-food and textile companies in Europe and consumer goods producers in China and other Asian economies are most vulnerable to these shocks. Careful monitoring of political and economic trends, alternative sourcing and stockpiling are strategies that can reduce the impact of these disruptions.

2. In the longer term, heightened political risk could lead to deteriorating economic conditions and tighter access to credit, raising payment risks for companies dealing with MENA (and, potentially, other emerging markets). Adequate export and political risk insurance cover and safe trade terms, such as documentary credit, will be key to mitigating counterparty risk.

3. In the wake of the crisis in the MENA region, lenders and insurance companies are likely to upwardly re-price the risk premium attached to dealing with emerging markets, thus raising operating costs for exporters and investors.

4. Growing instability in oil-exporting economies is likely to cause disruptions in oil supply and boost prices both in the short and long term; as energy costs rise, companies should aim to shorten their supply chains and adopt less energy-intensive production processes, where possible, to minimise risks.

5. Moreover, the risk of disruptions in natural gas supply to Europe could negatively affect companies in energy-dependent Spain and Italy, potentially causing further supply chain dislocations and increasing payment uncertainty in these countries.

6. Escalating hydrocarbon prices will offer more opportunities to businesses operating in the renewables sector, as governments and companies are likely to step up energy-source diversification to mitigate supply risks.

7. In this context, country risk information and market intelligence will play an increasingly essential role for companies that aim to minimise costs and risks when dealing with foreign counterparties. Country Risk Services’ products, such as monthly Country Riskline Reports, can provide this information.

Background: What is Happening and Why?

Between late 2010 and early 2011 a wave of spontaneous revolts in Tunisia and Egypt led to the downfall of the local regimes. Foreign exporters and investors in these countries are still being affected by the ongoing events, including looting, industrial action, supply chain disruptions and increased counterparty risk. Moreover, the success of the initial protests sparked new tensions across the Middle East and North Africa (MENA), threatening the stability of Algeria, Bahrain, Iran, Jordan, Libya and Yemen.

Uprisings in Tunisia and Egypt

The catalyst for these revolts was the suicide of young street vendor, Mohamed Bouazizi, in the Tunisian town of Sidi Bouzid in December 2010; Bouazizi set himself on fire to protest against a decision by the local authorities to seize his wares. In a few weeks demonstrations spread to the whole country, as many Tunisians took to the streets to protest against political repression and deteriorating living conditions. The combination of high youth unemployment, worsening living conditions, rising food prices, accusations of corruption and crony capitalism against President Zine el-Abidine Ben Ali and his family, and the lack
Unrest in Egypt led to the overthrow of President Hosni Mubarak’s regime in February

of legal outlets for widespread political discontent, led to an unprecedented uprising that the government was unable to stop. The aims of the revolt were to topple Ben Ali and replace his authoritarian regime with a multi-party democracy. The sudden collapse of Ben Ali’s regime opened a political vacuum. Parliament speaker Fouad Mebazaa replaced Ben Ali as president and a transition government, led by Prime Minister Mohamed Ghannouchi, but including members of the opposition was formed. In February parliament granted emergency powers to the government, which can now rule by decree; this measure should enable the authorities to tackle the challenges posed by the difficult political transition.

The Tunisian uprising markedly increased economic and commercial risks. During the protest, most businesses remained closed; they re-opened only gradually after the downfall of the regime. Retailers were particularly affected by looting; likewise, the tourism sector recorded major losses as visitors fled the country. Supply-chain disruptions and damage to offices and production plants were considerable; according to a February survey published by research centre IACE, average capacity utilisation in manufacturing industry fell to 52.9% in the wake of the uprising. Moreover, several banks were downgraded by ratings agencies, thus restricting access to credit on the international markets. In addition, there is uncertainty over the fate of 175 firms owned by relatives of former President Ben Ali, with financial institutions Banque de Tunisie and Zitouna Bank being placed under caretaker management. Inevitably, payment risks for foreign companies have soared.

The political success of the Tunisian revolution set a dangerous precedent for authoritarian regimes in MENA, with Egypt following a similar path: large crowds gathered in the country’s main cities to protest against deteriorating living conditions, corruption and authoritarianism; despite the relatively peaceful management of the protest by the security forces, the death toll amounted to around 150 by early February. Under pressure from the military, on 11 February President Hosni Mubarak stepped down and handed over power to the Supreme Council of the Armed Forces (SCAF), led by former Minister of Defence Mohamed Hussein Tantawi. The SCAF dissolved the parliament, appointed a committee to amend the suspended constitution, and committed to holding elections within six months. Although demonstrators cheered this military coup, there are significant concerns regarding the real intentions of the SCAF, which is made up of high-ranking officers linked to the previous regime; the outcome of the transition is still extremely uncertain.

![Tunisia's Share Price Index](source: Tunis Stock Exchange)
As in Tunisia, the economy also ground to a halt, as most businesses shut and re-opened only after Mubarak's resignation. For several days there were shortages of staple foods and fuel, internet access was blocked and phone communications were also subject to severe disruptions. Access to ports was also suspended, with several shipping companies re-routing their container ships to other regional port facilities. Positively, Egypt's unrest did not affect traffic flows through the Suez Canal, which continued as normal. Unsurprisingly, tourists and investors pulled out of Egypt; on 6 February the pound plunged to a six-year low against the US dollar. That said, FX reserves were equivalent to 7.0 months of import cover at the end of 2010 and are sufficient to cover the country's short-term requirements.

**Contagion Risk in the Rest of the Region**

In the wake of the successful uprisings in Tunisia and Egypt, the risk of protest contagion became increasingly real. Throughout February a series of demonstrations took place in Algeria, Bahrain, Iran, Jordan and Yemen, while Libya was engulfed in a violent spiral of protests and harsh military repression that left the country on the brink of civil war. The motives behind these revolts were similar: failure to address the long-standing problem of unemployment; rising inflation, which in early 2011 was again eroding households' purchasing power; a growing sense of injustice, fuelled by high levels of corruption and cronyism within the various regimes; and anger towards long-standing dictatorships and political repression.

Many governments tried to pre-empt the protests by adopting limited reforms: in Algeria, the authorities promised to lift the state of emergency that has been in place for almost 20 years; in Yemen President Ali Abdullah Saleh announced that he would not run for a further term at the next presidential elections in 2013; and in Saudi Arabia King Abdullah bin Abdul-Aziz unveiled a USD37bn package of pay rises, unemployment benefits and other social measures. Nevertheless, at the end of February the risk of contagion in MENA was still high.

The situation was particularly critical in Libya, where in late February protests against leader Mu'ammar al-Qadafi’s regime spread quickly across the country; several cities in the east of the country fell in the hands of the protestors. The uprising was met with an extremely harsh military response (including the aerial bombing of protesters) and left thousands dead. Moreover, as the country plunged into chaos, foreign companies and governments began operations to repatriate non-Libyan nationals and shut down hydrocarbon production.
**Outlook: What Will Happen Next?**

In addition to their regional significance, the latest events in the Middle East and North Africa (MENA) are likely to have a wider impact on the risk of doing business. In particular, the crises in Tunisia, Egypt and Libya are likely to affect supply chains worldwide and to change the perception of political and commercial risks for companies dealing with emerging markets. Moreover, instability in hydrocarbon-rich countries is also likely to inflate energy prices, further raising costs and disruptions risks for businesses.

**Re-pricing Political Risk in Emerging Markets**

In the years that preceded the 2008-09 global economic downturn, emerging markets became increasingly central to the world economy and international business. As countries such as Brazil, Russia, India and China recorded extremely high growth rates and showed reassuring political stability, investors and exporters’ attitudes towards the risk of doing business in these countries slowly relaxed. This positive perception was often reinforced by risk rating agencies’ favourable assessments of governments and companies. Moreover, Europe’s sovereign debt crisis also strengthened this view, as markets started to consider advanced economies such as Greece and Ireland more risky than many countries in Asia or the Middle East.

Nevertheless, the recent wave of protests and the possibility of a ‘domino effect’ in the Middle East are likely to prompt many market players to re-consider the impact of political risk on doing business in emerging markets. In the short term, businesses should be wary of further supply chain disruptions: in particular, Europe’s agri-food and textile industries are vulnerable to shocks in countries such as Morocco, Tunisia and Egypt; and the stability of major trans-shipment hubs such as the UAE, Oman and Yemen is key to China’s consumer goods exports (as well as those of other Asian economies).

In this context, rising political risk is liable to impact significantly on supply chains around the world. In the longer term, uprisings and military coups in the region could encourage governments old and new to adopt increasingly populist policies aimed at appeasing protesters’ demands; this could lead to rising government budget deficits, an increase in public debt, growing external imbalances and soaring inflation, thus exacerbating payment risks associated with these countries.

This re-assessment of political risk was already evident in the wake of the Arab uprisings, as investors pulled out of local stock markets and moved their money to safer currencies. The SHUAA Capital Index for North Africa (an aggregate indicator of stock market performances in the region) dropped from a high of 2,155.4 on 15 January to 1,911.2 on 21 February, equivalent to a decline of 11.3%; the same index for the rest of the Middle East recorded similar decreases.

![Graph showing the SHUAA Capital North Africa Index from January 10 to February 22, 2011. The index is on a scale from 1,800 to 2,300, with 1999=100. The graph shows a decline in the index from early January to mid-February.](image-url)
Likewise, the cost of insuring sovereign debt against default rose significantly: for example, Credit Default Swap (CDS) spreads for Egypt went from around 200 basis points (bp) in early January to more than 300bp by late February as markets started to fret about the external economic position of a country heavily dependent on FDI and tourism revenues for its solvency.

Although these effects will be seen first in MENA, businesses are also likely to re-price the risk premiums attached to trading and investing in other countries characterised by social instability, political authoritarianism or ethno-religious divides. Although this re-assessment is unlikely to affect all emerging markets, it means that insurance and financing costs for both foreign and local companies are liable to increase as the credit risk associated with businesses based in developing economies rises; likewise, borrowing conditions for governments in these countries are also set to tighten, with lenders likely to re-consider their existing and future commitments. As a result, we believe that understanding political risk will become increasingly essential to doing business internationally in coming years.

**Impact on Energy Prices**

The oil market has always been extremely sensitive to political and security turmoil in hydrocarbon-rich economies, as highlighted in 1979 during the Iranian revolution, when oil prices more than doubled. Unsurprisingly, in early 2011 oil prices reacted quickly to instability in Egypt and Libya: Egypt controls one of the world’s most important waterways, the Suez Canal, and the SUMED pipeline, which carry around 1.6m barrels per day (b/d); Libya exports around 1.8m b/d. Whereas operations in the Suez Canal and SUMED pipeline continued unabated even at the peak of the crisis, turmoil in Libya meant that foreign oil companies had to evacuate their personnel and reduce or shut down production. As a result, the price for Brent (dated) rose from a low of USD93.5 per barrel (/b) on 7 January to a peak of USD110.7/b on 23 February, thus breaking the psychologically significant USD100/b barrier.

In the short term, there is a growing risk that increased instability in the oil-rich MENA region might hike oil prices further. According to energy company BP’s Statistical Review of World Energy, the region sits on top of 61.1% of the world’s total oil reserves and 45.0% of total natural gas reserves, and produces 35.3% of total oil production and 18.9% of natural gas output. If unrest spreads further (particularly to key Gulf oil-exporters such as Saudi Arabia), or if international economic sanctions are adopted (against Libya, for example), oil prices are likely to mount further, with significant repercussions on business costs and the global economy. Moreover, disruptions in natural gas supply would negatively affect businesses in Europe, which is highly dependent on the MENA region. In particular, countries to watch for potential repercussions are Spain and Italy, as the former gets 64.8% of its total natural gas imports from MENA (mostly from Algeria, Qatar and Egypt) and the latter 48.3%, mainly from Algeria and Libya. Gas supply disruptions would significantly raise counterparty risk in these countries and could have ramifications on supply chains in Europe and around the world.
In the medium to long term, rising political risk and project financing costs are also liable to constrain investment in the hydrocarbon sector, thus further exacerbating energy costs and risks for companies. In the past, the Iranian revolution in 1979 and the adoption of international sanctions against Libya in the 1980s and 1990s led to a drop in foreign investment and expertise required to operate the complex energy industry; this meant that in both countries oil production fell and has never fully recovered. Critical factors to watch for will be: if unrest in the Middle East and North Africa spreads to other major oil-producing economies; if international sanctions are imposed on regimes; and if nationalisation policies are adopted by the local governments. In addition, rising oil prices are likely to arouse interest in renewable energy in hydrocarbon-hungry economies, such as in Europe and Asia; as a result, we expect opportunities and profits for companies operating in this sector to increase significantly.
Implications for D&B Customers

In addition to its regional significance, rising instability in the Middle East and North Africa (MENA) will have a significant impact on supply chains around the world, and on payment risks. Companies directly exposed to countries in the region will face significant short-term risks, owing to political and economic turmoil; in turn, affected companies are liable to impact on supply chains in other sectors and countries. In particular, European firms in the agri-food and textile sectors (and Chinese and other Asian exporters to the Middle East) are most vulnerable to these adverse shocks.

In the long term, banks, insurance companies and businesses are likely to re-assess and re-price political risk in emerging markets. In previous years, strong growth and socio-political stability in countries such as Brazil, Russia, India and China meant that many exporters and investors attached a low risk premium to dealing with emerging markets. In the wake of the uprisings in Tunisia, Egypt and Libya, we expect credit and insurance costs to rise, not only in MENA but also in other unstable and/or authoritarian countries.

A further critical factor for the business sector will be the impact of instability on energy prices. Unrest in Egypt and Libya meant that the price for Brent (dated) rose above USD100 per barrel for the first time since 2008. In the coming weeks, rising oil prices and natural gas disruptions to Europe are likely to raise production and transportation costs for companies and to dislocate supply chains. In the longer term, the risk of escalating hydrocarbon prices will remain high (although it will offer interesting opportunities for the renewable energy sector).
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