

Mattioli Woods Managing Wealth Express

Middle East and North Africa update – unrest, unease, uncertainty

With such turmoil in the Middle East and North Africa, the production of oil is once again becoming a global concern. We review the likely impact on prices and the possible effects on investment markets.

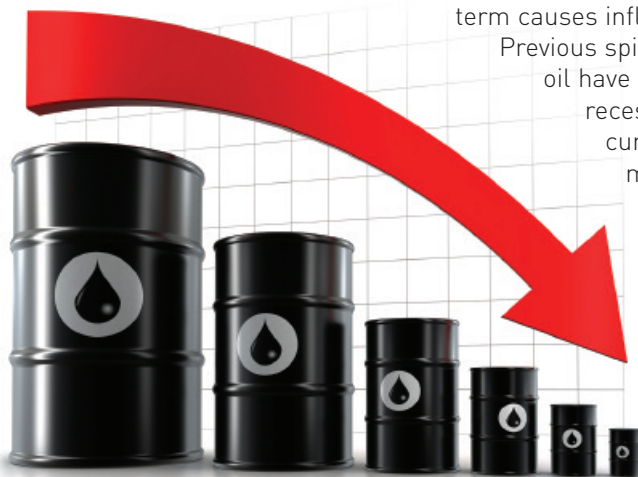
The current unrest in the Middle East and North Africa started with protests in Tunisia at the end of December, which was quickly followed by Algeria and Egypt. The protesters were highlighting corruption and high unemployment and seeking reforms. The Tunisian and Egyptian protests achieved their aims relatively quickly with both Presidents resigning, but this led to widespread unrest in the region with reports of protests in Iran, Iraq, Yemen, Bahrain, Jordan, Algeria, Morocco and Libya.

Although the economies of these regions are relatively small, the global impact would be slight if it was not for their production of oil and the likely effect on price. Whilst Tunisia and Egypt are not large oil producers, Libya and Algeria are, and the concern is that the unrest could spread to the heartland of the Middle East affecting the large oil producers of Iran, UAE, Kuwait and Saudi Arabia.

Economic impact

The price of oil acts as a tax to consumers, so the higher the price of oil, the higher the cost of energy, fuel and other products involving oil, which results in less disposable income. Rising oil prices tend to lead to higher inflation as increased costs are put on the consumer, which until the late 1980s generally meant higher interest rates. However, since the late 1980s most central banks have cut interest rates on the back of higher oil prices. This is due to the fact that higher oil prices cause a drag on economic growth, which over the medium-term causes inflation to fall.

Previous spikes in the price of oil have often led to a recession, but there is currently a good momentum behind the global economy and it should be able to withstand short-term higher oil prices.



Rank in 2009	Country	Oil production, 2009 (million barrels per day)
1	Russia	9.9
2	Saudi Arabia	9.7
3	United States	9.1
4	Iran	4.2
5	China	4
6	Canada	3.3
7	Mexico	3
8	UAE	2.8
9	Brazil	2.6
10	Kuwait	2.5
15	Algeria	2.1
17	Libya	1.8

Source: IEA

In a recent Goldman Sachs report, it is estimated that a 10% rise in oil could reduce economic growth by 0.2% per annum for the next two years. They estimate world economic growth at a robust 4.8% in 2011.

The Libya perspective

Libya produced an average of 1.6m barrels per day in January and this has declined by an estimated 430,000 barrels per day in February after multinationals such as Total, ENI, Repsol YPF and Gazprom closed production and evacuated staff. The current spare capacity in oil production is circa 5.3 million barrels a day, with Saudi Arabia accounting for 75% of this. If Libyan oil production was to stop completely, it would take Saudi around four to six weeks to increase their production to cover the extra 1.6m barrels per day, but there are also oil surpluses around the world, particularly in the US. Demand remains steady, so it suggests it

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is the fear of supply disruption and contagion that is driving up the price of oil. The outcome of the unrest in Libya is also likely to have an impact on the oil supply and price. There are three potential outcomes as follows:

1. Colonel Gaddafi stands down and an internationally recognised new leader is appointed. In this scenario, oil companies will return quickly and the disruption of oil supply is temporary.
2. Colonel Gaddafi stands down or stays on but Libya falls into civil war. Oil companies will stay away due to safety fears and political pressure. Oil supply will remain disrupted.
3. Colonel Gaddafi stays on. Oil companies will face considerable political pressure not to return to Libya. The National Oil Company could take over the facilities left by the multinational oil companies (as they did with US companies in the 1980s) but supply (and demand for Libyan oil) will remain disrupted.

Possible contagion

The unrest in the Middle East and North Africa has spread since the initial protests began in Tunisia and there is a concern that it will spread further. In addition to the trouble in Libya and Yemen, other countries such as Algeria, Syria, Iran and Bahrain also face

potential problems. UAE, Jordan, Qatar, Oman, Kuwait and Saudi Arabia are currently thought to be safe.

Saudi Arabia, along with Algeria and Bahrain has implemented fiscal reforms to try and appease the local population. Saudi's ruling royal family has agreed a \$35bn package, including a 15% wage increase for public sector workers. Whilst the wealthier states in the region, such as Saudi Arabia and UAE, look relatively stable, the unrest has clearly given the ruling parties a cause for concern. This has increased the pressure of reform and a desire to tackle long-standing problems such as unemployment, corruption and a lack of social and political freedom.

Investment impact

In previous oil shocks, equity markets have generally fallen in the short-term but recovered over the medium-term. The below table shows seven historic oil supply shocks and the subsequent impact on the price of oil and the Dow Jones Industrial Average equity index.

The spike in the price of oil often coincides with other economic events which can take precedent over the price of oil, such as the last two events which were at the end of the 'dotcom' bubble. The average fall in equity markets over the first three months following the oil shock is -3.87% compared to an average fall of -1.4% for the first year and an average rise of 19.75% after year three. The current uncertainty in the Middle East and North Africa will cause similar volatility over the next few months and we are recommending new equity investment to be phased over this period. However, longer term equity markets still look attractive despite the uncertainty around the oil price. As long as the large oil producers of Saudi Arabia, Iran and UAE remain relatively unaffected, the price of oil should not rise to the 2008 heights of \$147 a barrel, but we would advocate caution in investment planning over the next few months.

Event	Date	Peak production loss (million barrels per day)	Oil price change (%)			Dow Jones Industrial Average movement (%)		
			+1m	+3m	+6m	+3m	+12m	+36m
Yom Kippur War	Oct 73	5	57	100	350	-9.86	-36.26	3.27
Iranian Revolution	Jan 79	2	4	10	41	5.4	1.62	7.84
Iran/Iraq war	Sep 80	2.5	0	2	13	3.05	-6.17	28.28
Israel bombs Iraq nuclear reactor	Jun 81	0	-2	-5	-4	-11.55	-18.34	12.66
Iraq invades Kuwait	Aug 90	4	47	99	35	-15.32	4.08	22.82
PDVSA strike	Dec 02	2.5	13	36	6	-11.56	11.18	22.74
Gulf war 2	Mar 03	2.5	3	14	12	12.76	34.13	40.63

Sources: Morgan Stanley, Bloomberg, Dow Jones



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