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MENA: Winds of change not yet gale force

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Summary

The overthrow of Tunisia' regime was underpinned by factors common to the Middle East and North Africa (MENA) region. Continuing wider political unrest remains a risk; but the immediate likelihood of another regime collapse remains low. The short-term economic impact of the crisis in Tunisia will be meaningful, though may be mitigated by a longer-lasting improvement in the business environment. Other MENA countries are unlikely to see major negative economic effects, but markets may remain jittery.

Background

Events over the past week in Tunisia have set in motion an important period of political and economic change, both in the country and, potentially at least, in the MENA region more broadly. Even though civil unrest had been swelling in Tunisia for over a month, as recently as two weeks ago few would have confidently predicted the imminent demise of the 23-year rule of Zine el-Abidine Ben Ali which took place on 14 January.

The root causes of the unrest lay mostly in the population's growing disillusionment and frustration with the autocratic and corrupt Ben Ali regime, which had led to the enrichment of the extended family members of both the (now former) president and his wife. These sentiments were exacerbated by increasing food price inflation[1] and unfavourable demographics, notably a young and under-employed population (Figure 1). But as the Economist Intelligence Unit's (EIU) country risk assessment model suggests (Figure 2), Ben Ali's Tunisia was, in principle at least, far from being the most vulnerable country in the region to the sort of events which led to his downfall.

Pressure beyond Tunisia, though contagion risk not virulent

In the wake of the so-called "Jasmine Revolution" sympathetic protests and public displays of support for the revolt in Tunisia have emerged in other MENA countries, though nowhere have the disturbances yet come close to a similar level of disorder. Nonetheless, the risk of further food price-related demonstrations could emerge across the region, including in Egypt where the 2008 spike in food prices also triggered unrest. Egypt is also challenged by this being a presidential election year with uncertainties over a possible succession to Hosni Mubarak.

Despite these risks, we do not anticipate the near-term collapse of any other Middle Eastern regimes, particularly as the Tunisian example contained some important specificities which may limit its ability to be replicated in the near-term, notably:

- ***Tunisia boasts a highly educated, middle class population which organized protests using multiple media sources***, but particularly online resources (Facebook, Twitter). The population in many other MENA countries does not (yet) boast access to a similar ability to network so broadly. For example, Facebook penetration in Tunisia was 16% in August 2010, versus 5% in Egypt, and 6% in Morocco. The economic and educational advantages of Tunisians had often been cited as a reason why they would not revolt; but, in the end, it was their perception of the widening gap between the conditions for average Tunisians and those at the top which fuelled the discontent. Their ability to project a worsening of economic opportunities as a direct result of the current regime was an essential element in the revolt. It is hard to point to another MENA country with comparable circumstances.

- ***Religion plays no role in political life*.** While the Tunisian population has become broadly more religious over the past decade, its institutions remain fiercely secular. This, and the outlawing of religious parties, meant that the revolutionary "cause" was not associated with religion. It is not evident that this would be the case in many other MENA countries, which is likely to mean even more concerted (and potentially violent) efforts by the authorities to quell such protests.

- ***The level of repression of basic freedoms, particularly free speech, in Ben Ali's Tunisia was significant even relative to other*** countries in the region. There were no independent newspapers, and the suppression of any commentary critical of the state apparatus was total. Most other MENA countries allow greater space for opposition voices, and the media—while heavily monitored in many cases—is still far freer than it was in Tunisia.

- While Tunisia doesn't boast a large standing army (compared with other countries in the region), ***the military remained true to its mandate as a defender of the people*** (as opposed to the regime) during the crisis. This was an important factor which precipitated the toppling of the regime. In other Middle Eastern countries, the military is more committed to the maintenance of the establishment, a fact that may act as a greater deterrent to popular uprising.

Despite these important differences, the longer-lasting effects of the revolution will, in our view, be important and will continue to influence political developments in the region for many years to come. In particular, the success of the Tunisian population in overthrowing their leadership in a relatively quick period of time (less than a month), with relatively limited bloodshed, will serve as an example, and could well incentivize the formation of resistance movements, even if the estimated costs (both economic and in terms of human life) are higher.

Regional governments respond

Events in Tunisia are likely to serve as a salutary warning to other autocratic Arab leaders[2] as they become even more attuned to the demands of their populations related to the cost of basic necessities and the prospects for job creation. Indeed, some governments have already announced new economic measures to try to ease upward pressure on prices, such as in Algeria and Jordan.[3] And authorities in Yemen have indicated a potential willingness to accede to demands for political reform as well. Looking ahead, we expect further measures to be rolled out across the Arab world to mitigate the impact of rising prices, though this will also likely be accompanied by a hard-line response, by at least some regimes, to any significant civil unrest.

Many economic measures will no doubt come at a fiscal cost, and could well be just "kicking the can down the road," not least since past experience suggests that it can often be politically difficult to reverse them. If predictions of higher than historical food prices over the next decade prove accurate, this will be even more important. At worst, this is likely to have a

Figure 1. MENA demographic statistics

Economy	Population, mn (2009)	Population growth, pa (2005-09)	Population aged <15 (2010)	Population aged 15-60 (2010)	Median age in years (2010)	GDP, per capita (2009)	Real GDP growth, pa (2005-09)
Algeria	35.3	1.7%	27.0%	66.1%	26.2	$4,572	3.0%
Egypt	83.1	1.9%	32.1%	60.4%	23.9	$2,278	6.0%
Iran	74.2	1.2%	23.8%	69.1%	26.8	$4,869	5.1%
Iraq	*31.4*	*2.0%*	40.7%	54.6%	19.3	*$3,600*	*3.7%*
Jordan	6.3	3.0%	34.0%	60.5%	22.8	$3,357	5.8%
Libya	*6.4*	*1.5%*	30.1%	63.3%	26.2	*$10,740*	*5.4%*
Morocco	32.0	1.2%	28.0%	63.9%	26.2	$2,914	4.9%
Saudi Arabia	25.4	2.4%	32.0%	63.4%	24.6	$14,552	3.0%
Syria	*22.0*	*1.9%*	34.7%	60.4%	22.5	*$2,500*	*4.0%*
Tunisia	10.3	1.0%	22.9%	67.4%	29.1	$3,618	4.7%
Yemen	*23.4*	*2.7%*	43.4%	52.8%	17.8	*$2,500*	*3.5%*

Source: Economist Intelligence Unit, Nomura.

negative impact on the ability of governments successfully to implement long-term policies on poverty alleviation, which are essential to the avoidance of similar crises in the future. In other words, measures being taken now attempting to reduce the local impact of food price inflation and defuse tensions which could lead to serious civil unrest could well be storing up even bigger problems for the future.

Marking political risk to market

Up to the time of Ben Ali's demise, markets remained more or less unmoved by events in Tunisia. But his downfall has sparked a rise a regional risk aversion, with particularly negative reactions from the Egyptian stock market and sovereign debt spreads across the region. Recent ratings actions, including Moody's one-notch downgrade of Tunisia to Baa3 yesterday, have not helped to alleviate the negative sentiment. Equities have continued to sell off in recent sessions, and spreads have not retraced from their wides (Figures 3 and 4). Foreign investors appear to be lightening exposure to the region altogether, while many local investors appear to be at least partially reallocating toward to the Gulf, where governments have more resources to combat any political discontent over economic grievances.

Looking ahead, we expect markets to remain jittery as investors perceive political risk to be higher than they had previously reckoned, particularly in Egypt. But ultimately, we would expect these jitters to die down, particularly as extreme political tensions in Tunisia abate and the economy resumes normal activity. Nonetheless, it will be difficult fully to restore confidence in the regional political environment and, as such, spreads are unlikely to return to their pre-crisis levels any time soon, though some modest retracement should be expected. Equity markets could also stage a modest recovery, again particularly in Egypt since the selloff there has been more extreme. Note, however that the Tunisian stock market remains closed (since January 14th) and some further weakness could ensue upon its reopening.

…And Tunisia?

As for Tunisia, immediate security concerns appear to be abating, even as political uncertainty persists. In the wake of more than two decades of autocracy, and even longer one-party rule, it could well take several months (or longer) of wrangling before the political environment stabilizes. Nonetheless, so long as the security environment continues to improve, we would expect that the economy, which has already begun to resume normal activity, will begin to recover more fully. A few key points about the economic impact follow:

- Tunisian authorities have estimated the ***total cost of the unrest will reach EUR1.4bn, or approximately 3% of GDP, though they note that this will likely be mitigated by several factors***, including the resumption of normal economic activity, which should see surge of deferred purchases and export revenues which had been delayed during the crisis. Authorities also report having been reassured of several anticipated foreign direct investments (though it is too early draw longer-term conclusions about foreign investment). Some rebuilding (of shopping centres and the main train station in Tunis) could also contribute to increased economic activity in the period ahead. Stock market capitalization remains low (at about 20% of GDP), which should minimize the impact of market losses on the broader

Figure 2. Economist Intelligence Unit, risk assessment model

Economy	Overall Assessment	Security Risk	Political Stability Risk
Egypt	B39	B32	C50
Jordan	B39	B32	D65
Tunisia	C43	B29	C50
Saudi Arabia	C46	C50	C60
Morocco	C51	C43	C60
Syria	C54	B21	D70
Libya	C56	A14	C60
Algeria	D63	D61	D65
Iran	D63	B29	D75
Yemen	D69	E86	D75
Iraq	D78	E100	D80

Source: Economist Intelligence Unit. *Notes: (a) E = most risky; 100 = most risky; (b) ratings pre-da the Tunisia crisis* economy.

- While it is still early days, ***we would expect economic growth to slow to 2-3% in 2011, versus 3.8% in 2010***, and a previous government forecast of 5.4% (we expect that the government will reduce its forecast for economic growth this year as well). We would also expect a modest increase in inflation pressures in coming months, as commercial establishments have already begun increasing prices to make up for some lost revenue. However, this could well prove limited, being mitigated by a likely slowdown in credit growth, as well as anticipated declines in real estate prices and the stock market, both of which had been rising rapidly pre-crisis.

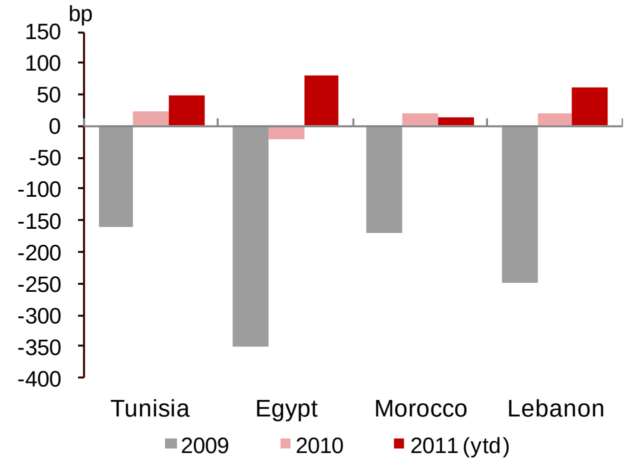
- There is no doubt that ***the tourism industry will be hard hit by the crisis***. Already suffering from a downturn as a result of slower economic activity in Europe, combined with the fact that the holy month of Ramadan falls during the peak summer months, many establishments are likely to suffer a significant decrease in occupancy rates, which will have a trickle-down effect throughout the sector. Nonetheless, given that the tourism sector represents less 10% of GDP, even a severe decline is unlikely to create a meaningful drag on aggregate growth.

- We do expect some ***widening of the current account deficit in 2011*** to ***almost 5% of GDP***, particularly as the tourism industry, an important contributor of foreign exchange, is deeply affected by the crisis. This widening was already under way as a result of the worsening trade balance in 2010. The likely slowdown of FDI, even if modest, will also present an important challenge for the financing of the growing deficit. Nonetheless, the limited convertibility of the Tunisian dinar means that the risk of significant capital flight remains low. Central bank reserves remain comfortable at US$9bn, or more than five months of imports, which should ensure that the current account widening remains manageable, at least for this year.

- The ***servicing of external debt does not appear compromised***, and the central bank has already moved to reassure creditors that it has ample foreign currency reserves to meet its 2011 payments. Sovereign obligations in 2011 are composed of two payments: EUR450mn on April 7 and JPY15bn on September 27. Moreover, although the budget deficit has widened in the past year as a result of the government's stimulus measures in response to the global crisis, it remains at a relatively manageable 3% of GDP.

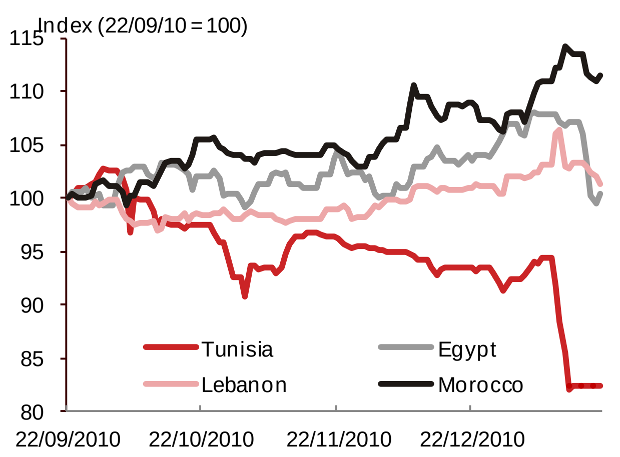
- ***Some of the most important economic challenges surround the fate of the banking sector.*** With a few of the country's key banks having been either partly or majority owned by members of the former president's family, focus could well turn to their health. As such, it will be important for banks, especially those which were closely associated with Ben Ali and his extended family, to reassure their shareholders and depositors that they have good understanding of their risk

Figure 3. Annual change in 5y CDS for selected countries



Source: Bloomberg, Nomura.

Figure 4. Stock Exchange performance (re-indexed)



Source: Bloomberg, Nomura.

exposure, and will make provisions for any loans that may be negatively affected by the current situation. The well-regarded Tunisian central bank should also act to ensure that depositors in all banks feel safe, especially since it will inevitably take time to have a proper understanding of the lending exposure of the banking sector to the former president's extended family. The extension of a blanket deposit guarantee could be helpful in this respect. Some steps important have already been taken to resolve the ownership questions around Ben Ali-linked banks, but more will be needed.

- Over the longer term, ***the removal of the corrupt, non-transparent and anti-competitive practices of the former president and his extended family is likely to herald a period of reinvigorated entrepreneurial activity*** in the country, provided the security situation stabilizes.

End Notes

[1] *For more on our assessment of the risks inherent in food price inflation see "The coming surge in food prices", Nomura Global Economics and Strategy, September 2010. For more political background see "The Politics of Food Price Inflation: An "Issues Which Keep Me Awake at Night" Special Report", 2 June 2008 – available on request.*
[2] *See "Issues Which Keep Me Awake at Night: 2011 Forecast", Nomura Equity Research, 24 November 2010 page 29.*
[3] *Press reports recently reported that Algeria has just purchased at least 600,000 tonnes of wheat to boost supply.*

Disclosure Appendix A1

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