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## MENA Unrest and Its Implications

### Executive Summary

- Countries in Middle East and Africa produce 42.6 percent and export 43.4 percent of global crude oil, so possibility of contagion within the region poses supply risks and caused oil price to increase.
- Since the MENA unrest, commodities outperformed equities and bonds significantly. There could be further upside for gold should the oil price maintain or continue trending higher.
- Emerging market equities seemed to have taken a bigger hit than developed market equities, possibly due to inflation concern, tightening measures and fund outflows.
- One key risk for the region lies in whether Saudi Arabia will be affected by social unrests as well.

The Middle East and North Africa (MENA) unrest started in Tunisia and has spread to other countries in the region such as Egypt, Libya, Bahrain and Yemen. The deterioration of the political environment in Libya has heightened risks in the oil market as possibility of supply shortage become more tangible. In this report we discuss the implication of MENA unrest on oil, commodities, and emerging market equities.

### Implications on Oil

Middle East and Africa are major oil producers and exporters, generating 42.6 percent of the world oil production and exporting 43.4 percent of world crude oil in 2009. As more countries face social unrests, fear of a supply shortage has pushed oil price to above US\$100/bbl. We have mentioned in our “Asset Class Update” (March 2011) report that the ongoing unrest in Middle East is unlikely to fizzle out anytime soon and things can remain irrational for longer than many would think. Moving forward, oil prices will be dependent on the degree of contagion effect within the region and OPEC’s reaction towards the situation in the long run.

**Table 1: Oil Production and Exports by Region**

Region	Production		Exports	
	Thousand Barrels Daily (2009)	Percentage of Total Production (2009)	Thousand Barrels Daily (2009)	Percentage of Total Exports (2009)
North America	6,526.70	9.46%	3,755.70	6.34%
Latin America	9,516.40	13.79%	6,704.00	11.32%
Eastern Europe	12,386.10	17.94%	7,843.30	13.24%
Western Europe	3,820.10	5.53%	8,319.10	14.04%
Middle East	20857	30.22%	18,196.30	30.71%
Africa	8562	12.40%	7,526.20	12.70%
Asia Pacific	7359	10.66%	6,903.70	11.65%
Total World	69026	100.0%	59,248.40	100.00%

Source: OPEC Annual Statistical Bulletin 2009

*Middle East and Africa produces 42.6 percent and exports 43.4 percent of global crude oil.*

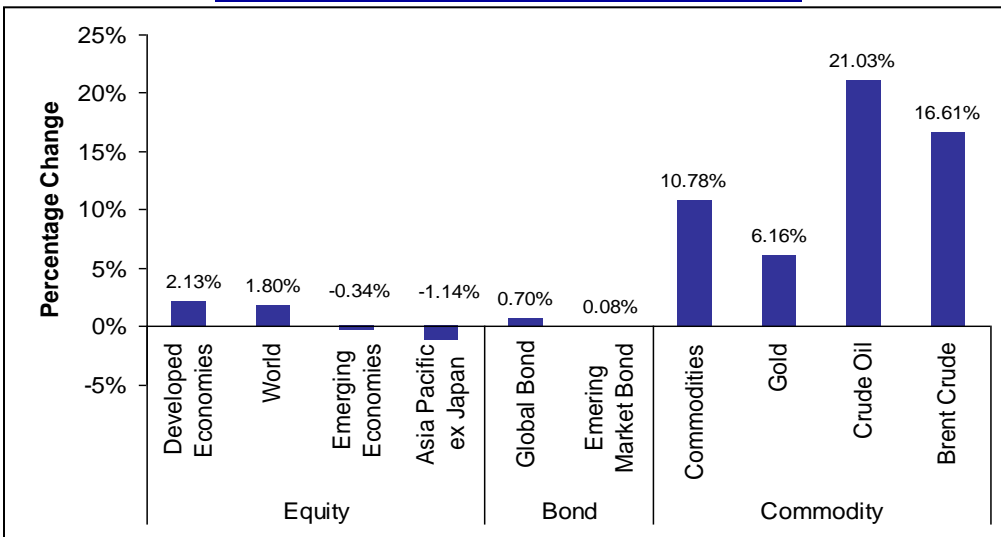


At this stage, political developments in the region are difficult to ascertain, especially with the lack of transparency. However, industry officials of some OPEC members have recently said that production increase could be expected by early April, and will almost make up the shortfall in supply from falling Libyan crude exports. While this could ease supply fears in the interim, we note that if Saudi Arabia is also hit by public unrests, the implications on oil prices could be much more severe than currently observed.

### Commodities Outperformed since the MENA Unrest

25 January 2011 signifies the start of Egypt riot and also the MENA unrests. Overall, bonds and equities underperformed commodities significantly since the crisis, possibly on the back of supply risks and inflation fears. Gold has gained 6.16 percent since 25 January and is currently trading at 1,426.30 US\$/oz as of 9 March. Previously, we mentioned in our “Asset Class Update” (March 2011) report that we are positive on gold in the long term. With recent development in MENA, we feel that gold could continue trending higher in the event that oil price stays elevated or edge higher as it is a good inflation hedge.

**Chart 1: Percentage Change since 25 Jan 2011**



*Since the start of the Egyptian unrest, commodities outperformed equities and bonds significantly.*

*Note: Indices used are MSCI World Index, MSCI All Countries World Index, MSCI Emerging Markets Index, MSCI Asia Pacific ex Japan Index, JPMorgan Global Aggregate Bond Index, JPMorgan Emerging Market Bond Index, TR/J CRB Commodities Index, Gold Spot \$/OZ, Crude Oil Futures, Brent Crude Future*

*Source: Bloomberg, as of 8 Mar 2011*

### Emerging Country Equities Took a Bigger Hit

For the period, Asia Pacific ex Japan equities was down by 1.14 percent. Most Asia countries except Malaysia are net importers of crude oil. In particular, crude oil made up 27 to 44 percent of total import values for countries such as India, China and Indonesia in 2010. Given the importance of oil in emerging countries, the MENA unrests affected equities in the region mainly through the implication of increasing oil price on inflation, tightening measures by government, and consequently fund flows.



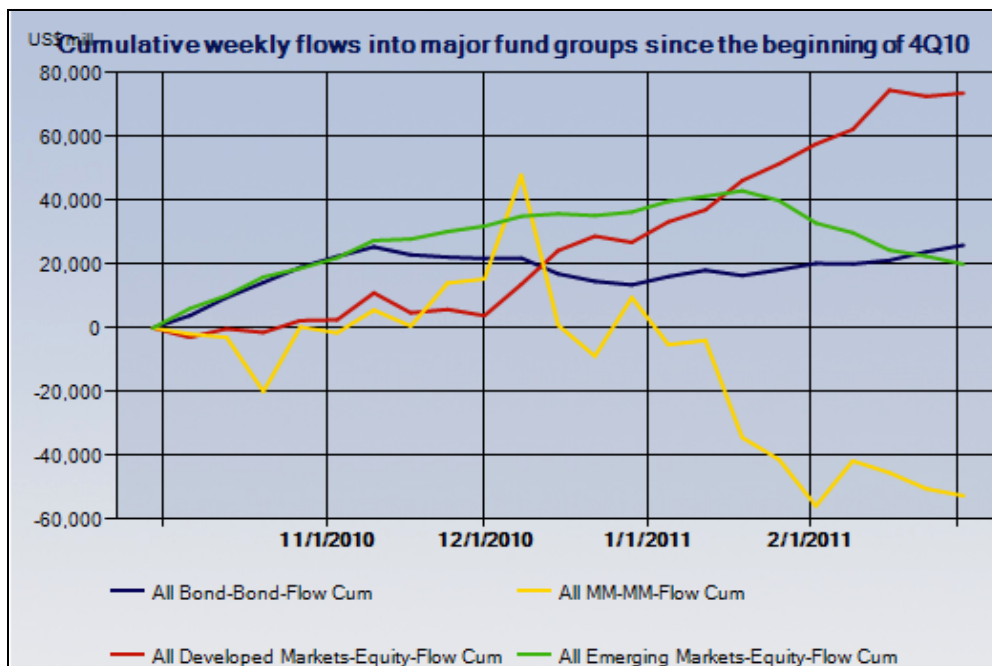
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## Unit Trust – Market Insights

10 Mar 2011

Since 24 January 2011, emerging market equities witnessed approximately US\$20 billion outflow while developed market equities experienced comparable inflows. (Chart 2) Before the MENA unrests, investors already appeared concerned about inflation and the possible tightening measures that emerging economy governments could implement to curb inflation. The increase in oil price due to MENA unrest added further inflationary pressure, increasing the chance of faster and more aggressive tightening. Therefore, while inflation issues and tightening measures in the emerging market may be some of the causes behind this shift in fund flow, we feel that the MENA unrest could have exacerbated the process. The outflow of funds could have been behind the underperformance of emerging market equities in the period and the MENA unrests partly contributed to it.

**Chart 2: Cumulative Weekly Flows**



Since 24 Jan 2011, emerging market equities fund had approximately US\$20 billion outflow.

Source: EPFR, as of 2 Mar 2011

Aside from inflation and tightening measures, we feel that uncertainties are greater in the long run. Emerging economies were already facing inflation, mainly due to increase in food prices caused by weather-related supply shortage and declining ending stocks. The inflationary pressure was further aggravated by the surge in oil price due to fears regarding supply shortage. As the inflationary pressure that we are observing is more of cost-push than demand-pull, it could slow economic growth in time to come. While we note that battling inflation could be of higher priority than maintaining growth for emerging economies at this juncture, over-tightening could stifle growth in the future. Therefore we feel that the key challenge for the government is to manage inflationary pressure in the short run while balancing growth in the long run. The ability of the emerging economies to find the right balance would be a key determinant in both their countries' progress and future equities performance.



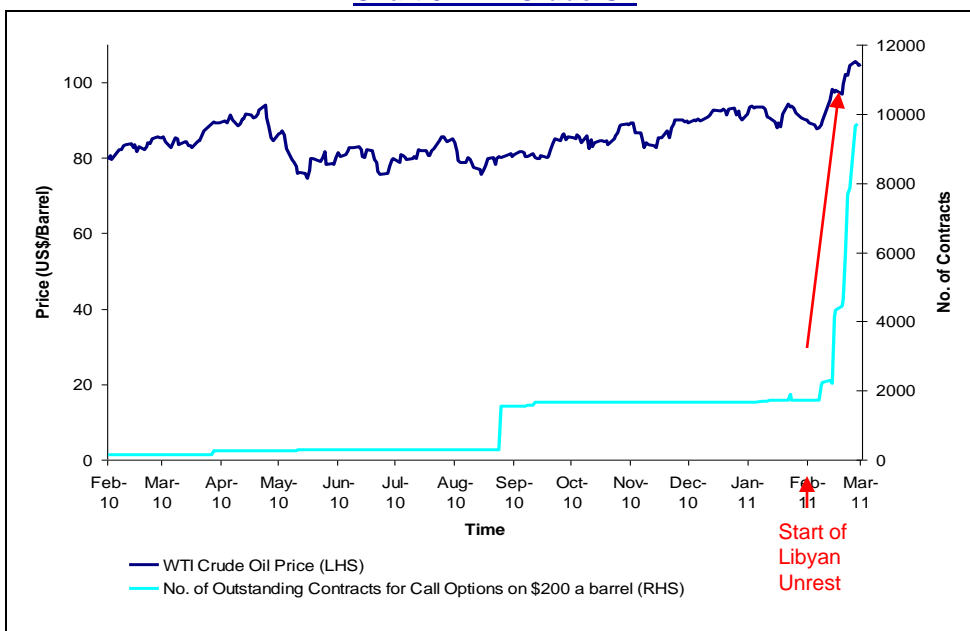
### Looking Ahead – Risks in Saudi Arabia

Speculation by traders on supply risks are pushing oil price up, but what is preventing oil price from getting out of control is mainly Saudi Arabia in our opinion. The unrest in Libya have cut output by as much as 1 million barrels a day, down two-thirds from a prevailing output level of 1.58m barrels a day before the start of the crisis, according to the International Energy Agency. In response, Saudi Arabia has increased oil production by 1 million barrels a day and has the capacity to pump an additional 3.5 million, according to James Smith, US ambassador to the kingdom.

As Libya's situation worsens, investors seemed more accepting towards the idea that the country might be undergoing a prolonged period of civil war as oil price retraced slightly the past two days. Therefore, the real risks to the economy could occur if the other oil-producing countries, in particularly Saudi Arabia, are faced with social unrests as well.

An article on Bloomberg stated that there are some websites "calling for a 'Day of Rage' in Saudi Arabia on March 11 and 20". Saudi Arabia produced 9.71 million barrels a day in 2009, almost six times as much as Libya, according to British Petroleum's Statistical Review of World Energy. Therefore, disruption to production in Saudi Arabia could be more impactful against oil prices than Libya. As shown by Chart 3, the number of call option contracts on US\$200 per barrel had increased to 9716 as of 8 March, almost five times the number in January. This implies that traders are increasingly optimistic that that oil price will touch US\$200 per barrel in the near future. While this is just speculation and no one can be certain whether Saudi Arabia will be affected, this should be a key risk and event that investors keep their eyes on. That being said, we would like to highlight that Saudi Arabia has higher GDP per capital than countries facing protest and lacked significant organized opposition forces up to this point.

**Chart 3: WTI Crude Oil**



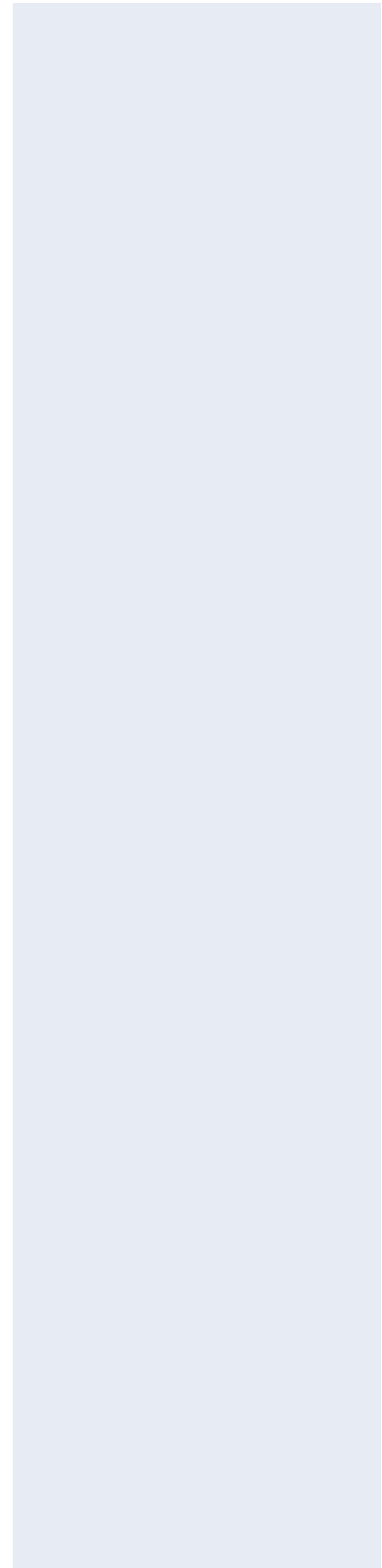
*Option traders are increasing their bet that the oil price can shoot up to US\$200 per barrel.*

Source: Bloomberg, prices as of 10 Mar 2011



### Conclusion

The spreading of the MENA unrest caught most investors by surprise and caused spike in oil prices due to heightened risk of a supply shortage. Emerging economies with high inflation appears to be at a tougher position as they have to balance between fighting inflation and preventing stifling of growth. Moving forward, investors should keep an eye on the development in Saudi Arabia as possibility of unrests in the country poses significant risks to oil prices. Overall, we feel that the situation in MENA is likely to persist for some period, and investors should probably look to manage risks by diversifying into inflation hedging tools such as gold.





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