MENA Poised for a Comeback in Spite of Trouble in the Gulf

By ECR - Jeremy Weltman, **Fri Mar 21, 2014**

Rising risk scores since 2013 are providing investors with encouragement that the worst is over for the troubled region. Yet sovereign risk remains heightened in familiar territories, with the Syrian turmoil persisting, leaving Gulf states and Israel as relative oases of safety.

MENA sovereign risk is stabilizing, according to experts taking part in Euromoney's Country Risk Survey, with many of the countries severely affected by the Arab Spring uprising and last year's weakened global growth prospects starting to see their scores improve, if modestly.

Since December, 14 of the 18 MENA sovereigns in Euromoney's 186-nation survey have enjoyed rising scores, with just two – Algeria and Libya – further downgraded.
Low-risk Kuwait and high-risk Iran are unchanged, according to the survey, with Iranian country-risk experts sizing up the diplomatic efforts to resolve a nuclear crisis that could help to improve an economy undermined by sanctions.

MENA Sovereigns, March 2014

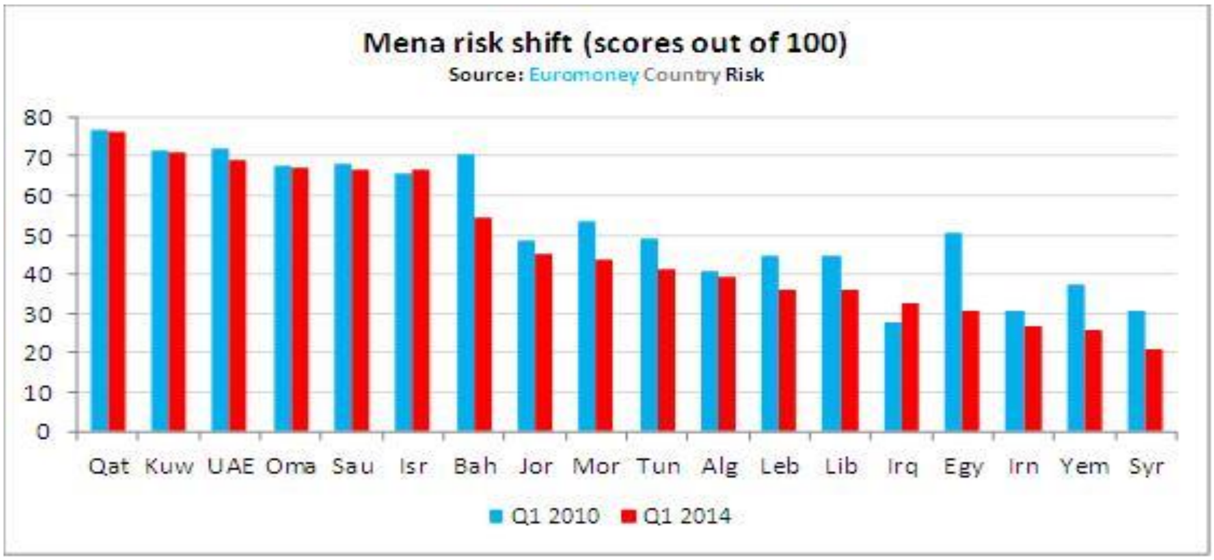
ECR Rank out of 186	Tier		ECR Score out of 100	Score shift since 2013	Score shift since 2010	Credit Ratings Fitch	Moody's	S&P
16	2	Qatar	76.34	0.11	-0.43	n/a	Aa2	AA
21	2	Kuwait	70.97	0.00	-0.51	AA	Aa2	AA
24	2	UAE	68.97	0.13	-2.97	n/a	Aa2	n/a
29	2	Oman	67.17	0.19	-0.57	n/a	A1	A
32	2	Saudi Arabia	66.59	0.04	-1.50	AA- (+)	Aa3	AA-
33	2	Israel	66.40	0.26	0.70	A (+)	A1	A+
54	3	Bahrain	54.61	0.01	-15.75	BBB	Baa2 (-)	BBB
77	4	Jordan	45.33	0.15	-3.17	n/a	B1	BB- (-)
78	4	Morocco	43.63	0.16	-9.91	BBB-	Ba1 (-)	BBB- (-)
82	4	Tunisia	41.15	0.46	-8.06	BB- (-)	Ba3 (-)	n/a
90	4	Algeria	39.34	-0.07	-1.60	n/a	n/a	n/a
102	5	Lebanon	35.92	0.14	-8.61	B (-)	B1 (-)	B- (-)
103	5	Libya	35.81	-0.20	-8.98	n/a	n/a	n/a
120	5	Iraq	32.45	0.30	4.89	n/a	n/a	n/a
131	5	Egypt	30.73	0.24	-19.58	B-	Caa1 (-)	B-
149	5	Iran	26.60	0.00	-4.27	n/a	n/a	n/a
151	5	Yemen	25.87	0.10	-11.61	n/a	n/a	n/a
163	5	Syria	21.07	0.06	-9.46	n/a	n/a	n/a

Sources: Euromoney Country Risk; credit rating agencies

The picture will become clearer when ECR releases its results for Q1 2014 next month, but these early indications suggest that the severe downgrading of many sovereigns in the region that occurred in the wake of revolution and its attendant economic problems has stopped.

The turnaround in Morocco and Tunisia is perhaps the most interesting for investors seeking medium-risk bond returns with the usual caveat that nothing is guaranteed. Egypt is also being watched closely again, with its score gradually recovering in response to a stabilizing political situation and financial support from regional partners.

Still, it's a long way back for those countries that have seen severe trend-score declines in the survey, especially with the intractable Syrian crisis drawing in bordering nations Lebanon and Jordan – Israel, too, with recent rocket attacks escalating – as ethnic violence spreads across porous borders and the monumental refugee crisis leverages socioeconomic risk. Libya and Yemen, moreover, still have their own economic troubles to contend with, and similarly Egypt with tensions still festering, growth weakened and a huge fiscal gap to fill keeping its score virtually 20 points lower compared with 2010.



Maghreb's shifting sands provide prime focus

The MENA region's risk disparity has never been wider. As of the third week of March, 55.3 points separates AA-rated Qatar, ranking 16th in the survey, from Syria ranking 163rd on just 21.1 points. The latter is one of seven extremely high-risk sovereigns rooted in the lowest of ECR's five tiered categories, of which only two – Lebanon and Egypt – receive a credit rating from Fitch, Moody's and S&P.

Above them is 90th-placed Algeria, a low-ranking tier-three sovereign still battling with internal political risk, slow reforms and other domestic and external problems with elections looming. According to ECR expert Kaan Nazli, senior economist at Neuberger Berman: "The most important change has been that incumbent president Abdelaziz Bouteflika will be running for the presidency in April, keeping political uncertainty high, as it is not known whether he is healthy enough to finish another term."

Bouteflika is promising constitutional change to improve democracy and business reforms to assist the economy, the need for which is underlined by Algeria's very low ranking of 153rd out of 189 countries in the World Bank's Doing Business 2014 report, having slipped two places since 2013.

However, it remains to be seen if those plans succeed. In the meantime, domestic tensions will fester over jobs, housing and rising living costs. Nazli sees the latter as one of three economic risks to monitor "with inflation picking up as a result of higher food prices, the budget balance worsening slightly due to hiccups in oil production (though still remaining low) and the current-account surplus declining for the same reason".

However, the region bordering Algeria is offering up alternatives. Morocco (ranking 78th) and Tunisia (82nd) are comfortable mid-tier-four sovereigns. Morocco slipped four places in the survey rankings last year and Tunisia by nine, with various economic and political risk indicators downgraded (see chart), but both countries have seen their scores rebound somewhat this year. Although Tunisia's political problems are not fully resolved – with four of its six political-risk indicators still scoring less than five out of 10 – domestic stability is restored at last, with a transitional government overseeing the drafting of a constitution to pave the way for elections this year.

With the state of emergency lifted, economic growth is forecast to strengthen this year to around 3%, inflation will fall to near 5.5% and the fiscal and current-account imbalances should moderate, according to forecasters, with support from external creditors and the prospect of subsidy reforms. Samir Gadio, an emerging markets strategist for Africa at Standard Bank, and one of ECR's survey contributors, nonetheless strikes a note of caution. In his opinion the political development "is not without its risks". He states, moreover: "Tunisia has a stagnating economy, requiring painful fiscal measures."

Morocco, on the other hand, ranking four places higher in the survey, is a safer bet, with the country improving after a new government was formed in the wake of the crisis to befall the coalition last year. Negatively, GDP growth will be slower in 2014 and inflation higher, with external debt mounting, though manageable. However, as Gadio explains: "Morocco was largely immune to the Arab Spring with fewer protests and the government has taken steps to cap subsidies with a partial fuel adjustment." Amid these continuing efforts to improve the large fiscal and external deficits, Morocco has also seen its foreign- exchange reserves stabilize, partly because of a resilient tourism sector, which, with the security of an IMF precautionary credit line and grants, has helped to stabilize the currency. "More reforms are necessary, to the pension system," says Gadio. "But it is interesting to note the diversifying economy with auto and aeronautical manufacturing, and the expansion of Moroccan banks into sub-Saharan Africa," keeping Morocco above its peers.

Trouble in the Gulf

Disagreements between Bahrain, Saudi Arabia and the United Arab Emirates, on the one hand, and Qatar, on the other, concerning the latter's refusal to label the Muslim Brotherhood as a terrorist organization, have opened up new diplomatic wounds between members of the Gulf Cooperation Council, which stretch back to border clashes between the Saudis and Qataris in 1992.

Saudi threats to block the land border, close Saudi airspace to Qatari planes and impose sanctions, amid the unprecedented withdrawal of ambassadors from Doha, highlight the rising tensions. ECR expert M. Nicolas J. Firzli, director-general of the **World Pensions Council**, goes further by stating that GCC policymakers "are faced with difficult choices as oil revenues have to be used as a priority to fund expensive public infrastructure and social entitlements to ensure political stability, and finance costly weapons programmes required to protect the Arabian peninsula".

However, experts believe the complete disintegration of the GCC is an extreme risk. Besides, high-flying Qatar, one of six tier-two MENA sovereigns (all Gulf States besides Israel) scores a hefty 76.3 points, signalling that efforts will be made to resolve the dispute diplomatically. In any event, Qatar's fiscal balances are protected by long-term supply contracts for its liquefied natural gas with customers outside the region – in Asia, Europe and the US – keeping economic growth bubbling along at 5% (bolstered by huge infrastructure investments) and the fiscal and external accounts comfortably in surplus. As the **WPC**'s Firzli points out: "GDP growth is around 4% in the GCC, compared with an average of 1% in MENA as a whole, and the public finances are generally in good shape."

If anything, it is Bahrain posing the most concern. Rooted to 51st spot in the global rankings on a score of 54.6, the only tier-three sovereign in the Gulf is still coming to terms with the domestic tensions fomenting outbreaks of violence during the Arab Spring some three years ago that have continued sporadically ever since, with national dialogue failing to institute reform.

With economic growth slowing and the nation's fiscal deficit widening to more than 5% this year, the IMF has warned of an unsustainable debt trajectory under a presumed moderate oil-price decline.
Bahrain's monetary policy/currency stability scores highly (at 6.8 out of 10), but other economic-risk indicators are less advantageous, along with most of its political indicators barring the strengths of non-payment/repatriation risk. The nation's demographics and unemployment trend are also background concerns.

Israeli bonds still safe
Any prospect that Bahrain could catch up with Israel are fading. The Jewish state's political climate remains bogged down, as usual, in its interminable security issues, but macro-indicators are highly favourable.

Israel is one of only two countries in the region to have enjoyed a rising score trend in the survey since 2010, continuing since December to leave the score less than two-tenths behind Saudi Arabia – now just one place above in the rankings.
Solid growth, low inflation, a budget deficit sliding below 3% of GDP and a growing current-account surplus signal continuing momentum for a country that has long shrugged off its war-footing, and its corruption and government instability risks.

[WPC web version]