المنتدى الاستراتيجي العربي
ARAB STRATEGY FORUM

6 GREY SWANS

FOR 2017

Author

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Introduction

The Arab Strategy Forum was launched by His Highness Sheikh Mohammed Bin Rashid Al Maktoum in 2001 as a platform to foresee the future and identify potential economic and political trends.

While most of our attention is understandably focused on widely discussed and potentially highly impactful secular trends, there is a subset of events that the last few years have shown the importance of, the "Black Swans".

Examples of Black Swans include the 2001 September 11th attacks and the sub-prime mortgage crash and subsequent global financial crisis.

Mathematician Nassim Nicholas Taleb defined these as high impact, outlier events that we can explain after the fact, but are exceedingly difficult to identify ahead of time.
By their very nature they are almost impossible to predict, so the usual recommended solution is to increase robustness and resilience to be able to handle extreme impacts.

However, there are some high impact events in this class where we can reasonably say that the probability of it occurring is being underestimated in popular perception, "Grey Swans".

Recent examples of these events include the United Kingdom "Brexit" referendum and the election of Donald J Trump to the Presidency of the United States of America.
These events typically have an three additional characteristics.

First, they are typically catalysed by a secular trend either peaking and breaking down or a steady trend accelerating sharply, often in an exponential manner. These are usually not captured by standard models that expect the future is quite similar to the past.

Secondly, the narrative around the higher, expected outcome, is highly complacent and a complete lack of preparation for the lower probability, higher impact event.
Finally, they are often characterised by the parties involved moving from a balance of cooperative behaviour to increased competition.

This report looks at seven potential "Grey Swan" events that could come to pass in 2017.

These events are either considered low probability or of potentially low impact, but in reality have the potential to make dramatic changes that we should all be prepared for.
These are judged on the basis of their potential impact (out of 10) and a gauge of how close we are to the trend or narrative breaking (out of 5).

EXECUTIVE SUMMARY

6 GREY SWANS FOR 2017

This report looks at six potential "Grey Swan" events that could come to pass in 2017. 'Grey Swans' are high impact events where we can reasonably say that the probability of it occurring is being underestimated in popular perception. These events are either considered low probability or of potentially low impact, but in reality have the potential to make dramatic changes that we should all be prepared for. 'Grey Swans' are typically defined by three characteristics: First, they are typically catalysed by a secular trend either peaking and breaking down or a steady trend accelerating sharply, often in an exponential manner. These are usually not captured by standard models that expect the future is quite similar to the past.

1. **A cyber-attack impacts cripples an economy:** The arms race escalates
(Impact: 8, Proximity: 5)

The frequency and impact of cyber-attacks, particularly state-sponsored attacks, are set to increase dramatically in 2017 with a potential real-world cost of hundreds of billions of dollars.

2. **A Global Trade War Ignites:** The Return of Protectionism
(Impact: 9, Proximity: 4)

We are entering a global trade recession where countries are likely to engage in protectionist measures to safeguard their own workers and industry. This could cause significant losses to a variety of industries and a potential financial crisis. We may see the first salvos in the US-China relationship with a Chinese devaluation at the start of the year.

3. **Bond yields break out:** Inflation Rises?
(Impact: 7, Proximity: 5)

Bond yields are set to reverse a multi-decade collapse towards zero percent as expectations of fiscal stimulus and inflation rise. If this reversal breaks out, it could be hugely damaging to financial markets, pensions, real estate valuations and real world institutions.

4. **The collapse of the EU:** From Brexit to Quitaly to Portugone?
(Impact: 7, Proximity: 3)

Fears of a EU breakup are likely to surge in 2017 as populist policies gain traction in a series of elections and bond yields start to widen in uncertain times. This will put huge pressure on the currency and if one more nation votes to leave many more could follow.

5. **Africa Sinks:** Violence Surges
(Impact: 7, Proximity: 5)

Food inflation, which may have been a catalyst for the Arab Spring, is likely to surge in African nations as growth slows, subsisidies are removed and currencies devalue. This could cause another wave of protest and political change in the region with significant disruption.

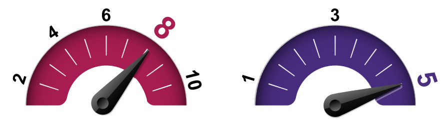
6. **The Western Fall:** The Death of Liberal Democracy?
(Impact: 10, Proximity: 2)

Summary: Liberal democracy and capitalism as championed by the West is in terminal decline. As a result, we are likely to see a surge in political violence, with governments behaving a more unilateral and competitive way, the detriment of global growth and stability.

CONTENTS

A CYBER-ATTACK CRIPPLES AN ECONOMY:

THE ARMS RACE ESCALATES



IMPACT PROXIMITY

Summary

The frequency and impact of cyber attacks, particularly state-sponsored attacks, are set to increase dramatically in 2017 with a potential real-world cost of hundreds of billions of dollars.

The internet has become a crucial part of all our lives. While the benefits are undeniable, the structures upon which it has been built are often outdated, leaving them vulnerable to potential attack.

There are two major forms of attack, those that aim to steal secrets from supposedly secure networks and those that attack internet infrastructure to restrict access, known as denial of service attacks.

While attacks have traditionally been carried out by independent groups of hackers for fun or profit, in recent years we have seen the rise of state-sponsored cyberattacks, a new front for conflict between countries with troubling implications.

The importance of cyberspace can be seen by NATO's latest position that an attack on cyberspace is an attack on NATO itself.

The USA took the unprecedented step on October 8th of formally accusing Russia of hacking the e-mails of the Democratic National Convention with the express purposes of influencing the outcome of the upcoming Presidential elections.

However, the deliberately distributed nature of the of websites from Twitter to Netflix to Amazon became unavailable as hackers used a so-called "botnet" of many thousands of hacked, internet-connected cameras to direct huge amounts of video traffic to a DNS provider, the phonebook of the internet, causing it to crash.

While this was claimed by the group "New World Hackers", the structure of associated attacks which were not claimed point to state-sponsored probing of critical systems to test the limits of their defences in preparation for future attacks.

Thus far, the impact of cyberattacks have been minor, but there have been some troubling real-world occurrences. For example, the Iranian nuclear program was infected by a malicious virus known as Stuxnet, which caused up to 20% of Iran's nuclear centrifuges to spin too fast and destroy themselves. The complexity of Stuxnet point to it being created by state actors and the result has been an acceleration of a cyber arms race with major nations creating specialised teams of hackers and cyberweapons for retaliatory purposes.

On the other side of the Gulf, in 2012 35,000 hard discs at Saudi Aramco were wiped by a virus known as Shamoon, which also targeted RasGas, interrupting the running of the world's largest oil producer.

These attacks are becoming increasingly sophisticated as countries are weaponizing their responses and we are seeing select infrastructure such as hospitals and power plants targeted.

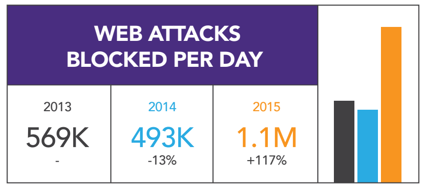
Cyber crime in general is estimated to have a global cost $445 billion, according to the World Economic Forum's 2016 Global Risks Report, but it is likely that in 2017 we will see a sharp increase in state-sponsored attacks that have a measurable impact upon the everyday lives of citizens and the economic output of countries, a level far above the select attacks we have seen so far.

To put this in context, the Atlantic Council estimates that major, escalating attacks could result in damage into the hundreds of billions of not trillions of dollars .

One possible vector may well be via global markets, with significant, sudden market distortions becoming increasingly common. The fragility of markets mean that billions if not trillions can be wiped off asset prices in moments

Other vectors could include critical infrastructure, transport links or banking infrastructure, causing massive data loss or disabling systems we rely upon for days. As these attacks step up from limited to wider in scale, there is significant risk of tit-for-tat escalation between nations with their own armies of sophisticated hackers. Unlike Weapons of Mass Destruction, there are no protocols or guarantee of mutually assured destruction to mitigate any escalation. Cyber defense spending is rising, but is still small relative to military budgets.

Given the creaky foundations upon which our connected world is built, this poses a real and imminent threat that is gaining recognition, but is still underestimated.
2017 is likely to be the year when we will all start to fear a Cyber Armageddon.



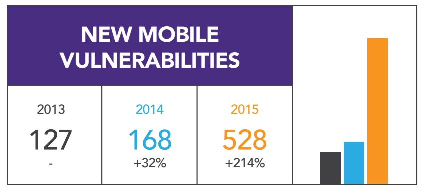
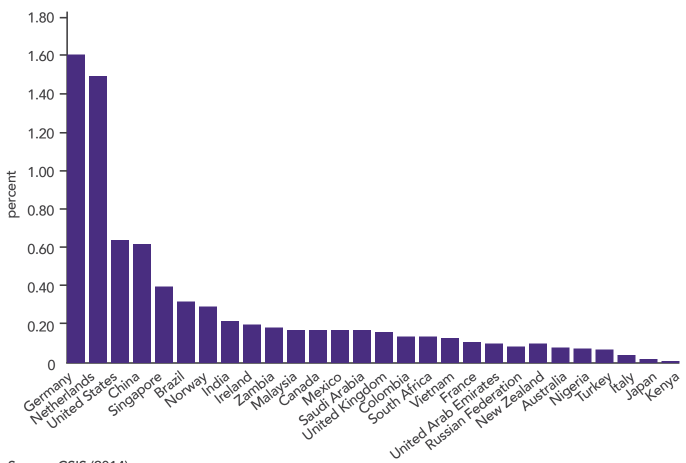
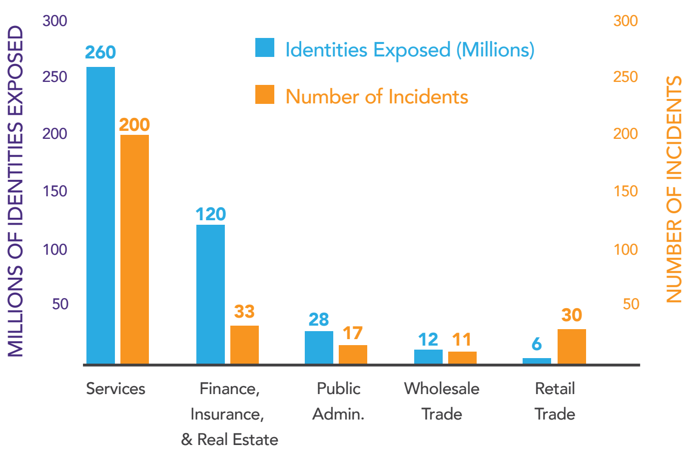


Figure 9: The cost of cybercrime and cyber espionage expressed as percent of GDP



Source: CSIS (2014)

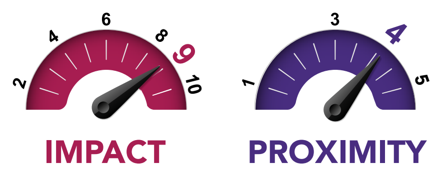
Top 5 High Level Sectors Breached by Number of Identities Exposed and Incidents



1 NATO Cyber Defence: http://www.nato.int/cps/en/natohq/topics_78170.htm
2 Wikipedia Stuxnet: https://en.wikipedia.org/wiki/Stuxnet
3 CNN: The Inside Story of the Biggest Hack in History: http://money.cnn.com/2015/08/05/technology/aramco-hack/
4 Cyber risks box 3 what if the us suffered a cyber disaster? http://publications.atlanticcouncil.org/cyberrisks/
5 https://www.symantec.com/content/dam/symantec/docs/reports/istr-21-2016-en.pdf is full of statistics (and other infographics) of growing malware threat, eg:
6 Costs of Cyber Crime (Source Center for Strategic and International Studies, "Net Losses: Estimating the Global Cost of Cybercrime," Economic Impact of Cybercrime II (Center for Strategic and International Studies, June 2014), http://csis.org/files/attachments/140609_rp_economic_impact_cybercrime_report.pdf)

A GLOBAL TRADE WAR IGNITES:

THE RETURN OF PROTECTIONISM



Summary

We are entering a global trade recession where countries are likely to engage in protectionist measures to safeguard their own workers and industry. This could cause significant losses to a variety of industries and a potential financial crisis. We may see the first salvos in the US-China relationship with a Chinese devaluation at the start of the year.

Since the financial crisis of 2008 major global central banks have worked together to support the global economy using advanced strategies such as quantitative easing and zero interest rate policies.

This has succeeded in stabilising the global economy, but growth continues to slow and the World Trade Organisation expects that trade this year will increase at its slowest pace since the post-2008 global recession, undershooting GDP in a rare occurrence in recent decades.

Trade growth normally outpaces global GDP growth and this slowdown is deeply worrying as it points to broader structural issues than have been highlighted by the global revolt against globalisation and free trade.

Trade has also been undermined by the poor recovery in fixed investment in developed economies, although the narrative is now starting to shift from Central Banks being omnipotent to policies focused more on aggressive infrastructure spending to stimulate end demand as exemplified by the reaction of markets and economists to the US Presidential election, welcoming the aggressive spending plans of the President-elect.

Trade has also been undermined by the poor recovery in fixed investment in developed economies, although the narrative is now starting to shift from Central Banks being omnipotent to policies focused more on aggressive infrastructure spending to stimulate end demand as exemplified by the reaction of markets and economists to the US Presidential election, welcoming the aggressive spending plans of the President-elect.

In an environment of slowing trade growth and more populist politics, we are likely to see a sharp return of protectionism now that many countries have already been through the process of competitive devaluation, particularly in emerging markets and Japan.

Historically, protectionist policies have led to a surprisingly rapid escalation of trade barriers between countries, which would have a further negative impact on global trade and potentially deliver a systematic shock given the assumption trade would grow forever and significant leveraged trade finance activities.

This may give renewed strength to the dollar, which is typically bad for commodities and emerging markets that would also suffer from their main export goods becoming less competitive.

We have already seen early signs of stresses in trade with shipping bankruptcies and fluctuating trade, but the speed of globalisation and liberalisation of trade may catch everyone by surprise as countries worldwide stop cooperating and start competing in earnest.

The political implications of protectionism are usually expressed through increased support for nationalist policies and parties and further suspicion of immigration and foreigners.

Aggressive fiscal stimulus and infrastructure projects could offset some of the negative impacts from this sharp change, but market and political fears are likely to cause turbulence before these are put in place as the next tool used by governments for stabilisation, particularly if bond yields and expectations of future rates remain low.

The way that this narrative can shift is likely to be seen at the end of 2016 and start of 2017 in the comments and reaction to President-elect Donald J Trump.

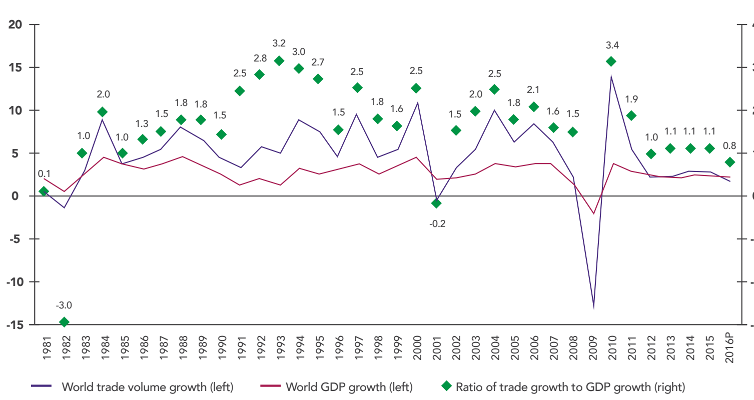
Fears of a potential trade war with China, with threats of 45% or higher tariffs, were overwhelmed by positivity towards his plans for tax cuts and high levels of infrastructure spending to stimulate the US economy and create jobs.

However, Trump negotiates in an aggressive manner and we are likely to see more rhetoric on trade as inauguration nears at the end of January 2017, particularly around China as a currency manipulator. This incentivises China to move their currency from the current managed peg, devaluing slowly, to a free float 10-20% lower. This would restore some of its lost competitiveness, with Chinese wages now double Mexican ones having been half of Mexican levels just a decade ago.

Trade deals have typically also been used as a means of exerting control and building alliances with neighbours. Trump's dismissal of the Trans-Pacific Partnership (TPP) means that China is free to then create their own trade zone, while the US influence in Asia is likely to move to being a guarantor of stability through a larger navy and clear red lines, working in a unilateral, not multilateral manner.

Trade wars are unpredictable and protectionism can escalate rapidly. Slowing global export growth means that there is increasing competition for trade volume and market share, which has dramatically increased the probability of disruptive outcomes as more and more countries stop cooperating and start competing with one another. Given the interconnectedness of global trade and financing of these activities, this could lead to a large economic shock of unexpected magnitude.

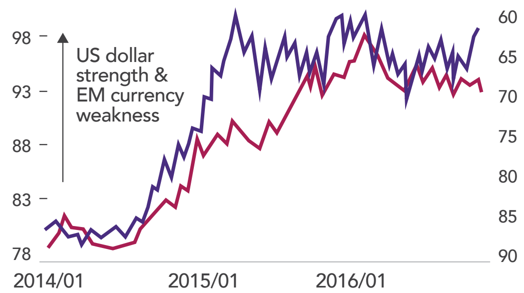
Trade Infographics
Rolling over of imports is a good one
(see WTO footnote for source)



Sources: WTO Secretariat for trade, concensus estimates for GDP.

Sustained US dollar strength poses risks for Emerging Market (EM) currencies

Sensitivity of EM currencies to dollar is interesting too:



Source: Bloomberg

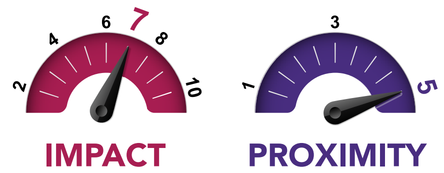
Charts of everything devaluing against the dollar over last few years

Since 01/01/2014
- Euro (-20%)
- Chinese Yuan (-11%)
- Ruble (-47%)
- British Pound (-26%)
- EM Currency index (below -30%)

5 WTO Trade to Grow at Slowest Pace Since Financial Crisis: https://www.wto.org/english/news_e/pres16_e/pr779_e.htm

BOND YIELDS BREAK OUT:

INFLATION RISES



Summary

Bond yields are set to reverse a multi-decade collapse towards zero percent as expectations of fiscal stimulus and inflation rise. If this reversal breaks out, it could be hugely damaging to financial markets, pensions, real estate valuations and real world institutions.

The last 35 years have seen one of the greatest bull markets of all time in developed market bonds as interest rates have fallen dramatically. This run has been so dramatic that many government bonds have moved to negative yields, with $13.4 trillion price for negative returns in October 2016, from $0 in 2013, a quarter of all issued bonds.

This has been positive for many large investors as coordinated Central Bank intervention has increased the value of the bonds they held, as well as supporting real estate prices thanks to decreasing the cost of mortgages and leverage on real estate transactions.

However, once you have negative yields, guaranteeing a loss for those who purchase them unless they find someone willing to buy at an even more negative yield, it is difficult for yields to fall much further as cash is a viable alternative.

So far, Central Banks have played the role of buyer of last resort, making purchases of debt at ever lower yields as part of their quantitative easing and direct purchasing programs to allow companies and countries under pressure to refinance and continue to operate in the hopes this would stimulate economic recovery.

As faith in their ability to control bond yields and inflation fails and the marginal buyer fades, historically safe developed market government bonds that fill pension funds look far riskier than before.

Some central banks, such as the Japanese, who have issued half of the world's negative yielding bonds are looking to drive inflation as high as possible to avoid the trap of low growth and low inflation they find themselves in.

This sets up a dangerous inflection point, with Fitch Ratings estimating that a reversal of yields to 2011 levels would lead to a staggering $3.8 trillion of losses versus current expectations of a mild rise in prices. Indeed, over $1 trillion of bond market value was lost in the week following the US Presidential election.

If bond yields start to rise then they could rapidly unwind the gains major funds have made in recent years, making pension and sovereign funds appear far more underfunded than they already are and worrying populations that have relied upon the promises of future pensions and economic stability.
There is also a cyclical component to interest rates and bond yields and it is likely that rates will rise along with bond yields as the market tries to price in the future after a period of relative stability.

The US Federal Reserve is likely to accelerate this sell-off with the market expecting a series of interest rate rises as the US labour market continues to tighten and inflation creeps back in, aided by expectations of higher costs on the back of President-elect Trump's spending plans. Other major nations such as Britain may be forced to raise rates as a falling currency needs higher rates to stabilise it and stop capital flight.

The end of the bond bull market would be particularly bad for the property sector as rising rates hit affordability, particularly in combination with rising populism and calls for redistribution in developed markets.

Property prices in developed markets have now risen to prices that are uneconomic for new entrants in the market absent significant help as rents are literally extracted from them. As long-dated borrowing, property investments may prove surprisingly sensitive to a reversal of the bond bull market and rising base rates, with transaction volumes rapidly dropping off much as they did in the 2008 financial crisis but without a bailout to support them.

Corporations that have survived thanks to being able to borrow for almost no cost will now find their profit margins falling and some may not survive if bond yields head back to pre-crisis levels, leading to an increase in bankruptcies.

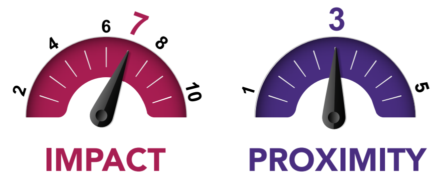
Emerging countries are also vulnerable to an increase in global yields. According to the Bank for International Settlements lending in US dollars to non-bank borrowers in emerging economies has almost doubled in the last 7 years from $1.7 trillion in Q1 2009 to $3.2 trillion in Q1 2016. If rising yields are accompanied by a strengthening dollar, this would place significant stress on emerging economies, with corporates in these countries having at least $340 billion of debt coming due in the next two years.

2017 could be the point at which after years of central banks trying to stimulate inflation through conventional and unconventional means, they are finally successful but unable to contain the financial ramifications of their actions.

Alternatively, growth could slow further and deflation come back with a vengeance with its separate set of challenges, making this an incredibly binary outcome.

THE COLLAPSE OF THE EU:

FROM BREXIT TO QUITALY TO PORTUGONE?



Summary

Fears of a EU breakup are likely to surge in 2017 as populist policies gain traction in a series of elections and bond yields start to widen in uncertain times. This will put huge pressure on the currency and if one more nation votes to leave many more could follow.

The structural flaws in the EU have been evident for a number of years, reaching a peak in 2012 with the Greek debt crisis.

Emergency measures and the actions of the ECB have calmed financial markets and allowed pressured countries to regain access to debt.

However, the recent surprise "Brexit" vote has highlighted structural tensions on the part of the populations of these nations that threaten to unravel the entire union as one country leaving could well become a stampede.

The timeline of Brexit is becoming clearer, with Prime Minister May of Britain indicating that the first notice for departure will be given in the first quarter of 2017, with final departure two years after that despite legal challenges.
Setting a fixed time for the departure of a significant member is likely to give significant support to parties that wish to move away from open borders and immigration, particularly as GDP growth falls below 1.7% and unemployment remains above 10%.[6]

This has been reflected in the ballot box, with the combined vote share of centrist parties dropping nearly 15% to just under 50% over the last decade or so in Europe according to Barclays Research.

Aside from the starting of the official Brexit process, next year also has several important elections in Italy, Germany, the Netherlands and France, all of which have a danger of turning out in support of anti-immigrant and anti-assimilation parties, particularly on the far right.

A breakup of the EU is not contingent on each of these votes going to the populist fringe, but we could well see two more referendums for exit announced next year, at which point the pressure would rapidly mount on EU assets. This would hit EU banks particularly hard as many are struggling under the current ECB monetary policy and have weak buffers against rising defaults.

As one of the largest trading blocs in the world, increasing concern about the future of the EU will only add to the volatility of global markets and a rapid widening of sovereign bond yields back to where they should have been had the ECB not staged significant intervention.

Fear of a breakup has receded significantly since the Greek crisis, but a resurgence would also likely impact the dollar as the Euro makes up 58% of the dollar basket.[7] This again would add strength to the dollar next year, potentially to "break out" point where it hits all risk assets, but most significantly emerging economies and commodities, with the Euro to US dollar exchange rate falling another 15-20% from here.

The politics that underpin the accelerated breakup of the Eurozone also typically don't lend themselves to regulatory stability or priority, as can be seen by the Conservative party's apparent decision not to make the ability of British finance companies to access the Eurozone a priority despite the sector contributing over $200bn to the UK economy.[8]

Politically, the fallout from a steady disintegration will be profound, with even centrist parties moving toward the positions of the populists and political extremists to address the growing dissatisfaction of their electorate. This bodes poorly for immigrants and minority groups as liberty is sacrificed for equality, with Islamophobia on the rise across the continent.

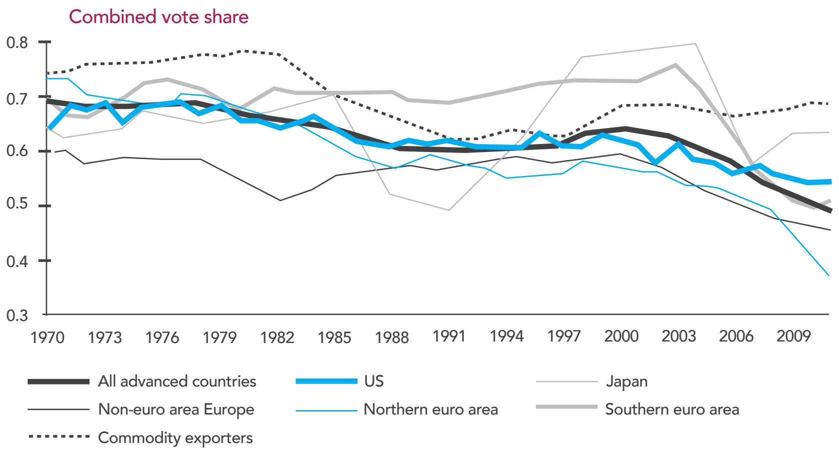
A weak Eurozone would also invite a more aggressive stance from Russia, who are also already funding non-centrist parties across political spectrum, with pro-Putin politicians gaining ground.

The recent shift of Iskander-M missiles by Russia to Kaliningrad and regular, increasingly armed flyovers of NATO states by the Russian air-force highlighting how Russia views NATO and the US as weak and unable to stop their advances.

The new US administration is likely to reinforce this stance, raising the chance of conflict between Russia and the EU as it can no longer fully rely upon US pressure to reign Russia in and is feeling increasingly vulnerable.

While it is almost certain that the EU will not exist in its current form in a decade, momentum is building rapidly for a re-emergence of the breakup narrative. In a cooperative coalition such as the EU, the departure of more than one member for populist reasons is likely to spell the end of the union as the nations that benefit least feel further pressure to depart. The impact is likely to be felt on sovereign bonds and the currency, which may well cause significant financial system distress and losses at the corporate level.

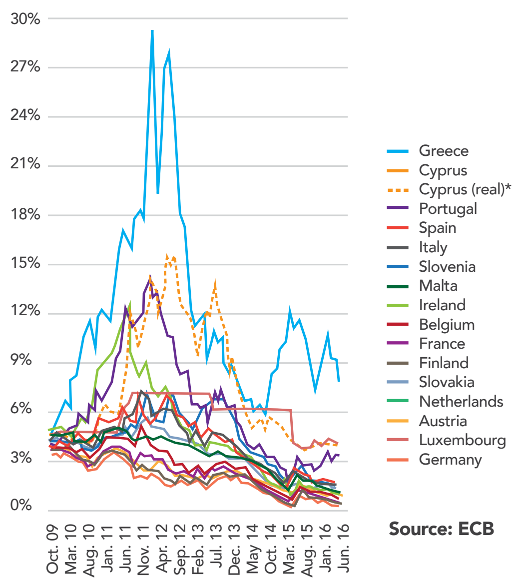
Combined vote share of centre-right and centre-left political parties in advanced economies, by group



Source: Barclays Research

Rise of non-centrist vote.
We can do just all advanced countries data every 10 years
- **1970: 70%**
- **1980: 68%**
- **1990: 61%**
- **2000: 66%**
- **2010: 49%**

Long-term interest rates



Source: ECB

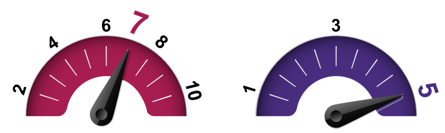
* actual market trade values without cut-off yield for Cyprus government bind maturing 3 February 2020

Interest rates for Greece, Germany, Ireland. Portugal, Spain from below, peak to trough.

6 https://www.ecb.europa.eu/press/key/date/2016/html/sp161009.en.html
7 https://en.wikipedia.org/wiki/U.S._Dollar_Index
8 http://www.oliverwyman.com/content/dam/oliver-wyman/global/en/2016/oct/Brexit_POV.PDF

AFRICA SINKS:

VIOLENCE SURGES



IMPACT **PROXIMITY**

Summary

Food inflation, which may have been a catalyst for the Arab Spring, is likely to surge in African nations as growth slows, subsisidies are removed and currencies devalue. This could cause another wave of protest and political change in the region with significant disruption.

As noted in the introduction, a key characteristic of Black Swans is that they are events often inappropriately rationalized by hindsight, as if it could have been expected if the data had been analysed in the right way.

This was the case for the Black Swan that was 2011's Arab Spring.

Countless hours have been spent researching what the potential catalysts were for the masses to demand a change of government in so many states. Theories have ranged from increased social media usage to overly oppressive laws to food price inflation in staple goods driving huge numbers to risk life and limb to protest and act against the perceived status quo.

While it is difficult to discern the exact drivers of the events of 2011, the rise in food prices as put forward by the New England Complex Systems Institute is a reasonable driver for large numbers to spill onto the streets at the risk of their lives as the basic social contract of the government helping them feed their families and help them move out of poverty was broken, often as wealth inequality grew as elites and corporations became unimaginably rich.
We do not necessarily need to see a spike in global food prices for protest, violence and political change to be catalysed, but rather steady increases due to devaluation and subsidy removal can cause populations to reach a tipping point.

The collapse in African currencies due to economic mismanagement, political dysfunction and sharply lower commodity prices in recent years is setting up what could be a repeat of the unrest we saw in 2008 and 2011.

Oil exporters and countries still suffering from the Arab Spring are likely to be the main victims, but there is increasing economic fragility in the rest of Africa due to trade ties with these nations.

While Africa is a diverse continent, the three leading countries are prime examples of this malaise.

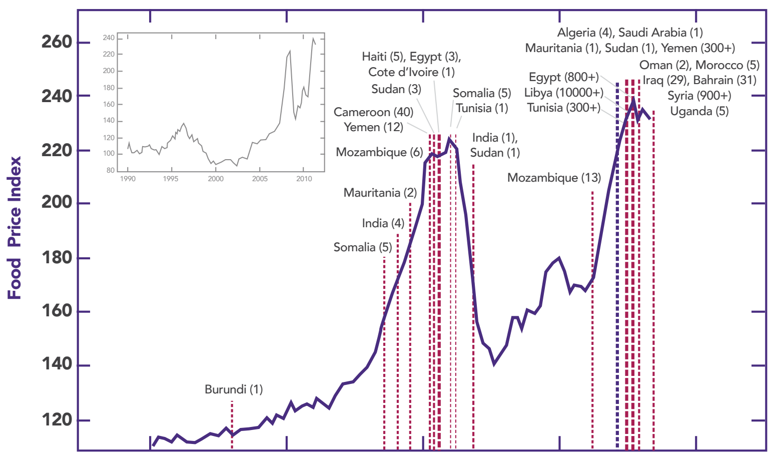
Egypt, still suffering from the aftermath of the Arab Spring, has an unsustainable economic situation due to collapsing tourism, with tax receipts barely covering interest costs and rampant inflation. The Egyptian pound recently lost half of its value as it moved from a currency peg to a free float. This, combined with significant reforms demanding by the IMF for an aid package including basic subsidy removal and increases in consumption taxes, is putting significant pressure on everyday Egyptians, with many already struggling from the slowdown in core industries and waiting for the new government to deliver after three years at the helm. Egypt requires significant international support to negotiate a dangerous year, targeted at those who now lack a social safety net. However, most of the support is likely to be at the top end that will take time to filter down.

In Nigeria, the collapse in oil revenues due to lower prices and the resurgence of attacks on oil facilities in the Niger Delta by militants seeking to extort the government, reducing production by over 25%, has led to a sharp slowdown in economic activity and huge pressure on the government of President Buhari. The Nigerian currency has already devalued by 65% over the last year to 315 Naira to the dollar, but the central bank is currently keeping the currency artificially pegged around this rate, with Naira on the black market now at over 450 to the dollar and local industry struggling to operate as the flow of dollars has almost dried up as a result. A further devaluation is all but inevitable unless we see a significant spike in oil prices. This will cause inflation to jump further at a time when the UN is warning that potentially over a hundred thousand could die of starvation in the north of the country where Boko Haram has displaced millions. In a country with a GDP of half a trillion dollars this is likely to cause huge resentment and protest, particularly as significant oil revenue remains unaccounted for and structural flaws mean that tax receipts to provide facilities and services for the majority of the population remain at levels similar to that of Gulf nations. In South Africa the ruling ANC is coming under immense pressure politically as once more growth slows, commodity prices are low and inflation erodes at the purchasing power of the populace. Populist movements globally and civil action are showing the displeasure of the people, but the prospect of mass civil unrest is lower than in other African nations due to stronger civil institutions and relatively higher living standards.

The narrative of "Africa rising" is coming under increasing pressure as currencies devalue, commodity revenues fall, social security nets diminish and growth across the continent rolls over. Millions of new entrants to the workforce will find it challenging to find employment in a new world of rapidly automation, particularly of service sector jobs, with educational levels rising but still insufficient. Given Africa is due to make up the bulk of population growth in the coming decades, significant additional investment needs to be made in its real resource, its people, to avert significant political upheaval in the coming years. If this is not done, it may be that we defeat extremist groups in the Middle East, only to see them grow ten times bigger and dig in in Africa, with other, non-Muslim, extremist groups also rising using a similar template to grab as much power as possible.

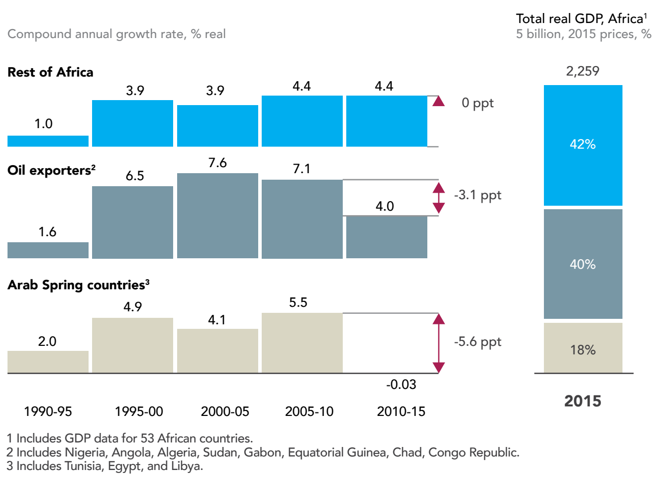
For 2017, we are likely to see increasing political unrest and a resurgence in violence in key African nations that could catalyse further disruptive political change, driven by competition for increasing scarce resources.

Food prices and civil unrest



Source: http://necsi.edu/research/social/foodcrises.html

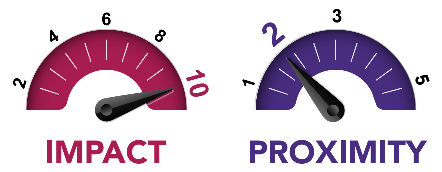
Annual GDP growth rate



Source: https://www.weforum.org/agenda/2016/05/what-s-the-future-of-economic-growth-in-africa/

THE WESTERN FALL:

THE DEATH OF LIBERAL DEMOCRACY?



Summary

Liberal democracy and capitalism as championed by the West is in terminal decline. As a result, we are likely to see a surge in political violence, with governments behaving in a more unilateral and competitive way, the detriment of global growth and stability.

In 2015, The Arab Strategy Forum estimated the cost of the Arab Spring at $833bn with a death toll of 1.3 million and 14 million refugees as a result.

During the upheaval, there was significant support from the West for regional governments to move directly to democracy and "the will of the people", turning away from the rulers they had supported for years.

While initially it appeared that Arab states would fall like dominoes, we instead saw an adjustment of the social contract in many countries to solidify support for the government. In others, the shift was premature, with a lack of civil institutions failing to stop a breakdown in social order, with the ensuing chaos allowing extremism to seep in and thrive.

While the Arab world continues to deal with the aftermath of 2011, 2016 has highlighted another dramatic change that may sweep the world, the rise of illiberal, majoritarian democracy in the West, a "Western Fall".

This shift is exemplified by the United Kingdom's "Brexit" referendum and the victory of President-elect Donald J Trump, as well as the increasing right-wing share of the vote across European nations, in some countries including fascist and Nazi-like parties.

Political scientist Francis Fukuyama theorised over 25 years ago that we were entering the "end of history" as nations inevitably headed toward the model of Denmark, a liberal, capitalist system of democracy. The desire for and freedom to pursue world-changing idealism, referred to by philosopher Isaiah Berlin as positive liberty, a force that could unleash good but often led to evil in good's name, would be replaced by economic calculation and a consumerist society, free from government interference and regulation, negative liberty in Berlin's terms.

This was to be a boring state of affairs and instead what has happened is that the world has become very interesting very quickly as the social contract of liberal consumption, economic advancement and social safety nets in the West have been undermined by the greed of the elites, excessive debt and a slowdown in growth.

To put it simply, many now no longer believe in the "American Dream" or its equivalent and yearn to be part of a movement to change the status quo, usually at the expense of the rights of minorities or foreigners who become the scapegoats.

This was the key driver of Trump's success, as his supporters took his call for change seriously, but did not take his more extreme ideas literally, whereas his opponents were the other way around. He made so many incendiary comments that a different part of his message stuck with different groups and over-rode less pressing concerns, effectively making the US election a referendum on change back to greater days.

The parties now in ascendance in global democracies, but in particular the rich West, are decidedly illiberal and increasingly authoritarian, leading to a division of society and disagreement on the very nature of democracy. In 1788, John Adams referred to the "tyranny of the majority" - what the majority of voters believed should not necessarily be the law in order to protect the minority. Instead most democracies are set up to be representative, so officials are elected to exercise their judgement, not give their obedience. This division in the basic understanding of democracy has been highlighted in the UK court case of whether "Brexit" had to be debated by parliament, which is sovereign in the UK, before being triggered or if a government with a majority could do as they pleased.

The flaws in democracy, with politicians doing whatever they can to be elected for another four years, including leveraging hate and saying outright lies, have been exposed in recent years, with the checks and balances theoretically provided by a free media and civil institutions coming under immense pressure. Other systems also have their flaws, but when led correctly top-down, authoritarian governments can make long-term decisions for the good of their citizens that many democracies now cannot, especially in times of rapid change.

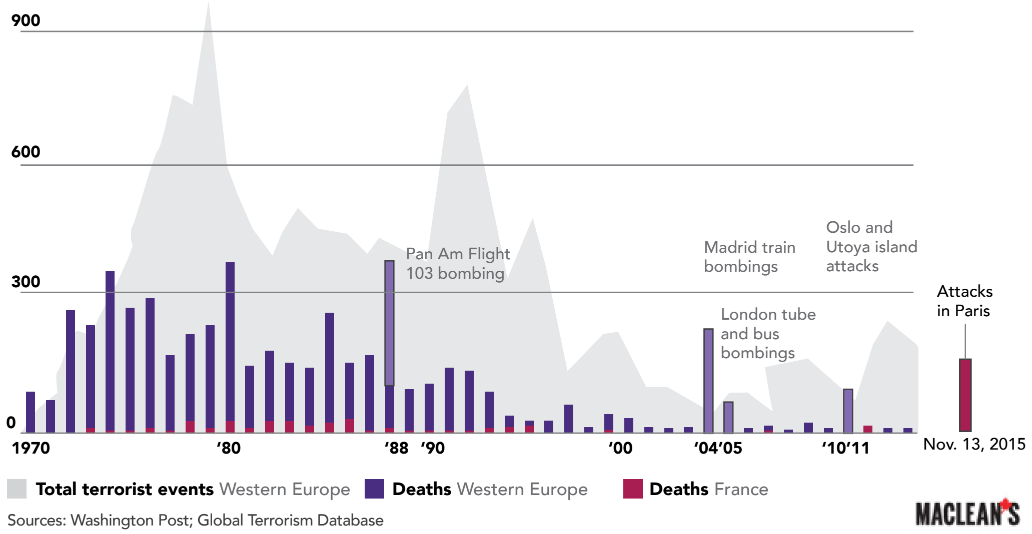
The upshot of this dramatic political shift to illiberal democracy is that we are likely to see violent blowback. Governments rule on a spectrum with voting legitimacy on one end and through violence on the other. We are seeing increasing protests in sharply divided societies and the targeting of minority groups now being ignored by leadership that is often sharply rolling back civil liberties to increase its control of society. Islamophobia in particular is on the rise and Muslims a prime scapegoat in the West. This has the potential to explode at any time as the frustration of the people and sharply divided societies break down, leading to a resumption of the spikes in political terrorism we saw in the 1970s.

Illiberal, authoritarian democracies elected on ideological platforms are also less likely to behave in a multilateral, cooperative way and instead compete for resources and power for their followers. This will lead to further erosion of the multinational institutions that have provided much stability to the world, further rolling back globalisation and eventually increasing regulation of all matters as the power of the elites eventually subsides to populism.

Just as the Arab Spring was meant to mark the rise of liberal democracy, the Western Fall may mark the twilight of liberal democracy globally and the end of Western leadership. The societal and political implications of a move to illiberal modes of power are profound and 2017 could see the first sparks of violence in divided societies and disruption of global flows and the international order from populist, competitive governments.

The global impact from the Western Fall could make the toll from the Arab Spring like a mere bump in the road once it is done.

Terrorism events and deaths in Western Europe and France, 1970-2014



Sources: Washington Post; Global Terrorism Database

BIOGRAPHY

Emad Mostaque is a Strategist at Ecstrat, a research consultancy that focuses on the intersection of governments, geopolitics, governance and markets. In this role he advises some of the leading funds globally on potential structural shifts building on insights from behavioural science and game theory. Emad has a particular focus on the structure of oil markets and developments in the Middle East and Africa Region, being one of the few to predict the fall of West Iraq in 2013, Business Insider's most important chart of the year. He appears regularly in global press on these areas and has written for a variety of publications including the Financial Times and Wall Street Journal. Prior to joining Ecstrat, Emad was a hedge fund manager and strategist at Pictet Asset Management, managing global and frontier funds and mandates and a strategist at Religare Capital Markets. Emad holds an MA in Mathematics and Computer Science from Oxford University and is also co-founder of Ananas, an initiative focused on curbing extremism building stronger communities using modern technology.

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