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Report

The World Economic Wars:

Their Impact on the GCC Economies

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Downward pressure on prices signals dangers for the world economy [Getty Images]

Abstract

The volatility in international economic markets poses a threat to the incomes and wealth of the GCC States. In the relapse of the Chinese stock market on August 24th, that declined by seven percent, the Gulf States net losses stood at six percent of their total portfolio assets. The loss to GCC economies also comes from the decrease in oil prices, costs of wars and political upheavals in the region as well as currency and gold price fluctuations.

The situation could linger for some time in the future. The world economy may not recover until 2017 and beyond. The economic titans of the world are also engaged in economic wars and rivalries. There is an on-going currency war and oil pricing war with China and the US engaged at a deeper level of desperate rivalry.

As a result, the GCC must come to realize the size of economic challenge that lies ahead. They need to develop home-grown strategies regarding oil quotas and production, portfolio management and gold reserves.

Introduction

Over the six months since February, 2015, the world markets have been in turmoil. The improvement in the US economy is on a more assured, but not necessarily stable, path. In contrast, the Chinese economy, which had been miraculously growing at two-digit rates for almost three decades, is now showing signs of fatigue. The European markets have been in disarray, sending mixed signals, but generally revealing a tottering movement. All of these steep ups and downs have had a direct and indirect impact on the economies of oil-producing countries, especially those of the Gulf Cooperation

Council (GCC). What is this impact? And where are the economies of the GCC countries headed, in light of this earth-shaking instability?

Oil Shock Impact

In an interview with CNN on the August 26, 2015 Amanpour show, Dr. Mohammed El-Aryan, the Chief economist at ALLIANZ and Chairman of President Obama's Global Economic Council, asserted that the price of oil will not rebound or restore its old level for a long time. He did not specify the length of this period nor the "old levels" he was referring to. Yet most observers and oil experts tend to be noncommittal regarding their predictions of oil prices. Dr. El-Aryan believes that Russia, Venezuela and Nigeria will be the hardest hit by the fall in oil prices. In these countries, oil and gas constitute a large share (70%) of exports and about 30-50% of GDP. They are not only in debt, but they suffer from shortages of foreign reserves (Nigeria and Venezuela) or rapidly declining reserves (Russia).

By contrast, Saudi Arabia, the largest oil exporter, and the UAE have significant foreign reserves. Their budgets may run into deficits, but they can cope easily by borrowing domestically and abroad. They can also cut oil production in order to decrease world oil supply and boost the price of oil. In the last thirty years or so, Saudi Arabia succumbed to the pressures of other OPEC members and decreased its production of oil by 20-30 %. That policy has now been abandoned because the Saudis discovered that lessening their production led over time to the loss of a hefty market share.

The Gulf States can manage to survive the oil price slump by decreasing their budgetary capital expenditures without negatively affecting the social order and invoking a negative public response. Some GCC countries and other OPEC producers are exercising pressure on Saudi Arabia to cut its production because oil prices, in their own estimate, are too low.

Other Losses

However, the loss to the Gulf economies is not limited to oil-market considerations. What Dr. El-Aryan failed to mention is the potential loss for the Gulf States if the returns on their large portfolios of deposits, bonds and securities, acceptances, real estate mortgage bonds and stock shares enter a bleak, unpredictable future. The workweek ending on August 25th witnessed an alarming fall in stocks around the world and an unpredictable movement in major good prices (gold and oil) and currencies. However, the intervention by the Chinese monetary authorities by decreasing interest rates and injecting about $20.0 billion into the Chinese stock market helped the stock markets around the world rebound by leaps. The panic-driven sales of stocks in China echoed

throughout world markets. Yet the Dow Jones achieved on August 26th and 27th as a result of the new policies adopted by China. What could be inferred from this thought-invoking event?

The China Paradox

The saying, "If France sneezes, the rest of the world catches cold," is attributed to Klemes Von Metterinch of the Austro-Hungarian Empire. The term was later used to refer to the U.S., particularly after 1929, when the Great Depression hit America and soon spread to the rest of the world. Until the crisis of 2008 and its aftermath, the statement turned out to be consistently true. The financial crisis of 2008 soon moved from Wall Street to Real Street (the real non-financial markets), and quickly affected the rest of the world economies. In these last few days, even though China was not in its best financial shape, it was still able to demonstrate two facts. First, when its economy and financial markets waivered, the rest of the world economy shivered. Secondly, by taking the initiative to address its own stock market, the world immediately responded in the same direction and in equal if not greater magnitudes. Does this mean that China is now as important to the world economy as the United States? What does this mean? And how might this development impact the economies of the Gulf States?

The recent tug-of-war encounters between the United States and China can be traced to a series of events since 2005, when China comfortably occupied the position of the second economic power of the world. In 2006, China's GDP exceeded that of Italy and France; in 2007 it overtook Germany; and in 2009 it surpassed Japan's.(1) The Chinese were not moved by this ranking, stating over and again that China remained a middle-income developing country in per capita terms. Yet the unprecedented growth of their foreign currency reserves, investments abroad--particularly in oil exploration, and rising consumption at home did not bode well for the United States. Awed by their heavy indebtedness to China (estimates range between $ 1.3-3.0 trillion) and by China's large dollar holdings, the United States started applying pressure on China to revalue its currency. China adamantly refused, lest it lose its export surplus and render its currency less stable and exposed to large speculative waves.

New International Currencies

Professor Robert A. Mundell, who won the Nobel Prize in Economics in 1999, served as a consultant to the Chinese government. His prize citation by the Nobel Academy focused on his Optimal Currency Regions' Theory, which he first advanced in an article in the American Economic Review in 1961.(2) According to Mundell, the world economic and monetary stability required that it should have three currency regions rather than one. Those should be the dollar zone, the euro zone and the Pacific zone (with either the

Japanese yen or the Chinese yuan at the helm). Later on, in 2005, Mundell came out in support of the yuan, while Richard N. Cooper of Harvard supported the Japanese yen. In 2009, when the Chinese GDP exceeded that of Japan, it became more evident that the momentum was in favor of the yuan.

After the 2008 financial and economic crisis and its tsunamic repercussions the world over, the call for including other international currencies besides the dollar emerged. In its 2008 Investment Report, the United Nations Conference on Trade and Development (UNCTAD) asserted that China was earning negative interest rates on its dollar-denominated holdings.(3) The call for including other currencies was repeated in the UNCTAD Annual Report 2009, alerting the world that the dollar alone cannot be a dependable source of global currency as long as dollar supplies depended on two negative factors, namely the US budget and trade deficits.(4) Such proposals were severely criticized by US officials and leading bankers and were eventually forgotten. The slow but steady recovery of the US economy allayed the fears over the de facto devaluation of the US dollar, especially in 2014 and 2015.

As for China, the battle is not over yet: although there is an official silence, there is covert support for abandoning the single currency regime. In 2007, a Chinese book, The Currency War, was published.(5) Author Song Hongbing claimed that the monetary policy of the United States is controlled by giant private banks who dictate policies to the Federal Reserve System which, in turn, is a corporation owned mostly by those banks. As a result, the U.S. must come to grips with this fact and develop monetary policies which are conducive to the world economy and not to the interests of these banks. The book was an instant hit in China, especially among Chinese politicians who tacitly approved its content and less belligerent attitude towards the U.S. The book was reprinted with some revisions in 2009 and 2011 and was translated into many languages.

The currency war between China and the U.S. is now gaining a renewed vigor not through Chinese authors, but mainly American commentators. Europe is now maintaining a mellow position as it tries to put the European markets back in order, especially after the Greek crisis.

To add fire to an already inflammable situation, Joseph Stiglitz in 2015 published an article asserting that the twenty-first century is the "Chinese Century."(6) According to his calculations of both the Chinese and American GDPs, China actually became the biggest world economy in 2014. According to Stiglitz, if the Chinese GDP is recalculated and switched from dollar terms to purchasing power parity (PPP) terms, the Chinese economy would be bigger, or the biggest. Such a proposal is yet to be recognized by the

three international organizations which publish GDP statistics, namely the World Bank, the IMF and the UN.

In a nutshell, the currency war is now turning into an economic war. The hidden energy war has been taking place for at least two decades. China, which is dependent on foreign energy sources, has been trying to circumvent this vulnerability by acquiring oil exploration concessions in many countries in Africa (Algeria, Congo, Sudan) and in some Central Asian republics (ex-Soviet Union). China wants to take full precautions against the U.S. mounting pressure on it by denying China oil supplies. In addition, China is apprehensive about the barrage of statements by some US presidential candidates, such as Donald Trump, who until now is the leading candidate of the Republican Party. Trump believes that China has been gaining at the expense of the US economy because US current and previous administrations have been poor negotiators in comparison with their Chinese counterparts.

China's Global Thoughts

China had already advanced two proposals which upset the Americans. The first was the revival of the old silk roads (land and marine roads). The second was the establishment of a new international fund for financing infrastructural projects around the globe. Initially the U.S. resisted the idea and exercised pressure on its allies not to join. When the Europeans and many other developing countries insisted on subscribing, the U.S. decided to let go. All of these developments which are cementing China's international profile are setting the stage for future economic rivalries.

A third frightening development which has not yet matured to a competitive level, but could eventually, is BRICS, the economic grouping made up of Brazil, Russia, India, China and South Africa. The five countries constitute about 42% of the world population and more than 20% of its GDP. The newly industrialized countries of BRICS had their heyday up until 2014. All of them are struggling to maintain their economic vitality. Each of them is grappling with complex economic woes which could weaken their resolve as an economic group. In contrast, the US economy is now growing convincingly and the bigger European economies are achieving low rates of growth in 2015, a tangible improvement over the recessionary cycle of pre-2015.

If Samuel Huntington, author of "The Clash of Civilizations,"(7) and doomsday writers like Bernard Lewis and Francis Fukuyama are correct, the Muslim world and Arabs in particular are in for a long war. The intent is to alienate Muslims from the American-Chinese clash, or enlist them against China. The strategy to do so has been atrocious and divisive. Although Arabs are continuously cautioned against naively believing in the existence of a conspiracy to divide and own them, Arabs always realize that their fears of such a conspiracy have been in retrospect correct and justified.

The geo-strategic position of the West Asia/North Africa region is too obvious to be ignored. The whole Middle East is a crucial region for both sides of potential world powers struggles and wars. Contributing to war arsenals is the economic wealth of the Arab world, such as oil, petrodollars, wealth assets and human capabilities. An observer must be vigilant to both short-term and long-term effects of the ongoing world economic war on the Arab world and the GCC in particular.

Measurement of Losses

Over the week ending on the evening of August 25th, hundreds of billions of dollars were wiped out. On the Chinese Black Monday of August 24th, the Shanghai, Hong Kong and Shenzhen stock exchanges—China's three major stock exchanges-- came tumbling down. The three markets have a capitalized value of more than $11.5 trillion. When they lose 7% of their value in one day, the estimated book value loss would be around $800 billion. Not all the loss is incurred by the Chinese, but also by many foreign investors, including banks, insurance companies, central banks, sovereign funds, pension funds and other institutional investors. Panic in the Chinese markets echoed in other markets. In one day the average loss around the world was at least 6%.

The estimated Gulf funds abroad are an unknown quantity. But an attempt to estimate their value would be worthwhile in order to assess the immediate book value losses incurred by various Arab investors.

According to the web portal bqdoha, the Sovereign Wealth Funds (SWFs) were $1.7 trillion in December 2012, or 30% of estimated SWFs in the world. Such a figure would have reached $2.0 trillion in 2014. Even if it is assumed that due to the decline of oil prices and the decreasing trade surplus of GCC countries, the figure stayed the same until August, 2015, the loss on China's Black Monday and the consequent crush in leading world markets would mean that GCC sovereign funds could have potentially lost $120 billion if all of these funds had been invested in stocks and capital financial instruments. Such investments would only constitute half of the SWFs investments and not all stocks had fallen. However, the loss in one day in the book value could have ranged between $45-55 billion.

On China's Black Monday, oil prices lost an average of about $3 per barrel and barrel equivalents. The total GCC loss in foregone oil and gas proceeds would have probably added up to $70 million in just that day. The MEE publication quoted the IMF estimate of the GCC loss as a result of the decrease in oil prices in 2015 to be $300.0 billion, or roughly $80.0 million each day. On the other hand, the Iranian daily, The Financial

Tribune, estimated in its May 6, 2015 edition that the annual oil revenue loss to GCC countries would be $287.0 billion, or roughly $78.0 million each day.

In 2013, according to IMF International Financial Statistics, the combined foreign reserves of the six GCC states was about $680 billion, 90% of which belonged to Saudi Arabia ($570.0 billion). If the financial loss was only 3% on Black Monday, 2015, the total loss in these reserves would add up to about $20.0 billion.

These are examples of the magnitude of losses. Of course, there is always the foreign exchange risk which results from the acute fluctuations of currencies. Since most GCC countries (all but Kuwait) peg their currencies to the dollar, and keep most of their foreign reserves invested in dollar-denominated deposits and highly-liquid financial instruments, the foreign exchange risk is minimal. However, a more diversified portfolio is recommended. The declining but unstable gold price is also worth discussing in this context. Gold as a monetary non-earning asset has caused all countries a capital loss as a result of its fast decline from almost $1,900 per ounce of troy gold in April, 2011 to $ 1,100 in August, 2015. Gold, which is supposed to be a reliable asset, has been a bubble and brought misfortune to those who escaped to it in fear of the erratic exchange rates among leading currencies.

The estimated value of foreign assets owned by private sector companies and individuals is not well known. Yet the GCC private assets may not be less than $1.5 trillion. If these have been exposed to similar risks as the assets of governments were, and were equally divided between capital assets and short-term instruments, the loss on Black Monday could have been around $62.0 billion.

In book value terms, the estimated total loss in one day to GCC economies would be in $billions.

	Private	**Public**	**Total**
Stocks	40.0	47.00	87.0
Financial Papers	22.5	20.00	42.5
Oil income	(only $80 million per day		
Total	**62.5**	**67.0**	**129.5**

Of course, as well as the price of oil and gold, much of these book value losses were recaptured. However, the markets will continue their erratic movement reflecting the balance of economic terror.

Conclusion

A loss of about $130 billion to both public and private investors in the GCC in one day serves as a strong reminder of how volatile the markets are. Such volatility did not come

by accident, nor was it an ephemeral shock soon to be forgotten. The sequence of shocks in 1987, 1996, 2004 and 2014 tells us that at least one shock will occur every 8-9 years. Some analysts may argue that this is a cyclical pattern imposed by market forces. Yet the author believes that these are man-made shocks. They are the product of the economic wars which serve the political and military rivalries waging between the economic superpowers of the world.

The future reveals a dismal picture, which the Gulf countries must observe with high vigilance and readiness. They need to strengthen their currency union and issue a unified currency. It will serve as a strong hedge against future shocks. It is true that the richer Gulf States can weather the storm for a few years at the current level of losses and expenditures. But if the currency and economic wars become second nature to the world economy, a solid strategy must be developed. Some less privileged GCC states feel that the current OPEC oil supply policies are hurting them and that the gap between their incomes and other more affluent members is widening.

More compassion among the GCC states is needed. They all face not only external challenges, but equally demanding domestic challenges, such as youth unemployment, poverty, feeling of disenfranchisement among the educated, and a large expatriate population who are now a second or third generation.

The GCC has always been relied on for a quick fix by many carpetbaggers of the world. These countries need to reconsider their actions because the challenge to the GCC is not only Iranian hegemony, but economic tsunamis over which they have little control.

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