



June 2017

## Global View

### Key Points

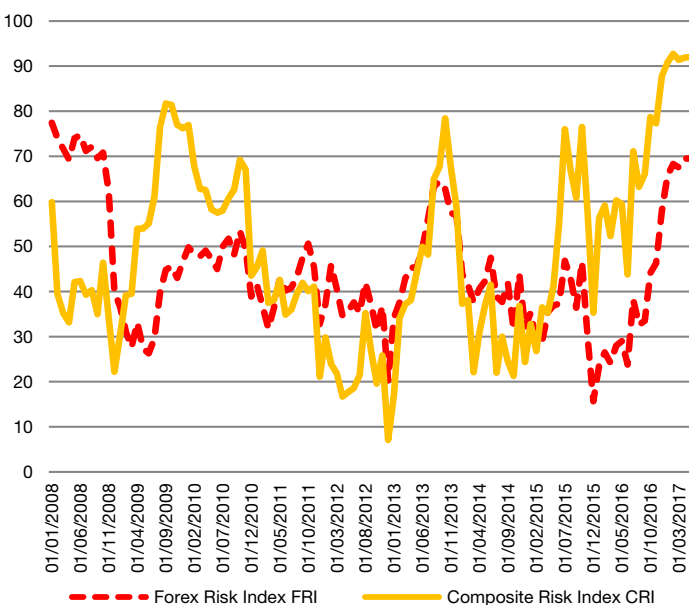
*Saudi Arabia now heads our country risk rankings. Its Composite Risk Index is flashing a major warning. At end-May 2017, the Saudi Risk Index hit a whopping 92.0 ('normal' range 0-100). Within the basket of factors, Forex Risk is especially high. Heightened forex risks have led the Authorities to sharply tighten domestic monetary conditions, which further compound problems.*

## Saudi Arabia – Never Say Never

Maybe geopolitics is the new economics? **But geopolitics depends on two dimensions: (1) the robustness of the local political-social systems and (2) the size and frequency of shocks that test them.** History shows that these shocks are usually financial in origin, often taking either a 'domestic' form, such as inflation and bank failure, or an 'international' form, such as devaluation and rapid forex reserve loss. We monitor these risks through our *Composite Risk Indexes* that cover some eighty economies. These are 'normalised' indexes of carefully selected financial and economic variables that range between 0-100, with higher readings indicating greater risk. The indexes have been designed as 'forward-looking' risk tools and have a set 50 mean and 20 unit standard deviation. **Major geopolitical crises appear to be preceded by large jumps in this Index of around 30-40 index points over a short, say, 6-9 month period, or by Composite Risk Index readings above 80, and often both.**

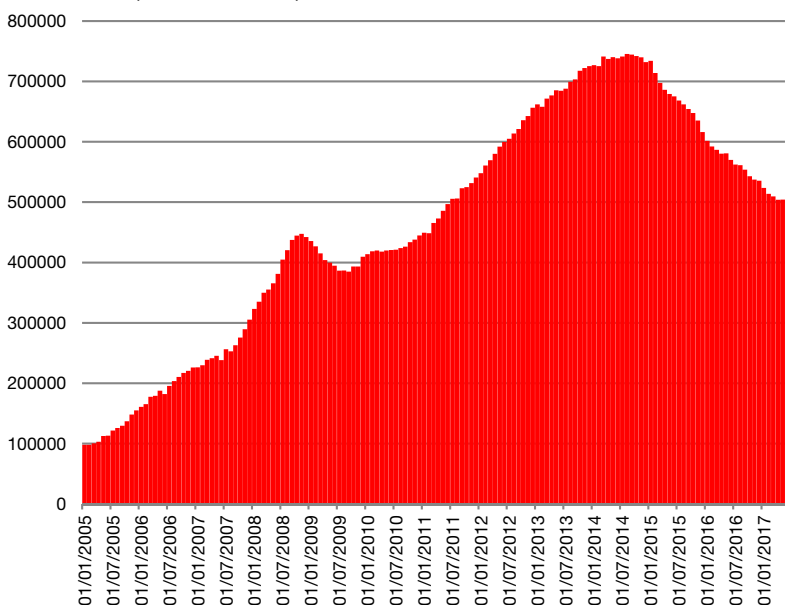
Figure 1 reports the Saudi risk data. The Composite Index comprises three dimensions – Exposure Risk, Financial Risk and Forex Risk, which measure, respectively, the concentration of investors in risk assets; the depth of liquidity in domestic financial markets, and the size and quality of capital inflows. The Forex Risk sub-component has been added to Figure 1. Both indexes show recent rapid increases, with the Saudi Composite Index now standing well above the 80 index danger threshold. Figure 2 highlights a more visible component of these troubles: the collapse in Saudi foreign exchange holdings. We acknowledge that these holdings do not embrace all financial resources available to the Kingdom. Notwithstanding, forex reserves have collapsed by one-third from their US\$740 billion peak in 2014 to barely US\$500 billion. In comparison,

**Figure 1**  
**Saudi Arabia Composite and Forex Risk Indexes**  
Monthly 2008-2017



Source  
CrossBorder Capital, IMF

**Figure 2**  
**Saudi Arabia, Forex Reserves**  
2005-2017 (US\$ in Millions)



Source  
CrossBorder Capital, IMF



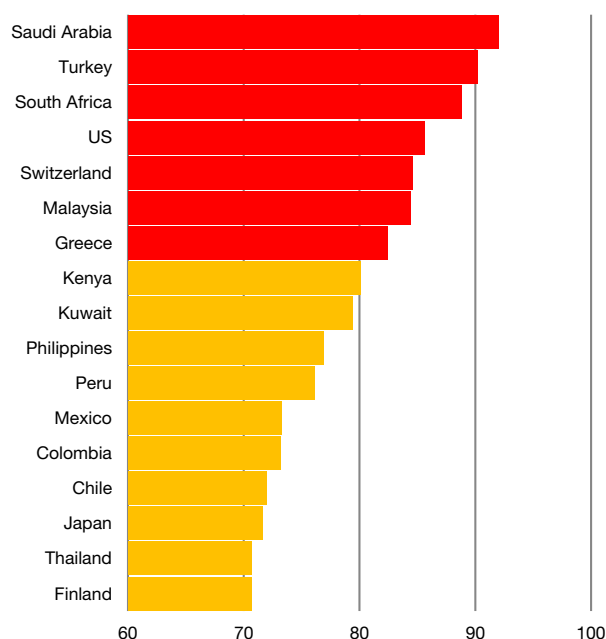
both the UAE and Kuwait have seen their forex reserve levels hold up, and Qatar has only suffered a moderate decline.

Figure 3 puts this risk data into a World context. **Saudi Arabia now tops our global risk rankings, followed by two other geopolitical 'hot spots' Turkey and South Africa.** Admittedly, the US also scores highly because of worsening domestic credit markets and a poor US dollar outlook, but at least America's social-political superstructure is among the most robust Worldwide. Figure 4 examines the history of recent well-known crises with their associated Composite Risk scores in the prior 12-month period. Crises tend to be associated with index scores around 80. The exception to this rule is Egypt's Arab Spring period in 2010-11. However, Egypt's Composite Risk Index did rise rapidly from under 25 points to touch 70 in the eight months ahead of the troubles. Equally, the fact that the Arab Spring soon fizzled out may be explained by this short-fall in the size of the shock compared to this 'normal' threshold, and by the subsequent vast inflows of foreign capital that helped to support the regime?

Two questions arise from this analysis. First, is the World overall significantly riskier? Second, where now for Saudi Arabia? Figure 5 reports our Composite Risk data for the World Aggregate. Global risks are elevated and have risen from their 2013/14 lows. However, they are around one standard deviation above 'normal' and appear to be subsiding.

The Saudi question is more problematic. Many have falsely warned before of pending regime change. This time may or may not be different? Saudi is asset rich and cash poor. **The acceleration in capital outflows is putting downward pressure on the Saudi Riyal and forcing the Central Bank to squeeze domestic liquidity to help support it. Something must surely give?** In short, the Saudi Risk Index needs to fall quickly and significantly. Yet it is hard to see how. Given the scale of current financial risks, the obvious factors to watch for are regional conflict, such as an escalation of the recent spats with Qatar and Iran, currency devaluation and/or oil market dislocations. But, on a wider view, Saudi's troubles may not only test the robustness of the domestic regime: they could also test the continuing power and influence of the US in the region. **So, could this be a crisis marked by a falling US dollar and rising gold?**

**Figure 3**  
**Ranking of World Economies by Highest Composite Risks**  
End-May 2017



**Source**  
CrossBorder Capital, US Federal Reserve, Bank of Japan, ECB, Swiss National Bank, IMF

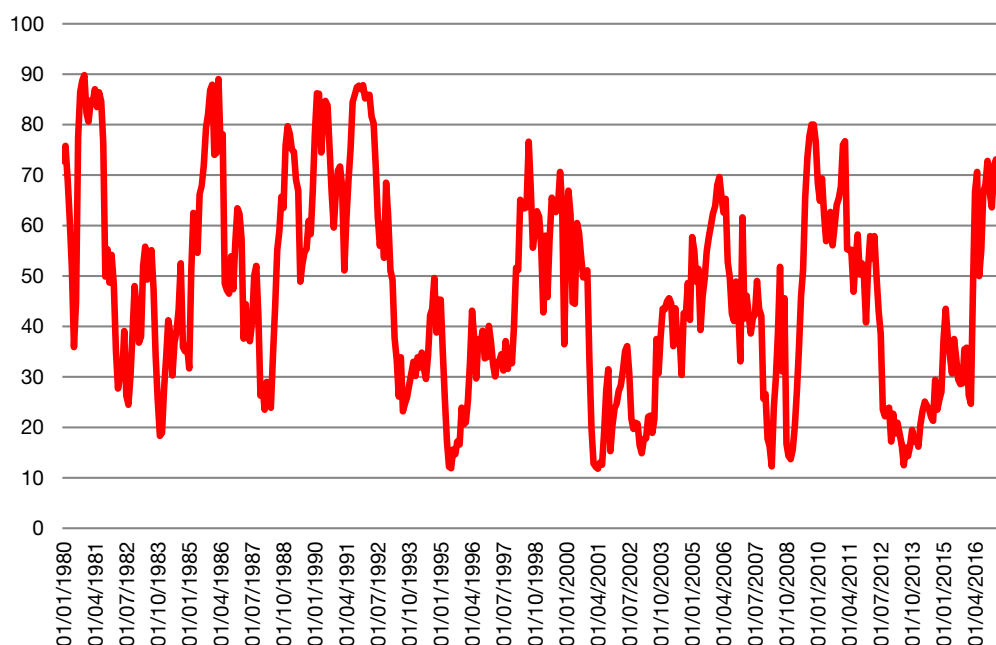
**Figure 4**  
**Examples of Crises and Composite Risk Index**  
Average 12 months ahead of crisis

Country	Composite Risk Index	Crisis
Argentina	76.8	1982 Falklands War
South Africa	84.4	1985 Rand Collapse
East Asian	75.0	1997 Asian Financial Crisis
Russia	79.7	1998 Rouble Debt Default
Egypt	62.2	2010 Arab Spring
Turkey	79.1	2016 Failed Coup
Nigeria	86.4	2016 Banking Crisis
Average	77.7	

**Source**  
CrossBorder Capital, IMF



**Figure 5**  
**World Composite Risk**  
Index 0-100      Monthly      1980-2017



**Source**  
CrossBorder Capital, US Federal Reserve, Bank of Japan, ECB, Bank of England, People's Bank of China, IMF

## **CROSSBORDER CAPITAL LIMITED**

**1 BURWOOD PLACE**

**LONDON W2 2UT**

**TELEPHONE 020 3755 2895**

**AUTHORISED AND REGULATED BY THE FINANCIAL CONDUCT AUTHORITY**

CROSSBORDER CAPITAL LIMITED, 2017. ALL RIGHTS RESERVED©

REGISTERED IN ENGLAND      COMPANY NUMBER 2687676

REGISTERED ADDRESS: 26 RED LION SQUARE, LONDON WC1R 4AG

This document is for information purposes only and does not offer any specific investment advice. Under no circumstances should it be used or considered as an advisory or offer to sell or a solicitation of any offer or advisory to buy any securities. The information in this document has been obtained from sources believed reliable, but we do not represent that it is accurate or complete, and it should not be relied upon as such.

Whilst given in good faith neither we nor any officer, employee, or agent of ours shall be liable for loss or damage, whether direct or indirect, which may be suffered by using or relying on the information, research, opinions, advice or recommendations contained herein or in any prior or subsequent written or verbal presentations. This report is provided solely for the information of professional institutional advisors who are expected to make their own investment decisions without undue reliance on this report and is not for use by private customers. The employees of CrossBorder Capital Limited may have a position or otherwise be interested in stocks mentioned in this report. This report may not be reproduced, distributed or published by any recipient for any purpose.