Protests Alter Forecasts for Premium Growth in MENA

The Arab Spring of 2011 has altered insurers’ prospects throughout the Middle East and North Africa (MENA). Political unrest can have direct effects on the insurance industry, including premium flows and a higher incidence of claims.

The International Monetary Fund (IMF) has recently published revised economic growth forecasts which, holding all other market factors constant, imply revised growth prospects for insurance premiums. Using these data, A.M. Best has performed an analysis of the economic impact of the protests, as well as the implications on country risk assessments and medium-term projections of premium growth in the MENA countries. Some key findings of this analysis are:

- While the protests will affect the insurance industries of each country to varying degrees, premiums for the region, as a whole, are projected to be only 0.7% lower in 2015 than they would have been otherwise.

- Eleven of the 16 MENA countries are expected to experience lower premium growth than they otherwise would have before the protests, while five other MENA countries are projected to experience modest increases.

- Relative to country risk assessments, with the exception of Tunisia, all the countries where the impact from the unrest is deemed high are classified as CRT-5, the highest risk tier.

![MENA - Changes in IMF GDP Growth Forecasts and Country Risk Impact of Unrest by Country](image-url)
Premium Growth Linked to Economic Activity

The Arab Spring of 2011, a time of mass social unrest and political turmoil in the Middle East and North Africa (MENA), has altered insurers’ prospects throughout the region. The revolutions in certain countries not only have taken a huge human toll in terms of violent protests, deaths, injuries, and arrests, but also have changed the region’s landscape in terms of its business environment, as well as economic, political and financial system risks, which are the metrics A.M. Best uses to assess country risk. This special report examines the impact of the protests on country risk assessments, and prospects for the regional economy and insurance premium growth in the MENA region.

A.M. Best’s current Country Risk Tiers (CRT) for the MENA countries and its assessment of the political unrest’s level of impact on each country are shown in Exhibit 1. With the exception of Tunisia, all countries where the impact from the unrest is deemed high are classified as CRT-5, the highest risk tier. (For more information, visit www.ambest.com for A.M. Best’s Assessing Country Risk methodology.) In September 2011, Egypt was moved from CRT-4 to CRT-5, due to its elevated risk. Although the country risk impact on Tunisia is deemed high, Tunisia’s classification as a CRT-4 has not changed at this time due, in part, to its relatively stronger economic, political and financial system conditions prior to the protests.

For the insurance industry specifically, political unrest can have direct impacts, including the disruption of business activity and possible liquidity issues. Premiums are likely to be depressed because of the days lost to the unrest and, in some cases, the inability or inefficiency in collecting premiums. Alternatively, there may be incidental benefits, such as increased premiums for cargo business due to increases in oil prices and reinsurance opportunities arising from reconstruction efforts and government infrastructure spending.

While claims due to civil unrest and civil war are typically excluded, the incidence rates of claims could be higher. Moreover, changes in government regimes resulting from political protests, at a minimum, can trigger a review of a government-owned companies’ senior management, preferential treatment or compulsory cessions. New regimes also can implement changes to insurance regulations and the supervisory authority.

Importantly, political unrest can also fundamentally change real economic activity in the short, medium and possibly long run, which can have far-reaching implications on the size of the insurance industry. Specifically, a country’s growth in inflation-adjusted insurance premiums is determined, at least partially, by the overall level of real economic activity in that country. Nominal gross domestic product (GDP) growth historically is highly correlated with insurance premium growth (see Exhibits 2 and 3 for examples for the cases of Egypt and Tunisia).

Although the political situations in the MENA countries are still developing, several key economic changes are already underway.
that can provide a better understanding of the potential impact on the insurance industry. The International Monetary Fund (IMF) has recently published revised economic growth prospects which, holding all other factors constant, imply revised growth prospects for insurance premiums as well. Using these data, A.M. Best has performed an analysis of the economic impact of the protests as well as the implications on medium-term projections of premium growth in the MENA countries.

The protests will affect the insurance industries of each country to varying degrees. The impacts range from Syria’s projected premiums in 2015 being 14.3% lower than they otherwise would have been before the protests, to Turkey’s projected premiums in 2015 being 1.0% higher. Premiums for the region, as a whole, in 2015 are projected to be 0.7% lower than they otherwise would have been. Thus, while the overall effect of the protests in the short-to-medium run is negative, it will be relatively minor on the regional insurance industry.

Revised Regional Economic Growth Outlook
In September 2011, the IMF downgraded its growth projections for eight of the 16 MENA region countries since the protests began, including Algeria, Bahrain, Egypt, Jordan, Lebanon, Oman, Syria, and Tunisia, and raised its projections for seven others, as shown in Exhibit 4.

Syria, interestingly, is the only country for which GDP is now projected to contract in 2011 (by 2.0%), whereas GDP for the other MENA countries is expected to continue to grow at positive, albeit slower, rates in 2011 and the years ahead. The economic impact on these countries due to the protests is expected to be felt most heavily in 2011, with growth rates generally returning to their pre-crisis growth path by about 2013 or 2014 (see Exhibit 5). Again, Syria is the exception, with growth rates expected to be below their pre-crisis growth path into 2016.

Even if the growth rates eventually return to their pre-crisis growth paths, there will be long-lasting reductions in absolute GDP levels that will be difficult to regain without significant accelerations in growth beyond pre-crisis norms. Specifically, GDP per capita in Syria in 2015 is forecasted to be 8.4% less than the forecast before the protests, while Egypt’s GDP per capita forecast for 2015 is 5.5% less; Jordan’s is 3.2% less; Algeria’s, 1.9% less; and Bahrain’s, about 0.3% less.

Drivers of Economic Growth In MENA Region
Changes in key sectors of the MENA economies, namely, tourism, private financing (particularly foreign direct investment) and the oil market, are largely driving the reductions in GDP projections. Tourism and investment are highly dependent on consumer and investor sentiment, and thus are vulnerable to shocks such as domestic unrest.

Several countries have experienced reduced tourism, a removal of foreign direct investment and higher risk premiums on debt and equity as a result of
the unrest. However, elevated oil prices resulting from the turmoil have been able, thus far, to support the economies of the region’s oil exporters, while creating further challenges for oil importers. The degree to which each country in the MENA region depends on these various sectors therefore determines the level of economic impact these economies will face due to the Arab Spring.

**Foreign Direct Investment**

Foreign direct investment (FDI) is an important sector in the economies of this region and has been heavily impacted in certain countries. The percent of GDP accounted for by FDI stocks and flows in each MENA country in 2010 is shown in Exhibit 6. (The share accounted for by FDI stock indicates the size of total FDI in the country relative to that country’s entire economy. FDI flows, on the other hand, represent the change in new FDI entering the country in a given year.)

The magnitudes of both the stock and flows of FDI relative to GDP can help determine the effects of changes in FDI flows on a nation’s economy. For instance, total FDI stock in Lebanon accounted for 95.5% of GDP in 2010, with FDI flows accounting for 12.6%. A change in FDI flows in Lebanon could have a relatively large impact on its GDP growth.

Alternatively, Bahrain’s total FDI stock accounted for 66.9% of GDP in 2010, while flows represented only 1% of GDP; therefore, a change or absence of that flow would have a smaller effect on GDP. Likewise, Kuwait’s total stock FDI accounted for only 5% of GDP and flows accounted for 1%, implying a change in FDI flows would have an even smaller impact on GDP.

New FDI flows into the MENA region have been reduced by this past year’s political turmoil because such flows rely heavily on investor confidence. The IMF projects that FDI in Egypt and Tunisia could be reduced by approximately 67% and 53%, respectively, in 2011, which implies GDP reductions in these coun-

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**Exhibit 4**

**MENA – IMF Economic Growth Forecasts for 2011 (before and after protests)**

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<tr>
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<tr>
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<tr>
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<td>-3.0</td>
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<tr>
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<td>1.2</td>
<td>-4.3</td>
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<td>4.8</td>
<td>1.0</td>
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<tr>
<td>Jordan</td>
<td>4.2</td>
<td>2.5</td>
<td>-1.7</td>
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<tr>
<td>Kuwait</td>
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<td>5.7</td>
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<td>Oman</td>
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<tr>
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<td>18.7</td>
<td>0.2</td>
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<tr>
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<td>UAE</td>
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<td>3.3</td>
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*Due to the heightened uncertainty of Libya’s political situation, the IMF has not provided a GDP growth estimate for the country; however, economic activity has declined significantly as a result of the revolution.
Source: IMF World Economic Outlook, October 2010 and September 2011.*
Exhibit 5
IMF Economic Growth Projections (October 2010 & September 2011)
These graphs show the International Monetary Fund’s economic growth forecasts from 2001 to 2016 for Algeria, Bahrain, Egypt, Jordan, Lebanon, Syria and Tunisia made before the protests (forecasted in October 2010) and after the protests (forecasted in September 2011).

Source: IMF
tries of up to 1 to 2 percentage points in 2011.

Tourism
The level that each MENA country relies on tourism is positively correlated with the degree of impact from the regional protests. Specifically, the larger the share of GDP accounted for by travel and tourism in a given country, the larger the downward revision to projected GDP growth for 2011 following the MENA protests. The countries with the highest tourism contributions to GDP include Lebanon, Jordan, Morocco, Tunisia, Egypt, and Bahrain (see Exhibit 7).

The IMF estimates that tourism in Tunisia alone decreased 40% from January to February 2011, and it expects further declines throughout the year. Tourism in the region is expected to recover very slowly, as it relies on consumer sentiment, which is based on long-term conditions of a country. A diminished tourism industry, therefore, could continue to be a drag on economic growth.

Tourists emanating from outside the MENA region probably will be the most able, and likely, to cancel their travel plans and take longer to return to the region. Exhibit 8, which presents the tourists’ origination points to select MENA countries for which data were available, indicates that nearly 40% of visitors to tourism-reliant Lebanon are from Europe and the Americas. Moreover, Europe and the Americas account for large majorities of tourists to the other tourism-dependent countries of Morocco, Egypt and Tunisia. Interestingly, the majority of tourists to Jordan and Syria are from the region, and thus, the two countries may experience less of a decline in tourism than others in the region.
Oil Market
Not surprisingly, the IMF reports that the MENA region’s oil exporters have more favorable long-term growth outlooks than the region’s oil importers. Indeed, there is a negative correlation between the level of oil exports in a given country and the IMF’s level of revision to projected GDP growth in 2011. Specifically, most of the countries experiencing prospective growth downgrades in 2011 are net oil importers, including Egypt, Jordan, Lebanon, Syria, and Tunisia. Moreover, countries with upgraded economic growth since the protests include key oil exporters – namely, Kuwait, Qatar, Saudi Arabia and the UAE.

During the MENA protests, there has been increased volatility in the oil market. Specifically, supply disruptions (especially in Libya) in the first quarter of 2011 led to oil prices spiking to USD 120 a barrel at the end of April. Prices currently are back down towards pre-crisis levels due partially to increased oil production from other members of the Organization of Petroleum Exporting Countries (OPEC), most notably Saudi Arabia, and the release of emergency reserves by International Energy Agency members. (OPEC members in the MENA region include Algeria, Kuwait, Libya, Qatar, Saudi Arabia, and the UAE.) The IMF projects that oil prices will rise 30.6% in 2011 over 2010; decrease 3.1% in 2012; and further decline 1.1% from 2013 to 2016.

Potential Effect on Insurance Premium Growth
As noted previously, economic growth is highly correlated with growth in insurance premiums. Therefore, it is possible to project inflation-adjusted insurance premium growth based on IMF forecasts of real GDP. Specifically, by keeping the relationship between premiums and GDP constant (i.e., a stable level of insurance penetration), a projected level of premiums can be calculated by applying the projected growth rates of annual real GDP to insurance premiums. Importantly, these projections focus on the effect of real economic activity alone on insurance premiums – all other market conditions (including inflation, structural changes in the insurance market, changes in consumer preferences and changes in regulation or government regimes) are held constant. A.M. Best recognizes that other market conditions, in fact, may change by 2015. For example, A.M. Best expects that compulsory covers and insurance awareness in the MENA region will raise insurance market penetration over time. Therefore, these projections create a baseline forecast. Changes in other market conditions will be reflected in variations around this baseline.

Exhibit 9 shows projections of inflation-adjusted premiums for 2015, based on GDP growth projected before and after the unrest. Likewise, Exhibit 10 presents the projected growth in premiums from 2010...
to 2015, pre- and post-unrest. As shown in these exhibits, 10 of the MENA countries are expected to experience a decline in premium growth. Syria and Egypt are expected to experience the largest growth declines due to the unrest. Alternatively, Israel, Morocco, Saudi Arabia, Turkey, and the UAE are expected to experience modest increases in insurance premium growth from pre- to post-unrest. The protests will affect the insurance industries of each country to varying degrees. The impacts range from Syria’s projected premiums in 2015 being 14.3% lower than they otherwise would have been before the protests, to Turkey’s projected premiums in 2015 being 1.0% higher. Premiums for the region, as a whole, in 2015 are projected to be 0.7% lower than they otherwise would have been.

Conclusion
Economic activity certainly will play an important role in the growth of the MENA region’s insurance industry. Moreover, the region’s long-term economic growth will rely heavily on investor and consumer confidence, which affects the important sectors of investment, tourism and oil demand. The turbulence of the Arab Spring has shaken consumer and investor confidence in the region, which is evident in the recent volatility of its equity markets. Clearly, other factors also impact equity markets, such as the global economic slowdown and the sovereign debt crisis in the eurozone. Equity markets across MENA are down 15.9%, on average – since the start of 2011 to mid-November – ranging from a full rebound in the Qatar exchange to a drop of 41% in the Egyptian exchange. The stock markets in Bahrain, Egypt, Jordan and Lebanon are among the region’s hardest hit and have not yet shown signs of recovery.

However, there is some evidence that investor confidence in certain other countries is gradually returning. Eight of the equity markets in the MENA region, while still down from January, have partially rebounded from their troughs earlier in the year, including those in Kuwait, Morocco, Qatar, Tunisia, Turkey, Saudi Arabia and the UAE-Dubai exchange. Moreover, elections in Egypt,
Morocco, Oman, and Tunisia in October and November could be turning points in the region’s political landscape and have captured the interest of the international community and investors. The stock markets in some of these countries have seen modest recoveries leading up to these elections – namely, those in Morocco and Oman, up 4% and 1%, respectively, since their troughs in August, and in Tunisia, up about 14% since June.

It is uncertain how long these countries will take to rebuild, and what the new regimes will look like. Ultimately, their futures rest, in great part, on the face of these post-Arab Spring regimes and the confidence that they can instill in consumers, investors and the business sector. A.M. Best will continue to monitor all relevant country risk factors in the MENA region and update its country risk tiers as warranted.
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