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The Qatar Situation: Part II

Last week, we discussed a short history of Qatar and its geopolitical imperatives. This week, we will analyze the events precipitating the blockade, the blockade itself, the GCC's demands and the impact thus far on Qatar. We will examine how the situation has reached a stalemate and, as always, we will conclude with market ramifications.

The Precipitating Events

As we discussed last week, a combination of conditions have allowed Qatar to avoid domination by Saudi Arabia, the generally recognized leader of the GCC. Qatar has powerful allies outside the region, friendly relations with Iran, is demographically unified and has an economy that isn't dependent on oil, all of which have allowed Qatar to follow independent policies. This situation has persistently angered Saudi and UAE leaders. Beneath these national concerns are also long-standing tribal rivalries.

However, these differences have been in place for a long time. It appears that there were three events that led the GCC, Egypt, Yemen and Sudan to react and initiate the blockade.

The offensive quotes. Inflammatory statements attributed to the Emir of Qatar, Tamin bin Hamad al Thani, were posted on Qatari government websites. The quotes were supportive of Iran, Hamas, Hezbollah and Israel. The statements were designed to offend. They called Iran an "Islamic

power," which would legitimize Shiite Islam, an apostasy to conservative Wahhabist Sunnis that are politically dominant in Saudi Arabia and powerful in other GCC states. And, any public support for Israel by an Arab sovereign is damaging. In response, Qatari officials immediately claimed they were hacked and, in mid-July, U.S. officials agreed with them—the U.S. claims the UAE orchestrated the hacking.¹ The UAE has denied the charge, but U.S. officials claim they have evidence that senior members of the UAE government discussed the plan and its implementation. Because al Jazeera has been banned throughout the GCC and other nations, the public in these countries may not know the statements were probably planted. In fact, the statements were so egregious that they border on incredulous. Although Qatar has reasonably good relations with Iran, we doubt any Sunni would be so complimentary to Iran as to call them an Islamic power. Supportive statements for Hezbollah and Israel appear highly unlikely as well. In other words, it's hard to believe that any head of state in the GCC would say such things, which increases the odds that this was a rather ham-fisted hack.

The falcon ransom incident. In December 2015, a 26-member falconer hunting party that included nine members of the Qatari royal family were abducted in Iraq.²

¹ https://www.washingtonpost.com/world/national-security/uae-hacked-qatari-government-sites-sparking-regional-upheaval-according-to-us-intelligence-officials/2017/07/16/00c46e54-698f-11e7-8eb5-cbccc2e7bfbf_story.html?utm_term=.edc12d615997

² <https://www.ft.com/content/57aeba9c-4c4f-11e7-a3f4-c742b9791d43> (paywall)

Falconry has become a very expensive sport. The birds themselves can cost upwards of \$100k each. The preferred prey, the houbara bustard, has been extensively hunted to near extinction on the Arabian Peninsula. Thus, hunters are forced to seek this prey in more dangerous places, e.g., Iraq, Afghanistan and Pakistan. According to reports, the hunting party had made arrangements with the Iraqi interior ministry. Unfortunately, the interior ministry is said to be deeply infiltrated with Iranian sympathizers.

When the hunting party was in Iraq, its local guards melted away and helicopters commanded by Shiite militias landed and took the party away. It is unclear where they were held; it is believed they were in the “green zone” in Baghdad at least part of the time, although there are reports that suggest some of the party may have also been held in Iran. Over the next 15 months, the al Thani family negotiated with various parties to secure the release of the members. It is estimated that the total ransom was \$1.0 bn.³ Of that amount, \$700 mm was paid to Iranian operatives and regional Shia groups. The remainder was paid to various Islamist groups in Syria, some of which may have links al Qaeda.

The ransom irritated the GCC nations for numerous reasons. First, nearly \$40 mm per person seems like a lot of money. Second, paying Sunni jihadist groups in Syria isn't unusual (other GCC nations support Syrian rebel groups as well) but ones with clear al Qaeda links are questionable. Third, the fact that the party was so negligent as to trust Iraqi interior ministry officials looks either naïve or reckless. But, the biggest reason for the anger is that it is highly probable that Iranians or Iranian-backed Shiite groups

benefited from the kidnapping. The other GCC nations expect Iran to be unfriendly and behave accordingly. It's possible that the Qataris' relations with Iran led them to underestimate the threat. It has been said that this incident was the one that “broke the camel's back,” and led to the decision to force Qatar to adhere to the rest of the GCC's goals.

The Trump visit. In late May, President Trump paid a visit to Saudi Arabia. By all accounts, he was well received. Relations between the U.S. and Saudi Arabia had deteriorated during the Obama administration. The previous administration had supported the Arab Spring, which the Saudis viewed with suspicion. Obama also supported the ouster of Hosni Mubarak and the election of the Muslim Brotherhood in Egypt, two moves the Saudis strongly opposed. The Obama government suggested that it wanted Bashar Assad out of Syria, a move the Saudis supported, but when the Syrian leader used chemical weapons on his citizens, a previously established “red line” for U.S. action, President Obama demurred and did not bomb Syria for its transgressions. This decision deeply concerned the Saudis as it raised questions about America's military commitment to the region. But, the most egregious action by the previous administration was the nuclear deal with Iran. The nuclear deal likely removed the threat that America would bomb Iran's nuclear sites. If successful, the deal would delay Iran's progress toward a nuclear weapon, but the Saudis likely harbor fears that the deal won't be successful.

Thus, the Saudi Royal Family was glad to see Obama go and wanted to make a good impression on the new president, which appears to have occurred. President Trump's speech in Saudi Arabia stressed the need to contain terrorism and a case could

³ <https://www.ft.com/content/dd033082-49e9-11e7-a3f4-c742b9791d43> (paywall)

be made that the Saudis viewed Qatar's foreign policy as fostering terrorist groups. The Saudis likely concluded they had U.S. support for bringing Qatar to heel. Tweets from President Trump after the blockade was implemented generally support that idea.

The Blockade

On June 6th, the members of the GCC (save Qatar), along with Yemen, Sudan and Egypt, announced a total economic blockade of Qatar and declared Qataris in their nations as *persona non-grata*, forcing them to leave their states.

This is a very aggressive action. There is a body of international law that governs blockades, sanctions and quarantines. Although a blockade isn't always an act of war, a "total blockade" is such an act. For a blockade to not be an act of war, the parties enforcing the blockade must allow basic necessities to pass the secured border. Because Saudi Arabia and the UAE are refusing to allow any trade to occur, technically, this is an act of war.

Initially, there was a run on goods. Households, facing the potential for shortages, raced to stores to secure basic necessities.⁴ We suspect the blockading nations assumed that Qatar would give in to its demands in the face of economic panic.

A few days later, the demands were delivered. Here is the list:

1. Reduce diplomatic ties and close diplomatic missions with Iran, expel any members of Iran Revolutionary Guard Corps (IRGC) and end military and intelligence cooperation with Iran.

⁴ Such behavior is rather common when an event has some lead time. Similar buying occurs before hurricanes, major snowstorms, etc.

2. Close Turkey's military base and end all military cooperation with Turkey.
3. Sever all ties to terrorist, sectarian and ideological organizations, specifically, the Muslim Brotherhood, Fateh al-Sham and Hezbollah.
4. Stop all funding for groups and individuals designated as terrorist by the GCC, Egypt and the U.S.
5. Return terrorist figures and wanted fugitives to their respective countries where they are sought.
6. Shut down al Jazeera.
7. End the practice of granting citizenship to wanted nationals of the GCC and Egypt, and revoke existing Qatari citizenship to nationals who are wanted by the above.
8. Pay reparations to those who have suffered financial or physical loss due to Qatar's policies.
9. Align military, political, social and economic policies with those of the GCC.
10. End contact with political opposition figures of GCC nations and Egypt.
11. Shut down other news outlets that are funded directly and indirectly by Qatar.
12. Submit to these demands within 10 days or they will become invalid.
13. Consent to monthly compliance audits in the first year followed by quarterly audits in year two and annual audits thereafter.

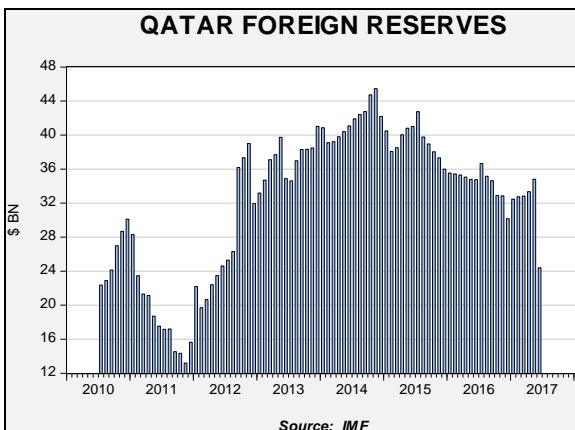
Qatar did not respond to these demands. If they had, it would have been a significant loss of sovereignty. Even Secretary of State Tillerson suggested that it was doubtful that Qatar would acquiesce to these ultimatums.

Given the harsh nature of these demands, it begs the question...did the GCC leadership expect the blockade to quickly crush the Qatari economy and force compliance, or are Saudi Arabia and Egypt (the two most

significant militaries among the blockade group) planning military action? After all, in the period before WWI, the Austrian-Hungarian Empire made what are considered by some to be excessive demands on Serbia in response to the assassination of Archduke Ferdinand. Most historians believe the empire was spoiling for a war and thus expected the rejection of the demands which would trigger a military incursion.

Thus far, we haven't seen any evidence that mobilization for war is underway. If one were to occur quickly, it would be solely a Saudi operation. Egypt has a significant regional military force but it would take time to mobilize troops. With Saudi Arabia involved in Yemen, it isn't obvious that the kingdom is prepared for another war.

And so, if war isn't coming, the GCC must be expecting that the blockade will be sufficient to meet the goals of Saudi Arabia, the UAE, et al. There is evidence that the blockade has adversely affected Qatar. For example, foreign reserves have plummeted. As the chart below shows, Qatar's foreign reserves fell \$10.4 bn in June and represent about 4.4 months of imports. We would expect the decline in reserves to moderate in July, but the economy has clearly been hurt by the blockade.



The problem for the GCC nations aligned against Qatar is that there isn't an obvious endgame if the blockade fails to force Qatar to follow Saudi foreign policy aims.

There are two issues that have emerged from this action. First, the two leaders pressing the blockade, Saudi Crown Prince Mohammed bin Salman and UAE Crown Prince Mohammed bin Zayed, are the de facto rulers of their respective kingdoms. Both are young; the former is 31 and the latter is 56. They are both "making their marks" and a failure would potentially undermine their power. Second, the comparison to the Austro-Hungarian Empire's demands on Serbia to the GCC's demands on Qatar are important. The former made demands on Serbia that it (and the other European powers) generally believed Serbia would not accept. Simply put, the Austro-Hungarian Empire's demands were a pretext for war.⁵

Qatar cannot accept these demands without a severe loss of sovereignty. Shutting down al Jazeera would be a serious loss of face for Qatar, but weakening relations with Iran would put Qatar's economy at risk since both nations cooperate in managing the offshore natural gas fields.

The path to resolving this conflict could include a new set of demands that are less onerous. The GCC has tried that but they still insist on al Jazeera being closed and relations with Iran being downgraded. As long as these demands remain, the likelihood of resolution is low.

⁵ Interestingly enough, Serbia accepted all of the demands except one, which required Serbia to allow Austro-Hungary to conduct an investigation in Serbia.

Stalemate

The leadership of the GCC shows no signs of backing down. Qatar shows no signs of accepting the GCC's demands. The longer this standoff continues, the greater the likelihood that Qatar will deepen relations with Turkey and Iran. We expect the latter to tread cautiously in Qatar. The huge American military presence in Qatar will likely prevent Iran from making major inroads into Qatar. At the same time, Turkey will view this spat as an opportunity to expand its influence.

Although we expect the U.S. to quietly work to resolve this issue, President Trump's supportive comments of the Saudis and the accusations of Qatar's funding of terrorism will make the State Department's work more difficult. At the same time, the U.S. military would prefer to keep its installation in Qatar; moving is costly and risky, and being in Qatar allows the U.S. to use the favorable geography to project power into the region. Of course, Saudi Arabia, the UAE and Bahrain are all important U.S. allies, thus the U.S. isn't interested in necessarily picking sides. For the U.S., this is a bit like watching a group of friends quarrel; American interests are better served if everyone can get along.

Thus, the situation will likely continue for the foreseeable future. The most likely outcome is that Qatar will learn to live with the blockade and, over time, it will become less effective. The leadership of the UAE and Saudi Arabia won't be able to back

down; Qatar can't either due to the onerous nature of the demands. The U.S. will try to craft a face-saving outcome for both but it isn't obvious to us what that would entail. In the end, Turkey is probably the big winner here—Qatar needs outside friends and Turkey wants to expand its influence in the region.

Ramifications

So far, oil markets have taken the war in Yemen, the collapse in Syria, the war against IS and the steady encroachment of Iran into Iraq in stride. The Qatar blockade is being treated in the same fashion. In isolation, the Qatar blockade will probably not be the event that triggers an oil supply disruption in the Middle East. However, when examining this event in the broader context of a region experiencing increasing turmoil, this blockade, which has the characteristics of overreach by Saudi Arabia, increases the likelihood of a crisis in the region.

If the Trump administration decides to decertify the Iranian nuclear agreement and tensions escalate further, the attention diverted to the Qatar blockade may increase the odds that this event or some other triggers a broader crisis that disrupts oil flows. Although energy equities have languished this year, investments in this sector may offer some protection from a problem in the Middle East.

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