

MENA Geopolitics December

Mourning the Martyrs in Muharram

While North Africa is busily transitioning to a set of neo-Islamist, GCC-sponsored Sunni democracies (we are positive on this trend), Shia groups in the Middle East have started to stir. In this monthly we focus on some of the key elements of the Shia tradition that may have a significant impact on global markets in the near future.

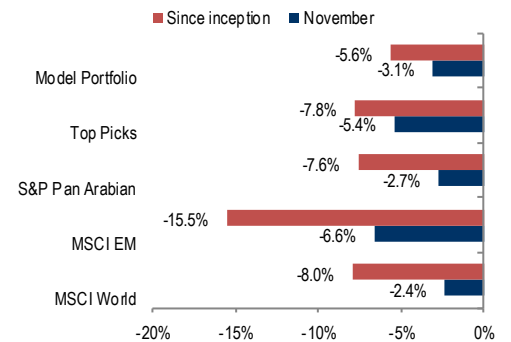
Key takeaways:

- ❖ **Potential flashpoint:** Tensions could be inflamed on December 6th (Ashura) with Saudi Arabia meriting particular attention. This could lead to a sharp spike in oil. We are also highly cautious on Iraq, where violence could easily spark a civil war
- ❖ **Syrian endgame:** As predicted earlier this year, December looks to be the crunch point for Syria. Elections or power transfer remain the likeliest outcomes.
- ❖ **Bahrain beginning:** The arrest of five individuals plotting to blow up various targets in Bahrain last week including the Saudi-Bahraini causeway is a harbinger of potentially more terrorism to come. The Shia majority is nursing its wounds and without proper dialogue will start to lash out.
- ❖ **Iran & bombs:** Warnings of an attack on Iran have been circulating for 30 years. It's different this time and we see the probability of an attack rising sharply as we head into 2012 (probability 40% on a 12 month view from 0% last year). The only solution to this mess is dialogue, which has now effectively been taken off the table. We see January/February as the point of peak probability for military action.

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Potential flashpoint on December 6th, Ashura

"Every day is Ashura and every land is Karbala"

In our opinion, the above quote encapsulates the essence of one of the main elements of Shia Islam that has come to the fore since the Iranian revolution in 1979. It basically translates to: tyranny and oppression are present everywhere and must be challenged everywhere.

Some history (next 4 paragraphs, apologies), helps contextualize this. Looking at the origins of the split between Sunni and Shia Muslims helps put this quote in context. In essence, it comes down to the question of who had authority after the Muhammad (ﷺ) passed away in 632.

The Sunnis believed it was his companions and preferred those who could enforce rules and continue the expansion of the Muslim state, whereas the Shia believed authority passed down through his family, notably his cousin/son-in-law Ali. Sunnis viewed their leaders as having legislative authority but not necessarily religious authority; whereas Shia believed their leadership being of the family of Muhammad (ﷺ) had both legislative and spiritual authority, with the extent of spiritual purity/awareness varying amongst the different Shia groups.

The Sunnis were the majority group and thus the caliphate (leadership of the Muslim state) went to Umar (assassinated 644) and then Uthman (assassinated 656) before finally passing to Ali, who was convinced to take the position after initially refusing. Ali was assassinated in 661 (turbulent times) and this was the point that the split started to widen as Iraqi Muslims pledged allegiance to his son, Hasan, whereas Muslims in the Levant and Egypt pledged allegiance to Muawiyah, another companion of Muhammad (ﷺ) and Uthman's cousin. Muawiyah was Governor of Syria and had refused to acknowledge Ali's caliphate as he believed more could have been done to apprehend Uthman's killers. As his military prowess was superior to that of Hasan, a peace settlement was rapidly negotiated after Muawiyah marched on Iraq and a brief skirmish at Sabat, with Muawiyah becoming Caliph and Hasan retired to Medina before dying (possibly by poison) in 669.

The original agreement between Muawiyah and Hasan was for Muawiyah's successor as caliph to be in effect elected, but he chose to pass the mantle to his son Yazid when he died in 680 (natural causes). Hussein, Hasan's brother and current legitimate leader according to the Shia as the only living grandson of Muhammad (ﷺ) was aghast at this and, together with other prominent Muslims were aghast at this and mobilized against Yazid, refusing to accept him as Caliph as they rejected monarchy as a legitimate ruling system in Islam. On the way from Mecca to Kufa in Iraq (Ali's capital) on October 10th of 680, the tenth day of the Muslim month of Muharram, known as Ashura, Hussein plus 71 of his companions fought against 4,000 or more of Yazid's soldiers. The exact details of the battle are debated, but the end result was that Hussein's party was wiped out and his head put on a spear to take back to Kufa.

For Shia this event exemplified sacrifice (for the purity of Islam), martyrdom, revolution and standing up to tyranny and oppression, no matter what the odds. Hussein's status as a temporal and spiritual leader allowed him to be used as a paradigm of virtue (having the quality of infallibility) and redemptive figure. As the theology of Shia Islam continued to evolve, passing down through 9 further generations of Hussein's descendants (he was the 3rd Imam) in the view the most populous group currently ("twelver" Shia as twelve generations), it did so while Sunnis were dominant, reinforcing the emphasis on standing up to oppression real or perceived and operating from an underdog status. This was particularly acute given the Shia position that the Imams that followed Hussein were all poisoned.

The exception to this was the twelfth Imam, known as Imam al-Mahdi, who twelver Shia believe entered "Minor Occultation" at the age of 5 in 873, where he was hidden away and communicated only through deputies until 941 when he entered "Major Occultation", wherein he was hidden away until the time comes for his return to fight against the *Dajjal* (anti-Christ) and some tyrants ruling over Muslims. After he wins and brings (true) Islam back to the world Jesus (ﷺ) will come back according to Shia eschatology.

President Ahmedinejad of Iran has indicated that he believes the time is near and could possibly be accelerated as a devout follower of Imam Mahdi. This is one of the main drivers for President Netanyahu of Israel commenting on the Iranian leadership as follows:

"You don't want a messianic apocalyptic cult controlling atomic bombs. When the wide-eyed believer gets hold of the reins of power and the weapons of mass death, then the entire world should start worrying, and that is what is happening in Iran."

Returning to Karbala, the month of Muharram for Shia's is one of reflection and commemoration of those martyred. The typical venue for this is the communal "*majlis*" (meeting) wherein stories of their exploits are told (often quite poetically) and extreme outpourings of grief are common. These commemorations reach their apogee on Ashura, the tenth day of Muharram (6th of December this year), where Shia around the world hold marches to commemorate and honour Hussein, who they view as the greatest martyr of all. These are somber but quite enthralling events, with some taking it to the extreme through self-flagellation in certain areas but usually just a wailing and gnashing of teeth in their black garb.

These emotions were successfully tapped during the Iranian revolution by Ayatollah Khomeini in aiding the fall of the Shah subtly and then taking control after the revolution (ironically turning Shia Islam more Sunni, while the jihadists turned Sunni Islam more Shia). It also served to energize the Iranian population to reject a peace proposal after pushing back Saddam Hussein's original attack on Iran and move into Iraq itself to overthrow the tyrant. The fervour was especially evident in the "human wave" attacks where, due to a lack of weaponry, thousands of Iranians would run across minefields and swarm tanks and artillery positions, which is another instance feeding into foreign perceptions of Iran's rationality (or lack thereof).

Monitoring Saudi Arabia's Eastern Province

As we move toward Ashura this year our main concern is over what happens in Saudi Arabia's Eastern Province, the oil-rich area where the majority of the Shia population of Saudi live (approximately 15% of the total Saudi population).

Last week we saw 4 Shia youth die of gunshot wounds in the Eastern province, two at the funeral of the first victim. The official line was that they were unfortunately caught in the crossfire between security forces and gunmen from an un-named foreign state (likely starts with Ir, ends with an), echoing a machine gun/molotov cocktail attack at the start of October, just after the Saudis were told of the DC assassination plot.

The external security forces who have been built up over the course of this year were pulled back from Shia-dominated towns at the start of Muharram as tensions rose, but the ability of the Shia elders to control the anger of the youth, likely growing during the *majlises*, is a question mark for us as the situation following the deaths and given the timing is significantly worse than March, with protestors saying some surprisingly aggressive slogans not fit for a public note and firebrand clerics breathing fire (figuratively speaking).

Saudi Shia view themselves as being marginalised citizens due to the dominance and nature of the official Saudi Sunni brand of Islam and its implementation, but this discontent has been steadily decreasing as a result of King Abdullah's positive measures and growing wealth.

In most Saudi towns Ashura marches are banned, but we expect to see significant numbers on the street come the 6th as emotions build up. Thousands of chanting Shia on the street will be tough to police, but hopefully the reaction will be a hands off one in line with the withdrawal at the start of Muharram. However, this has the effect that protests may then be seen as sanctioned, with continued marches past Ashura testing the patience of the Interior Ministry, headed up by the current Crown Prince Nayef. In the last few days some Shia mosques have been closed in certain areas, indicating that things may not go as smoothly as hoped.

There is also the factor that if the intelligence of the security forces is true and it was external gunmen starting up this violence to ferment discord, then they are almost certain to do so during this high-profile, emotive event, forcing a sharp and severe reaction.

Any deterioration during a march of size will elicit a sharp reaction from the oil market as concerns arise over the stability of the Saudi regime and the 10 million barrels of oil they currently supply to the market. We believe that such concerns are unfounded and, given the size and level of spend on internal security; any uprising will be rapidly dealt with (although hopefully this won't happen). As such, market reaction is unlikely to be prolonged and we have no concerns on the stability of the Saudi monarchy in the near term now that the Crown Prince (Nayef) and Second Deputy Prime Minister (Salman) have been appointed.

Ashura in Iraq and Pakistan likely to be very sombre indeed

This year we put the probability of attacks on Ashura marches in Iraq and Pakistan over 90% as Sunni jihadist groups have started to increase attacks in advance of this as we expected.

We are particularly concerned about the impact this might have on Iraq as we believe the current government is on its last legs and in the wake of the effective full US withdrawal at the end of December Sunni-Shia violence is likely to flare, causing stability to dissipate once more after one of the most violent summers since 2007.

The dynamics of the various Iraqi factions are complex, but we think that one main factor that is shifting is the moderating influence of Ayatollah Sistani in terms of predominantly not engaging in violence has started to wear thin.

To divert slightly back to our reconstruction of a Shia mindset, the role of the Ayatollahs is an important one. They are effectively religious experts who gain this qualification by being recognised as such by other religious experts of stature. Given the development of Shia Islam, the need for this class of scholars only arose after the Major Occultation we touched upon earlier as before this the spiritually superior and infallible Imams had a perfect exegesis of the primary texts and will of God.

They typically did not get involved in the running of the state, even when the state was Shia such as the Safavid dynasty. As such, Ayatollahs and lower level scholars codified and formalized the law, providing answers to questions followers had much as any religious jurist would. The equivalent Sunni codification was nearly finished by the time the twelfth imam left in the guise and is something we discuss in our section on the evolution of Islamism.

The upshot of this is that a typical Shia will follow a *marja* (religious point of reference), essentially one of the top Ayatollahs and his associated students in most things, providing some continuity of practice (also sending money to said Ayatollahs, which helps). The leading Ayatollahs are concentrated in Najaf near Baghdad and Qom near Tehran. An interesting development in this is the emergence of the concept of "guardianship of the jurist" (*vilayat e faqih*) by Ayatollah Khomeini, wherein he expanded the traditional interpretation of guardianship and leadership from the spiritual realm for the Ayatollahs, leaving political rule to the caliphs or sultans, to a wider ranging rule covering most aspects related to the benefit of the people. While most Shia in Iran follow *marjas* that advocate this view, it is rare outside of Iran for this to be held, with most twelve Shia outside of Iran drawing their line of authority from Iraqi or Lebanese clerics.

One particularly prominent Iraqi cleric was Ayatollah Khomeini, the teacher of Ayatollah Sistani, who eschewed politics for a focus on welfare and wellbeing. Ayatollah Sistani has taken a much more active role in the development of Iraq, even issuing fatwa emphasizing that clerics must be involved in politics to help shape the future of Iraq by encouraging their followers to participate in elections and not retaliate against jihadist and Baathist violence.

As the years have progressed and the death toll mounted, this message has worn thin with several groups retaliating in kind. Violence at Ashura close to the withdrawal may well be the final straw for many in our opinion. Given Iraq provides a significant portion of the market expectations for incremental oil supply over the next 4 years, the market could become significantly tighter before stability is seen again. Libya is significantly safer in our view.

Syrian endgame

The Syrian regime is not part of mainstream Shia Islam, but rather belong to an offshoot known as the Alawis, which is more of a community than religion, making up about 12% of the population and ruling in a largely secularist fashion. Iran recognized the Alawis as Shia primarily because they joined Iran's "revolutionary" axis.

They have controlled a Sunni majority and other minorities through the promise of a carrot in terms of revenue opportunities for rich Sunni merchant families and the threat of the stick for the masses through their extensive security forces and highlighting that only they can stop sectarian violence. As a minority ruling a majority the main concern for the Alawis is survival.

With the advent of Arab League sanctions on Syria our May prediction of elections or power transfer in December is becoming increasingly likely as money runs out with the tourism industry (15% of GDP) dead and the central bank barred from transacting with its neighbours, limiting their ability to appeal to rich Sunnis. The violence we have seen otherwise has destroyed their reputation with the masse. We do not see significant change occurring at the top and maintain that the army is unlikely to splinter into pieces, but rather see increased Sunni representation and a more pro-Sunni government coming in place, potentially through one of Bashar al-Assad's cousins.

Foreign military action remains highly unlikely given significant Russian armed support for Syria to protect their strategically important naval base there.

Bahraini beginning

Last month four Bahraini nationals were arrested in Qatar on allegations of being spies for Iran and planning to target the Ministry of the Interior, the Saudi embassy in Bahrain and the Saudi-Bahraini causeway that links to the two countries. An additional person was apprehended later. According to security services they had significant amounts of US dollars and Iranian riyals and admitted to going to Iran to train in how to blow things up.

This is quite an alarming incident as, if the security services are correct, it plays into the accusations that the Bahraini protestors were instigated by Iran and builds on these fears amongst the GCC Sunni nations, particularly when coupled with other alleged Iranian terrorist activities over the last few months.

The recent [500 page report on potential human rights violations](#) during the by Professor Cherif Bassiouni found no evidence of Iranian involvement and, given most Bahrainis follow Iraqi marja as opposed to Iran, we believe the link is somewhat tenuous. However, the reality is that attempts to restart dialogue have predictably fallen flat with recent wounds still sore and the main Shia opposition group al Wefaq loudly complaining about being sidelined. This has had the effect of increasing local agitation and leading to an increasing likelihood of extreme reactions against the current authority. We may see a return to protest

It will be a long road to reconciliation in Bahrain, but if the charges against Iran can be made to stick (we await more details), the authorities are highly unlikely to soften their stance save in the face of another round of mass protests.

Iran & bombs

1. Iran: Iran will not back down from its nuclear program and at current rates of refinement (not present before) will likely achieve nuclear breakout capability within a year as we highlighted in our report “Iran So Far – Weaponising?, 7th November”, rendering it effectively immune from invasion. High oil prices and Russia/Chinese support neuter sanctions and sabotage will become increasingly ineffective and raise the chances of a silly Iranian response, such as those we’ve seen recently. The only solution to avoid war is dialogue

To understand why Iran won’t back down, we need to look at the birth of the current nation as well as the mindset outlined above. After overthrowing the unpopular Shah in 1979, Iran was almost immediately attacked by Iraq in 1980 with the support of the international community, particularly those who sold Saddam chemical weapons to dissolve thousands of Iranian lungs. The only support came from Israel (unofficially) and North Korea who sold them weapons.

The war ended shortly after the USS Vincennes blew up Iran Air Flight 655 in 1988, killing the 290 civilians on board as it approached Dubai airport in its civilian air corridor. Ayatollah Khomeini was scared of the US getting involved in the conflict (power preservation being very important) and reluctantly signed a ceasefire agreement with Saddam.

Since then Iran has had to deal with international isolation and consistently tightening sanctions until the recent rise of Russia and China as viable trading partners who don't feel threatened by them and benefit from a strategic alliance.

They have had to create almost all of their industries internally and built on their existing revolutionary mindset to develop a matching determination for self-reliance wherever possible.

Even opposition groups such as the Green movement support the nuclear program for this reason and we firmly believe that the current intention is to achieve "breakout" capability as many other countries have within the strictures of the Nuclear Non-Proliferation Treaty wherein if threatened they could rapidly develop nuclear weapons and enrich their existing stock to weapons-grade within a matter of months. This would be sufficient to deter any potential attack on Iran and also increase their general influence over the region, something all Iranians would like to see having grown up in an underdog mentality.

Sanctions are neutered by high oil prices and the proclivities of China and Russia and serve only to punish the populace. Due to the nature of the government being the result of the revolution of the Iranian people and an integral part of the religion, there is a significant urge for reform rather than revolution, despite what many talking heads and Chalabi-wannabes might say. We also do not believe that there is anything integral in the religion calling for the destruction of Israel and see the rhetoric as polemical in nature.

The lower classes in Iran have seen their situation improve since the removal of subsidies last year (\$100bn a year out of \$350bn GDP, largely for fuel) and replacement by direct payments has lifted many out of poverty. This situation will be further improved with the mass privatization program being implemented via the hand out of “freedom shares”, transferring wealth to the lower classes before it moves upwards. The upper classes are fine with upper Tehran being more expensive than many parts of London and the middle class are suffering the most but have been weakened by sanctions and a steady deterioration in trust for outside help.

Sanctions and containment have also allowed Khamenei to sweep aside his reformist challengers as lack of engagement and the economic malaise when oil was lower during Khatami’s time as President in 1997 to 2005 led to the backlash against liberalism that installed Ahmedinejad in 2005. As we head toward Presidential elections in 2013, the battle between Ahmedinejad and Khamenei for the soul of Iran is becoming increasingly intriguing, with Khamenei likely consolidate his power by abolishing the Presidency at that point.

The recent explosions in Iran have been hinted to be the work of Israeli secret police, but have not engendered a response so far beyond the dead being called martyrs. The reaction to the UK

cutting off the Iranian Central Bank was far more interesting, with a student mob whipped into a fervour, not helping in proving that Iran is not a messianic, apocalyptic cult of zealots.

The purported expansion of Iranian activity in a manner that enabled it to apparently be linked to Saudi Arabia in several cases such as the Bahrain causeway bombing and DC assassination plot were also interesting as they mark, if true, a major escalation in the Cold War between the two regional powers. One imagines that if Iran achieves breakout capability that they will become considerably more aggressive in projecting their influence, something that won't be lost on their neighbours who will rapidly develop the same capability.

2. Israel: Ehud Barak and Netanyahu believe a nuclear Iran is an existential threat and comes down to the balance between losses from an attack versus Tel Aviv getting a dirty bomb and disappearing. With the Arrow missile defence system they will be comfortable in their ability to handle Iranian missiles, leaving the rockets of Hezbollah as the main point of retaliation.

With the new Iron Dome defense system intercepting even mortars, the government is becoming increasingly positive on their ability to handle this with minimal casualties. Hezbollah's integration earlier this year also complicates things for them as if they attacked Israel, it would effectively be Lebanon declaring war and would lead to a shock and awe style response from Israel and its allies, well beyond the 2006 conflict. Hezbollah's subsequent banishment from Lebanese politics would make certain parties in the region very happy.

Sabotage and assassinations can delay the program but now it's in the final stretch the levels of concern in the Israeli government are increasing rapidly. With significant leverage over US foreign policy ensuring protection and their position as regional hegemon deteriorating rapidly as they are surrounded by Islamist democracies, Israel will now be feeling vulnerable for the first time in decades and won't particularly care about a spiking oil price.

3. USA: All of the major Republican candidates except Ron Paul are effectively in favour of military action. Congress and Senate are passing extreme sanctions and killing diplomacy with bills such as [H.R.1905](#), which has massive bipartisan support, effectively cuts ties with anyone who deals with the Iranian Central bank and prohibits any US employee or official from talking to an Iranian employee or official without 15 days advance notice and permission from the President and the Foreign Affairs Committee (Cuban missile crisis was 13 days).

Having said that, Obama can no longer negotiate with the Iranians after the DC assassination plot and the full backing the administration gave to its veracity, an act, which if it had occurred would have led to immediate military action. Combined with the IAEA report, which doesn't contain any new or verifiable information but this provides a pretext for military action should sanctions fail, as they most likely will, with no realistic mechanism for lifting them.

A strike would be a blow to a fragile economy, but the UNESCO debacle shows that the US will back Israel to the hilt no matter what and exert very little control over them. Obama also sold Israel bunker-buster bombs required to destroy fortified facilities such as the centrifuge plants, something Bush refused to do. Finally the US is pulling out of Iraq at the end of the year, reducing potential retaliation and also opening up the most direct route for Israeli planes once they turn off Iraqi air defences.

4. Saudi Arabia: While Saudi Arabia's position on Iran has varied, with King Abdullah even holding Ahmedinejad's hand in 2007, rivalries run deep and it is clear that these are the two main powers within the region. Events in Bahrain and the Eastern Province as well as the various "plots" uncovered have caused further deterioration in this relationship and Saudi Arabia now views Iran as its number one threat, bringing to mind their exhortation relayed to the US to cut the head off the Iranian snake. The disintegration of OPEC is related to this and the GCC will now be actively managing its own oil price band. By encouraging the Arab League to join in as they have in Libya and now Syria, it lends additional clarity to and support to any international measures such as an airstrike.

When might an attack happen?

We upgraded the probability of an attack after the DC assassination plot in October to 40% on a 12 month view, cautioning that it was highly unlikely that we would see this happening before the IAEA report was released in the middle of November and harsher sanctions were subsequently put into effect, with rhetoric increasing around the sanctions before dying down.

This has happened as expected, although we did not foresee the events at the UK embassy or the explosions in Iran. We anticipate EU sanctions against the Iranian Central Bank to go through this week, followed by harsher US sanctions in the following 2-3 weeks. Given the severity of these bills, we would be surprised to see action before they are enacted and have some time to settle in and prove ineffective. We would put the chances of an attack at 20% prior to this and up to 40% by the end of the year. Upon reflection, the easiest time to carry out an attack would be after the US shuts off the air defence system over Iraq around Christmas.

From then until the end of January the rhetoric against Iran would still be sufficiently fresh to add some justification to a strike and gain international support (always helpful although not needed if it really is an existential threat), particularly if Iran can be goaded into doing something silly. We put the odds in this period at 50%. We also expect chatter to get rather quiet prior to any attack and note the vociferous discussion in the Knesset is subsiding.

Once we get to March/April, the Iranians will most likely have refined enough uranium to 20% to build one bomb having repaired the damage to the Esfahan refinement plant, so the probability will start to decline although the final republic candidates will be banging the war drums (except Mr Paul). Protection remains cheap given the nature of the event and our preference remains short-dated oil calls 20% above spot given oil (WTI preferred) would head to \$150 easily once the news was out.

Fallout likely to be relatively muted

We will explore the scenarios in more depth in a future note, but maintain our original position that the most likely outcome would be a short, sharp spike followed by a collapse in the oil price as the Strait of Hormuz was not block so as not to annoy China and retaliation would mostly be directly against Israel as opposed to the USA and allies such as Saudi Arabia. The Samson option is not on the table in our opinion, although the Iranians would like others to think it is, echoing Israeli general Moshe Dayan in trying to portray themselves as a “mad dog, too dangerous to bother”.

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