
The Emerging Market Adviser

Overview: Oh, What a Tangled Web We Weave

A flock of black swans glided into plain view, as the global environment took on a new level of unexpected complexities. It started with the triple whammy in Japan, when the northern tip of Honshu was devastated by a massive earthquake, followed by a thundering tsunami and crowned with a nuclear meltdown. The implications of the partial shutdown of the third largest economy on the planet and one of the most important sources of high tech products was enough to send powerful reverberations through the global financial markets. Japanese industrial giants halted their purchases of raw materials. The producers of televisions, telephone handsets and automobiles rushed to take inventory of their Japanese-made components, as well as scour the planet for alternate suppliers. Likewise, global financial institutions braced themselves for a probable liquidation of assets by Japanese households and institutions as they repatriated funds to commence the reconstruction process. Speculators prepared for the probable scenario by pushing up the value of the yen to record levels. While investors were trying to assess the implications of the calamity, more black swans waddled onto the stage.

The allied attack in Libya, along with Saudi Arabia's intervention in Bahrain, could drive a deep fissure through the global geopolitical arrangement. The west should have known from the start that they were never dealing with sanity, when it came to Colonel Muammar Gaddafi. A radical renegade, who had no qualms about violating international law and murdering innocent civilians, he was not expected to quietly walk away from his fiefdom. The dithering on the part of the Obama Administration, and particularly within the U.S. military brass, allowed Colonel Gaddafi to regain his footing. Reeling from two bungled wars in the south Central Asia, the rising menace in the South China Sea and deep spending cuts, the Pentagon was in no mood to take on a new commitment in North Africa. They wanted NATO to take the lead. The problem was that the alliance was deeply divided. At one end of the spectrum were the French, and partially backed by the British, who advocated a swift intervention to prevent the rebels in Benghazi from falling into Gaddafi's hands. Such an event would trigger reprisals that would mirror the bloodbath that occurred in the Balkans two decades ago. At the other end of the spectrum were the Italians and Turks. Italy has huge economic interests in Libya, and the Berlusconi Administration has close ties with the Gaddafi family. Likewise, Turkey is vehemently opposed to any western military intervention in the region. Unable to use NATO resources, the French, British and Americans had to cobble together an ad-hoc alliance to take military action. Nevertheless, the so-called BRICs, as well as the Germans, were against the start of a new era of colonialism from which they were happily emerging. The problems in Libya are destroying the spirit of cooperation among the G-20 that was witnessed only two years ago, during the onset of the global financial crisis. Competing economic interests are pitting nations against each other in a way that has not been seen since World War II.

The same goes for the Saudi intervention in Bahrain. With all of the turmoil in Japan and Libya, the events in the Gulf are not getting much attention. Nevertheless, the armed repression of the Shia majority by the Sunni leadership could trigger an unexpected chain of events. Seeing the U.S. thinly spread on the ground, and with a great deal of reluctance to take on new military commitments, Iranian Shias have a unique opportunity to make an overt military move across the Persian Gulf. Naturally, any military action on the Arabian Peninsula would send oil prices soaring, as investors worried about the biggest oil producing region in the world. This could also trigger the start of a Sunni-Shia civil war that would certainly destabilize many countries across the Middle East, as well as have dark implications for several U.S. allies. Such a scenario would also be an opportunity for many of these governments to show all of their cards, thus allowing them to display the panoply of unconventional weaponry that lie deep within their arsenals. Unfortunately, we are now witnessing the reverberations from the collapse of U.S. hegemonic power. With its single-minded desperation to restore its financial footing in the aftermath of the Lehman collapse through a series of monetary and Keynesian experiments, the U.S. bankrupted itself to the point that it can no longer sustain the web of geopolitical arrangements that ensured its system of international stability. Thanks to the monetary nonsense of Fed Chairman Ben Bernanke and the Keynesian tomfoolery of Professor Paul Krugman, the U.S. is on the skids. The result will be a chain reaction of unexpected events that will derail the future of the global economy.