

## September Market Review: Implications of the Kurdish Referendum

Ahmed Tabaqchali, 2nd October 2017

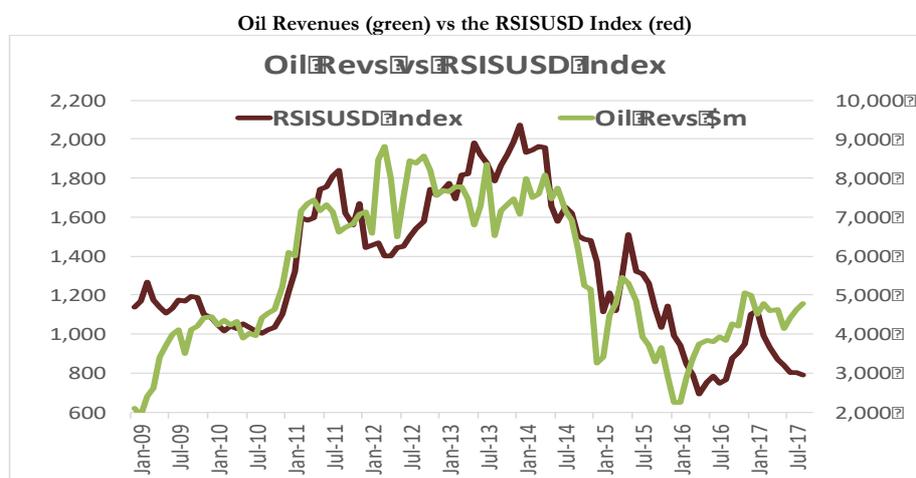
In spite of the intense international focus, the Kurdish referendum was almost a non-event for the market during the month. Thoughts on the referendum's implications will follow after the market review.

The month was compressed to just over two weeks of trading due to the Eid and Islamic New Year holidays, while the last 10 days were marked by the start of the month of Muharram, one of the four sacred months of the year. In Iraq, it has an oversized role as the 10<sup>th</sup> day of the month known as Ashura, occurring October 1<sup>st</sup>, marks the start of the 40-day annual Arba'een pilgrimage. It is estimated that over 20 million Shia pilgrims will visit Karbala to commemorate the martyrdom of Iman Hussein, which was a bifurcation point in the Shia-Sunni divide.

The equity market, as measured by the RSISUSD index, ended the month down -1.9%, as the month was further compressed with average daily turnover down to 3 year lows. Most of the losses took place in the last 2-3 days of the month as buyers disappeared and prices were marked down.



The pick-up in oil revenues due to the rise in oil prices, as the supply-demand shifts into balance, should have positive implications for the equity market. The market's correlation with oil revenues, especially since 2014 (below) supports the thesis that the market's correction since February has run its course and the current phase is likely to be followed by an upward move.



## Thoughts on the Kurdish referendum and its implications

The Kurdish Region of Iraq (KRI) would need Brent prices consistently above USD 60 for its budget to break-even under its official borders, but above USD 80 for its budget to break-even within its aspirational borders<sup>i</sup>. Given that this is an austerity budget, it is composed mostly of current spending and oil related payments with hardly any capital spending. It follows that the KRI would need Brent prices near USD 70 for many years to build the financial wherewithal to contemplate independence within its official borders let alone its aspirational borders. The Kurdish Regional Government (KRG), aware of its financial position, is thought to have planned the referendum to strengthen its position in a post-ISIS Iraq in the 2018 parliamentary elections, in the same way that the referendum of 2005 did for its fortunes in post-Saddam Iraq.

The Iraqi constitution has no provision for a secession and is silent on referendums on important issues. The referendum would not have caused controversy, especially internationally, had it been used to obtain a mandate to seek a negotiated secession as it has been billed. However, the issue that ignited the regional and international opposition was the forceful inclusion of that is termed the “disputed territories” or about 40% more land than the official KRI area. The constitution refers to “Kirkuk and other disputed territories” but does not specify them, but they are areas with Kurdish majorities.

However, this is not as simple as it seems given the complex web of minorities living in the area: The area used to be part of major ancient trade route, in which the Iraqi part begins with the Syrian and ends with the Iranian borders, and over the centuries was settled by diverse populations. The last to settle were Turkic peoples during the Ottoman Empire who eventually became the Turkmen of Iraq. Kirkuk, in particular, is problematic as it's claimed by Arabs, Kurds and Turkmen with the latter being the most likely to have a legitimate claim. The discovery of oil in Kirkuk in 1927 and the following boom, diluted the Turkmen population with migration of Kurds from the north and Arabs from the south. The census of 1957, accepted by all, showed at the governorate level that the ethnic makeup was 48.2% Kurds, 28.2% Arabs and 21.4% Turkmen but that the city of Kirkuk was 37.6% Turkmen, 33.3% Kurds and 22.5% Arabs<sup>ii</sup>. These percentages changed significantly under the prior regime which enforced Arabisation at the expense of Kurds and other minorities, but saw a process of reversal after 2003 with the return of some Kurds but not so much the Turkmen.

The complexity can only be glimpsed at by noting that while at a governorate or district level a simple majority might be Kurdish, yet many villages and towns that dot the area are almost entirely made up of different minorities. The area was almost in limbo after 2003, being administratively part of federal Iraq with some of the areas close to the KRI border policed by the KRG. After the fall of Mosul to ISIS in 2014 and the collapse of the Iraqi army, the area fell under the control of Kurdish military forces, in the process increasing the official KRI by 40% in both land and population. An uneasy state of affairs prevailed while the country battled ISIS, in which the areas were policed by the KRG but administratively and financially managed by the federal government.

Therefore, the inclusion of the disputed areas, and not the rights of the Kurdish people for self-determination, caused the Iraqi, regional and international opposition. The forced inclusion of these areas, were it to be accepted, even as a basis for dialogue with federal Iraq, would legitimize similar future actions in the region, and hence the coordinated regional response. Away from the heated war of words, actions on the ground are different and aim to re-set the relationship between Federal Iraq and the KRG to a more even keel. An example of re-establishing federal authority is setting shadow border posts on Turkish and Iranian sides of border, outside the KRI, on important trade routes to Iraq via the KRI (about 27% of all Iraq inbound land trade), collecting custom fees but allowing trade flow. It's logical to conclude that action on oil exports would be along similar lines and should accelerate restabilising dialogue. None of the measures would work without regional support or without the tacit agreement of international players. Economic realities will ultimately prevail with the KRG's re-establishing dialogue and forming alliances with the moderate forces in Iraqi politics. Crucially, the

crisis has strengthened the position of these moderates under the current prime minister, already bolstered by the success of the ISIS campaign.

The almost unanimous international support for a unified Iraq should lead to financial support for its reconstruction and reinforces the argument discussed [last month](#): the realignment of interests of regional players in dealing with the root causes of the conflict, i.e. the deep economic and political disenfranchisement, that were such fertile grounds for the rise of extremism. That after the military resolution, these would be long-term solutions which will involve significant investments in infrastructure to bring much-needed developments and create prosperity.

#### *Disclaimer*

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<sup>i</sup> Asia Frontier Capital calculations, estimates and analysis based on data from World Bank reports, Pareto Securities company reports on E&P companies operating within the KRI & news wire reports

<http://documents.worldbank.org/curated/en/229971468195834145/pdf/106109-WP-P159972-KRG-Economic-Reform-Roadmap-post-Decision-Review-PUBLIC-v1-05-29-16-2.pdf>

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<https://www.reuters.com/article/us-kurdistan-oil-loan/rosneft-traders-lend-more-to-kurdistan-ahead-of-referendum-sources-idUSKCN1BC565>

<sup>ii</sup> [https://en.wikipedia.org/wiki/Kirkuk\\_-\\_Demographics](https://en.wikipedia.org/wiki/Kirkuk_-_Demographics)