TAKING IT TO THE STREETS

What the New *Vox Populi* Risk Means for Politics, the Economy and Markets

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"And those people should not be listened to who keep saying the voice of the people is the voice of God, since the riotousness of the crowd is very close to madness." — Alcuin to Charlemagne, 798 A.D.

It seems like political risk is on the front page every day: crowds of protestors gathering, a rally calling for independence, a military coup, or scenes of civil conflict. Is there more unrest globally, or is 24/7 media coverage creating this perception? Is social media to blame? We think the answer to this question lies in better understanding what we call *Vox Populi* risk, a new variation of political risk which we have been tracking for the past two years. We define *Vox Populi* risk as shifting and more volatile public opinion that poses ongoing, fast-moving risks to the business and investment environment. In this report, Citi's Political Analysis team documents a dramatic and measurable increase in the number of elections, mass protests and government collapses over the past three years — a 54% increase versus the previous decade — as well as a proliferation of new and fringe political parties, many of which are anti-establishment.

Although there have been periods of *Vox Populi* risk throughout history, the difference today is that these events are happening in high income developed markets and middle income emerging markets, many of which have enjoyed a sustained period of growth and improvements in living standards — and are integrated into the global economy and financial system. The authors of the report that follows believe that *Vox Populi* risk is a structural change and that it will be a risk factor affecting both the investment and business environment for the foreseeable future.

What is causing this change? The authors believe the new *Vox Populi* is being fueled by growing perceptions of incoming inequality and anxiety about globalization, particularly amongst middle classes. In developed markets, this has resulted in new and alternative political parties which are having an impact on policy debate and increasing the formation of fragile coalitions and referendum risk. In emerging markets, there is a greater chance of street demonstrations, rebellions and sustained tensions that elections may fail to resolve. In some cases, local protests can become a geopolitical risk almost overnight. For petrostates, a fall in petroleum prices is leading to an outcry for improved governance and a more equitable distribution of income.

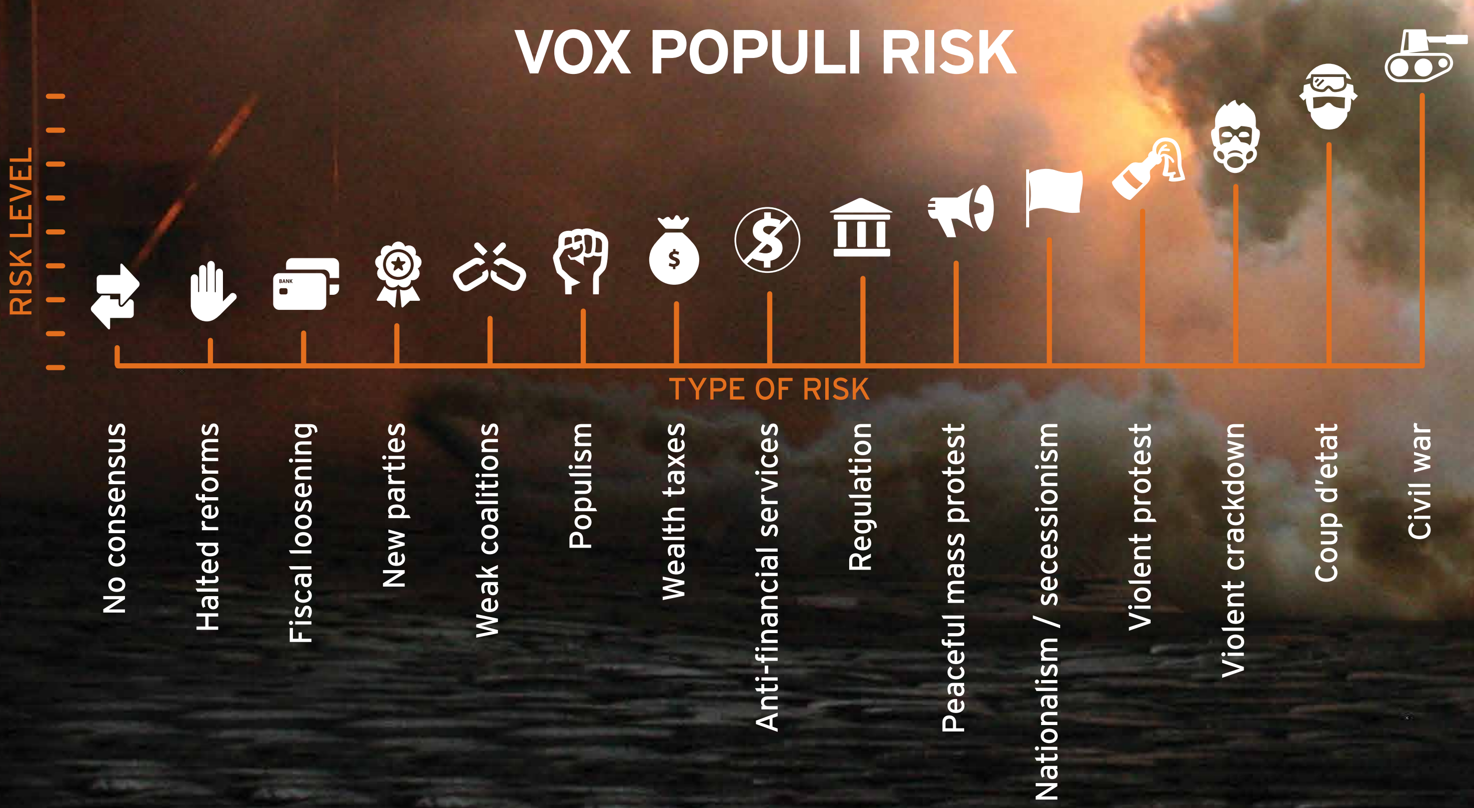
Thus far, companies and markets have been able to localize political risks thanks to continued low interest rates. Once rates rise, the impact of systemic political risks could grow. Greater fragmentation, disruption, and the geopolitical implications of more vocal, more quickly mobilized public opinion could start to weigh more heavily.

Applying the assumption that *Vox Populi* risk is unlikely to recede in the immediate future, this report explores its impact on the global political environment, including a host of upcoming elections in 2014 and 2015, the global recovery and economic outlook, financial markets and key sectors such as commodities.

Giving the People What They Want

A Risky Business

Shifting and more volatile public opinion – *Vox Populi* – is a new structural risk that will generate uncertainty in the business and investment environment.




DM/EM Election & Mass Protests (2000-2013)
25
20
15
10
5
20
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
Pre-Crisis Average:
14.1
Post-Crisis Average:
21.7
Mass Protests (2000 - 2010)
Mass Protests (2011 - 2013)
KEY
Mass protests
Elections
Average
Countries in orange are included in the Mass Protests maps.
11 YEARS
2000 - 2010
3 YEARS
2011 - 2013
Australia
Austria
Belgium
Brazil
Canada
China
Colombia
Czech Republic
Denmark
Egypt
Finland
France
Germany
Greece
Hong Kong
Hungary
India
Indonesia
Ireland
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Vox Populi Risk: The New Politics of the Street and the Ballot Box

Judging by the mood in global markets, the financial crisis is over. All hail the recovery. Yet it seems like political risk features in the news every day: another street protest; a new government collapse; a rally calling for independence; the outbreak of civil conflict. The past 6 months have witnessed the first US federal government shutdown in 17 years, a military takeover in Egypt, Ukraine's second revolution in a decade and the annexation of part of its territory, a recurring cycle of protests and elections in Thailand and Turkey, the continuation of Syria's civil conflict and the periodic eruption of tensions in the South China Sea. Meanwhile, global markets have barely batted an eyelash and appear to be pricing the most likely outcome: risk is either not perceived, or ignored.

Are investors justified in assuming that economic recovery will temper an otherwise restive public mood and that super-empowered central banks will take care of the rest, including more 'conventional' economic risks, such as sovereign debt sustainability in the euro area periphery, banking sector risk in the euro area following the Asset Quality Review and the Stress Test that will report later in 2014? Our analysis suggests that the unconcious uncoupling between geopolitical risk and financial markets could be misplaced, as what we call *Vox Populi* risk — a new variation of political risk driven by shifting and more volatile public opinion — has increased markedly over the past 4 years, and is likely to continue to generate uncertainty in the business and investment environment. *Vox Populi* risk is also likely to interact with conventional economic and financial risk to create a potent and potentially poisonous brew.

Vox Populi risk events are on the rise and manifest themselves as: 1) election risk; 2) "flash mob democracy" mass protest risk; 3) referendum risk; and 4) geopolitical risk

According to emprical research produced by Citi's Political Analysis team, (which we believe to be the first of its kind) the yearly average number of elections, government collapses and mass protests (*Vox Populi* risk events for the purposes of this study) have increased a remarkable 54% since 2011 compared to the previous decade. We classify *Vox Populi* risk events into four main categories: 1) election risk; 2) " flash mob democracy" mass protest risk; 3) referendum risk; and 4) geopolitical risk. In contrast to previous waves of political risk, which were often concentrated in less-developed, lower-income countries, *Vox Populi* risk is manifesting itself in middle-income emerging market and industrialized countries — a systemically significant subset of sovereigns more likely to generate wider market impact.

An increase in non-mainstream political parties….

During 2011-2014, non-mainstream political parties have seen an unprecedented spike in support, sapping political capital from governments, prompting fragile multi-party governing coalitions and often surprising markets by producing unexpected election outcomes. At the same time, mass protests have swept a swathe of middle-income EM democracies despite their governments having delivered a sustained period of growth and improved living standards. Around the world, grass-roots pressures are increasing the risk of fragmentation; social, political and even geographical, as anti-government, anti-establishment sentiment reaches all-time highs and trust in institutions plummets.

Figure 1. The Yearly Average of Elections and Mass Protests in Major Markets Has Jumped 54% in the Post-Crisis Environment

Source: Citi Research

….driven by more vocal middle classes…

Although we document a marked increase in the number of politically generated events across EM and DM countries — observing that the nature of the risk varies slightly — more vocal middle classes are a common feature. For developed markets, *Vox Populi* risk is being fueled by perceptions of growing income and wealth inequality and demands for change that often mask a desire to keep the status quo in public resource allocation, favoring the aging and the middle class. In emerging markets, street demonstrations are giving political expression to new middle classes and placing increased demands on political systems and on the capacity of state institutions to deliver key public goods and services, including health, transportation and education, as witnessed in 2012 and 2013 in some of the largest ever protests in Russia, Brazil, Turkey South Africa and India. For petro-states, falling petroleum prices (they haven't really fallen signficantly) are leading to an outcry for improved transparency and governance and a quest in many countries for revenues to be more equitably distributed.

…and perception of elite corruption

What triggers *Vox Populi* risk? A frequent catalyst is the perception of elite corruption. Time and again, evidence of elite misbehavior has rapidly galvanized public dissatisfaction across income groups and regions, accelerated by social media. Yet one somewhat counter-intuitive finding in our research is that countries that experience *Vox Populi* risk events, such as large street protests, do not necessarily go on to have changes in government at the ballot box. Instead, internal tensions may remain high without a change in leadership, but elections may bring a weaker leader with less political capital.

Another dog that didn't bark, is the absence of large-scale social unrest during the darkest days of the eurozone crisis. Although a rapid reversal of living standards is historically associated with protests and revolutions, our analysis underscored the fact that austerity-related protests were limited, generally failing to meet Citi's definition of a mass protest. Even the eurozone periphery countries hardest-hit by the crisis have seen limited social unrest. This finding is consistent with our long-standing view that political risk would be expressed through the ballot box in advanced economies, rather than on the streets. In the case of the eurozone, the political calendar helped minimize the impact of *Vox Populi* risk at the most fragile time for markets. This year's European Parliament elections will be the first major political test, and are expected to return the largest-ever results for non-mainstream parties, and often anti-euro and anti-EU parties. Consistent with this logic, countries where trust in institutions and the political process is lowest are most at risk of assymetric outcomes, like revolutions and civil conflict.

Could a return to growth reverse the trend? Our findings suggest that the rise of *Vox Populi* risk is linked to a convergence of factors, particularly middle class anxiety and concerns about globalization. Indeed, improved growth prospects do not appear to be diminishing the support for anti-establishment parties, such as the UK Independence Party (UKIP) in an economically bouyant UK, while the influence of the Tea Party movement in the US continues, despite periodic media attempts to write its political obituary. If anything, a more positive growth outlook could, by reducing the risk of protest votes bringing in a government that could damage an already weak economy, embolden voters tempted to support non-mainstream alternatives. When considered alongside the continuation of stubbornly high unemployment, we believe the *Vox Populi* phenemenon is a structural change that could continue to generate political uncertainty into the next election cycle, with 2015 seeing a resumption of the European national election cycle.

Market reaction to *Vox Populi* risk has been remarkably calm…

So how do markets respond to *Vox Populi* risk? The answer appears to be, with remarkable calm, indeed hardly at all — for now. There have been bursts of market volatility in response to surprises brought on by increased political risk but investors are treating *Vox Populi* as a localized rather than a globally systemic issue. For instance, the Ukraine-Russia tensions, consistent with our view that the markets currently only price the most likely outcome but not the risks, have resulted in a sharp mark-down of Ukrainian assets (currency, stock market, sovereign and corporate debt) and a significant mark-down of Russian assets. The material risk that the conflict could spread and deepen, resulting in sectoral-level economic sanctions against Russia and even the cut-off of gas and oil shipments from Russia to Europe cannot be observed in any European asset prices – the euro, European stock indices or debt markets. This might reflect the palliative effect of cheap money as central banks have "come to the rescue" and boosted asset prices that would normally be hurt by higher political risk premiums. The extraordinarily low safe yields resulting from these same policies have created a hunger for yield among private investors that may have rendered them blind even to significant risks.

The withdrawal of cheap money could mark a return to political risk, but for now markets are seemingly overlooking a confluence of developments that would, in a world with less liquidity, have likely prompted greater concern. For corporations, we think the impact from operating in a volatile political environment will be more tangible, whether manifested through more frequent changes of government, a more challenging legal and regulatory environment, or recurring mass protests.

…while the economic impact has short- and long-term components

In terms of its economic impact, *Vox Populi* risk fuels uncertainty, leading households to increase precautionary savings and businesses to lower capital formation — reducing two major components of domestic aggregate demand. Reduced political capital for leaders can mean short-term, populist policymaking, reduced willingness to underake reforms, higher taxes and more regulation, sometimes for punitive rather than for sound economic reasons, all of which can result in negative incentives to work, save and invest: ultimately suppressing future growth.

On the positive side, *Vox Populi* risk is boosting diplomacy

Vox Populi risk is also influencing geopolitics. One positive byproduct is a boost for diplomacy — in the case of the Syrian chemical weapons disposal agreement and the historic first step towards a diplomatic breakthrough on Iran's nuclear program — as public opinion ties leaders' hands, effectively prohibiting the use of military force. Yet a more muscular isolationism would bear wider implications for global alliances and conflict resolution, likely affecting energy security and the nuclear non-proliferation agenda, among other things. Markets have grown accustomed to the post-Cold War peace dividend, and history suggests markets have trouble pricing in paradigm shifts.

Since the fall of the Berlin Wall 25 years ago, companies and investors have operated in an environment characterized by relative stability, the erosion of ideology as a driving force, rising integration in the global financial system and unprecedented economic expansion. In the first post-Cold War era, politics and security played a relatively minor role in disrupting markets and the global economy. If *Vox Populi* risk continues or worsens, it could fuel a change in this trend prompting more frequent disruptions to trade and commercial relations and challenges to the global system — a New New World Order, where the rules of the game are under new management. But whose?

What Is *Vox Populi* Risk? Is it Really New? How does it Work?

Vox Populi risk is the presence of shifting and more volatile public opinion, the pressure it places on policymakers and its relationship to markets

The power and influence of public opinion has gained in importance and influence in the aftermath of the global financial crisis and advent of the Arab Spring. We define *Vox Populi* risk as the presence of shifting and more volatile public opinion, the pressure it places on policymakers and, through that, its relationship to markets. Citi Research[1] first coined this concept in 2012 to identify what we observed as the emergence of a new type of risk to the investment environment and the policy-making sphere. Examples abound, from new trends like the idea of crowd-sourcing, to some of the largest-ever mass protests and popular demands for representative government manifesting themselves in new regions of the world. Far from being in retreat, democracy appears to be on the march and people power on the rise. For better or for worse, the consequences are generating changes in national political outcomes, as well as in the international system, with widespread implications. Sociologist Charles Tilly has noted that, rather than being entirely separate phenomena, these events fall along a continuum referred to as "contentious politics."[2]

Trust in public institutions has declined…

More globalized public expectations and the decline of the post-World War II social contract means that constituents demand more from political leaders than ever before — yet the capacity for these leaders to deliver is limited in a slower-growth world. Trust in elites — whether business, political or media — and in institutions has declined, as noted by Edelman Public Affairs in its annual Trust Barometer. This disconnect fuels popular discontent, especially when coupled with stagnant or declining living standards.

But global equity indices are trading at all-time highs

In the meantime, global equity indices trade at all-time highs. Political flare-ups can induce short-term bursts of global market volatility, as we are seeing with the Ukraine crisis now, but the longer-term impact has been remarkably small. This may reflect the greater weighting of stock markets in more politically stable countries. It may also reflect the soothing influence of the ultra-low interest rates and open-ended liquidity being provided by leading DM central banks, or it may simply reflect investor complacency. They can see the local risks from increased political tensions, but they do not yet appear to see this as part of a broader global theme that should demand higher risk premiums across all markets.

Indeed, capital markets may inadvertently be contributing to social and political tensions by virtue of their "unconscious uncoupling". Cheap money has boosted asset prices. This will have helped to stabilize fragile economies. However, it also widens wealth gaps; the asset-rich have got richer. But high levels of unemployment suggest that the trickle-down to a broader constituency has been slow.

Protest movements in the past had greater influence in a domestic environment

How new is *Vox Populi* risk? To be sure, protest movements have had a significant impact on the global landscape in the past. The civil rights and anti-Vietnam War movements in the US in the 1960s, the labor and student movements in Europe during 1968, and the 1989 "Winds of Change" that ultimately brought an end to the Iron Curtain and Soviet Union are prominent examples. But in a less globalized environment their influence was mainly domestic, in the US and European context, and regional in Central and Eastern Europe.

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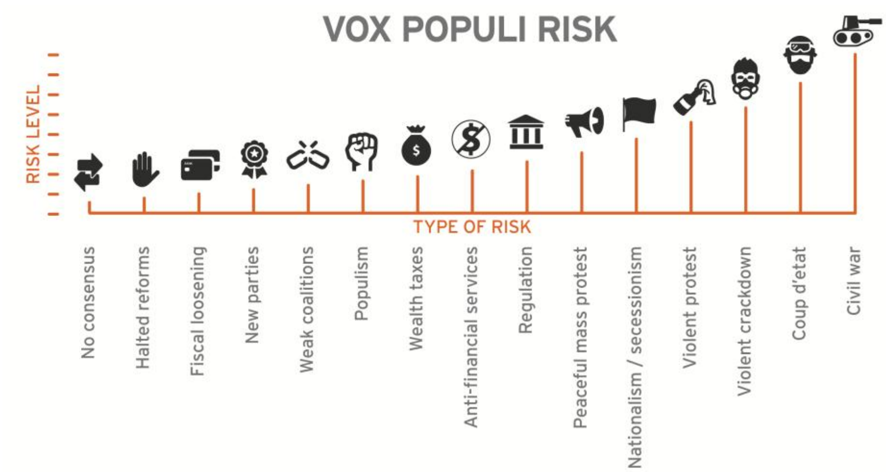
[1] Tina Fordham "Global Political Insights: The Year of Living Dangerously Comes to a Close", Citi Research, October 24, 2011

[2] Doug McAdam, Sidney Tarrow and Charles Tilly. *Dynamics of Contention.* Cambridge University Press, 2001.

Today's protests are feeding upon each other in a more global way

Contrast these protests of the 1960s and late 1980s with the Arab Spring, where the example of the self-immolation of a Tunisian fruit-seller sparked a wave of protests across a region that had little recent experience with it. The US's Occupy Wall Street movement crystallized the sentiment of "We are the 99%," pitting elites against the overwhelming majority. Two years later, across the world in Nigeria, a plan for the removal of fuel subsidies quickly turned into a mass protest under the banner of "Occupy Nigeria". The American Occupy movement itself claimed to draw inspiration from the Arab Spring and the Spanish *Indignados* movement. Although Occupy Wall Street failed to accomplish any concrete political outcomes in the US where it originated, its anti-establishment, anti-elite catchphrase encapsulates a concept that has resonated with middle classes across both developed and emerging markets.

Figure 2. The Continuum of *Vox Populi* Risk and Some of Its Effects



Source: Citi Research

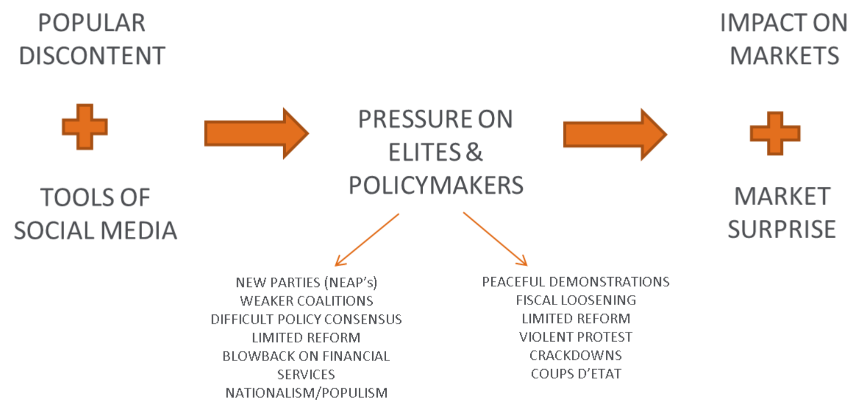
Figure 3. Fractious Politics: A Few Effects of *Vox Populi* risk Over the Past Two Years

- Bulgaria: Hung parliament
- Finland: Anti-bailout MP's push government's hard stand
- France: Resurgent far-right Front National
- Greece: Rise of hard-left and neo-Fascist parties
- Italy: Hung parliament
- Spain: Catalan secessionist movements
- UK: Push for Scottish independence and in-out EU referendum
- US: First government shutdown in 17 years, aborted Syria intervention

Source: Citi Research

Even leaders swept into office on the back of a popular mandate may find themselves on the wrong side of public opinion very quickly, as post-revolutionary Egyptian President Mohammed Morsi learned. One consequence has been the emergence of shorter-tenured governments with reduced room for policy maneuver, and even the handover of power to non-elected technocrats. One such example was European Commissioner Mario Monti's brief tenure as Italian prime minister; he has been followed by two more unelected premiers, Enrico Letta and Matteo Renzi. Across the developed world, elected leaders are hamstrung by ever-shorter honeymoon periods, roller-coaster public approval ratings, legislative gridlock, fractious political party systems, and austerity budgets.

Figure 4. The Mechanism of *Vox Populi* Risk



Source: Citi Research

These developments are also taking place between election cycles, underscoring how in an environment of popular discontent, disgruntled publics may not be willing to wait years for new elections before they demand the opportunity to make their views known. Where elections occur, they more frequently result in fragmented outcomes, such as multi-party coalitions, as in the UK in 2011 (the first coalition government in Britain since 1974) and hung parliaments, as in Italy and Bulgaria in 2013.

Figure 5. After Decades of International Convergence, Fragmentation?

Source: Citi Research

The Empirical Basis for *Vox Populi* Risk

To quantify the effect of *Vox Populi* risk, we examined the elections, mass demonstrations and other political events in the countries that make up the MSCI Developed Markets and Emerging Markets universes. We classified these as *Vox Populi* risk (VPR) events.

VPR events in our analysis had more or less political impact depending on the presence of key characteristics that may combine to produce a market-moving surprise. These include mass protests in multiple cities, the presence of violence, a failed election or hung parliament, the rise of new political actors or NEAPs, and secessionist or territorial claims. The presence of two or more of these factors could be considered a high-VPR event, the presence of one a mid-range VPR event, and the lack of any a low-VPR event.

Of the 69 *Vox Populi* risk events that we identified, 43 had limited political impact as most were regularly scheduled elections with expected outcomes

We noted 69 such events between 2011 and April 2014, though most (43 of 69, or 62%) had limited political impact. In general, these were regularly scheduled elections where incumbents were successful or where the election's outcome was largely expected. Typical in this group is the Singapore election in 2011. Nine events had a particularly destabilizing impact on political trends. In general, these large-scale events involve coup d'états, massive protests, snap elections resulting in hung parliaments, or conflicts where opposing parties disputed the basic nature of the state (i.e., pro-/anti-democracy or secessionist movements). Within this group are the Greek election of May 2012, Turkey's Gezi Park protests, and the Egyptian military intervention that removed Mohammed Morsi. The final 17 had an intermediate political impact, like the South African labor protests and the rise of NEAPs in Finnish and Austrian elections. These tended to be mass protests that didn't have a significant policy impact or elections where populist parties made notable gains.

Events that impacted global politics the most were ones that were a surprise to the markets or involved irreconcilable fights between elite groups

What characterized the *Vox Populi* risk events that most affected global politics? First, these political events came as a surprise to markets on account of a sudden election, a hung parliament, or a rapid descent into protest. Even where our political analysis anticipated risks or polling data may have been predictive, markets were often caught unaware. Second, many of the most serious events involved irreconcilable disputes between elite groups over the basic nature of the state: whether between democracy and authoritarianism, between opposing social bases, or as part of center-regional tensions.

- **The element of surprise.** Consistent with a broad academic literature on market price action, the highest-impact *Vox Populi* risk events come as surprises. In general, this means an unscheduled election or government collapse, a spontaneous/unexpected mass demonstration, or an election that ended in a surprise result or hung parliament. Snap elections are an outcome limited to parliamentary democracies, meaning these systems may represent disproportionate political risk in times of economic stress. All of our high-VPR events were unscheduled, as were 14 of the 17 mid-impact VPR events. Low-VPR events were scheduled and predictable 29 of 43 times.

- **Irreconcilable elites.** Thirteen VPR events could be said to revolve around the basic nature of the state, meaning they were pro-representative government in the case of an authoritarian regime, or a coup d'état or secession movement. This included five of the nine high-VPR events, including a revolution in Egypt, the Russian intervention in Crimea, and mass protest in Thailand. The five mid-or-low VPR events include pro-democracy protests in China, and student and farmer protests seen to be related to the FARC insurgency in Colombia.

Little impact from the effects of GDP growth, austerity policies, government corruption or violence

What didn't affect global politics? Contrary to the popular narratives of what may be driving contemporary social unrest, we found limited evidence of the effects of GDP growth or austerity policies or violence. While all of these variables are represented at least in some respect, no strong patterns or relationships are apparent in DM or EM markets.

- **GDP per capita.** GDP per capita was lower in high-VPR countries (mean $14,100, median $11,600) and higher in low-VPR countries (mean $25,700, median $12,700). All three groups had a broad distribution of incomes, however. In the high-VPR group, we found countries such as Egypt and Brazil but also Italy and Greece. The low-VPR group included Norway, the US and Taiwan, but also Colombia, China and Mexico.
- **Austerity as a risk factor.** Fifteen of the 69 events revolved around austerity as a key factor. Most of these were in Europe, where austerity has dominated the public debate. This includes four of the nine high-VPR events, but it also includes low-risk European elections and mid-risk European protests.
- **Corruption as a catalyst.** Eleven events explicitly involved state corruption as a motivation for discontent. Only two were high-VPR (Brazil and Italy). The rest were a mix of mass protests (in Brazil or China) or elections called in the midst of corruption scandals (in Finland, Austria and the Czech Republic).
- **Violence.** Comparatively few events in the dataset could be characterized as violent: eight of 69. This group included Egypt, Brazil, Turkey, Greece and South Africa, as well as Russia's involvement in the Crimea. These were the only events that had any reported deaths. Most deaths were in Egypt (over 2,200 in both events); only South Africa and Russia had more than 10 reported deaths (40 in Marikana, 80 in Ukraine). Nevertheless, political science literature suggests that when the majority of the public regards demonstrators as having a legitimate grievance, the deaths of protestors can often galvanize public support in their favor — often to the detriment of incumbent governments.

Surprise and *Vox Populi* has been a driver of short-term volatility

Related to the element of surprise, *Vox Populi* risk has been a key driver of short-term volatility. Looking at the largest single-day moves in the VIX over the past five years, half were due to political- or policy-driven events. Notable political event risks over 2013 that have moved markets include the consequences of elections and riots of the type in our *Vox Populi* risk event dataset. Also included were market-related public statements by US President Barack Obama (Figure 6).

Figure 6. Liquidity Aside, Politics Still Matters. Many Of The Top One-Day VIX Moves Since QE Began Correspond to Political Events.

Date	%Change in VIX	%Change in S&P	Political Events	Financial/Macro Events
2/25/2013	38.7%	-1.83%	Italian election	
8/8/2011	30.1%	-6.59%	US downgrade	
8/4/2011	28.9%	-4.77%		ECB, BoJ actions, slowdown fears
5/6/2010	26.7%	-3.11%		Flash crash
4/27/2010	25.8%	-2.17%		Greece downgrade
1/28/2011	25.7%	-1.79%	Tahrir Square	Japan downgrade
5/7/2010	25.0%	-1.43%	UK election, Greece riots	
10/30/2009	23.9%	-2.74%		End of month
1/22/2010	22.6%	-2.13%	US policy uncertainty, Fed	
1/24/2014	21.3%	-2.01%		China fears, US earnings miss
1/21/2010	19.8%	-1.95%	Obama calls for bank regulations	
3/16/2011	19.3%	-1.76%		US housing data, Fukushima disaster continues
3/1/2011	19.2%	-1.68%	Libyan civil war	
2/20/2013	19.2%	-1.24%		Fed communication

Source: Chicago Board of Exchange, Bloomberg, Associated Press, CNN Money.com. Citi Research

Social Media Fuels "*Flash Mob Democracy*", but Doesn't Guarantee Political Transformation

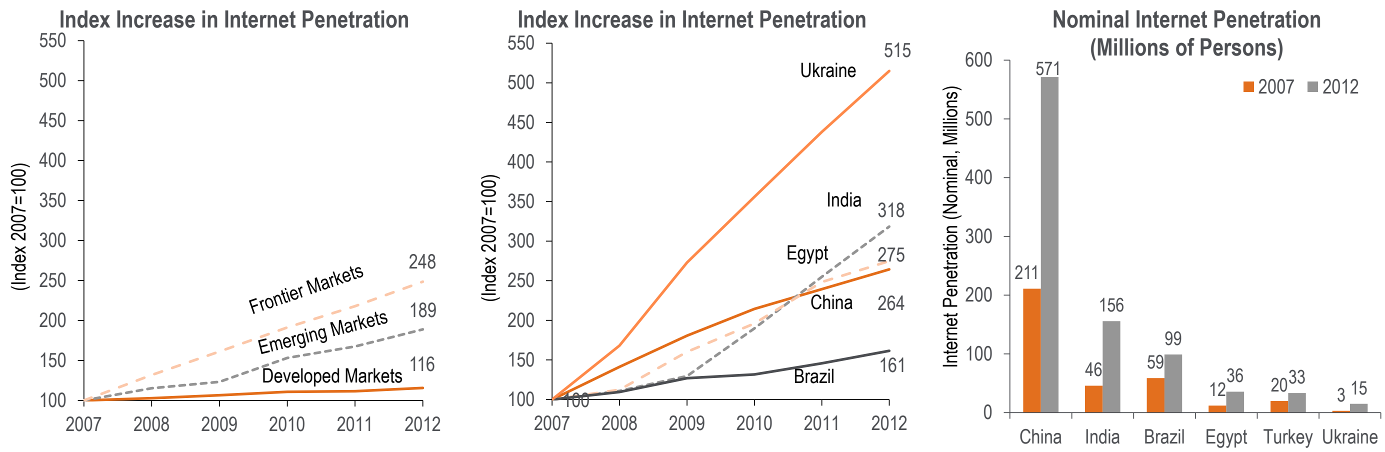
Advances in social media and the Internet have driven the speed of contemporary mass protest and ease of organizing large crowds

Why is public opinion more globalized and faster moving than in the past? Although technology enables protests, rather than being a casual factor, advances in social media and communications technology have driven the seemingly instantaneous nature of contemporary mass protest. Protests in Egypt, Brazil and Turkey were organized online, as was the Occupy Wall Street movement. These tactics have been copied and re-interpreted around the world. Episodes of what we call "flash mob democracy" can appear overnight and rapidly multiply across cities, towns and regions, placing significant pressure on government elites. Skyrocketing Internet penetration in the past five years suggests the trend is likely to intensify. This allows would-be revolutionaries to organize in multiple cities around a whole country in days or even hours.

The rise of the internet has been rapid in emerging markets

India has seen over 100 million more Internet users gain access to the Internet, a possible factor in its election this year. Even in smaller countries, the impact can be significant. Ukraine's Internet penetration increased from roughly 3 million up to 9 million people, representing a 515% jump from 2007 to 2012. China, in the same five-year period, gained an amazing 360 million more Internet users. This rapid increase leads to an obvious question: as China's economy becomes more globalized and its population more connected, could it, too, see a rise in protest activity similar to other EM countries with large, emerging middle class populations?

Figure 7. Internet Penetration Skyrocketed Between 2007 and 2012, With the Addition of 360 Million New Users in China Alone.



Source: World Bank, Citi Research

Although quicker to organize, Internet-inspired protests don't always convert into concrete political outcomes

Though the potential for online protests to generate short-term instability is high, the recent rash of large-scale EM protests has generally failed to translate into changes of government or even policy. What accounts for this? Part of the explanation lies in the fact that Internet-led protests, although they can be organized quickly and benefit from their ability to produce a sense of "safety in numbers", usually lack the societal networks and leadership necessary to focus such popular discontent and convert it into concrete political outcomes. The absence of a significant benefit to Turkey's opposition parties as a result of the Gezi Park protests highlights the increasingly decentralized nature of protest activity. Traditionally, successful political movements drew their organizational support from civil society, vanguard political parties, universities or a religious institution. Without the establishment of such networks, these outbursts of popular discontent may fizzle with little concrete political impact, with the most significant collateral damage coming in the form of dented approval ratings — and reduced political capital — for incumbents, rather than regime change.

Vox Populi, with the help of social media, create many more veto groups that can eliminate individual components of a program, often making what is left incoherent and unworkable. At the same time, it can also significantly lower the cost of lobbying to remove an unpopular policy. That is particularly true for fiscal austerity and structural reform where there are often a significant number of losers. Is it emasculating representative democracy with its capacity to reach compromises across issues and time? There is no "invisible hand of the flash mob" that ensures that the uncoordinated actions of single-issue movements produce a set of policies and administrative actions that make sense. If anything, the overarching trend is one of fragmentation rather than a groundswell of support in favor of a particular political agenda. One possible, and notable exception, is regulation and taxation, particularly of unpopular industries.

Vox Populi and Macroeconomics: Uncertainty Curbs Growth

Economic drag is seen with coups d'état but also in the short-term with *Vox Populi* events and longer long-run growth is also expected to suffer

Jay Ulfelder, scholar of democratic transitions and prediction, found that coups d'état typically result in a 2% economic drag on the affected countries during the year of the intervention, and then another 1-2% the following year before returning to trend. This could be called the "coup output gap"?[3] By extension, could mass protests and prolonged periods of heightened political uncertainty produce a similar decline in GDP figures? With this in mind, we expect not just the short-term negative effects on GDP forecasts that Ulfelder discusses, mainly driven by domestic aggregate demand but we should also expect lower long-run growth because of bad policies, clientelism and a neglect of incentives to work, save and invest.

Greater uncertainty leads to household savings and a domestic demand…

One of the oldest observations about household and firm decision-making under times of uncertainty is that greater uncertainty increases precautionary savings (thus reducing consumption demand) and, by raising the option value of waiting to find out how the uncertainty will be resolved, lowers capital formation. This means the two main components of domestic demand (accounting often for 80% of domestic demand or more) are adversely affected by the greater uncertainty created by *Vox Populi* risk. [4]

More generally, there is a wider economic impact from Vox Populi risk beyond asset prices. There are many important business decisions and economic policy decisions that are not directly or visibly driven by liquid financial markets. For example, the impact of Ukrainian VPR and the subsequent Russian involvement in Crimea will have important consequences for European investment in the infrastructure of reduced energy import dependence from Russia. This means more investment in transportation, shipment and storage facilities for gas (including LNG), coal, oil and uranium. It means greater investment in the electric power transmission grid, integrating the Baltics into the wider EU high-tension electric power transmission grid.

….and is also a deterrent to capital expenditure

Greater political risk, including VPR, is a deterrent to capital expenditure in the countries where it occurs, even if these countries don't have well-developed liquid and deep financial asset markets. Inward foreign direct investment in VPR-afflicted countries like Thailand and Ukraine is bound to suffer. Any economic action that is costly or even impossible to reverse, like engaging in greenfield investment in a factory or storage facility, is likely to be discouraged by VPR. Business decisions with a 30-year horizon, like exploration for natural resources or capital expenditure on extraction, transportation and storage facilities, are likely to be put on hold until VPR is resolved.

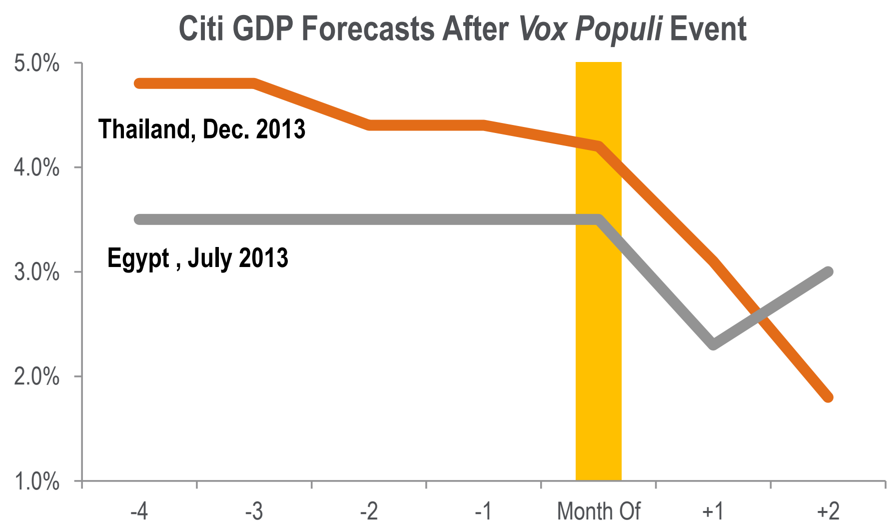
Although most of the outstanding stock of equity is traded in the markets of a limited number of advanced economies, most physical capital expenditure now occurs in emerging markets. In addition, although the US now accounts for 49% of stock market valuations and Europe for another 25%, a significant part of the future stream of profits and earnings priced in these markets are generated by real economic activity in emerging markets whose local stock markets are often small, illiquid and not systemically important.

[3] Jay Ulfelder. "Coups Slow Economic Growth." Jay Ulfelder blog. July 11, 2013.
[4] William Lee. "Policy Uncertainty and Investment - How Much Lower Must Real Interest Rates Go?" Citi Research. February 3, 2014

Both Thailand and Egypt saw immediate drops in economic forecasts following VPR events

In our analysis, we noted immediate drops in the GDP forecast for countries which experience high *Vox Populi* risk events. Following the December 2013 unrest in Thailand, Citi's GDP forecast dropped materially the next month and continued to drop. The same happened in Egypt after the July 2013 military intervention, though the Gulf States' attempts to shore Egypt's current reserves helped stem the fall.

Figure 8. Major *Vox Populi* Events Caused Citi GDP Forecasts To Drop Materially



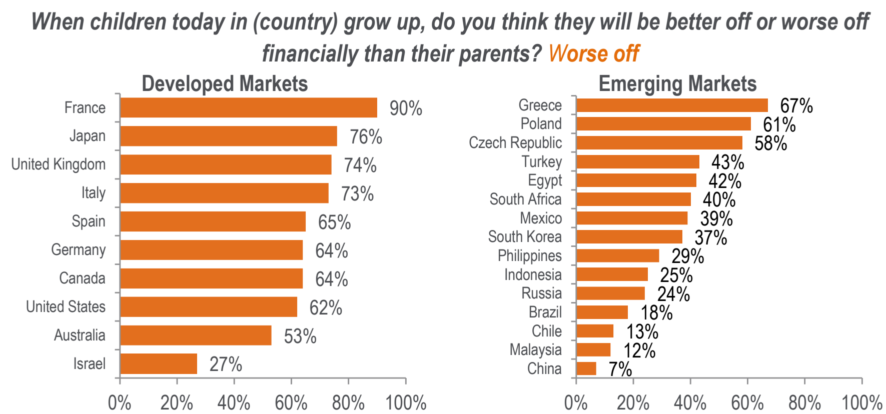
Source: Citi Research. Data reflects 2014 GDP forecast before and after the Thailand unrest of December 2013 and the Egyptian military intervention of July 2013.

Vox Populi and Macroeconomics: Income Inequality Fuels Political Economy of Discontent

Middle class anxiety from growing income and wealth inequality is a driver of *Vox Populi*

Perceptions of growing income and wealth inequality are increasingly regarded as being at the heart of middle class discontent. This discontent has been exacerbated by the financial crisis and the subsequent rollback in middle class living standards, the first in decades in some countries. In the US, real wages have been stagnant for over a decade. Polling data has shown that populations across DM and EM countries are experiencing significant middle class anxiety. In 2013, for example, Pew reported a majority believing their children will be worse off financially than they are themselves. In many instances, such as the US, this represented a historical change in trend. In France, this majority was 90%, and in Japan, 78%.

Figure 9. Middle Class Anxiety: Large Numbers Across Major Markets Believe Their Children Will Fare Worse Than Themselves



Source: Pew Research Global Attitudes Project, Citi Research. Surveys conducted March-April 2013, margins of error ranging +/- 3.3-7.7%.

Global inequality across countries has decreased, but within individual societies, it has shot up

Thanks to rapid EM growth, global income inequality across countries has decreased significantly and indeed the Gini coefficient has declined since the beginning of the century. Yet within individual societies — that is, the national, regional or local communities that define people's reference groups and benchmarks against which they measure their personal material well-being — inequality has skyrocketed. Globalization has raised worldwide incomes, removing the focus from poverty reduction. For the first time in the study's eight-year history, the 2012 World Economic Forum (WEF) Global Risks report identified income inequality as the most likely global risk for the next 10 years. A WEF expert survey suggested that inequality was connected to more than 40 global challenges studied, exceeding state failure, corruption, and climate change in perceived significance.

However, parents fearing their children will be worse off than they are is not fear of inequality per se. Rather, we think it should be interpreted as anxiety that the system is changing in a way that people have less faith that the path to prosperity, and the opportunities it affords, will be as open to their children as it was to themselves. This decline in optimism, if sustained, could strengthen demands for social safety nets and reduce incentives for advanced education and other choices. Even if all children were expected to be equally poor, the parents would still care. Regardless, concerns about income inequality have been at the core of some of the most high-profile examples of *Vox Populi* risk in DM, including Occupy Wall Street in the US and the *Indignados* protests in Spain. Both movements were profoundly middle class protests, galvanizing protestors against the rollback of the social safety net and rising youth unemployment. So far, no significant political actor has been able to capitalize upon this anxiety, but it represents fertile ground for aspiring political upstarts.

Generational inequality is also on the rise but hasn't been captured well yet

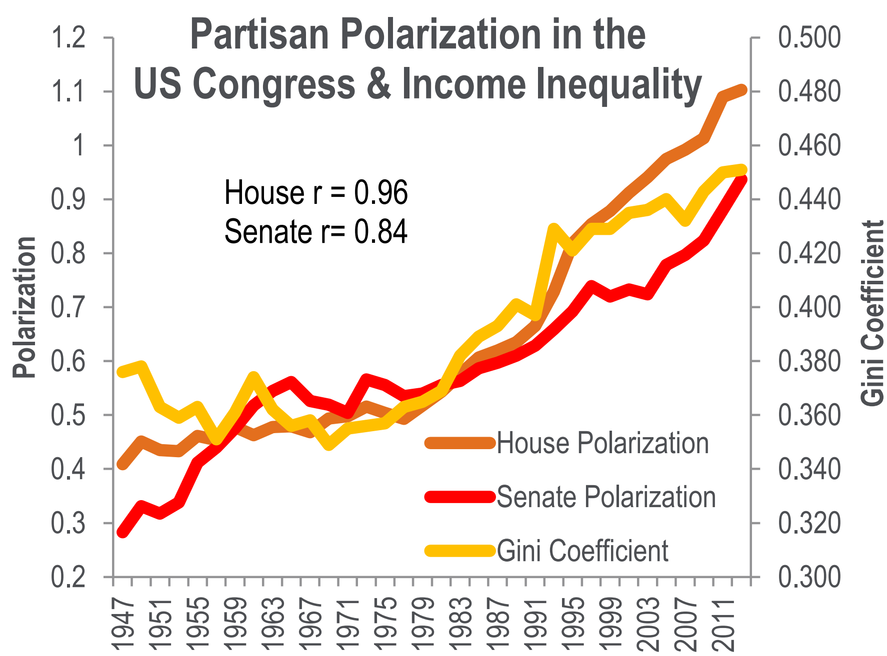
The pain of the financial crisis and its aftermath has been borne overwhelmingly by the young. In the US, Social Security and Medicare benefits are sacred cows. In Europe, where long-term contracts with benefits, rights and entitlements, including last-in first-out severance rules and other seniority features are held disproportionately by the older workers, with the young making do with so-called 'flexible' contracts, which are often not materially different from the day laborer arrangements of the past. But this inter-generational disparity is not captured well by the snapshot Gini coefficients for income or wealth.

> The worsening employment situation has intensified the risk of social unrest.
>
> – INTERNATIONAL LABOR ORGANIZATION

Income inequality is driving partisan polarization in government

The impact from income inequality may not be limited to street protests. American political scientists have observed that income inequality is highly correlated with the rise of partisan polarization in the US Congress. Income inequality may be fuelling a political economy of policy elites who are operating within an environment of seemingly irreconcilable differences.

Figure 10. Partisan Polarization in the US Has Risen Along with Income Inequality in a Highly Correlated Way



Source: Poole and Rosenthal/Polarized America, Federal Reserve Bank of St. Louis FRED, Citi Research

Vox Populi Risk in Developed Markets: Discontent is Anti-Reform, and Mind the Generation Gap

The struggle for limited state resources fuels polarization, gridlock and aversion to structural reform

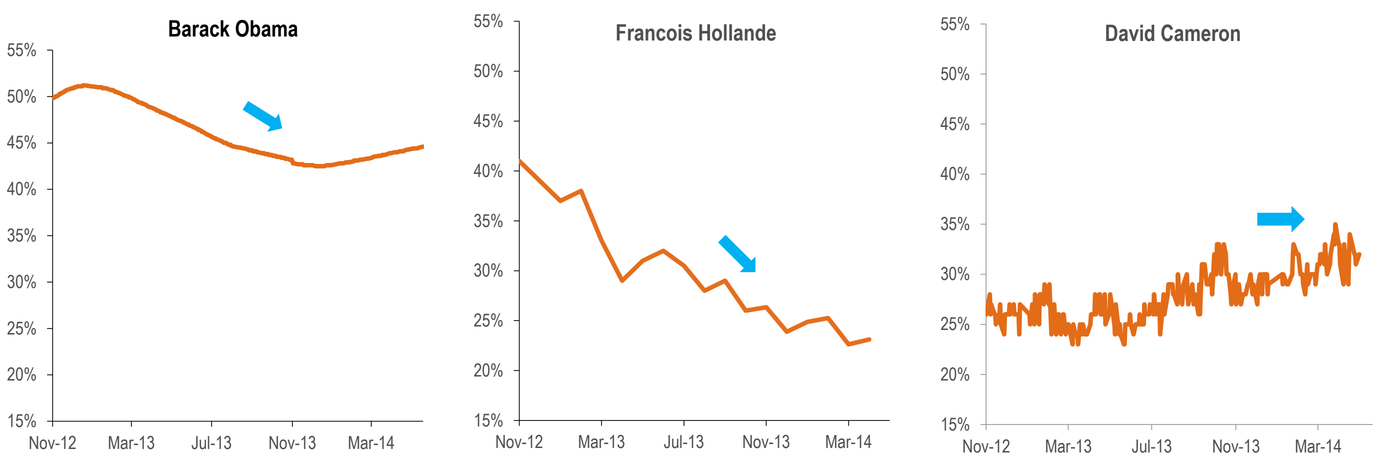
In a cycle of deleveraging, the interests of creditors and debtors in society are opposed in a zero-sum game. Today's political battle lines are drawn over the allocation of state resources rather than ideology. The conflict can be negative-sum if the fight over the distribution of the rents destroys some or most of these rents. Such divided interests fuel polarization, gridlock and aversion to structural reform. There are demands for "change," but typically citizens seek to maintain the status quo for themselves.

DM leader approval ratings continue to plummet as middle classes constitute an anti-reform bulwark

Developed market (DM) middle classes now often constitute an anti-reform bulwark, punishing austerity-budget incumbents in the voting booth. The UK think tank Policy Network noted the fact that the middle classes are the beneficiaries of the prior fiscal order, which "makes pensions and welfare payments to old cohorts practically untouchable."[5]

In the US, budget cuts have fallen almost exclusively on the young, with entitlements such as Social Security and Medicare largely untouched. The fact that older voters now in many countries outnumber younger voters (with older voters generally more likely to vote than younger voters) reinforces the bias in public sector resource allocations in favor of aging populations. With governments a major employer of the middle class, public sector reform may constitute a third-rail of post-crisis politics. As traditional mainstream parties implicate themselves in the reform process, the risk increases that must-win middle class voters reject them and turn increasingly to unconventional political alternatives. In this environment, job approval for most DM leaders has stopped or stayed low over the past two years — Angela Merkel being the most notable exception.

Figure 11. Public Approval for Major DM Leaders Has Dropped Or At Relatively Low Levels Over the Two Years



Source: Pollster.com/The Huffington Post, Electionista, Sondage-en-france.fr, YouGov UK, Citi Research

[5] Patrick Diamond and Guy Lodge. "European Welfare States After the Crisis: Changing Public Attitudes." Policy Network, January 2013.

This begs the question: for how long can the old out-vote the young before the dynamic shifts? Inter-generational tensions were a major factor in the 2013 Italian election result that produced a hung parliament where no political party was able to gain an absolute majority of seats. What prevents this tension from being a more significant factor is likely to be the apathy of younger voters, who typically score low on political participation, forfeiting their power at the ballot box and maintaining the electoral primacy of baby boomer voters. Could a catalyst emerge that galvanizes youth voters and sees them engage in the political process? So far, the issue capable of inspiring this change is not apparent.

Rise of the NEAPs

New, extreme or alternative parties are on the rise and represent an "anti" orientation

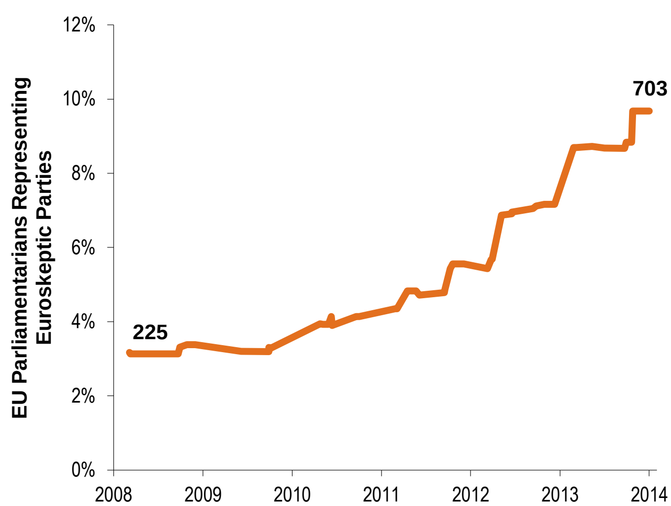
A byproduct of the erosion of the post-War political order is that mainstream political actors have been joined on the scene by new players. Our term for these new political parties, which span the political spectrum, is NEAPs, or *new, extreme or alternative parties*. As a rule, these movements and political parties are anti-establishment, and, in the European context, euroskeptic. Some represent single issues or simply a generalized "anti"-orientation, rather than the broad platforms that could draw in a wider coalition. When NEAPs attack the mainstream parties from their right and left flanks, mainstream parties are likely to adopt some NEAP policy positions as they try to maintain their constituencies, in a sort of political cross-dressing. Thus, even if not elected to lead governments, NEAPs are having a significant influence on the policy debate. UK Prime Minister David Cameron has placed an in-out referendum on British membership in the European Union (slated for 2017) at the center of the national debate, over the objections of large segments of his own party and mainstream British business interests, in an effort to stem the rise of the euroskeptic UK Independence Party (UKIP). UKIP is draining support from Conservatives heading into May 2014 European Parliamentary elections, and even has some Tories worried about the 2015 UK general elections.

Figure 12. Challenges to Mainstream Political Parties and the Rise of Euroskeptic or Anti-Establishment NEAP's

Country	Party(ies)	Country	Party(ies)
Austria	Freedom Party	Japan	Japan Restoration Association
	NEOS	Latvia	National Alliance
	Team Stronach	Lithuania	Order and Justice
Belgium	Vlaams Belang		Way of Courage
	Attack	Luxembourg	ADR
Czech Republic	ANO		The Left
	Usvit	Netherlands	Freedom Party
Denmark	People's Party/DF		Reformed Party
	Red-Green Alliance		Socialist Party
Finland	The Finns	Poland	Solidarna Polska
France	Front National		Your Movement
Germany	Afd	Portugal	Left Bloc
	Pirate Party	Slovakia	Slovak National Party
Greece	ANEL	Spain	Secessionist & nationalist parties
	Golden Dawn		United Left
	Syriza	Sweden	Left Party
Hungary	Jobbik	Sweden	Sweden Democrats
India	Aad Aadmi Party	United Kingdom	Respect
Ireland	Sinn Fein		UK Independence Party
	United Left Alliance	United States	Tea Party movement
Italy	Five Star Movement		

Source: Citi Research

Figure 13. In European National Parliaments, NEAP Parliamentarians Have Tripled Since The Crisis Began



Source: Citi Research

The NEAPs trend is particularly pronounced in Europe

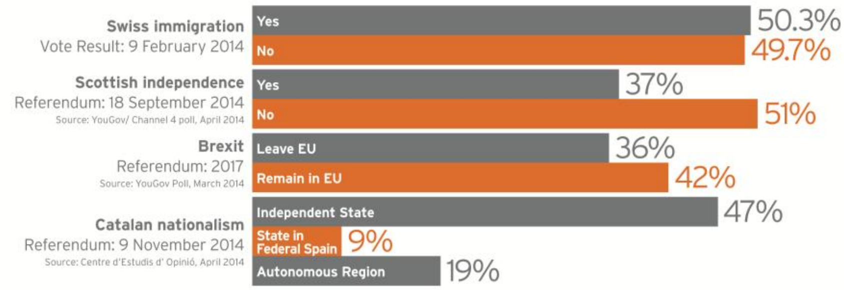
The NEAPs trend is particularly pronounced in the EU, though far from exclusive to it. By our calculations, the number of European Union parliamentarians representing euroskeptic parties at the national level has tripled since 2011 to over 700, or around 10%, out of ~7,200 members. These new movements have won seats in 21 of the 28 EU national parliaments. The largest include Italy's Five Star Movement, which won a surprising 25% of the vote in 2013 elections, as well as Greece's Syriza, Poland's Palikot Movement and Hungary's Jobbik. We expect that a significant number of NEAP members will enter local government and the European Parliament over the coming year.

In the Netherlands' Geert Wilders and his Freedom Party have announced plans to create a bloc that would bring together euroskeptic and anti-immigrant parties after 2014's European Parliament elections, potentially joining with France's National Front. A large euroskeptic bloc in the European Parliament could further inhibit progress toward the integration and reforms at the EA and EU levels that are necessary for further political and fiscal integration. Having said that, we note that "anti"-parties may struggle to work together toward a shared political objective. Indeed, in the run up to the European Parliament elections, many have been at pains to declare their unwillingness to collaborate with parties they fear will tarnish their brand, particularly where there may be perceived concerns of xenophobia. Even the notable performance by NEAPs in European Parliamentary elections this year may not necessarily translate into a concrete policy agenda; instead, they may act as spoilers, slowing the machinery of policymaking. A possible exception may be in the area of further regulation and on curbs to immigration; among the few areas where the "antis" find common cause.

Anti-establishment forces haven't arisen merely from center-right or anti-system positions. The populist Left may be resurgent as well, directly positioning itself to speak to the issue of income inequality. New proposals for minimum wage hikes have made headlines in the US, and in Germany was even a key plank of the incoming grand coalition's governing agreement. In 2015, Switzerland will hold a referendum on a basic income program for all citizens, though it's worth noting that Swiss voters rejected a plan to cap executive pay as late as March 2013. The potential policy impact in DM is considerable as evidenced by most legislatures having enacted or are considering new regulation that focus on anti-financial services legislation, CEO pay, wealth taxes, minimum wage increases, and restrictions both on new immigration and on the rights of old and new immigrants.

Not all of these new groups are specific responses to the post-crisis politics of austerity and bailout demands. Poland's Your Movement, for example, drew together liberal, anti-clerical, and anti-establishment opinion at a moment when the country's center-right-leaning political party spectrum offered no serious leftist alternatives. Outside Europe but within this anti-establishment category could include the Tea Party movement in the United States and Japan's Restoration Party. But in our view, all reflect dissatisfaction with the longstanding mainstream parties that have dominated the post-War political system in developed democracies, and a demand for political alternatives that is not strictly a consequence of economic factors.

Figure 14. Referendum Risk: Centrifugal Forces Increase Uncertainty, But Will They Change the Status Quo?



Source: Citi Research

Referendum Risk: How European Votes May Surprise Markets and Lead to Policy Uncertainty

A number of governments are struggling with regionalism, secessionism and a drive for the return of sovereignty

Against this backdrop of discontent and mistrust for institutions, several DM governments are struggling with regionalism, secessionism and a drive for the return of sovereignty. Even a failed vote may set the stage for a market-moving surprise in Europe, in what we call *referendum risk*. Both Scotland and Catalonia plan to hold independence referendums in 2014, and in 2017 the UK is due to hold an in-out referendum on EU membership. Though none of these ballots are expected to translate into victories, they add to the sense of political uncertainty and fragmentation, weighing on confidence and sentiment.

Surprise outcomes could have immediate market impacts or wide-ranging policy consequences. First, the result of an election might in and of itself surprise investors. Second, national governments' attempts to outmaneuver public opinion may lead to negative policy consequences. With this in mind, we view referendum risk as a new and potentially potent form of *Vox Populi* risk, as a retreat to nationalism and localism becomes a powerful popular response to globalization.

- **Switzerland immigration controls (February 2014).** On February 9, 2014 Swiss voters narrowly approved (50.3% to 49.7%) a referendum to restrict immigration from the EU. This vote was seen as contrary to EU-Swiss bilateral treaties guaranteeing freedom of movement as part of Switzerland's membership in the Schengen Zone, and the Swiss government will now have to enact legislation implementing the referendum's results. Though the vote had limited impact on Swiss capital markets, many of Europe's euroskeptic and anti-immigrant politicians are seeking to build support now that the issue has gained prominence.[6] With this in mind, national leaders may attempt to counteract or co-opt these parties' positions, with unforeseen consequences for medium-term European integration.
- **Scottish independence (September 2014).** The Scottish National Party-led government in Edinburgh has scheduled a referendum on independence from the UK on September 18. The referendum is expected to fail. By the end of February, for example, 48 opinion polls held in Scotland have shown the 'No' side up by at least seven points or more. Only one survey has shown the 'Yes' side closer – and that was commissioned by the SNP. Even so, the possibility of a UK breakup has generated political uncertainty within the country and confusion abroad. British and European policymakers have spoken out strongly against the likelihood that an independent Scotland can stay within the EU and the sterling currency zone.

[6] Giada Giani et al. "Euro Economics Weekly - Could Eurozone Politics Return to the Fore?" Citi Research. February 14, 2014.

- **Catalonian independence (due in November 2014).** Catalonia, one of Spain's regional economic powerhouses, has long had an active separatist movement, and its support has grown as Catalans associate the central government in Madrid with austerity, unemployment and waste, in addition to long-standing complaints about net budgetary transfers from Catalonia to the rest of Spain. Regional elections in November 2012 were largely fought on the independence issue, and pro-sovereignty Catalan President Artur Mas took his victory as a mandate to proceed with a referendum. A favorable vote for independence, scheduled for November 9 (but likely postponed after a recent constitutional court ruling) would come as a surprise to markets today, as the Spanish government has vowed to block it as unconstitutional and therefore illegal, since under the Spanish constitution only the central government can call a referendum. When Citi Research last considered the issue, our European Economists expected the loss of Catalan-based government revenue to cause a significant negative fiscal impact for the Spanish sovereign in the short term.[7] At the time, our forecast for Spain's 2012 fiscal deficit was at 7.1% of GDP. Today our 2015 deficit forecast is an improved 4.8%, but the basic argument still applies.

- **'Brexit' in 2017.** In perhaps the most extreme case of referendum risk currently on the political horizon, growing euroskepticism in the United Kingdom has culminated in the proposal for an in-out referendum on Britain's EU membership. Prime Minister David Cameron has suggested that, were the government to be re-elected in 2015, he would call for such a vote to take place in 2017. Brexit would have a significant impact on the economic and business environment; what's more, polls are in favor of secession, were the vote to take place. In January 2013, Citi United Kingdom Economists wrote, "EU exit would be a major economic negative for the UK, damaging the UK's ability to attract foreign direct investment (FDI) in globally traded goods and services industries." [8]

[7] Ebrahim Rahbari and Antonio Montilla. "Elections In Catalonia: Down The Path Of 'Two-Speed Spain'." Citi Research. November 23, 2012.
[8] Michael Saunders and Ann O'Kelly. "UK Economics Weekly - "Brexit" – Could It Happen? Would it Matter?" Citi Research. January 18, 2013.

In Focus: Referendum Risk: Secession Votes More Likely to Fail than Pass, Other than in the Post-Communist Countries

In the modern era, referendum votes are more likely to fail than pass, unless the country is post-colonial or post-Communist. Indeed, only three new states have come into existence that weren't the result of an explicit European decolonization process or a Communist collapse since 1974, and all these were a product of a United Nations process.

Post-colonial and post-Communist. Of the 29 independence votes conducted by decolonized or post-Communist nations, only two failed to pass: a 1967 vote in Djibouti, then called French Somaliland, and a 1992 vote in Montenegro. Both countries later conducted favorable secession referenda.

Little luck in Europe and North America. Fourteen independence votes have been held in the West since World War II, but only one (Iceland) resulted in the creation of an independent state. The Faroe Islands (Denmark) and Newfoundland (United Kingdom) also voted to secede, but the Danish parliament overturned the Faroese vote and Newfoundland later decided to join Canada. Most secession ballots have been unsuccessful, most notably in Quebec (Canada) and Puerto Rico (United States).

Quebec. The Canadian province of Quebec has held two sovereignty votes, one in 1980 and one in 1995. The 1980 vote was a clear loss for the sovereignty movement, 60% 'No' to 40% 'Yes.' But the 1995 vote shocked Canadians by its much closer result. The pro-sovereignty position started strongly and was expected to win, but a vigorous campaign by the pro-Canada side and the promise of concessions by Prime Minister Jean Chretien closed the gap and the vote failed, 51% to 49%.

Puerto Rico. The American territory of Puerto Rico has held four status votes since 1967, the most recent in 2012. Island politics revolve around the status issue, and Puerto Rican politicians divide themselves into pro-status quo and pro-statehood political parties, rather than the mainland Republicans and Democrats. The independence option has never won more than 6% of the vote over four ballots.

Czechoslovakia. The other most notable Western split, Czechoslovakia in 1992, was conducted by the Czechoslovak parliament without reference to a popular vote. At the time, the Slovak National Assembly in Bratislava had already issued a declaration of independence. Even though opinion polling suggested that the electorate would oppose the move, the federation parliament in Prague brokered a deal between the Czech and Slovak leadership and the break was effected at the end of the year.

Post-Communist and post-Soviet. Between 1990 and 1992, nine of the fifteen constituent republics of the Soviet Union and five of the six divisions of Yugoslavia held independence votes. Fifteen of the sixteen votes passed, with the aforementioned exception of Montenegro. The breakaway regions of Nagorno-Karabakh (Azerbaijan), South Ossetia (Georgia) and Transnistria (Moldova) have also held votes, but none have been internationally recognized.

Three new nations, but birthed under UN supervision. Starting in 1993, Eritrea, East Timor and South Sudan all conducted successful independence votes following civil wars or invasion. All of these votes were conducted under the auspices or supervision of the United Nations. Somaliland also declared independence in 2001 and has operated as an autonomous republic in the Horn of Africa without international recognition since that time.

Figure 15. In Fifty-Four (54) Independence Votes Since WWII, Few Have Passed Outside Post-Colonial and Post-Soviet Spheres

Decolonization & Trusteeship			Post-Communist Independence			Europe & North America			New States		
Country	Year	Result	Country	Year	Result	Country	Year	Result	Country	Year	Result
Mongolia	1945	Passed	Slovenia	1990	Passed	Iceland	1944	Passed	New Caledonia	1987	Failed
Cambodia	1955	Passed	Armenia	1991	Passed	Faroe Islands	1946	Passed	Eritrea	1993	Passed
Guinea	1958	Passed	Azerbaijan	1991	Passed	Newfoundland	1948	Passed	East Timor	1999	Passed
Algeria	1961	Passed	Croatia	1991	Passed	Saarland	1955	Failed	Somaliland	2001	Passed
Jamaica	1961	Passed	Estonia	1991	Passed	Puerto Rico	1967	Failed	South Sudan	2011	Passed
Samoa	1961	Passed	Georgia	1991	Passed	Aruba	1977	Failed			4 of 5
Malta	1964	Passed	Kosovo	1991	Passed	Nevis	1977	Failed			(80%)
Rhodesia	1964	Passed	Latvia	1991	Passed	Quebec	1980	Failed			
Djibouti	1967	Failed	Lithuania	1991	Passed	Puerto Rico	1993	Failed	**Post-Soviet Breakaways**		
Comoros	1974	Passed	Macedonia	1991	Passed	Quebec	1995	Failed	**Country**	**Year**	**Result**
Micronesia	1975	Passed	Turkmenistan	1991	Passed	Bermuda	1995	Failed	Nagorno-Karabakh	1991	Passed
Djibouti	1977	Passed	Ukraine	1991	Passed	Nevis	1998	Failed	South Ossetia	1991	Passed
Palau	1993	Passed	Uzbekistan	1991	Passed	Puerto Rico	1998	Failed	Transnistria	1991	Passed
		12 of 13	Bosnia	1992	Passed	Puerto Rico	2012	Failed	South Ossetia	1992	Passed
		(92%)	Montenegro	1992	Failed			3 of 14	South Ossetia	2006	Passed
			Montenegro	2006	Passed			(21%)	Transnistria	2006	Passed
					15 of 16						6 of 6
					(94%)						(100%)

Source: Citi Research based on data from the Journal of Public Money & Management, national election agencies. This chart does not include any votes related to the current Ukraine crisis.

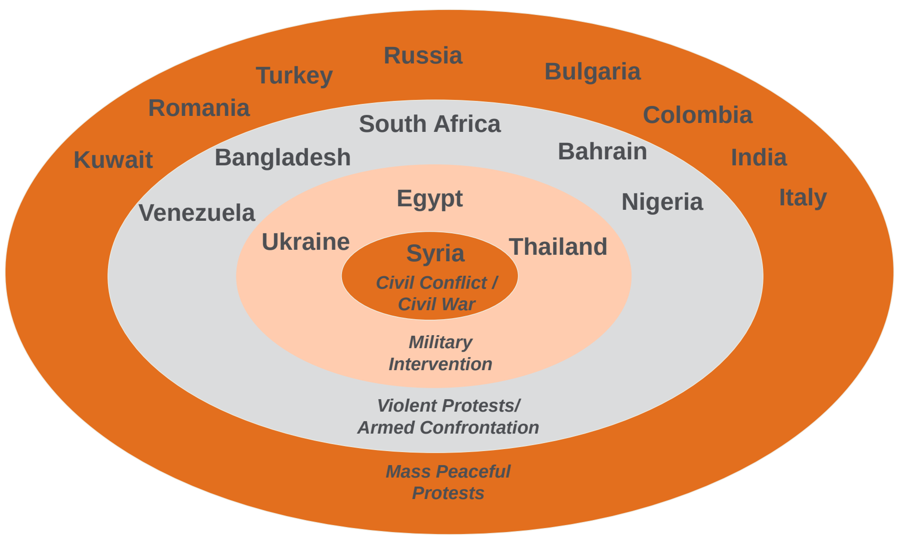
Vox Populi Risk in Emerging Markets: Mass Protest Can Be Pro-Reform – Yet May Not Lead to Change in Government

In younger democracies or states where the ballot box is not an option, social unrest becomes the most vivid example of *Vox Populi* risk. In terms of unrest, *Vox Populi* risk can be captured in the emergence of new social movements, street demonstrations, rebellions and insurgencies, even coups d'état and revolutions. Unelected leaders in less democratic regimes also face threats to legitimacy, even in cases where they have successfully delivered improved living standards in the pre-crisis period. In 2012 and 2013, major public protests occurred in Bangladesh, Brazil, Bulgaria, Egypt, India, Jordan, Morocco, Pakistan, Romania, Russia, Slovenia, South Africa and Turkey. Even after protest movements culminate in crises or revolutionary transformations, history suggests that they also re-emerge periodically in the subsequent months or even years later — a pattern suggesting that protests beget protests.

New middle class in EM are increasing demands on the political system

A key byproduct of the new EM middle class is their increased demands on the political system. These can include higher public spending on transport, health and education, greater accountability for public officials, plus greater civil and political rights. In many emerging and frontier markets, the poor quality of the official bureaucracy and the often routine nature of graft and corruption can fuel distrust of elites.

Figure 16. Protests and Civil Conflicts, 2011-2014



Source: Citi Research

Brazil and Turkey: Protests and Elections in Two of the Fragile 5

How a crisis is handled is as important as what the crisis is about

When *Vox Populi* risk presents itself on the streets, a key variable determining whether it will translate into wider disruption is the nature of the government response. A government's conciliatory posture can lower the risks resulting from social unrest, while a defiant crackdown, especially when the deaths of protestors is involved, will likely increase them. To illustrate this, we compare the paths of Brazil and Turkey.

Figure 17. Protests By The Numbers: Little Similarity in Key Indicators, Except for Long Tenures in Office for Ruling Parties in the Biggest EM Economies with Social Unrest

	Brazil	Indonesia	Russia	South Africa	Turkey
Leader	Rousseff	Yudhoyono	Putin	Zuma	Erdogan
Tenure of party in government	**10 years**	**9 years**	**14 years**	**19 years**	**11 years**
Party orientation	Social democratic	Center-right	Conservative	Social democratic	Conservative
Freedom House rating	Free	Partly free	Not free	Free	Partly free
Next elections	October 2014	April 2014	2016	Summer 2014	Spring 2014
Catalyst for protests	Transit fare hikes	Fuel price hikes	Democracy activism	Labor disputes	Istanbul park redevelopment
GDP growth (2013F)	2.3%	5.8%	1.3%	1.9%	4.0%
Unemployment (2013F)	5.5%	6.3%	5.5%	24.7%	9.8%
Inflation (2013F)	6.2%	6.4%	6.8%	5.8%	7.5%
Personal satisfaction rate	59%	15%	22%	17%	21%
Business climate (rank of 185)	130	128	112	39	71
Corruption indicator	63	28	13	59	61
Rule of law indicator	52	34	24	58	57

Source: Freedom House, World Bank, Gallup World Poll, Citi Research

The Brazilian government sought to resolve the conflict quickly through negotiation…

In Brazil, reaction to the perceived harsh police response to the Salad Revolution protestors on the streets of Rio de Janeiro swung popular support behind the demonstrators and with it the sympathy of the media and government officials (indeed many figures in the ruling Workers' Party (PT), including President Dilma Rousseff, are products of 1980s-era protest and revolutionary movements). Ultimately, in a change of stance, the Brazilian government agreed to reverse the transit fare hikes that sparked the protests, and to commit to a dialogue on reform. Rousseff's approval rating dropped from a high of 65% in March 2013 to 30% following protests in June 2013, according to Datafolha. Even given that Rousseff's approval ratings have improved slightly and she remains the favorite for re-election in 2014, albeit with her challengers enjoying a modest boost, this new challenge has had an impact on her political calculus, that of her Workers' Party, and of the opposition.[9]

…while the Turkish government took a hardline response to protestors

Turkish Prime Minister Recep Tayyip Erdogan's response to the May 2013 Gezi Park incident sought to limit protests with a strong response by the security services. The spread and duration of the protests increased pressure on the ruling AK Party (AKP). Erdogan's approval ratings dropped from 62% in December 2012 to 53% in June 2013, and now stand at 44% in February 2014, according to MetroPoll.[10] With falling approval ratings, prospects for constitutional reform may be delayed, but given the party's performance in spring municipal elections, plans to hold the first direct elections for the Turkish presidency in 2014 are likely to go forward. Thus, despite the scale of the protests, the AKP-led government largely retains its core support, while the opposition has failed to capitalize upon public dissent, suggesting division and paralysis rather than political change may be the key outcome. With Brazil and Turkey heading into elections this year and 2015, there is significant potential in both cases that protest activity will return – yet in both cases, the incumbent political parties are expected to be re-elected, albeit by smaller margins, according to the latest polls.

[9] Datafolha. "Após Cair Pela Metade, Aprovação a Governo Dilma Volta a Crescer." August 12, 2013. Based on a survey of 2,615 adults conducted August 7-9, 2013, margin of error +/- 2%.

[10] Tom Peter. "Poll Shows Erdogan's Popularity Has Taken A Hit. Could He Lose His Mandate?" *The Christian Science Monitor*, June 18, 2013.

In the Turkish case, the protests highlighted existing social and political divisions — as well as the continued fragmented state of the opposition. The incumbent AKP is likely to see its core political support, drawn largely from the country's new middle classes, continue. Yet its approach to the Gezi Park protest may mean that the opposition to its policies remains, occasionally generating periodic disruptions, even as it lacks the strength to displace the incumbent party at the ballot box. In Brazil, a longstanding consensus-based model may reduce the intensity of future protests — but pave the way for more "within-system" political challengers over time. We surmise that these "flash mob" protest movements may serve as mid-cycle referenda on incumbents, reducing their room for maneuver and willingness to undertake unpopular policy measures, such as reforms.

Despite China's rising middle class, it has not experienced *Vox Populi* risk events

Having said that, not all EM economies are experiencing *Vox Populi* risk in its most disruptive form. In China, local strikes and protests – called "mass incidents" by Chinese authorities – were reported to have doubled between 2006 and 2010 to 180,000 nationwide, according to the *Wall Street Journal*[11]. Yet 85% of Chinese report being satisfied with their country's direction, 70% rate their living standards as higher than they were five years ago, and 67% say their personal economic situation is good – all at or near the top of more than 40 countries surveyed by the Pew Research Global Attitudes Project.[12] These snapshots of public opinion suggest that, despite China's growth, environmental and government challenges, the risk of any Jasmine Resolution may be limited. Nevertheless, Chinese authorities appear mindful of the risk that perceptions on corruption can pose to government legitimacy, judging by Beijing's crackdown on visible official corruption. And as previously mentioned, the strong correlation between internet penetration rates, a globalized economy and protests suggests that China could see more such activity in years to come.

[11] Tom Orlick. "Unrest Grows As Economy Booms." The Wall Street Journal, September 24, 2011

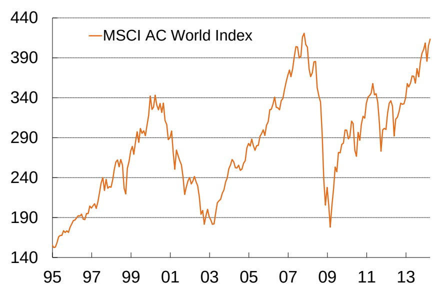
[12] Pew Research Global Attitudes Project. "Global Indicators Database." Accessed September 13, 2013.

Vox Populi Risk and Markets

Markets seem relatively immune to rising *Vox Populi* risk

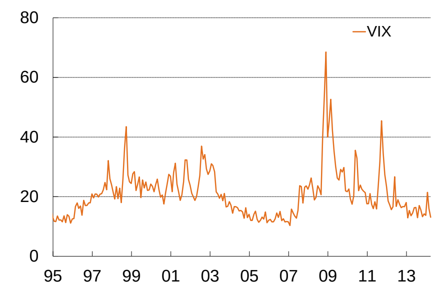
For now, global markets seem remarkably immune to rising VPR. After all, the MSCI AC World equity benchmark is trading around all-time highs (Figure 18). The US VIX index, sometimes called the investor "fear index," remains down around multi-year lows (Figure 19).

Figure 18. Global Equity Prices



Source: Citi Research, Datastream

Figure 19. US VIX Index



Source: Citi Research, Datastream

Volatility in riskier parts of the world seems to be increasing the desirability of assets in more stable DM economies

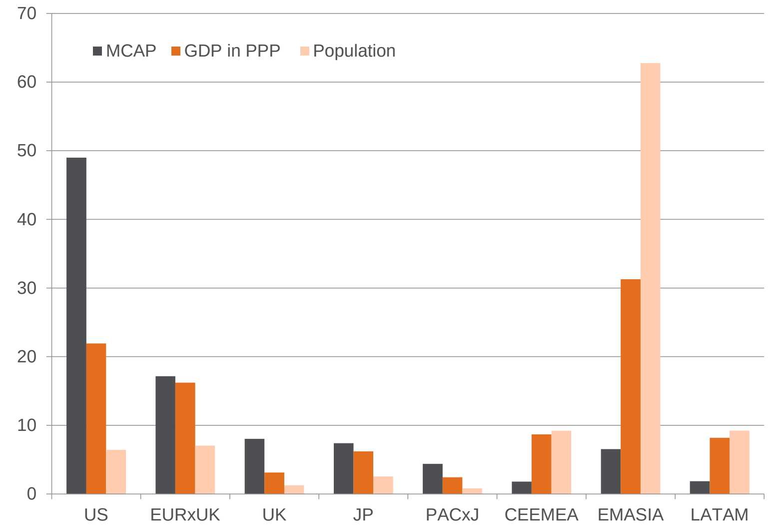
This does not mean that bursts of increased political risk cannot induce bursts of global market volatility, as we are seeing with the Ukraine crisis. However, the longer-term market impact has generally been more localized. So, global investors might see the current crisis as a reason to sell Russian assets. They might even see it as a reason to sell EM assets. But they do not it as a reason to sell the S&P. If anything, volatility in riskier parts of the world seems to be increasing the desirability of assets in the more stable DM economies. Rapidly rising London house prices are clear enough evidence of that trend.

Central banks have boosted asset prices that could otherwise have been damaged by high political risk premiums

Why are markets treating VPR as a localized rather than globally systemic issue? This might reflect the palliative effect of cheap money. Central banks have (intentionally) boosted asset prices that could otherwise have been damaged by higher political risk premiums. For now, global markets seem more interested in Janet Yellen's next move on QE than Vladimir Putin's next move in Ukraine. Maybe this will change, but only when we have seen the end of DM near-zero policy rates and open-ended liquidity at those extraordinarily low rates.

For those perplexed by this apparent investor complacency, we would highlight that markets can give a skewed perception of what matters. This is made very apparent in Figure 20. Here we rank country/regional equity market weightings against their economic importance. We also show their percentage of the global population. The US dominates global equity markets, accounting for 49% of market cap. It also accounts for a meaningful, if not dominant, 22% of global GDP. However, it only accounts for 6% of the world's population.

Figure 20. % Weighting In Global Equity Market, GDP And Population



Source: Citi Research

Although more of the population is in emerging markets, investors care most about DM as it's a larger % of market cap

By contrast, EM economies account for only 10% of equity market cap but 81% of the global population. So, by definition, any analysis of *Vox Populi* risk is going to care most about what happens in EM. After all, they are so much more of the *populi*. However, we think investors are going to care most about what's happening in DM economies and the US in particular. That's why it's easier to see the impact of the Lehman crisis in Figure 18 than the Arab Spring. Investors are doing what comes naturally – worrying about what matters to them.

This doesn't mean that markets can't be more seriously affected by elevated political tensions, especially in more systemically important DM economies. For example, global equities fell by 25% in 2011 on fears of a Eurozone break-up and subsequent sovereign and bank insolvencies. Rising political tensions in the peripheral countries contributed to the sell-off. Even the mighty S&P wobbled in response to events on the streets of Athens.

However, even here central bank action came to rescue. Ever since ECB president Mario Draghi said that he would do "whatever it takes" to preserve the euro, the ability of Eurozone political chaos to drag down global markets is much reduced. Global investors no longer ask us about the latest government collapse in Italy or rise of extremism in Greece. These are still very real political themes, it's just the markets seem to care about them much less.

The US financial crisis of 2008-09 and the Eurozone crisis of 2010-12 both threatened the very integrity of the world's financial system. That is what made global investors take notice. The fact that current heightened political risks have shown less ability to move global markets reflects that investors do not (yet) see them representing similar systemic financial threats.

Indeed, we suspect that robust global markets may actually be adding to *Vox Populi* risks. Rising asset prices have made the rich richer. The trickledown to the "other 99%" is proving more elusive. In DM economies stock markets have risen more than unemployment has fallen. Wealth gaps have widened. There is a broad perception that the response to the financial crisis has benefited the elites more than the rest.

This has added to well-established grievances about rising income inequality. Many good DM blue collar jobs were lost as globalization shifted large parts of the manufacturing base to lower-cost EM economies. The bargaining position of lower-skilled workers in DM economies has been further undermined by loosening immigration policies and the subsequent inflows of cheaper labor. Of course, many have benefited from the positive impact of globalization. In particular, hundreds of millions have been lifted out of poverty as EM workers have gained access to higher-paid jobs. DM shareholders have benefited as lower labor costs have allowed companies to keep profit margins high. But this has put pressure on DM wages. For example, the US median household real incomes have gone nowhere since the mid-1990s. A broad sense of rising inequality has proven a fertile hunting ground for populist politicians.

Global markets will be able to localize periodic outbursts of *Vox Populi* risk

Overall it seems that, unless events really escalate, global markets will be able to localize periodic outbursts of VPR. However, the Eurozone crisis showed us that the focus on political risk can rise sharply if investors see the prospect of a more systemic threat to global market stability. In the meantime, the ongoing themes of higher asset prices and globalization have contributed to a widening sense of income inequality. So even though global markets may seem remarkably immune to VPR right now, we believe they are indirectly contributing to it.

Although the effect may not be seen on the macro level, increased regulation on the micro level is having an effect

While, for now, global markets seem able to withstand rising VPR at a macro level, we can see some more micro impacts. Greater regulation of the deeply unpopular Banking sector has affected profitability. More scrutiny of the sector's frequent misdemeanors has been accompanied by increasingly punitive fines. Windfall taxes have also been imposed. Overall, however, an anti-capitalist backlash has not really materialized. Post the financial crisis, global corporation tax rates have fallen, not risen. Governments have been more interested in attracting multinational jobs than taxing their profits. In EM countries, resentment of crony capitalism has emboldened government attempts to break embedded domestic monopolies. In those companies that are listed, shareholders could lose out alongside the oligarchs.

Vox Populi Risk in Resource Economies: Challenges to the Rentier States

Lower oil prices are a particular worry in petro-states

The coming year looks to be one of wider and deeper strain for petro-states — countries whose government revenues are particularly dependent on oil and natural gas exports — given the outlook for moderately if not significantly lower oil prices. The factors that gave rise to the so-called Arab Spring have become a more permanent part of the domestic landscape for many if not most petro-states, and continuing pressures for governments to spend their way to legitimacy and authority will grow if lower prices cause revenue gaps to widen.

The US Energy Information Administration (EIA) estimates that last year total OPEC revenues amounted to $940 billion, $42 billion less than in 2012, and that estimated OPEC revenues could fall to a little more than $900 billion this year, a drop of over $80 billion, or 8%, in just two years. On a per capita basis, that's a decline of $351, or 11%, over the same period. This is a result of rising populations, falling prices and stagnant production.

The underlying factors giving rise to the predicament these countries are now in have their origins in the relatively distant past — the 1970s, the decade in which OPEC came into its own. The sharp rise in oil prices after the 1973 Yom Kippur War was accompanied by a decade of nationalization of oil-producing properties and tightened government control over the petroleum and natural gas sectors, with the OPEC cartel putting a floor under prices that boosted the rents received from low-cost production, creating the conditions for rentier states to flourish. Before the uprisings in North Africa in the winter of 2010-11, these countries successfully survived several periods of sharply lower prices: 1981-82, 1985-86, 1989-90, and especially 1998-99. But the surge in prices over the last decade gave rise to a false hope that these countries could avoid reform and spend their way out of difficulty. Several new factors make it close to impossible for this to happen as oil and gas prices stabilize and appear to be weakening.

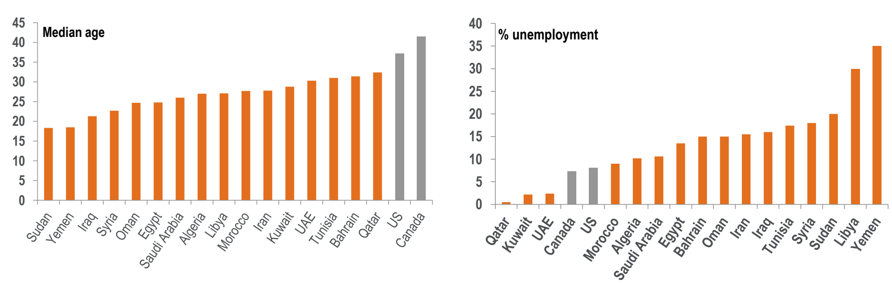
Figure 21. Fiscal Oil Breakeven Prices for Selected Countries ($/bbl, 2011-2014)

	2011a	2012a	2013a	2014e
Qatar	38	42	46	46
Kuwait	44	49	54	58
Saudi Arabia	77	74	84	88
Oman	78	80	94	104
UAE	92	79	68	67
Libya	183	89	99	100
Iraq	93	95	99	93
Russia	100	115	118	112
Iran	84	130	140	143
Bahrain	111	115	119	117
Algeria	111	120	113	113
Venezuela	140	170	165	156
Yemen	195	237	215	201

Source: Citi Research

Underlying conditions in many oil producing countries – with the notable exception of Norway in the OECD and the smaller countries in the Gulf Cooperation Council (Kuwait, UAE, Qatar) – are skewed to create problems. These include rapid population growth, falling per capita income, stark income inequality, high levels of unemployment and an increase not just in the awareness of opportunities elsewhere in the world, but also of social media and an ability to communicate internally and internationally. Tribal and religious schisms exacerbate these other trends.

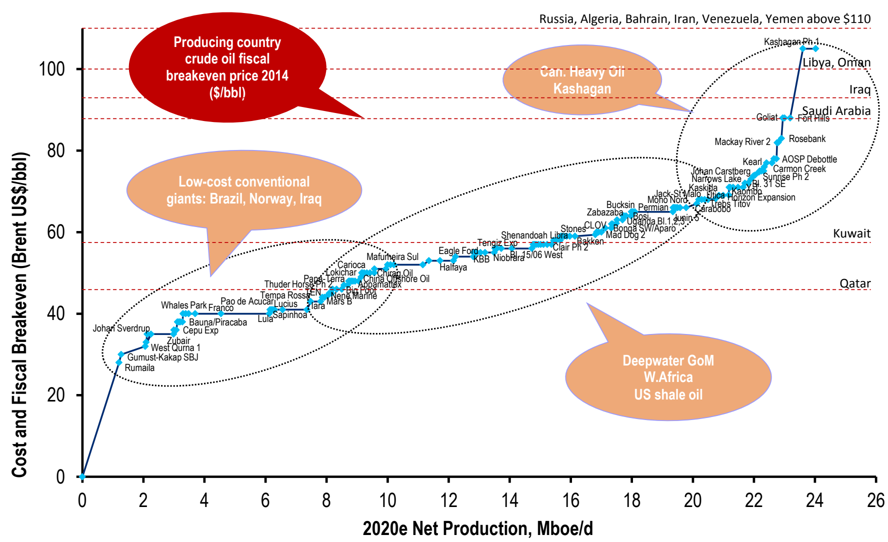
Figure 22. MENA Countries: Young and Unemployed



Source: CIA World Factbook, Citi Research

All of the petro-states, from Russia to Venezuela and across the Middle East, have tried to deal with these problems by spending at home and most of them are under rising pressures to boost income growth. In petro-states it is more easily achieved through faster rent consumption from higher extraction rates, or higher prices than through difficult economic reforms, especially reforms that curb domestic energy use (ending price subsidies) or promote economic growth and employment outside the petroleum sector. Due to price subsidies, fuel prices in many of these countries are very low, driving some of the most rapid consumption growth rates in the world. In addition, slow progress in developing more natural gas resources has meant more crude oil is burnt directly for power generation. Curbing domestic energy use in transportation and developing alternatives to direct crude burn for power generation could free up oil for more lucrative export revenues, but these measures remain politically difficult, keeping the pressure on to grow income from targeting prices.

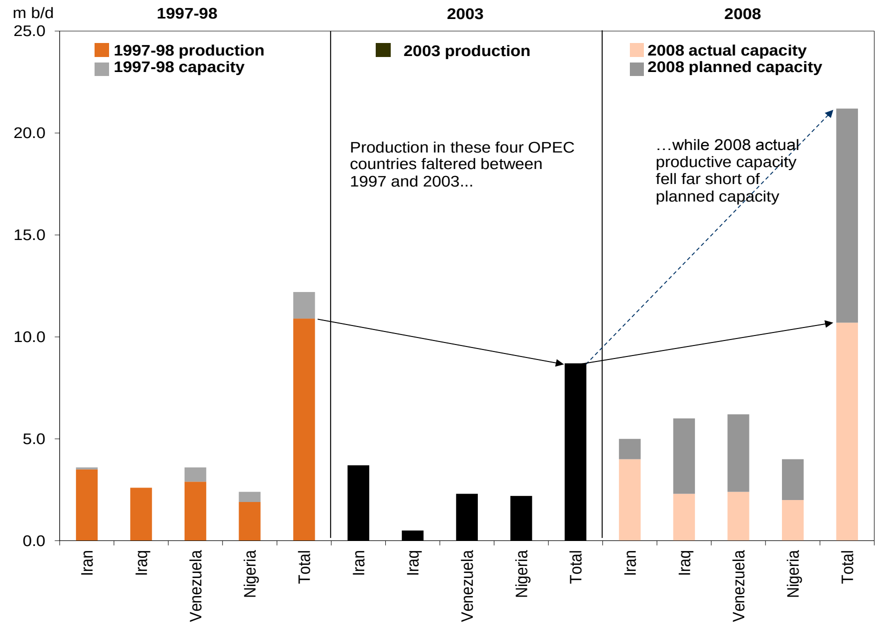
Figure 23. Project Breakeven Costs for Planned IOC New Developments to 2020



Source: Citi Research estimates

OPEC has historically sustained revenue by agreeing production quotas enabling the group as a whole to put a floor under prices well above OPEC's very low costs of production. But rising social welfare requirements are stretching the budgets of all the producers.

Figure 24. Failure of OPEC Crude Oil Supply through the 2000s vs. Expectations at the Time

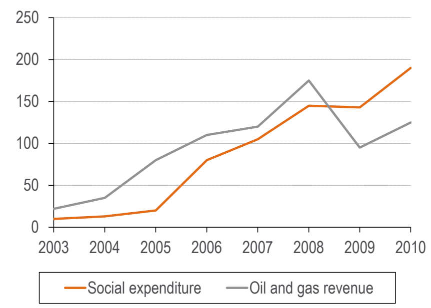


Source: EIG, Citi Research

OPEC countries are confronting supply problems through disruptions

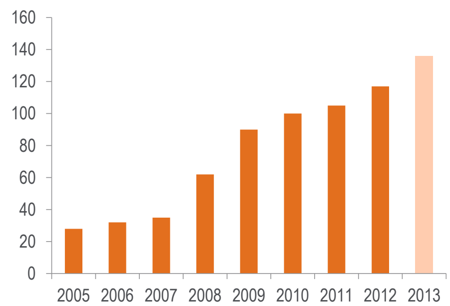
Additionally, OPEC countries are confronting supply problems of their own stemming from domestic disorder, which first emerged in the late 1990s. As of 1998, four OPEC members — Iran, Iraq, Nigeria and Venezuela — had plans to raise output by a combined 10 million barrels per day (10m b/d) by 2008. But disruptions at home resulted in 2008 output for the four countries being lower than in 1998. These supply disruptions created the context for the 2011 Arab Spring.

Figure 25. Russian Government Oil & Gas Revenues Versus Social Spending ($bn)



Source: Russian Ministry of Finance, Citi Research

Figure 26. Russia's Fiscal Breakeven Oil Price ($/bbl)



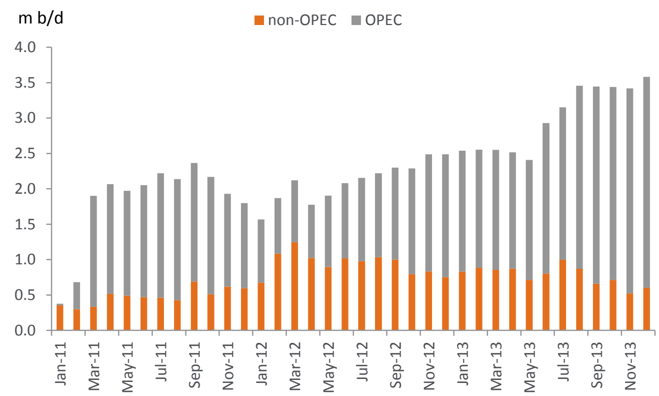
Source: Russian Ministry of Finance, Citi Research

Participation in governance and a quest for greater revenue or income to be better distributed are issues shared across petro-states

Two issues arise to one degree or another across these petroleum-based economies. One is an outcry for participation in governance and the other is a quest for greater revenue or income to be better distributed than the concentrated distribution at the top in many of these countries. So far the result has been most vivid in Libya, Yemen and Nigeria, but 2014 could see this call for greater 'voice' for the bulk of the citizens spread beyond these countries and reach Venezuela and Iraq as well. Certainly the two episodes of disruption in Libya — after February 2011 and since August 2013 — are a dramatic part of the rise of total global oil disruptions across OPEC and non-OPEC countries that have occurred since the early part of 2011. Before then, the average level of oil supplies taken off the market was about 500,000 barrels per day

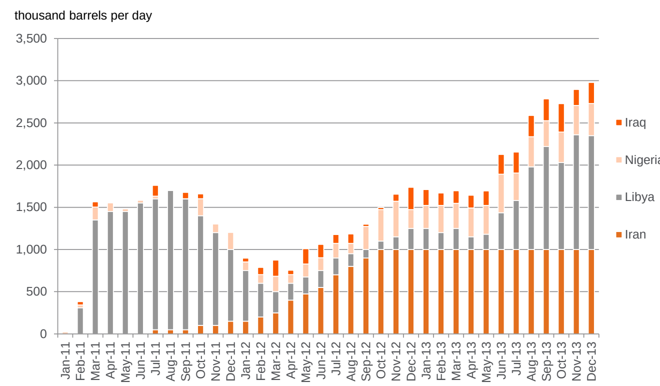
(500-k b/d) — with exceptions like 2002-03 when disruptions occurred in Nigeria, Venezuela and of course Iraq during the second Gulf War. Since then, the average level of disruption has been around 2m b/d) and in recent months has topped 3.5m b/d at times. Some of this includes Iranian supplies that have been off market because of internationally imposed sanctions.

Figure 27. Crude Oil Supply Disruptions in OPEC and Non-OPEC Countries (2011-13)



Source: Citi Research

Figure 28. Crude Oil Supply Disruptions in Iraq, Nigeria, Libya, Iran (2011-13)



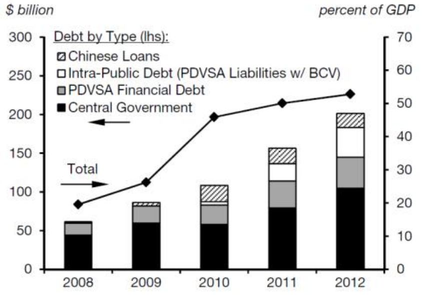
Source: Citi Research. Note that the EIA counts Iran supply disruptions at 600-k b/d; this does not include the total outage of ~1.5-m b/d, but represents the volumes that EIA assesses can be brought back to market quickly.

There is increasing competition for rents — a "grab" for rents

Aside from issues related to what individual oil-producing countries are seeing unfold in terms of the ultimate nature and structure of governments and governance at home, a critical theme has been what we think can be called "The Grab" for rents. In Libya, participation of many competing factions in receiving rents from oil production looms large and the very lack of a national military makes it difficult for the central government to maintain order at home, particularly in the context of a widespread distribution of weapons among local militias as a hangover from the uprising against Gadhafi. Questions are arising about the division of oil revenues between the central government and oil producing areas, between the state oil company and the central government, and between them and local communities and tribal groups and even between groups of oil workers. Rebel forces have blocked crude production from certain fields and exports from the eastern ports, and some groups have launched attacks against the Libyan parliament in Tripoli, as well as in Benghazi. All this distributional conflict has hit production hard, which now stands at the 200-300k b/d level, a far cry from the fast resumption of supplies post-civil conflict up to the pre-conflict 1.5-m b/d level by mid-2012.

The "Grab" also pervades politics in Nigeria, which confronts elections this year that revolve significantly around sharing of rents, as it does in Iraq, particularly but not only between Baghdad and the Kurdish Regional Government (KRG) in the north. It could also spread to Venezuela, where a government burdened by debt and facing rising social discontent can do little to raise revenues and has seemingly just about run out of new opportunities to finance further debt. And the openness of domestic disputes in Libya, Yemen, Nigeria and Iraq over sharing of rents can be found in more subtle ways across the other petro-states, including Russia, Kazakhstan, Azerbaijan and the GCC countries, but they have deep financial cushions that could enable them to weather the stormy environment ahead and even make headway in initiating reforms to overcome the dilemmas of being petro-states.

Figure 29. Venezuelan Public Sector Debt Obligations



Source: IIF

Today's global oil environment is quite different from prior episodes of stagnant or lower prices. A decade of high prices — helped by OPEC policy and insufficient investment — has supported global upstream capital expenditures that are bearing fruit. While these hydrocarbon resources are further up the cost curve than the low-cost supplies within OPEC, much of this, including major upside potential, sits in the $50-80/barrel project breakeven range, below the $110 Brent price level seen on average in the past few years. New production has been forthcoming from an array of non-OPEC producers, starting with the countries in North America based on unconventional resources from shale and oil sands that could add more production in 2014 than total oil demand growth. While some non-OPEC supply outside North America has disappointed so far this year, particularly Kazakhstan, supply does continue to outpace demand. Meanwhile, global geopolitical supply disruptions continue to keep productive capacity offline in OPEC and non-OPEC countries at much higher persistent levels than before. But, over the next few years, ongoing supply growth and tepid demand growth could lead to a downside breakout of the price range that Brent has seen in the last few years. This means a cut in OPEC output would be needed to prevent inventories from growing and to prevent a slide in prices, but the challenge is: who can afford to cut when the time comes? The shale and deep water supply revolutions are not likely to dissipate any time soon, and OPEC countries, with stagnant total production, should see their global market share reduced.

Figure 30. Global Oil Supply-Demand Balances by IEA, EIA, OPEC Secretariat and Citi Research (March 2014)

IEA (m b/d)	2013	Q1 2014	Q2 2014	Q3 2014	Q4 2014	2014	13' Growth	14' Growth
OECD Demand	46.1	45.8	45.3	46.2	46.6	46.0	0.1	-0.1
Non-OECD Demand	45.4	45.6	46.8	47.3	47.4	46.8	1.2	1.4
Total Demand	91.4	91.3	92.1	93.6	94.0	92.8	1.2	1.3
Non-OPEC Supply	54.7	55.7	56.1	56.2	56.8	56.2	1.3	1.5
OPEC Crude	36.8	36.4					-0.7	-
Total Supply	91.5	92.1					0.6	-
Call on OPEC Crude	30.4	29.2	29.6	30.8	30.7	30.1	-0.2	-0.3
EIA (m b/d)	**2013**	**Q1 2014**	**Q2 2014**	**Q3 2014**	**Q4 2014**	**2014**	**13' Growth**	**14' Growth**
OECD Demand	46.0	46.3	45.2	46.0	46.5	46.0	0.1	0.0
Non-OECD Demand	44.4	44.5	45.9	46.2	45.7	45.6	1.1	1.2
Total Demand	90.4	90.7	91.1	92.2	92.2	91.6	1.2	1.2
Non-OPEC Supply	54.0	54.6	55.5	56.0	56.1	55.6	1.4	1.6
OPEC Crude	30.0	29.8	29.5	29.9	29.5	29.6	-0.9	-0.4
Total Supply	90.4	90.6	91.3	92.3	92.1	91.6	1.1	1.2
Call on OPEC Crude	30.0	29.9	29.2	29.8	29.7	29.6	-0.7	-0.4
OPEC (m b/d)	**2013**	**Q1 2014**	**Q2 2014**	**Q3 2014**	**Q4 2014**	**2014**	**13' Growth**	**14' Growth**
OECD Demand	45.9	45.8	45.2	46.1	46.1	45.8	-0.1	-0.1
Non-OECD Demand	44.1	44.4	45.0	45.9	46.1	45.3	1.1	1.2
Total Demand	90.0	90.2	90.2	91.9	92.3	91.2	1.1	1.1
Non-OPEC Supply	54.2	55.5	55.1	55.4	56.3	55.6	1.3	1.4
OPEC Crude	30.2	29.8					-0.9	
Total Supply	90.1	91.1					0.5	
Call on OPEC Crude	30.2	28.9	29.4	30.7	30.0	29.8	-0.4	-0.4
Citi (m b/d)	**2013**	**Q1 2014**	**Q2 2014**	**Q3 2014**	**Q4 2014**	**2014**	**13' Growth**	**14' Growth**
OECD Demand	46.1	45.8	45.3	46.2	46.6	46.0	0.1	-0.1
Non-OECD Demand	45.4	45.6	46.7	47.2	47.3	46.7	1.2	1.3
Total Demand	91.4	91.3	92.0	93.4	93.9	92.7	1.2	1.2
Non-OPEC Supply	50.5	51.9	51.9	51.6	52.6	52.0	1.1	1.4
OPEC Crude	30.5	30.0	30.0	30.4	30.6	30.2	-0.9	-0.2
Total Supply	91.5	92.1	92.5	93.3	94.1	93.0	0.6	1.5
Call on OPEC Crude	30.4	29.2	29.4	30.5	30.4	29.9	-0.2	-0.5

Source: : IEA, EIA, OPEC Secretariat, Citi Research

OPEC as a whole is under stress to put a floor under prices

At the same time, fiscal and other pressures make it doubtful that these countries will be able to jointly reduce production by enough to put a floor under prices. And Iran and Iraq have served notice in OPEC that they would not look to constrain their own production in the future, given their view that others in OPEC have financially benefited from their lost production in recent years. So, OPEC as a whole is under stress, having lost credibility that they can limit price rises by raising production very much, and also confronting in 2014 a test of the organization's ability to put a floor under prices if supply abundance materializes. Meanwhile, social media could potentially have strong demonstration effects. If Iraq or Libya or Nigeria were to succeed in what we view as the long-shot possibility of finding a solution to a fair sharing of petroleum rents, the lessons are likely to spread across other petro-states as well.

If rents continue to shrink, petro-states could become fragmented along tribal, regional or sectarian lines

In a less optimistic scenario, falling oil prices and thus shrinking rents would set the two forces against each other: the pressure to rein-in government expenditures even as the *Vox Populi* call for a fairer share of political power and rents. Without addressing their internal structural issues, petro-states could even become fragmented along tribal, regional and/or sectarian lines. The *New York Times* has suggested that six states in MENA, from Libya to the Gulf, could potentially fragment into 14 new entities, with Libya's regions more driven by tribal and regional power struggles – with the country's oil production split roughly half-half between the west and the east – and Sunni-Shia lines playing an important role in the Arabian Peninsula, along with ethnic and tribal lines.

Though arguably a democratizing force in one sense, the Arab Spring movements have also left power vacuums and social and economic turmoil in their wake, providing favorable conditions for al-Qaeda and affiliated and other extremist groups to enter the fray. This trend could increase tension and instability in the region, and manifest in growing threats to oil and gas infrastructure from possible terrorist attacks.

Vox Populi Risk and the International System: A Boost for Diplomacy as a Silver Lining?

How can shifting and more volatile domestic public opinion affect the geopolitical sphere? One of the more profound consequences of *Vox Populi* risk for the functioning of the international system is the increasing evidence that the use of military power is less available as an option for leaders – even those with executive war powers.

Public willingness to support military conflicts has fallen and is a boost for diplomacy

As evidenced during the aborted effort to reinforce the so-called US "red line" against chemical weapons usage in the Syrian civil war in August 2013 and again in the early stages of the Ukraine crisis in the spring of 2014, public opinion is increasingly against the use of "hard power". A possible silver lining for this change in public willingness to support the use of military force is a boost for diplomacy, which helped lead to the breakthrough between Iran and the P5+1 efforts and the surprise Russian-US cooperation on disposing of Syria's chemical weapons.

The Ukraine crisis, which started as street protests and has accelerated to become one of the most significant geopolitical challenges since the end of the Cold War, is an example of *Vox Populi* risk's potential impact on the international system, highlighting how country risk can become geopolitical risk overnight. Russia's involvement in the Crimea has ruptured its relationship with the West. This has raised concerns about further violations of the post-Soviet borders, as well as reduced cooperation on a host of geopolitical challenges, such as Iran's nuclear program and the disposal of Syria's chemical weapons. Yet Western military action did not gain traction in the debate about possible responses to the Russian actions in Crimea.

Although a growing reliance on "soft power" could encourage rogue forces

Of course there is a divergence of views about the reluctance to exercise force, and fears in some regions that a growing reliance on "soft power" could give encouragement to rogue forces, such as non-state actors or countries operating outside international norms. In our view, regardless of the consequences, it will be difficult for a US or European leader to secure public support for military engagements that involve soldiers on the ground or manned aircraft in the skies for the foreseeable future, increasing the reliance upon diplomacy and policy levers such as sanctions — which generate their own array of consequences.

More broadly, these shifts have exposed fractures in regional and international blocs like the EU and the Arab League. In other places, like China and Japan, populist or nationalist government sentiment has seen military buildups.

The Outlook for the Future

What next for *Vox Populi* risk? Although the modest economic recovery could blunt further intensification of support for radical and populist political parties or large-scale mass protests, we expect the continuation of volatile public opinion, pressure on policymakers, and demand for political alternatives to endure.

With such variable economic and governance indicators between countries experiencing unrest over the past two years, there is considerable difficulty in establishing key variables to anticipate *Vox Populi* risk. The academic literature supports the notion that economic downturns, high and rising inflation and fiscal contractions — typically not merely the presence of one alone, but often the whole group of indicators — subject states to extreme pressure.

With such pressure comes increased risk of instability. Another factor commonly cited by scholars is longstanding or ageing leadership. Certainly the key Arab Spring countries all had in common the presence of longstanding leaders: 12 years in Yemen, 24 years in Tunisia, 30 years in Egypt, and 42 years in Libya. Also relevant are political and socio-economic indicators, such as the presence of an election year, worsening infant mortality, recent coup activity or unrest, and ongoing instability either at home or in neighboring states. It's often said that instability breeds instability.[13]

In our analysis, we highlight the importance of surprise when it comes to VPR events that can affect markets; looking at our VPR event tracker, markets have been caught off guard by a significant proportion of VPR events, suggesting that the longstanding disconnect between politics and markets continues.

States that mitigate or weather unrest tend to have the support of broad-based coalitions and/or social cohesion, a strong fiscal position to support public expenditure, either through tax revenue or resource royalties; the presence of independent institutions, and support from international actors, whether diplomatic, financial or military. [14] The presence of many of the sources of stability could help explain the somewhat counterintuitive absence of major incidence of social unrest in the austerity-wracked eurozone periphery.

States that experience more acute incidence of *Vox Populi* risk tend to exhibit the opposite: deteriorating ties to traditional domestic allies, a weakening fiscal base, and/or an erosion of regional or international support.

Between 2014 and 2016, another major election cycle will take place, with polls in Belgium, Brazil, Hungary, India, Indonesia, Lebanon, Portugal, Romania, South Africa, Sweden, Thailand, Turkey and the United States, as well as for the European Parliament, among others. Several of these already grapple with *Vox Populi* risk. Again, history suggests that the re-emergence of protest in the run-up to elections is likely — though a change in leadership may not necessarily be.

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[13] See, for example, Jack Goldstone et al. "A Global Model for Forecasting Political Instability." *American Journal of Political Science*, 54 (1), January 2010. Jonathan Powell. "Determinants of the Attempting and Outcome of Coups d'etat." *Journal of Conflict Resolution*, 56 (6), 2012. Jay Ulfelder. "Assessing Coup Risk in 2012." Blog post. January 30, 2012.

[14] Adapted from Sean Yom and F. Gregory Gause III. "Resilient Royals: How Arab Monarchies Hang On." *Journal of Democracy*, 23 (4), October 2012.

Figure 31. What Lies Ahead: Major-Market Elections for 2014-2016

2014	2015	2016
Brazil	Argentina	Australia
European Parliament	Canada	Croatia
France (municipals)	Denmark	Ireland
India	Mexico (legislative)	Japan (Upper House)
Indonesia	Nigeria	Mexico
South Africa	Poland	Russia (legislative)
Spain (Catalonia)	Portugal	South Korea
Turkey (local, presidential)	Spain	Taiwan
United Kingdom (Scotland)	Turkey	United States
United States	United Kingdom	

Source: Citi Research

It has been suggested that democracy is in decline in the aftermath of the global financial crisis. Certainly voter participation rates have been on a steady decline for decades, especially among the young. Yet the public demand for political alternatives, the spike in protest activity and the flexibility found in the world's democracies refute that point. Demand for participatory democracy shows no signs of slowing, nor do the pressures and opportunities of globalization. We think it will be the ability of leaders to respond to public concerns while anticipating the shifts in the global system that will largely determine the shape of things to come.

Appendix: *Vox Populi* Events in DM and EM Since 2001

Figure 32. Appendix: *Vox Populi* Events in Developed and Emerging Markets, January 2011-April 2014

Country	DM/EM	Date	Event	Catalyst/Outcome	*Vox Populi* Risk
Australia	DM	September-13	Federal election	Tony Abbott's Coalition defeats Kevin Rudd's Labor	Low
Austria	DM	September-13	Federal election	SPO/Faymann re-elected, NEAPs Stronach and NEOS enter parliament	Mid
Belgium	DM	none			
Brazil	EM	July-13	Mass protest	Salad Revolution	High
Canada	DM	May-11	Federal election	Conservatives/Harper re-elected	Low
Canada	DM	May-12	Mass protest	Student protest in Quebec, fall of Charest's Liberal government, election of PQ	Low
China	EM	February-11	Mass protest	Pro-democracy protests following Arab Spring	Low
China	EM	November-12	Leadership handover	Xi Jinping becomes paramount leader	Low
Colombia	EM	November-11	Mass protest	Student protests	Low
Colombia	EM	August-13	Mass protest	Agricultural protests	Low
Colombia	EM	December-13	Mass protest	Protests in support of deposed Bogota mayor	Low
Czech Republic	EM	October-13	General election	CSSD defeats TOP/Civic Democrats, rise of ANO	Mid
Denmark	DM	September-11	General election	Thorning-Schmidt's Red Coalition defeats Rasmussen/Venstre	Low
Egypt	EM	January-11	Mass protest	Mubarak deposed after mass demonstrations	High
Egypt	EM	March-11	Referendum	Post-Mubarak constitutional changes pass	Low
Egypt	EM	January-12	Parliamentary election	FJP wins majority in Shura Council	Low
Egypt	EM	May-12	Presidential election	Morsi defeats Shafik	Low
Egypt	EM	December-12	Referendum	Morsi-backed constitution passes	Low
Egypt	EM	December-12	Parliamentary election	Islamists take control	Low
Egypt	EM	July-13	Mass protest, coup	Morsi deposed, government crackdown on Muslim Brotherhood	High
Egypt	EM	January-14	Referendum	Sisi-backed constitution passes	Low
Finland	DM	April-11	General election	Katainen elected, rise of True Finns	Mid
France	DM	April-12	Presidential election	Hollande defeats Sarkozy	Low
France	DM	June-12	Legislative election	Socialists and allies defeat UMP and allies	Low
Germany	DM	September-13	Federal election	Merkel re-elected, grand coalition with SDP	Low
Greece	EM	May-10	Mass protest	Anti-austerity protests	High
Greece	EM	May-12	General election	Hung parliament, rise of Syriza and Golden dawn, collapse of PASOK	High
Greece	EM	June-12	General election	Samaras's ND defeats Tsipras's Syriza	Mid
Hong Kong	DM	none			
Hungary	EM	none			
India	EM	April-11	Mass protest	Anti-corruption protests	Mid
India	EM	January-13	Mass protest	Anti-rape protests	Mid
Indonesia	EM	June-13	Mass protest	Fuel price protests	Mid
Ireland	DM	February-11	General election	Enda Kenny's Fine Gael defeats Fianna Fail	Low
Israel	DM	July-11	Mass protest	Economic protests	Mid
Israel	DM	January-13	General election	Netanyahu re-elected, new coalition with Yesh Atid	Mid
Italy	DM	February-13	General election	Hung parliament, rise of Five Star Movement, Letta cross-party government	High
Italy	DM	November-13	Mass protest	Pitchfork protests	Mid
Japan	DM	December-12	General election	Abe's LDP defeats DPJ	Low
Japan	DM	July-13	Election	Abe's LDP and allies take control of Upper House	Low
Korea	EM	December-12	General election	Park Gyun-hee elected	Low
Malaysia	EM	May-13	General election	UMNO re-elected	Low
Mexico	EM	July-12	General election	Pena Nieto/PRI defeats Vazquez Mota/PAN	Low
Mexico	EM	December-13	Mass protest	Anti-Pact for Mexico protests	Low
Netherlands	DM	September-12	General election	Rutte re-election, new coalition with Labour, brief rise of Socialist Party	Mid
New Zealand	DM	November-11	General election	Key's National Party re-elected	Low
Norway	DM	September-13	General election	Solberg's Conservatives defeat Stoltenberg's Labour, Progress Party enters coalition	Mid
Peru	EM	April-11	General election	Ollanta Humala elected	Low
Philippines	EM	May-13	General election	Aquino's Liberals and allies gain seats	Low
Poland	EM	October-11	General election	Tusk's PO re-elected	Low
Poland	EM	September-13	Mass protest	Anti-government protests led by opposition	Low
Portugal	DM	June-11	General election	Passos Coelho's Social Democrats defeat Socrates's Socialists	Low
Portugal	DM	March-13	Mass protest	Anti-austerity protests	Mid
Russia	EM	December-11	General election	United Russia wins Duma election	Low
Russia	EM	December-11	Mass protest	Pro-democracy protests	Low
Russia	EM	March-12	General election	Putin elected to third term	Low
Russia	EM	February-14	Military intervention	Russian intervention in Crimea	High
Singapore	DM	May-11	General election	People's Action Party re-elected	Low

South Africa	EM	August-12	Mass protest	Marikana labor unrest	Mid
Spain	DM	May-11	Mass protest	Indignado Movement	Low
Spain	DM	September-12	Mass protest	Catalan National Day protest 2012	Mid
Spain	DM	November-12	Election	Catalonian election, Artur Mas re-elected on sovereignty platform	Mid
Spain	DM	September-13	Mass protest	Catalan National Day protest 2013	Mid
Sweden	DM	none			
Switzerland	DM	October-11	General election	All-party coalition continues	Low
Switzerland	DM	February-14	Referendum	Immigration referendum	Low
Taiwan	EM	January-12	General election	Ma Ying-jeou/Kuomintang elected	Low
Thailand	EM	July-11	General election	Yingluck Shinawatra's PTP defeats Vejjajiva's Democrat Party	Low
Thailand	EM	October-13	Mass protest	Anti-Shinawatra protests	High
Turkey	EM	June-11	General election	General election, AKP re-elected	Low
Turkey	EM	May-13	Mass protest	Gezi Park protests	High
United Kingdom	DM	none			
United States	DM	September-11	Mass protest	Occupy Wall Street protests	Low
United States	DM	November-12	Federal election	Obama re-elected, divided Congress	Low

Source: Citi Research

Notes

IMPORTANT DISCLOSURES

NOW / NEXT

Key Insights regarding the future of *Vox Populi* risk

GLOBAL REACH

Protest movements have had a significant impact on the global landscape in the past however the short term impact of these movements to the economy and the investment environment was mainly domestic as news traveled slowly. / The Internet and social media has increased the speed with which information is sent and digested, creating "flash mob" democracy and greater awareness of global events.

POLICY

Mainstream political parties became the dominant parties past World War 2 with clearly defined definitions and constituents. / The rise of new, emerging and alternative parties with "anti" sentiments is creating gridlock in many governments which ultimately hinders economic growth.

SHIFTING WEALTH

Thanks to rapid emerging market economic growth, global income inequality across countries has decreased significantly, raising world incomes and reducing poverty. / Income inequality within individual societies has shot up with parents now fearing their children will be worse off than they are themselves as an aging population uses their voting strength to block cuts to public resources such as retirement and healthcare.