Longview Global Advisors

# The Long View 2019: Issues to Watch, Questions to Ask

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## Intoduction

As 2018 comes to a close, one of its striking characteristics is the head-spinning pace of developments in domestic and international affairs. Another is the rising sense that political risks could blow the global economy off course. One year ago, growth was occurring everywhere, and business forecasts were the rosiest in years. While there were plenty of political risks in 2018—US-China relations, Brexit, NAFTA, North Korea, Saudi Arabia, Iran, and pivotal elections in Italy, Mexico, Brazil, and the US—market sentiment sailed past them. Now, however, global growth is moderating, markets across the board are falling, and the world feels tense.

At the outset of 2018, Longview Global Advisors invested in and formed a strategic alliance with GlobalWonks, a technology start-up that provides online access to 1,500 social science and business intelligence experts located in over 100 countries around the world. In December, we queried the network about issues to watch in 2019. This outlook includes many of those findings.

This fast-moving and complex dynamic makes it difficult to form a view of the future. As such, this brief reviews developments over the last year and uses conceptual frameworks to suggest how the year ahead may unfold.

## China-US: "Cold War II"

Over the past 30 years, the West, and America in particular, has equated China with business opportunity. This attitude fueled China's globalization and economic development, and in the process, China evolved from an emerging market into a superpower—one that dominates Asia and shapes global goods and capital flows, technology development, and, even, the climate. Lately, China has come to be seen not as an opportunity but as a threat. This shift in perception was the dominant geopolitical development in 2018, and it is going to shape the global business environment in 2019 and for many years, perhaps decades, to come.

At the start of 2018, US-China tensions were framed as a trade dispute. US tariffs were aimed at rebalancing trade in manufactures between the two countries, with opponents of the measures arguing that tariffs were bad for costs, supply chains, and consumers. Since then, the field of play has quickly expanded, and there is much more at stake. In remarks to the US Senate in March, Admiral Philip Davidson, the commander of the US Indo-Pacific Command, asserted that China's navy was "capable of controlling the South China Sea in all scenarios short of war." Around the same time, Defense Secretary Jim Mattis signed off on a new National Defense Strategy that labeled China a "strategic competitor" that uses "predatory economics" and is "undermining the international order from within the system by exploiting its benefits while simultaneously undercutting its principles." Treasury Secretary Steven Mnuchin has also been using his platform to warn countries against accepting Beijing's Belt and Road ▶

infrastructure projects lest they get trapped in crushing debt spirals that lead to Chinese asset-stripping. The business media, too, has shifted from lamenting the risks to free trade by a misguided White House to breathless investigative reports about China's cheating on trade, use of prison labor, cyberwarfare, and technology and data theft. In this worldview, costs and consumers have become secondary concerns.

The changing China narrative in 2018 is reminiscent of the situation in 1946, when the perception of the Soviet Union quickly shifted from one of an exhausted World War II ally to one of a menacing bear that was sponsoring antidemocratic insurgencies and drawing an Iron Curtain across Europe. Washington's response to the Soviet "menace" was halting and haphazard at first, but it developed into a comprehensive strategy of military, economic, and ideological containment backed by a network of alliances.

The Trump administration's approach to China has been to barrage Beijing on a number of fronts. Beijing had hoped that President Donald Trump's wings would be clipped with Democratic victories in the US midterms. That hope was misplaced, as China has become a bipartisan threat. Both Democrats and Republicans have broadly concluded that the US needs to adopt firm measures to rebalance economic, geopolitical, and technological relations. And while the White House has been stymied on many policy fronts and threatened by investigations, it has found that being tough on China is a winning political formula. As the US gears up for the 2020 presidential election, Democrats are going to be tripping over themselves to show that they can be even tougher. Finally, the EU and Japan, despite their frustrations with the White House, are quietly aligning with Washington to confront Beijing on trade, investment, and technology policy. Even as US markets stumble, the White House still feels it has momentum. As with North Korea, claims of rapprochements will likely be rhetorical.

*Box: The significance of slowing growth*

In the fourth quarter of 2018, a consensus emerged among economists that global output is slowing and downside risks are accumulating. Slowing growth in China, and the US are the key drivers. For instance, Goldman Sachs in November forecast that global growth would slip from 3.8% in 2018 to 3.5% in 2019 and continue slowing in 2020. There is no consensus, however, on how to interpret this trend.

A key question is whether the moderation underway is to be expected (given the aging economic cycle and the withdrawal of monetary stimulus) or a sign of emerging vulnerabilities. The unusually broad fall in asset prices seen in the fourth quarter of 2018 could be a welcome correction from past market exuberance, and rising risk perceptions could lead to a reduction in the massive debt load that has accumulated. On the other hand, rising US interest rates and tighter liquidity could trigger debt crises in the corporate sector as well as key markets such as Italy, Turkey, and Argentina. Another risk factor is that central banks and governments remain extended from the 2008 global financial crisis, and their ability to intervene and coordinate policy will be constrained.

The nascent US-China cold war, Brexit, and technology and country-level risks complicate the 2019 economic and business narrative.

On the other side of the equation, President Xi Jinping has consolidated his hold on the leadership and is using nationalism to boost support for the Communist Party. His signature goal is to make China great again and he said that his country won't succumb to American "bullying." Discussions to defuse the conflict have been episodic. In December, following a ▶

dinner meeting of the two presidents, Beijing offered to dial back tariffs on American autos and indicated that it was prepared to resume agricultural purchases from the US. Reports also emerged that the government was going to rework the Made in China 2025 strategy, which aims for supremacy in critical technologies. Beijing has also been adjusting the formula of its Belt and Road Initiative. But these recalibrations are likely to be largely cosmetic and certainly will not meet the aggressive economic containment objectives the White House has laid out. Beijing has also made clear that it will not be deterred from pursuing its long-term economic and geostrategic ambitions.

During the Cold War, US trade with the Soviet Union was minimal: In a landmark deal, Stolichnaya was bartered for Pepsi cola. But the US and China have the world's deepest trade and investment relationship, and despite the political science school of thought that argues that trading nations do not go to war, international businesses and investors are getting caught in crossfire between the two countries.

> Presidents Xi and Trump have pledged to make their respective countries great again. China-US relations are likely to get worse before they get better, and business leaders on both sides of the Pacific will have to adjust to the new geopolitical context.

Business leaders on both sides of the Pacific will have to adjust to the new geopolitical context. Mergers and acquisitions that involve Chinese firms or investors will be subject to more wide-ranging national security reviews and exposed to more seemingly random political interventions. Restrictions on the sale of technologies that have potential national security applications will expand. Anti-corruption, tax, public procurement, and other rules will be also rolled in to bolster national defenses. Chinese investors, tourists, and students will be told to avoid the US, and their American counterparts in China will face increased scrutiny and restrictions. US products and firms will be subject to social media–fueled boycotts in China, and "Made in China" could become a tainted tag. Trust, the basis of all business relationships, will erode.

The ability of the Chinese or American business communities to shape the relationship is limited. When NAFTA was at risk, Canadian and Mexican business leaders engaged their counterparts in the US to lobby for the continuation of free trade. Presently, the American and European business communities are jointly rallying to preserve free trade between the US and EU. The Chinese business community does not have such friendships: Foreign businesses and investors have complained for years about an unequal playing field and strategic threats when operating in China. And, presidents Trump and Xi have placed a premium on national identity and on securing the support of their respective business communities. In short, China-US relations are likely to get worse before they get better.

### Brexit: Where is the UK headed?

Prime Minister Theresa May came to power following the 2016 Brexit referendum saying that she was battle-tested and the right person to deliver the will of the people. Alas, her performance has crushed any confidence in her ability to lead the nation and see it through its most important policy challenge. There are many complaints about her performance, but May's predicament reflects that of the nation: Hubris about having cake and eating it too has succumbed to the reality that the UK has no leverage in the divorce. ▶

Because it has taken so long for the UK to come to terms with the EU, negotiators have essentially agreed to a transition deal that preserves the status quo until at least the end of 2020, with an uncertain relationship expected to emerge thereafter. In effect, May has arrived at a very soft Brexit. But Dublin and Brussels are also insisting on a border-free Ireland, and the presumed weakening of the relationship between Northern Ireland and Great Britain—plus the lack of a clean break with the EU—has thrown the British parliament into political paralysis.

Accordingly, Brexit remains one of the most tangible global risks heading into 2019. With the clock ticking down to March 29, three broad paths stand before the nation: crash-out, deferral, or cancellation. The May government has said it will not try to pass its unpopular deal until mid-January, and by then Brexit will only be 10 weeks away. As policymakers argue, companies will start panicking about their supply chains because customs and border inspection wait times are expected to surge from minutes to days, health providers will fret about acute shortages of medical supplies, and travelers will be warned against plans to venture abroad. Facing a growing prospect of economic paralysis, parliament may succumb to May's transition deal. Brussels has a reputation for last-minute fixes, and to avoid the worst effects of a crash-out, the EU, too, will offer last-minute deferrals to avoid near-term disruption.

> Brexit remains one of the most tangible global risks heading into 2019. The UK is not only facing a potential "no-deal" crash-out of the EU on March 29, it may not have the leadership to manage the situation. Even if an exit crisis is averted, the country will remain deeply divided over the right course for the future.

Many Brits remain hopeful that Brexit will be cancelled—most likely through a second referendum. In a significant ruling, the European Court of Justice in December said that such a move would be permissible. In a November survey of UK voters, 54 percent of respondents said they would vote to remain in the EU. Calling off Brexit would eliminate tremendous economic uncertainty and adjustment costs for business, investors, and workers, but it would not solve the UK's profound political problem: The 46 percent who still want Brexit would be deeply dismayed and angry at their politicians for failing to pull it off. The Conservative Party is already pulling itself apart over Brexit, and the abandonment of its signature policy could lead to the election of a hard-left Labour government, which would likely bring its own style of political chaos and economic destruction.

While the economic risks of Brexit for the EU are more diffuse, there are significant political risks. The specter of Brexit gave rise to a surprising degree of consensus among the remaining 27 EU member states, in part because of the bloc's vexation with Britain's ambivalence to EU integration over the past four decades. By ridding itself of a pesky UK, Brussels could focus on the EU's pressing existential problems: slow growth, border security, common defense, fiscal integration, and rising nationalism. A drawn-out Brexit or outright cancellation will extend the diversion risks for Brussels and which could ultimately contribute to crashing the EU. In any event, should the UK remain in the EU, its political clout will be greatly diminished.

The bigger picture is that although the British have asserted that they are not European, the people and their political leaders have no clear vision of what they want their country to be in the 21st century. The UK faced down a referendum on Scottish succession in 2014, and Northern Ireland's ties with Great Britain look more tenuous than ever. Given the political mess, Brits may take a cue from France and hit the streets in violent protest (egged on, of course, by Moscow). The country's reputation for maintaining a stiff upper lip and muddling through will be put to the test in 2019. ▶

## Innovation: Technology becomes politicized

Breathtaking technological advances will again be a dominant theme in 2019. For example, the rollout of 5G wireless networks will allow for further development of the internet of things, mobile commerce, and autonomous vehicles. 5G also will create profound economic leapfrogging opportunities, especially for emerging and frontier markets. But just as important, the technology narrative is bifurcating: Businesses and investors are focused on opportunity and transformation while citizens and governments are increasingly focused on risks and information control.

Technology companies set out to develop so fast that they will disrupt others, including governments, before they get disrupted, but governments are poised to put the brakes on tech companies in 2019. Technoskepticism in Europe will intensify on several fronts in the coming year, particularly over enforcing the General Data Protection Regulation and antitrust measures as well as curtailing profit shifting and tax base erosion. Technoskeptic urges in the US are clearly on the rise, though the divided government will slow developments.

> It used to thought that technology had no borders and that all could benefit from the information revolution. Instead, technology and data are the new playing field of geopolitics. Business leaders will have to pay more attention to technology policy and risks.

Perhaps the most significant issue in 2019 will be how debates on technology are confounded by geopolitics. Countering Russian interference in elections and political movements and restricting Chinese technological and intellectual property encroachment will continue to gain in importance. While tech companies will be promoting the borderless cloud, governments will be trying to draw national boundaries around critical data flows and technologies that are deemed essential to national security. Finally, cybercrime will evolve into cyberwar and businesses will find that attacks on their data systems and operations will not only be an economic threat, but also an everyday tool used by state and non-state actors for geopolitical advantage.

## The Rest of the World: Idiosyncratic or systemic risks?

Many of the countries to watch in 2018 are on the list again in 2019. These include Mexico, Brazil, the US, France, North Korea, Saudi Arabia, and Iran. There will be a number of important elections to watch in the coming year as well (see elections table, next page). While many of the issues at hand are domestic, they also have significant cross-border implications. Moreover, in-country developments are likely to be impacted by the global issues outlined above.

Although political risks did not appreciably impact global market sentiment in 2018, as the year comes to a close, the global risk narrative has rapidly evolved and become more sensitized to individual developments. An overarching issue to watch in the coming months is whether country-specific or “idiosyncratic” risks materialize and align to have systemic effects that depress global business and investor sentiment and economic growth. Conversely, could blaring headlines lead to an overreaction in the markets?

### *EU*

Observers in Europe almost universally have a negative view of macro trends in their region. A looming Brexit and the upcoming European Parliament elections are the two most dominant concerns. If euroskeptic forces gain a significant number of seats in the European Parliament, it could crack the bloc’s core commitment to the freedom movement and slow progress on pressing issues such as immigration, defense and security, and fiscal policy. The global economic slowdown will only add to Europe’s woes. ▶

Developments in the EU's two most important countries bear watching. In Germany, the emergence of Annegret Kramp-Karrenbauer (dubbed "mini Merkel") as the leader of the ruling conservative party and potential successor to Chancellor Angela Merkel is a positive sign for pragmatic policy and predictability. In contrast, France suddenly looks ungovernable. It is not clear whether Emmanuel Macron will be able to continue his reform course, especially the pension reform, given social tensions and his decreasing popularity. And his predicament could kindle the resurgence of the nationalist right in 2019.

In the longer term, the integrity of the EU remains an open question. After Brexit, the bloc is facing significant governance challenges from Poland, Hungary, and Italy. An inability to manage its borders and flows of economic migrants and refugees from Africa and the Middle East could reverse Europe's grand integration project. For Moscow, breaking EU cohesion is a top geopolitical priority, and cyberwarfare has been its most effective weapon.

*Table: Key elections to watch in 2019*

| Region | Timing | Significance |
|---|---|---|
| Nigeria | February | An unpopular incumbent could be voted out. Security, energy, and infrastructure deals will be in question. Anti-corruption efforts could take a back seat. |
| Ukraine | March | Election politics could amplify territorial disputes with Russia. |
| Indonesia | April | Nationalist and populist pressures are diverting attention from growth and business policy priorities. |
| India | April/May | A test of the Modi government after recent state-level electoral setbacks. Nationalist pressures on economic policy could rise. |
| EU | May | Sets tone for the next European Commission. A surge by euroskeptics would complicate EU-level policymaking on immigration, fiscal policy, and defense and security. |
| South Africa | By August | A test of the unity of the ruling African National Congress. This will affect state-owned enterprise reform and anti-corruption efforts. Union activity will be an important signpost. |
| Argentina | October | A test of the pro-business Macri government following the country's 2018 economic crisis and sharp budget cuts. Leftist populists could come roaring back. |
| Canada | October | The Trudeau government will be seeking another mandate to protect the environment and fight inequality. The vote will be a referendum on polarization and populism. |
| UK | If called | A Brexit crash-out could precipitate an economic and political crisis with splits in the main parties. A hard-left Labour government could emerge. |

*Source:* GlobalWonks, December 2018.

### *Ukraine*

War in Ukraine has reemerged as a potentially high-impact risk in 2019. Ukraine has a general election in March, and Russia is reportedly massing military forces on Ukraine's border—perhaps in a bid to create a political crisis and provoke Ukrainian President Petro Poroshenko to postpone the vote. The government in Kiev could move to escalate the conflict for domestic political ▶

benefit, and Russia, having seen no reprisal after its blocking of the Kerch Strait in December, could retaliate. Another major advance into Ukraine by Russia would add stress to a Europe preoccupied with Brexit, but it likely would result in hard-hitting sectoral sanctions by the EU and the US, resulting in widespread damage to businesses in and trade with Russia.

### *Mexico*

Mexico's outlook remains TBD. In July, Andres Manuel Lopez Obrador (AMLO) won Mexico's presidency with a resounding mandate for change from the country's voters. AMLO took office on December 1 but has yet to produce a policy agenda that is clear or coherent. Corruption, gangs, drug cartels, and a record homicide rate (four times that of the US) were major electoral issues, but addressing this will be a slow and exacting process that is likely to disappoint. So far, AMLO has vacillated between working with and around powerful state governments address these challenges. Other key themes in his campaign agenda represent a potentially significant shift from the last 30 years of northern- and export-oriented economic strategy, namely themes on combatting widespread poverty and promoting equitable growth by allocating more resources to rural areas (especially in the south), boosting social subsidies and the minimum wage, and improving infrastructure and public services. Finally, a nationalist AMLO is going to need to find ways to cooperate with a nationalist Trump on issues such as Central American migrants, border security, and narcotrafficking. The coming year will prove whether his five-year presidency is pivotal or just more of the same.

The US-Mexico-Canada Agreement (USMCA) is likely to be ratified in 2019, but the process will be noisy and drawn out, as the new Democratic majority in the US House of Representatives will have to approve an implementation plan. Sealing the deal is a White House priority, and Trump has added urgency by threatening to pull out of NAFTA if the USMCA gets bogged down. Legislators will want to avoid this, so any changes are likely to be at the margins (such as changes on labor provisions).

### *Brazil*

Brazil's President-elect Jair Bolsonaro takes office on January 1, and, as in Mexico, his honeymoon year will prove whether his presidency is pivotal or ineffective. Bolsonaro's weak record as a legislator raises big questions about his leadership potential. Nevertheless, investors are bullish and betting his team of pro-market advisors is going to implement major reforms, including trimming pensions and labor rights, privatizing critical industries, limiting government intervention in state-owned enterprises, reducing wasteful spending, and cutting red tape and taxes. But he will face considerable pushback in congress. Bolsonaro built his candidacy with authoritarian populist appeals, and businesses should be prepared for greater social and political volatility as well as resistance from organized labor. Slowing global growth and troubles in neighboring Argentina and Venezuela will hamper his economic turnaround efforts.

### *Venezuela*

Will 2019 be the year that Chavismo rolls off the cliff? Despite economic chaos, the government of President Nicolas Maduro has demonstrated its ability to stay in power. Pressure may come from abroad in 2019. As hundreds of thousands of refugees cross the border, Venezuela's neighbors may converge on the position that Maduro must go. The demise of the ruling regime would send a powerful message across the region about the failures of leftist populism, but Venezuela is deeply divided politically and any successor government will struggle to knit the economy and its political factions together again. There will be no quick fix. ▶

### *Saudi Arabia*

Risk aversion will be the dominant theme regarding Saudi Arabia in 2019. The performance of Crown Prince Mohammad bin Salman (MBS) has been disastrous. The lurid allegations around the assassination of Jamal Khashoggi have destroyed MBS's image as a modern and innovative reformer. In addition, MBS led Saudi Arabia's charge into the calamitous Yemen civil war, which is now drawing scrutiny in the US and Europe. He has also failed to achieve Saudi objectives in Syria and he has championed the blockade of neighboring Qatar, which has riven the Gulf Cooperation Council and precipitated Qatar's exit from OPEC. Finally, his Vision 2030 modernization plan has achieved little, the limited privatization of Saudi Aramco has been postponed indefinitely, and weak oil prices will rob the initiative of needed resources. Most observers, however, do not foresee a change in the kingdom's line of succession in the near future.

### *India*

The government of Prime Minister Narendra Modi has been pursuing an ambitious policy agenda that includes the promotion of manufacturing and exports, the improvement of infrastructure, the fight against corruption and red tape, and the bolstering of India's military and geopolitical stature. Despite modest success and several notable missteps, Modi and his Bharatiya Janata Party are likely to succeed in a crucial general election scheduled for the spring and remain in power until 2024. As China's economy slows and perceptions of China as a threat grow, India will rise in global stature. The IMF believes India's economy will grow by 7.4 percent in 2019—1.2 percentage points above expectations for China.

### *North Korea*

North Korea remains a low-probability but high-impact risk in 2019. The US's demand that the country denuclearize is a nonstarter for Pyongyang (and its erstwhile allies in Beijing and Moscow). Kim Jung Un views a nuclear capability and the capacity to deliver nuclear weapons to US territory as the ultimate guarantor against external threats—something his country has faced since its founding. That the US and South Korea started talking with North Korea is a substantial improvement in relations from one year ago, when a military conflict looked possible. Nevertheless, the White House's signals of its intent in 2019 are confusing—the intelligence community is warning that North Korea's nuclear and missile development programs are moving forward while Trump says everything is okay. Meanwhile, North Korean cyberattacks continue daily. And as the US-China superpower conflict heats up, Beijing could spoil Washington's quixotic peace efforts. ■