

# CROSSROADS

*At the Intersection of Geopolitics and Geoeconomics*

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Here are some critical issues to watch around the globe over the coming month:

## North America

- US President Trump has succeeded in one of his major goals: renegotiating NAFTA, now known as USMCA. USMCA is a standard modern trade agreement requiring a higher minimum wage in certain industries to reduce the advantages of labor-abundant states and strengthening intellectual property rights. One unique aspect of USMCA is that it is subject to review by all three states every six years and can expire a decade after review if a single party wants it terminated. The termination provision is likely to prevent Canada or Mexico from pulling away from the US and toward China. However, it does also create vulnerabilities for the US that could be exploited in the future.
- Global equities declined substantially in October. Gains have largely been eliminated for the year, indexes are in correction territory, and several S&P sectors have declined 10-15% in the last three months. On October 26<sup>th</sup> the S&P 500 and Nasdaq Composite Indexes joined the small-cap US benchmarks in correction territory (down more than 10% from recent peaks). The narrowly focused Dow Jones Industrial Average avoided a correction and held up best, but the Nasdaq was the sole major US benchmark still ahead for the year.
- The INF Treaty was designed to limit missiles with ranges between 300 - 3,400 miles. The Trump Administration has rightly pointed out that Russia has been in violation of the treaty since 2014. NATO has warned that Russia is creating a missile that will be able to hit our allies with little to no warning. For its part, Russia asserts that the US is itself in violation of the treaty. While tempting, the urge to scrap the INF Treaty is misguided and would lead to the creation of more nuclear weapons by both Russia and the US. If the US begins revamping its nuclear arsenal it will further delegitimize its standing with regard to non-proliferation in North Korea and Iran.

## Europe

- In a first, the EU rejected the Italian budget for not sufficiently addressing the deficit or reducing the debt. The government in Italy has said they will not be swayed by concerns within the EU and will

proceed with tax cuts and spending increases. This episode will only serve to further widen the growing divide between the EU and populist governments.

- British Prime Minister Theresa May has declared an end to austerity. The Chancellor of the Exchequer, Philip Hammond, has only agreed to fiscal stimulus plans if there is an agreement on a Brexit deal. In the wake of no deal, he has stated that there will need to be continued austerity. This forces a collision between Hammond and Brexiteers as the specter of a no-deal Brexit looms large. This clash comes on the heels of new movements to replace Theresa May with Boris Johnson as Prime Minister and Leader of the Conservative Party.
- In contrast to the flailing Italian fiscal situation, Spain has put forth a budget which achieves its progressive agenda and meets the minimum standards of EU fiscal rules. The Spanish government is targeting a budget deficit of 1.3% of GDP. The gaps in the budget will be sealed by increased taxes on wealthy individuals and corporations. The most ambitious policy measure is a 22% increase of the minimum wage. The goals of such policy measures are admirable, but the effect of a major increase in both taxes and wages on companies could stall the struggling economy.
- German Chancellor Angela Merkel announced that she will be stepping down as leader of the Christian Democratic Union and will not seek the chancellorship in 2021. This comes at a point when the popularity of Chancellor Merkel has plummeted and the two parties within her coalition suffered severe electoral losses. It is likely that Merkel's replacement will move away from the international approach of Merkel and begin to turn inward. Countries used to a willing partner in Berlin may have to look elsewhere for support or leadership.

## Asia-Pacific

- The 13<sup>th</sup> annual summit between Japan and India is likely to focus on closer strategic cooperation between the two major naval powers as well as joint connectivity and infrastructure projects. The two leaders are expected to issue a joint statement about their intentions for pursuing a free and open Indo-Pacific area in cooperation with the US. This summit and subsequent statement signify the two

countries' cooperation to counter China's growing regional influence and counter possible protectionism.

- The summit between President Xi Jinping and Prime Minister Abe and China signifies a historic turning point in Japan-China bilateral relations. The two countries signed a currency swap arrangement to strengthen financial stability and cooperation in trade and finance. Japan remains wary of China's growing regional power but with US tariffs biting both the Chinese and Japanese economy, the two countries are pushing for stronger financial and economic ties.

### Middle East

- The Kingdom of Saudi Arabia is facing increasing criticism for the death of Jamal Khashoggi, a Saudi journalist with the Washington Post who was critical of the regime. The Saudi government has conceded that individuals associated with the Saudi government ordered Khashoggi's murder. Pressure is mounting on President Trump to retaliate against Saudi Arabia, and others in the international community have been highly critical of Mohammad bin Salman.
- The Turkish lira has risen to its strongest point in three months as the Turkish Central Bank has capitulated to pressure and raised interest rates, and the finance minister has put forth a plan that will rebalance the economy and confront inflation. This also comes on the heel of an ease in diplomatic tensions between Turkey and the US with the release of an American pastor.
- In anticipation of US sanctions on Iran, China has reduced its imports of Iranian oil. China has been the largest consumer of Iranian oil, and their move to cut consumption grants the US greater leverage in the coming sanction regime. The US sanctions on Iran are also the beneficiary of renewed calls by Saudi Arabia to increase minimum barrels of oil produced a day (likely to mitigate pressure from the Khashoggi murder).

### South America

- Far-right candidate Jair Bolsonaro won the runoff election to become the next President of Brazil, adding to the global movement towards populism. The Brazilian economy is still recovering from its worst recession in decades and Bolsonaro campaigned heavily against the growing debt and slow growth that resulted from the leadership of his opposition. Supporters of Bolsonaro are hoping that

his policies will lead to a more open Brazilian economy through trade agreements and lower import tariffs, but many fear that his nationalistic agenda will prevent significant progress.

- The IMF approved a \$56bn loan for Argentina to stabilize the country's troubled economy. The approval follows the passage of an unpopular austerity budget through Argentina's lower house which was designed to meet the IMF's requirement for a bailout. To meet the requirements, Argentine President Mauricio Macri vowed to cut \$10bn in health, education, public works, etc. With this loan, the IMF has committed to lend the largest amount of money in its history. If the loan program fails, an outcome that experts are projecting as most likely, Argentina may be forced to default on its loans including those from the IMF.
- to reach an agreement with protesters.

### Sub-Saharan Africa

- Mozambique turned down a plan for debt restructuring following the discovery of \$2bn worth of hidden debts in 2016. The offer, submitted by creditors like Credit Suisse, proposed to swap the loans into new debt that would tie interest payments to Mozambique's future economic performance. Mozambique's refusal to accept debt restructuring further fuels the likelihood that the country is waiting until it can raise enough tax revenues from its newly discovered natural gas reserves.
- Zimbabwe's currency is losing value at an alarming rate as the country attempts to recover from years of financial instability under former President Mugabe. The devaluation follows a series of austerity measures and a shortage of foreign exchange which led to a massive swell in prices as well as food and fuel shortages. Experts doubt that hyperinflation will reach the levels it did in 2008, but the currency crisis could still have significant effects on the already-fragile economy and confidence in the new government.

### Suggested Readings

[In Merkel, Europe Loses a Leader](#)

*NYTimes Editorial Board*

[The Committee to Save the World Order](#)

Ivo H. Daalder and James M. Lindsay

[The next recession](#)

*The Economist*