

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

- The Fed took its benchmark rate from 2.25% to 2.5%. On top of this hike, Fed officials announced they were reducing the projected number of hikes from three down to two for 2019. It seems that Fed officials are coming to the conclusion that for the current macro-environment the benchmark rate is approaching the neutral level they desire to see.
- Defense Secretary Jim Mattis resigned in protest of President Trump's decision to withdraw American troops from both Syria and Afghanistan. The continuous tremors and declining credibility of the administration will be affecting its effectiveness.
- The US government shut down after President Trump's insistence for wall funding. This is the third government shutdown this year as President Trump doubles down on his unwillingness to negotiate. The Democrats are willing to designate money for border security but not for the Mexican wall border.
- The S&P 500 and Nasdaq Composite are on pace for their worst quarter in seven years, as the stock market has continued its drop. The drop resulted in the worst Christmas Eve performances in history, and, despite having the best day in nearly a decade on Dec. 26th, the stock market exhibits signs of significant volatility due to earnings repricing, lower expectations, a slowdown in growth, the trade tensions with China and the uncertainty surrounding Brexit. Given the significant drops in equity markets, a recent rally that started on December 26th may give some momentum to the market in early 2019.

Europe

- UK Prime Minister Theresa May has survived a tumultuous leadership contest; however, she has pledged that she will not seek another term as Prime Minister. As the clock ticks down, it is becoming clear that the UK is headed for a hard Brexit. The turmoil surrounding Brexit has, and may continue to, place pressure on the pound and British equities, which however have been cheapened enough to start becoming attractive. If the UK does go through a hard Brexit the currency may weaken even further, inflation could spike, unemployment would probably rise, mortgage defaults could increase, and UK equity markets could experience another drop. A

dollar-cost-average approach to British exposure has started looking very attractive.

- In Germany, Annegret Kramp-Karrenbauer, a.k.a. AKK, has been selected as the next leader of the CDU. AKK is considered "business as usual" and was the desired successor of German Chancellor Angela Merkel. AKK's ascension to leadership has calmed many fears about any shift of the CDU further to the right. However, her rise to leadership has done nothing to address concerns about the waning coalition, and it remains to be seen if putting a new face on the same policies will carry the day with the German public. If Germany cannot conquer its internal struggles, that will mean trouble for the EU at large, especially as American leadership becomes increasingly sparse.
- Protests erupted in France over a tax on diesel fuel that was part of an initiative to lower French dependence on fossil fuels. The social unrest was at a high level even by French standards, and police and protesters clashed in the streets. President Macron responded to the episode by reversing the fuel tax and offering tax relief to large portions of the French economy. Many fear that this will push the French deficit over the 3% maximum threshold set by the EU. If the French deficit continues to grow, this could provide the EU with a bit of a conundrum despite the recent settlement for now with Italy over budget deficit issues. Does it trade stability for consistency and hold the feet of the French government to the fire? The Italian and French situations present a unique dilemma that threatens turmoil within the EU and, when combined with Brexit, perhaps the European experiment as a whole.

Asia-Pacific

- According to the National Bureau of Statistics, Chinese industrial companies' profits declined 1.8% in November from a year earlier, down from a 3.6% rise in October. Total profits for December were 86 billion USD. The weak performance of the Chinese economy, primarily due to the US' trade war, will cause slower Chinese economic growth throughout 2019. The decreasing growth will cause a weaker currency and will likely exacerbate the conflict between China and the US. We see little room for

cooperation between the US and China which will further undermine international trade in 2019.

- The Japanese stock market closed the year down. Japan has expanded its defense budget for the twelfth year in a row. A significant amount of this spending will go toward consuming American-produced hardware. The United States has been pressuring Japan to decrease the trade deficit between the two countries; thus, this increased consumption, combined with Japanese rhetoric on containing China, likely means that the US and Japan will move more closely together.

Middle East

- OPEC and its partners agreed in December to cut oil production by 1.2 million barrels a day for the first half of 2019 to prop up prices, with Saudi Arabia planning to absorb a majority of the reductions. However, the cuts were perceived as not high enough – given the over-supply of oil – and prices continued dropping. If OPEC implements further production cuts, oil prices may rise in 2019 and could likely stabilize at around \$65 for Brent and \$57 for WTI, as the global oil oversupply is corrected.
- Qatar announced it will be leaving OPEC in January and shifting its focus to natural gas, which plays a more significant role in the country's economy. Qatar makes up less than 2% of OPEC's total oil production, so it is unlikely that their departure will affect OPEC's role in global oil markets. However, this move likely signals Qatar's decreasing reliance on GCC countries.
- The Turkish lira strengthened against the dollar at its strongest level since early December. In addition, Turkey announced its second drilling platform will begin in the Mediterranean in January in search of oil and gas. The drill will operate within Turkey's Exclusive Economic Zone (EEZ). The announcement follows a declaration by Greek Defense Minister that Athens will declare their own EEZ around a small island one mile off the Turkish coast for gas extraction. Given this potential for conflict and the uncertainty still surrounding the lira, the Eastern Mediterranean Sea could attract some attention in the next few months.

Latin America

- Scrapping the controversial education reforms launched by his predecessor, Mexican President

Andres Manuel Lopez Obrador proposed a new plan to make public education free and eliminate teacher evaluations. Critics of this plan say that the government will not be able to afford such reforms. Bigger-than-expected spending increases or forecasts for a narrower primary budget surplus could prompt renewed declines in the peso. If the new government does not deliver on its promise to cut costs, it could experience capital flight. For at least the first few months of his presidency, we recommend caution regarding Mexican exposure.

- The Russian Ministry of Defense announced its intentions to send two Russian Tu-160's, strategic bombers capable of carrying conventional or nuclear-armed cruise missiles, to Venezuela. While the reason for the transport is unknown, this may signal Russia's inability to provide the actual economic aid that Venezuela needs. Russia's insistence that this is only a temporary measure lends further credibility to the notion that they will not likely offer a lifeline to Maduro.

Sub-Saharan Africa

- Deadly protests sparked by Sudan's disastrous economic situation rallied through its capital in the form of protests. Amnesty International placed the death toll around 37. The economic situation in Sudan is disastrous, as inflation in Sudan has increased to around 70% with citizens facing regular bread and fuel shortages.
- After a significant rise in terror attacks and a rising death toll, Burkina Faso has asked for international assistance to conduct counter-terrorism efforts. More than 250 people have been killed since 2016. Primary attack targets have been government offices and military outposts near the country's borders with both Mali and Niger. Few countries have shown interest in providing direct support, but instability in the region could allow the spread of jihadism from the Sahel all the way into the Gulf of Guinea.

Suggested Reading

[Trump's Tax Cut One Year Later: What Happened?](#)

Jim Tankersley

[The Free-Trade Paradox](#)

Alan S. Blinder

[America's longest-ever expansion will approach its end in 2019](#)

The Economist

A look back at the important events of 2018

- The United States' trade war with China
- Stock market volatility and performance
- Brexit developments and leadership contest
- Emerging market currency breakdowns (Especially the Argentinian peso and the Turkish lira)
- Murder of Jamal Khashoggi by Saudi Arabian officials
- President Donald Trump's renegotiation of NAFTA (now USMCA)
- The exit of the United States from the JCPOA (Iran Nuclear Deal)
- The waning popularity and struggles of French President Emmanuel Macron
- German Chancellor Angela Merkel's announcement she will not seek an additional term.
- Rise of populist leaders in Latin America and Europe
- Rockiness of stock market at the end of the year
- Democratic gains in midterm elections

A look ahead at potentially important events of 2019

Conventional Wisdom

- The Canadian Liberal party will win out in the 2019 Federal Elections. It is likely that Conservatives, and other parties, will see some gains; however, the Liberal Party is well-positioned to retain its majority heading into 2019.
- The World Bank has projected that Chinese economic growth will slow to 6.2% in 2019. The Chinese authorities (both government and central bank) are expected to follow loose policies and possibly flood the markets with liquidity.
- Oil prices will rise in 2019 as OPEC cuts its output.
- The Fed will raise rates no more than two times (down from the expected four as recently as late October).
- Turkish President Erdogan will seek to attack Kurdish forces friendly to the United States to prevent a Syrian Kurdish state similar to that in Northern Iraq. The withdrawal of US troops means this will almost certainly prove successful.
- Similarly, the withdrawal of US troops from Afghanistan will lead to a weakening of Afghan security forces and a revitalized Taliban. In the case

Unconventional wisdom

- After the UK follows through with its exit from the EU, it will be faced with significant and unaffordable choices and will have to salvage the situation in some way. It is likely that the UK will seek to hold a second referendum after a Hard Brexit and under a Labor government, the UK votes for a reversal of the first referendum.
- After the murder of Jamal Khashoggi, dozens of members of the Al Saud family demand a change in the line of succession. The loyal opposition wins the day within the royal family and MBS is prevented from taking the throne.
- of both Syria and Afghanistan, the withdrawal of US forces means that the Islamic State and other terrorist groups will be given an opportunity to regroup and reorganize themselves.
- The UK is almost certain to fail to reach an agreement with the EU that is palatable to both parties. Failure to reach an agreement will lead to the UK leaving the EU without a plan in place—a hard Brexit.
- Markets may take a more optimistic look in the early part of 2019, but by the second half of 2019, recessionary signs may bring back volatility and anxiety.
- As the US moves forward with leaving the Intermediate-Range Nuclear Forces Treaty, amid the current US administration's clear distaste for arms control, the future of arms control looks bleak in 2019. The New START Treaty, which limits nuclear warheads and delivery systems, is likely the next to go with President Trump calling the agreement a "one-sided deal."
- India's rating companies have belatedly realized that the IL&FS Group — Infrastructure Leasing & Financial Services Ltd. and its associates — is woefully short of liquidity—to the tune of \$12.5 billion in debt. Banks and mutual funds are primarily responsible for this debt. Their exposure threatens to reverberate throughout India's financial system, and India experiences a Lehman moment.
- Two NATO members come very close to war in the Eastern part of the Mediterranean Sea.