المنتدى الاستراتيجي العربي
ARAB STRATEGY FORUM

ARAB STRATEGY FORUM'S OUTLOOK ON 2018

Global Economic Trends And Events

Global Political Trends And Events

Middle Eastern and North African Economic Trends And Events

Middle Eastern and North African Political Trends And Events

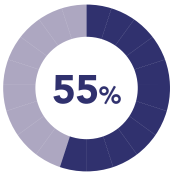
PREPARED BY **EURASIA GROUP**

GLOBAL ECONOMIC TRENDS AND EVENTS

Fiscal expansion leads to USD appreciation, triggering US protectionism

Tax cuts increase US deficits by at least $1.5 trillion, triggering higher yields and a stronger dollar. Donald Trump's administration responds with heightened protectionist measures (anti-dumping, for example) targeted at China and the EU, and it delivers tough talk on NAFTA.

Assessment



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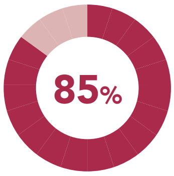


IMPACT

Rationale

- The combination of higher budget deficits driven by tax cuts and the Federal Reserve's gradual sale of US bonds as it unwinds its quantitative easing program will raise US bond yields and lead to USD appreciation.
- Mercantilism is a core component of Trump's appeal with his base.

Implications

- Protectionism will trigger foreign retaliation against successful US exporters and their partners in the technology, agriculture, and aerospace industries.
- US relations with the EU and China will deteriorate further, and election-year political stresses within Mexico will rise.
- A strong USD, higher US yields, and increased protectionism will be a very difficult combination for emerging markets.

Signposts

- The size of deficits resulting from a US tax cut package.
- Advances in NAFTA negotiations.
- Rhetoric from the US Trade Representative office and in Treasury currency manipulation reports.

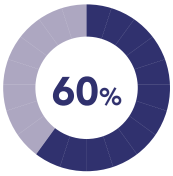
Contrast to Consensus

The interaction of US fiscal policy, USD strength, and US trade policy as a combination of negative effects is at odds with prevalent bullishness and fund flows into emerging markets.

Europe continues to deliver positive economic surprises

Broad-based Eurozone economic recovery continues with 2.0% growth in 2018.

Assessment



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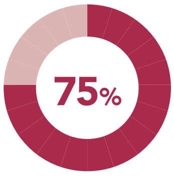


IMPACT

Rationale

- Credit conditions continue to ease, and economic momentum remains high.
- Structural reforms increase business confidence, and the relationship between French President Emmanuel Macron and German Chancellor Angela Merkel strengthens the partnership between their countries.
- Italian elections result in a centrist coalition that does not rock the boat on Eurozone or EU membership.

Implications

- Favorable conditions for ongoing gradual reforms in the Eurozone, thereby fueling a virtuous circle of growth.
- European assets continue to perform well.

Signposts

- Euro-area sentiment indicators.
- Italian election result.
- Progress of banking union talks.

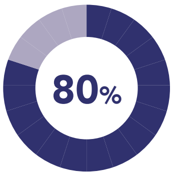
Contrast to Consensus

While markets have been largely positive on Europe in 2017, there has been concern that 2018 will bring renewed political and economic risks.

Brexit hurts the UK economy but without spillovers

UK economy continues to suffer Brexit uncertainty, while Europe performs well.

Assessment



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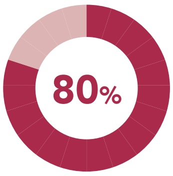


IMPACT

Rationale

- Persistent political divergences within the UK will make it hard to reach compromises with the EU.
- Brexit and its problems have served to inoculate populations in the rest of Europe that might be inclined to repeat the experience.
- The EU remains strongly opposed to granting the UK favorable trade access, especially on services.

Implications

- The UK economy would face worse growth/inflation prospects, thereby potentially forcing the Bank of England into hikes that could prove risky in a low growth economy.
- London's role as a European and global financial center would suffer, to the benefit of New York, Frankfurt, and Dublin.
- The Euro would continue to outperform the British pound (GBP).

Signposts

- Whether Theresa May holds on to the position of prime minister.
- The progress of Brexit negotiations.

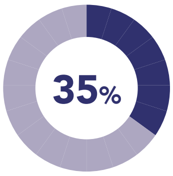
Contrast to Consensus

The market belief that the GBP looks cheap on a long-term basis must be recalibrated, because of a permanent trade access shock affecting high-value service exports.

Rude political and economic awakening for Latin America's Big 2

The combination of antiestablishment currents, NAFTA troubles, and a Chinese slowdown create big negative shocks for Mexico and Brazil.

Assessment



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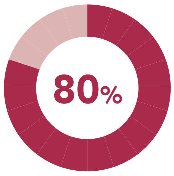


IMPACT

Rationale

- A tougher US negotiating stance on NAFTA may coincide with a Mexican election year.
- Brazil's election will be held against the backdrop of a discredited political class and lower commodity prices resulting from China's recent slowdown.
- Higher US rates and a stronger dollar will add to pressure on both Brazil and Mexico.

Implications

- Uncertainty leads to lower inbound portfolio investment and FDI into Mexico and Brazil.
- Heightened pressure on domestic central banks to resort to politically unpopular rate hikes.
- Contagion into other EM assets, especially in the local currency fixed income space.

Signposts

- Whether NAFTA negotiations run into the Mexican election campaign.
- The price of key industrial commodities.
- Major party nominations for the Brazilian presidency..

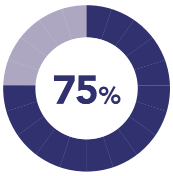
Contrast to Consensus

The market has underappreciated the confluence of domestic political and international economic factors for two benchmark emerging market countries and their potential contagion risks.

Oil prices will not take off in 2018

Even with strong demand growth, likely diminishing compliance of all OPEC/non-OPEC production restraint combined with rising non-OPEC supply will keep prices in the $50s for most of 2018, thereby continuing to affect producers.

Assessment



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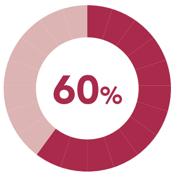


IMPACT

Rationale

- While there is evidence that productivity gains in US shale oil production are reaching a point of declining returns, prices in the mid-$50s or above would still accelerate the rate of growth.

Implications

- With crude oil prices in the $50s for most of 2018, budgetary pressures on some of the financially weaker major exporters will remain.
- Conversely, countries with a very high oil intensity to their GDP, such as India, will get more economic stimulus from lower prices.

Signposts

- Persistent concerns among major producers suggesting that they do not want to push oil prices to a level that would accelerate competing supply growth.
- Continued strong levels of investment in upstream capex in the US, even if those investment levels are not rising.

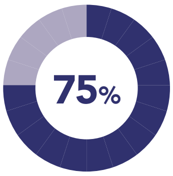
Contrast to Consensus

Many oil market participants on the speculative side of the trade are confident that OPEC and Russia may err on the side of pushing prices substantially higher in 2018, brushing aside concerns about competing supply.

The EU doubles down on protectionism

In 2017, all eyes were on the US's flirtation with protectionism under the newly elected Trump. 2018 will be the year when it becomes clear that the EU too is becoming increasingly protectionist in its own way.

Assessment



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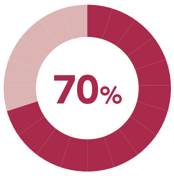


IMPACT

Rationale

- France's Macron and Germany's Merkel have grown increasingly wary of strategic acquisitions by foreign investors, particularly Chinese takeovers of European technology providers.
- These concerns are driven by two overlapping priorities: protecting European jobs and avoiding foreign penetration of national security-related industrial sectors..

Implications

- Foreign investors may be surprised at the widening spectrum of so-called "strategic sectors" in which investments may be tightened or hampered.
- Europe's approach to economic diplomacy could create unexpected tensions in Europe's foreign affairs, including with major emerging powers.
- Emerging powers may increasingly turn to each other in a bid to expand their trade ties as both the US and EU turn inwards.

Signposts

- Stagnation or abandonment of ongoing free trade agreement negotiations, particularly with East Asian and/or Latin American partners.
- The implementation of new investment-screening mechanisms similar to the US's Committee on Foreign Investment in the United States; the process has already been initiated at both EU and national levels.
- The creation of so-called European champions similar to Alstom-Siemens and Fincantieri-STX.

Contrast to Consensus

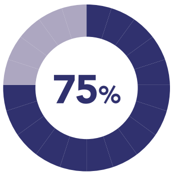
While the idea of "Fortress Europe" is not new, a perception that the EU today is crippled by internal divisions masks real efforts underway by local players to craft a strategic vision for protecting the European market.

GLOBAL POLITICAL TRENDS AND EVENTS

Russia and China will no longer turn the other cheek to Trump

In 2017, both Moscow and Beijing were careful to avoid reacting too forcefully to foreign policy moves by Trump they disagreed with. This caution was due to Xi's focus on maintaining stability ahead of China's 19th Party Congress and to Russian President Vladimir Putin's hope for a reset with the US. With both prospects behind them, China and Russia will forego their tip-toeing in 2018 and return to a more characteristic approach of pushing back against the US.

Assessment



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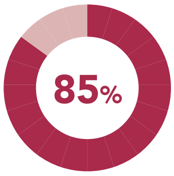


IMPACT

Rationale

- China's and Russia's caution was driven by factors specific to 2017—the 19th Party Congress and hopes for a reset—that will not be present in 2018.
- Moscow and Beijing will also likely be frustrated by the few benefits they have received in exchange for their willingness to accommodate Trump in 2017. China, for instance, will likely be offended by the Trump administration's likely increase in trade actions given Beijing's perception of having helped Washington on the North Korean issue.

Implications

- China may ramp up informal retaliation against US companies in the Chinese market.
- Russia may revert to new cyber operations against the US, possibly through indirect channels such as supporting the cyber actions of other US foes.

Signposts

- Negative statements by Putin or Xi directed at Trump himself, rather than the US as a generic actor.
- Reduced Chinese and Russian willingness to support US efforts on issues of common interest (for example, Iran, Syria, terrorism, North Korea).

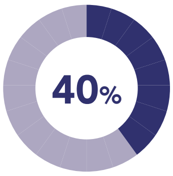
Contrast to Consensus

The public has not fully appreciated how uncharacteristic China's and Russia's subdued response to US actions has been in 2017, and observers may consequently be surprised when Beijing and Moscow return to "normal."

Republican Internal Conflict

In 2018, Trump may turn against the unpopular establishment of his own party and blame them for his lack of legislative successes. Trump's former chief strategist, Steve Bannon, has left the White House and declared war on the GOP establishment. If Trump is still without sufficient legislative victories, he will join that campaign, supporting primary challengers to GOP incumbents and functionally fracturing the party.

Assessment



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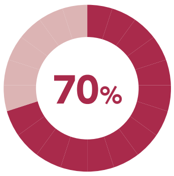


IMPACT

Rationale

- The US president may be tempted to deflect blame for his lack of legislative victories away from the White House.
- His instincts are antiestablishment—he won the primary and the general election by running against an establishment he branded as corrupt, and he may return to that posture if threatened.
- Trump knows his base voters will listen to him over GOP congressional leaders, who are unpopular.

Implications

- In the short term, vulnerable GOP legislators are likely to hew even closer to Trump for fear of attracting primary challenges.
- Democrats would be more likely to take back the House and Senate as Republicans nominate candidates who are too conservative to win general elections.
- In the long term, such a move by the president would weaken and further divide the party's leadership and its base voters.

Signposts

- Trump continues to criticize GOP congressional leaders, distancing himself from them and blaming them for failures or delays to his agenda.
- The White House gives explicit backing to primary challengers running against Republican incumbents.

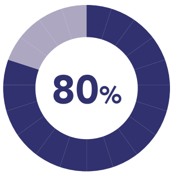
Contrast to Consensus

Many observers treat Trump as a normal Republican, but he is not actually ideologically committed to the GOP. His political style requires a foil—someone he can paint as corrupt and self-interested. He has struggled to find that enemy as president, but the GOP establishment could be a tempting option.

Italy's next election creates yet another weak government in Europe

Italy will hold its next elections in the first half of 2018 and the result is unlikely to be good for stability, domestic or European. The worst outcome for markets would be the rise of a euroskeptic coalition comprising the Five Star Movement (M5S) and other fringe parties. But even a more moderate coalition of mainstream parties would be unlikely to be stable or have the political capacity to implement structural reforms.

Assessment



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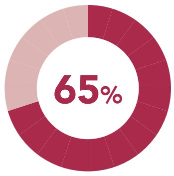


IMPACT

Rationale

- The M5S party is among the country's most popular and is well placed to win upcoming elections.
- Electoral rules may prevent the M5S from forming a government even if it wins the most votes, but the alternative—a united front of highly heterogenous mainstream parties—would also struggle to carry out a constructive agenda.

Implications

- Italy is the world's eighth-largest economy and Eurozone's third largest. Its health is hence critical to European and global economic stability.
- Italy is often seen as a bellwether for the rest of the Eurozone's Southern periphery. Its stability is therefore crucial to avoiding contagion effects.
- Even if it does not lead to a crisis or downward spiral, the lack of effective governance in Italy may hamper efforts to improve Eurozone integration.

Signposts

- M5S's performance in pre-election polls.
- Signs of entente—or lack thereof—among the M5S and other euroskeptic parties.
- Changes—or lack thereof—in M5S's rhetoric about the euro and Eurozone reform.
- The popularity of mainstream Italian political parties.

Contrast to Consensus

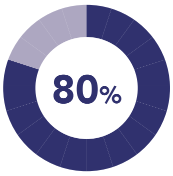
While observers have correctly recognized the risk of an M5S victory, the public seems to be less aware of the risk that even a non-Eurosceptic government could prove underwhelming when it comes to its ability to govern constructively.

MIDDLE EASTERN AND NORTH AFRICAN ECONOMIC TRENDS AND EVENTS

European and Japanese banks will avoid major investments in Iran

European and Japanese institutions will maintain a cautious outlook in 2018 toward investment in Iran, given escalating tensions between Washington and Tehran. Even if the Iran nuclear deal (Joint Comprehensive Plan of Action, or JCPOA) does not unravel, increasing hostility in the "non-nuclear" realm will discourage substantial investment by most major banks.

Assessment



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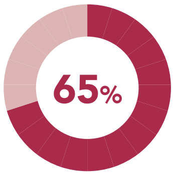


IMPACT

Rationale

- Since the implementation of the JCPOA, major European and Japanese banks have abstained from forming relationships or financing projects in Iran, creating bottlenecks in Tehran's efforts to take advantage of sanctions relief.
- Renewed tension between the U.S. and Iran will ensure this trend continues. The Trump administration's new Iran strategy, which emphasizes aggressive non-nuclear sanctions and confrontation with Iran across the Middle East, will create frequent flash points.

Implications

- Some companies will finance deals on their own, but most major firms will be unwilling to take on that risk.
- Lack of banking interest and reduced economic benefits will make the investment climate even more risky.

Signposts

- Statements by U.S. and Iranian officials questioning the value of continued adherence to the JCPOA.
- Announcement of new financial relationships with Russian and Chinese lenders.

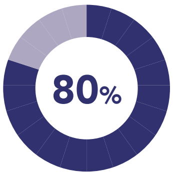
Contrast to Consensus

The drumbeat of headlines announcing major "deals" between firms and Iran suggests some progress – but ignores a nearly across-the-board lack of financing to move the arrangements forward.

OPEC deal extension will support growth of Gulf economies in 2018

An extension of the OPEC/non-OPEC production restraint agreement will yield relative price stability and increased revenue for Gulf nations. Governments will use these funds to support investment and economic growth.

Assessment



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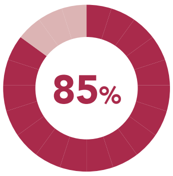


IMPACT

Rationale

- Crown Prince Mohammed bin Salman is seeking price stability.
- The Russian president is interested in boosting oil revenue ahead of elections in the spring of 2018.
- Other producers are also benefiting and are likely to cheat on the terms of the deal, limiting price gains.

Implications

- Brent prices average close to $60 but will not rise significantly above that on a sustained basis.

Signposts

- OPEC decisions.
- Respect for OPEC/non-OPEC agreements.

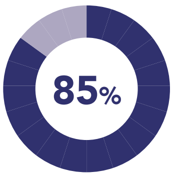
Contrast to Consensus

We do not expect an agreement that does not include reference to some form of tapering.

Development of natural gas resources in Egypt will reduce current account and fiscal deficits

Despite being the third largest producer of natural gas in Africa, over the past few years Egypt has become a net importer of gas because of fast-rising domestic demand driven by power generation. However, a series of recent offshore discoveries are likely to reverse this trend in the next few years. Bringing the offshore fields of Zohr, North Alexandria, and Nooros on line will reduce natural gas imports to zero and boost fiscal revenue by the end of 2018. This improvement will help to narrow the country's current account and fiscal deficits.

Assessment



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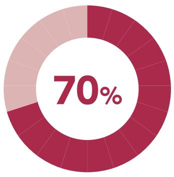


IMPACT

Rationale

- After a devaluation of the Egyptian pound and increase in foreign reserves, Egyptian authorities have prioritized clearing arrears in the energy sector to boost investment. This improvement will accelerate upstream investment and thus enable hydrocarbon companies to meet their production deadlines.
- Additional natural gas volumes will eventually allow Egypt to stop importing gas. Slowing imports, combined with currency devaluation and austerity measures, will help to shrink current account and fiscal deficits.

Implications

- External economic risks will continue to decrease as Egypt's demand for foreign capital declines.
- The longer-term need for continued IMF assistance will also decrease, and foreign investors will remain bullish about the country.

Signposts

- Any delay or problem in the completion of these offshore projects or in ramping up production.
- Exchange rate volatility, which could compound or ease economic constraints.

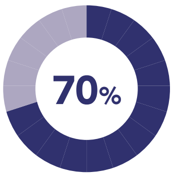
Contrast to Consensus

While there is optimism about Egypt's economic trajectory, many observers believe that there are quite few challenges that must be addressed efficiently.

Libya's oil output will gradually increase to 1.25 million barrels per day (bpd) over the course of 2018

Repeated disruptions due to persistent instability and the lack of a peace deal crippled oil production during 2017, preventing Libya from reaching its target of 1.25 million bpd by the end of the year. Nevertheless, production has managed to increase over the past few months to about 1 million bpd. This slow upward trend will continue in 2018 and bring total output to about 1.25 million bpd by year's end.

Assessment



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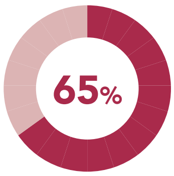


IMPACT

Rationale

- This gradual increase in oil production will be possible thanks to the central bank earmarking funds for repair work in the oil and gas sector, and the National Oil Corporation's ability to negotiate truces among militias around the main hydrocarbons facilities.
- Though authorities managed to quickly and easily raise production from about 400,000 bpd to about 1 million bpd in 2017, additional gains will be more difficult to achieve in 2018 because of technical challenges.

Implications

- Slowly rising oil production will generate much-needed additional revenue for Libya's budget.
- Higher oil production will also contribute to moderating global oil prices.

Signposts

- A long-lasting oil disruption in southwest Libya could delay oil production increases.
- A peace agreement between the main factions could boost oil output above this target.

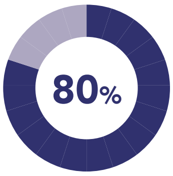
Contrast to Consensus

Most market players remain skeptical about Libya's increases in oil production and its ability to deliver further gains in 2018.

MENA governments will not abandon their austerity push

Authorities will continue to embrace fiscal reforms to manage their budget deficits.

Assessment



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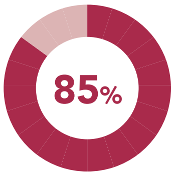


IMPACT

Rationale

- Gulf governments are fiscally constrained, yet budget deficits are under control.
- North African countries face even more acute challenges and will prioritize managing their fiscal deficits and mounting debt loads over economic growth.

Implications

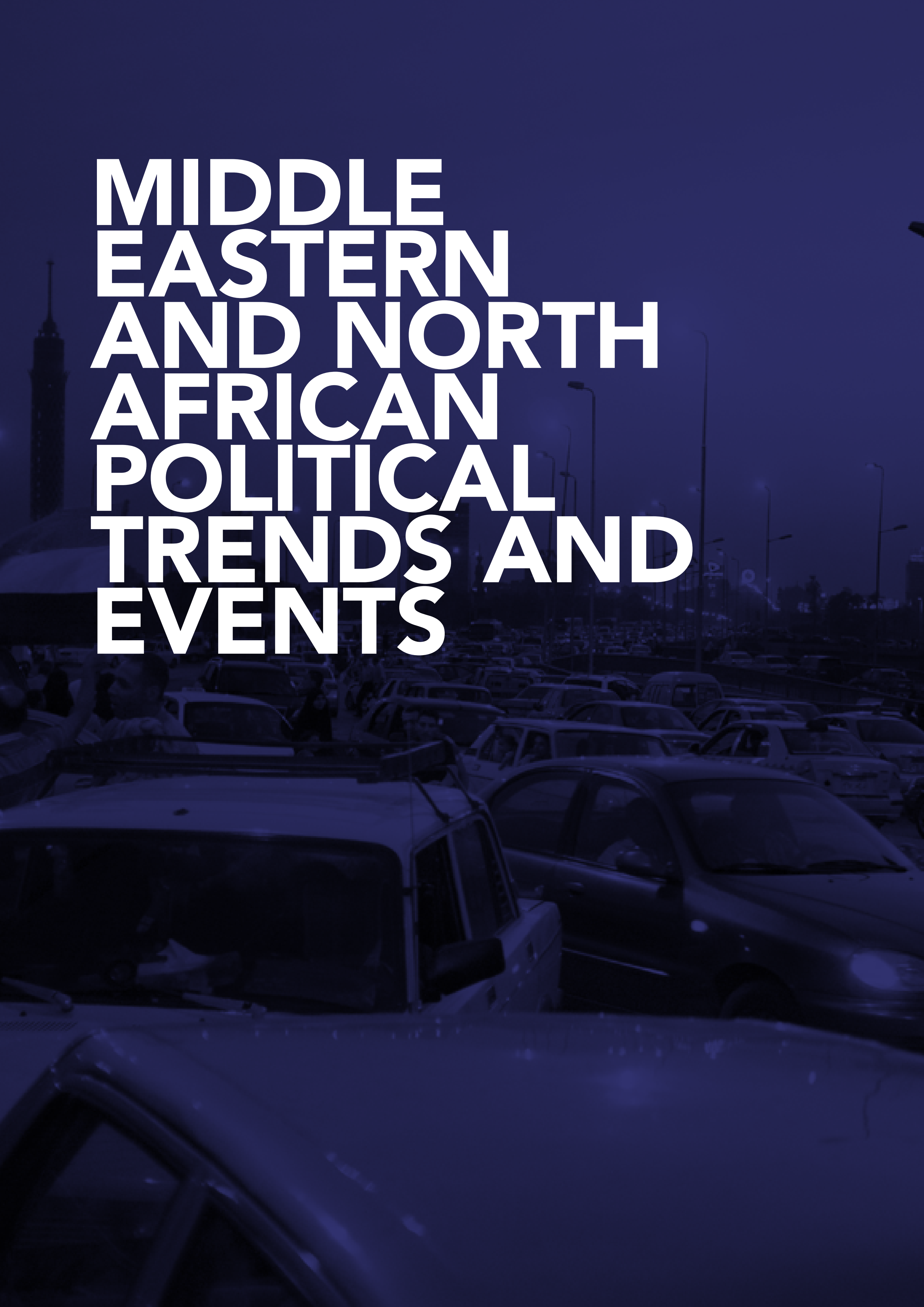
- The viability of MENA economies will improve over the long term.

Signposts

- 2018 budget spending caps.
- IMF programs or advisory opinions stressing the need for fiscal rebalancing.

Contrast to Consensus

Despite some challenges, governments in the region still appear to support the broad contours of reforms.

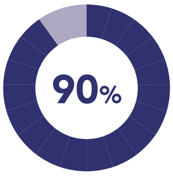


MIDDLE EASTERN AND NORTH AFRICAN POLITICAL TRENDS AND EVENTS

Iraq's central government will undermine Kurdish autonomy

The government in Baghdad will take concrete steps to limit Kurdish autonomy in response to the independence referendum.

Assessment



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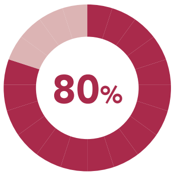

IMPACT

Rationale

- Prime Minister Haidar al Abadi will seek to permanently shift the balance of power to decrease risks of the country's split in the future.
- No effective resistance is likely to emerge since the Kurds are split between support for the Barzani and Talabani families.

Implications

- Control of the oil resources will allow Baghdad to impose new conditions on Kurdish areas.
- Independent Kurdish oil flows will decrease significantly, and the central government could potentially take control of them.

Signposts

- A deal between the central government and the Kurds over new revenue sharing arrangements.
- Turkish transfers oil flowing to the port of Ceyhan to central government storage.

Contrast to Consensus

Contrary to common perceptions, the Kurdish region no longer speaks with one voice and will fail to revive old political or revenue-sharing structures.

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