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ARAB STRATEGY FORUM

STATE OF THE WORLD IN 2019

GLOBAL POLITICAL PREDICTIONS

THE MAY 2019 EUROPEAN PARLIAMENTARY ELECTIONS WILL LEAD TO GREATER POPULISM IN EU INSTITUTIONS

LIKELIHOOD 80% **IMPACT** 65%

Traditionally, European parliamentary elections have been fairly underreported events, as their economic and geopolitical impact was deemed to be relatively minimal. But the May 2019 elections will be of far greater significance for several reasons.

- First, fringe political figures and parties are likely to make gains in the European Parliament. All 751 seats in the parliament are up for re-election in May. Moreover, as before, the 2019 election will be 27 national ballots with a European dimension. Since 2014, the contrast between supporters and critics of the EU has been made sharper by the migration crisis, Brexit, and the election of governments that clearly champion either a national or a European approach. Politicians on both sides of this debate hope to spin the pan-European ballot as a decisive victory for their side. Mainstream pro-EU groups (center-right, liberal, and center-left) will retain their majority and continue to work together on legislation. But their majority will be smaller than it has been in the past and Europe's far-right parties will be more successful in building one group, just as the far left managed to do in the previous parliament.

- Second, there is a real risk that the European People's Party (EPP) could become far more radical in its approach toward policymaking. Indeed, the most important battle will be for the spirit of the center-right EPP group, whether it retains its pro-EU instincts or becomes open to collaboration with groups further to the right. The late 2018 meeting between Italian Interior Minister Matteo Salvini and Hungarian Prime Minister Viktor Orban, whose Fidesz party remains in the EPP, shows that there are strong forces within the EPP pushing for a much tougher stance on migration, which could unite right-wing members of the European Parliament (MEPs) against the EU institutions.

- Finally, it is worth noting that the result of the European parliamentary elections will directly affect the composition of the next EU Commission–both its president and the cabinet. Historically, Germany and France wanted weak EU leaders who they could control. But today, Germany and France increasingly recognize that they need heavyweights in key positions to represent the EU to a divided continent internally and to stand up for it internationally. The problem to date is that frontrunners for the EPP and the Alliance of Liberals and Democrats for Europe (ALDE) may fall short of such a profile.

The risk is that next year's EU elections will lead to a parliament that is more radical and a European Commission that is less able to resist these radical tendencies. This would, in turn, lead to more gridlocked and hesitant European institutions, which would be unable to take the assertive action needed for Europe to reach the next stage of its development.

CHINA WILL SUBSTANTIALLY REDEFINE ITS BELT AND ROAD INITIATIVE

LIKELIHOOD 60% **IMPACT** 70%

In 2018, China was surprised to find itself facing criticism on the Belt and Road Initiative (BRI) from countries that had welcomed the BRI with open arms since its inception in 2013. Presidential elections in Malaysia and Pakistan brought in leaders who began publicly questioning and, in the case of Malaysia, cancelling big-ticket BRI projects. This criticism shows no sign of slowing in 2019, with Chinese investment having been a hot-button issue during election campaigns in Indonesia, the Philippines, and Brazil. As a result, Beijing will likely rearrange the way it continues to unroll its BRI strategy, which will have costs for both China and its partners.

The concerns from China's partners have not fallen on deaf ears. Han Zheng, the Politburo Standing Committee member responsible for the BRI, has talked about improving BRI regulations and standards. In addition, the People's Bank of China has started to work closely with the IMF on understanding debt sustainability issues. Beijing is increasingly likely to mitigate risks in select developing markets. Such reforms could include:

- Developing more partnerships, when possible, with other developed countries like the EU and Japan

- Better environmental and economic assessments in markets where pushback is growing

- Increased transparency and open tenders that become the norm rather than the exception

Over time, an upgrading of standards could make the BRI more sustainable and help its long-term prospects, but both Beijing and its partners will first have to reckon with the possibility of short-term losses. Particularly in places where the BRI is already deeply embedded, such as in Southeast Asia, Africa, the Middle East, and Eastern Europe, challenges are likely to arise for several reasons:

- First, countries in these areas will no longer be able to fully rely on Beijing's deep pockets, as Beijing's SOEs and banks struggle to align with international best practices, slowing investment across the board.

- Second, countries will need to be open for alternatives to Chinese investment. The US, the EU, and Japan all have their own regional investment initiatives–although these usually come with political and governance conditions.

- Finally, many markets previously viewed as key BRI beneficiaries, such as troubled states like Zimbabwe and Venezuela, may not pan out and could be abandoned altogether.

NARENDRA MODI WILL WIN INDIA'S 2019 ELECTION BUT WITH A WEAKER MANDATE

LIKELIHOOD 85% **IMPACT** 55%

The Bharatiya Janata Party (BJP) is very likely to win India's 2019 general election, and Prime Minister Narendra Modi will hold onto his position. It will not, however, be a sweeping victory as it was in 2014, and Modi may well start his second term on a more modest footing. This will have implications for the government's ability to push through the country's next stage of economic and political reforms.

While Modi remains popular, and Congress is in disarray, voter fatigue and ongoing rural distress will dent his party's standing during the election. The BJP is not expected to win more seats than in 2014, but an outright loss to the opposition Congress Party is also highly unlikely. Instead, the BJP is likely to secure a plurality in the 545-seat parliament, but not a majority, which will increase the importance of its partners that comprise the National Democratic Alliance (NDA), for Modi to secure the 273 seats needed for a majority.

Currently, the Modi government is in a period of stasis, hesitant to unveil any major economic initiatives that could provide headwinds to the economy ahead of the national election. For instance, the introduction of the goods and services tax in 2017, which was a critical reform and a milestone for the government, led to a temporary slowdown in growth and consumption; Modi does not want a repeat of that experience. Accordingly, the culmination of the election will allow his administration to again focus on key reforms. But the prime minister's capacity to fully embark on sensitive policies will be tempered by the makeup of his government. Modi will likely need to provide incentives to non-BJP parties, which will distract his administration from fully prioritizing economic policies. This will also limit Modi's ability to continue India's foreign policy pivot, which has seen the country move closer to the US. If, for example, some of Modi's alliance partners do not favor greater proximity with Washington, he will need to balance his overtures and not undermine the dynamics within his coalition government.

BRAZIL'S NEW PRESIDENT WILL BE WEAK AND HAVE MIXED SUCCESS IN REFORMING THE ECONOMY

LIKELIHOOD 65% **IMPACT** 45%

Far-right legislator Jair Bolsonaro was elected Brazilian president on 28 October and will serve a four-year term set to begin on 1 January. Bolsonaro's victory comes on the backdrop of antiestablishment sentiments worldwide and a Brazilian middle-class that is angry at the political class amid an economic crisis, poor public services, and the unraveling of the world's largest corruption scandal. Bolsonaro will enter office with the mandate to change how traditional politics, based on coalition-building by traditional parties, is conducted.

The key risk to Brazil's future—and its position on the geopolitical world stage—is that the country may not succeed in reforming sufficiently. Indeed, the sustainability of an economic recovery will be highly dependent on the incoming government's ability to undertake fiscal adjustments, namely through the approval of a pension reform. The incoming administration will have to negotiate with legislators and will likely end up with a modest pension reform proposal. This will be problematic, as with a strong opposition in a polarized environment, the honeymoon period for Bolsonaro will be rather short. Bolsonaro's margin of victory, of ten percentage points, pointed to a very clear victory, but not a landslide triumph: It was narrower than the margins in the 2002, 2006, and 2010 elections. Thus, Bolsonaro will also have to negotiate with legislators in congress to approve critical reforms. He will ultimately have to work with the political class that he rejected throughout the campaign period.

The risk is that measures of fiscal consolidation, namely pension reform, are not approved in 2019, prompting the loss of market confidence in the administration and a very challenging economic environment. Bolsonaro's combative style in such a scenario could then lead to various types of institutional conflicts and crises, further slowing down the economic outlook.

There is one risk that has probably been overstated, however, and that is the risk of a waning democracy. Admittedly, Bolsonaro was elected in a highly polarized environment where many voters rejected his socially conservative rhetoric that attacked minority groups in Brazil. In addition, his praise of the country's military regime (1964–1985) raised concerns about the role of democratic institutions in his administration. But Brazil's robust institutions—including a highly independent judiciary; a decentralized federal political system; and a highly fragmented congress of 30 parties—would turn any constitutional change into a tall order. It also remains clear that any authoritarian attempt in Brazil would be extremely costly for any president, regardless of his popularity.

VENEZUELAN PRESIDENT MADURO WILL REMAIN IN OFFICE THROUGHOUT 2019, DESPITE HEADWINDS

LIKELIHOOD 65% **IMPACT** 45%

Venezuela's economic and political situation will continue to plague the country in 2019. Despite some pragmatic gestures, the government remains fundamentally unwilling to change its economic model of controls, which is generating hyperinflation and still acute goods scarcity. At the same time, the collapse of oil production–which is on pace to decline from 2.5 million barrels per day (bpd) in 2013, when Maduro took office, to 1 million bpd–will continue to erode the government's cashflow and deepen the economic crisis. Officials are facing growing creditor actions that are set to become more disruptive over the next year, while increasing international isolation will also continue to undermine the government's financing options.

Against all odds, and despite his lack of popularity, President Nicolas Maduro will likely remain in power. The headwinds will, however, complicate his ability to provide key stakeholders with money, power, and immunity, diminishing their incentives to continue backing him.
He also remains vulnerable to internal threats, particularly given his inability to resolve the deepening economic crisis. While this reality will make it difficult for Maduro to remain in office beyond the end of 2019, a few factors make it likely that he will likely remain in power until that time:

• First, social tensions have diminished somewhat, owing to a continued exodus of Venezuelans from the country, significant minimum wage hikes, and a stabilization of imports enabled by the government's decision to default on its external debt.

• Second, the president has been able to sow dissension within the opposition's ranks, breaking up the formerly unified front opposed to his rule.

• Third, with help from Cuban intelligence, the government has been able to contain any planned military uprisings, making it harder for the armed forces to coordinate actions against Maduro.

ELECTIONS IN NIGERIA AND SOUTH AFRICA WILL DELIVER CONTRADICTORY RESULTS FOR THE CONTINENT'S REFORM PROSPECTS

LIKELIHOOD 70% **IMPACT** 60%

Africa's two largest economies, South Africa and Nigeria, will hold pivotal elections in early 2019, presenting an opportunity for both countries to reverse the economic stagnation and political turbulence of the past year. But while elections in South Africa are likely to improve the ability of the current government to influence policy outcomes, they could further complicate governance in Nigeria. The risk is that African governance will improve only modestly in 2019, with potential negative effects on the global oil price through Nigeria's vulnerability to its Niger Delta militancy.

South Africa: Since coming to power in early 2018, South African President Cyril Ramaphosa has had to preside over a ruling African National Congress (ANC) divided between factions loyal to his platform and those loyal to former president Jacob Zuma. Ramaphosa wants to enact changes in the policy environment that will help revitalize an economy still recovering from a decade of mismanagement under Zuma. But pro-Zuma ANC elements, alongside the Economic Freedom Fighters party, have fought to obstruct these plans and weaken Ramaphosa by pushing populist policies, such as uncompensated land expropriation. This has curbed his political capital, prompting him to adopt an accommodative stance toward his rivals for the sake of maintaining party unity ahead of the elections. Despite the economic downturn, Ramaphosa is likely to win by a comfortable margin, giving him more political control over the ANC. This will make it easier for him to neutralize opponents to his reform agenda and couch radical proposals in more restrictive language to allay investor concerns. Thus, the policy outlook for South Africa should improve to some extent in the aftermath of the elections.

Nigeria: In Nigeria, the opposite scenario is more likely. The ruling All Progressives Congress (APC) has suffered a wave of key defections, handing the opposition People's Democratic Party (PDP) significant momentum and complicating President Muhammadu Buhari's re-election bid. A sluggish economy and persistent insecurity in the middle belt have made the elections, due in February, a very close affair. Yet Buhari's incumbency advantage and enduring popularity with northern voters could be enough to get him over the line. Buhari's victory margins, however, are unlikely to be dominant, heightening the risk of an inconclusive election, which could see him commence his second term with a legitimacy deficit. This could be further compounded by the chances that both houses of the legislature, currently headed by PDP figures who defected from the APC, could be controlled by the opposition in the aftermath of the elections.
A PDP-headed legislature will put up vigorous opposition to Buhari's agenda, which could lead to policy gridlock. Furthermore, persistent concerns about Buhari's health are likely to linger–although Vice President Yemi Osinbajo could take over if Buhari goes abroad to seek medical treatment–and a resurgence of the Niger Delta militancy in the event of his re-election would further constrain his ability to govern effectively. If the opposition candidate Atiku Abubakar wins the election, Nigeria's economic prospects may be slightly better, but the improvement would be modest.

ISRAEL/PALESTINIAN TERRITORIES: ROUGH ROAD AHEAD FOR TRUMP'S 2019 PEACE PLAN

LIKELIHOOD 70% **IMPACT** 60%

President Donald Trump and his team have devoted a lot of energy to the so-called deal of the century between the Israelis and Palestinians. Close consultation with Washington's regional partners has occurred and will help US officials sell the deal in the region. While the details and the exact timing of the plan's release have not be disclosed, it could be announced in early 2019. Trump's peace plan will most likely be based on the concept of the two-state solution: an independent state of Palestine in the West Bank and Gaza Strip, alongside the state of Israel. It will likely take a pro-Israel tilt to an extent unseen in previous US proposals. Trump has already tipped his hand by recognizing Jerusalem as the capital of Israel and moving the US embassy from Tel Aviv.

- The US administration will not support the theoretical "right of return" for Palestinian refugees as evident through pulling funding from the UN agency that administers aid to them. Furthermore, Trump's proposal will likely differ from previous US plans by its economic incentives. It will likely include specific and sizable plans for public and private sector investments in infrastructure, education, and other sectors for all the parties involved.

- The deal will face challenges, but it will not be irrelevant. Netanyahu, if he is still serving as prime minister after likely elections in 2019, will most likely receive the plan enthusiastically. The plan's territorial concessions will however cause consternation on the right, especially among the settlers who form large bases of support for the far-right parties. From the Palestinian perspective, the proposal is likely to increase political divisions between Hamas and Fatah. Palestinians in the West Bank have largely written off the Trump administration. A deeply unfair peace plan may induce some protest, but large-scale violence is very unlikely because the Palestinian street has already "priced in" the administration's bias toward Israel

GLOBAL ECONOMIC PREDICTIONS

US-CHINA TRADE TENSIONS WILL GET WORSE BEFORE THEY GET BETTER

LIKELIHOOD 80% **IMPACT** 85%

Far from being quickly resolved, economic tensions between the US and China are likely to worsen in the first half of 2019, for three reasons:

- First, US President Donald Trump firmly believes in the need for China to reform its economic model away from an industrial policy-driven one toward a more transparent and market-oriented one. This is not something that can be achieved overnight, and it will require extensive negotiation to find a compromise.

- Second, both Trump and Chinese President Xi Jinping have been able to avoid suffering the worst of economic backlash in their domestic economies. This means they have mostly been able to evade political pressures to de-escalate tensions.

- Finally, China has increasingly come to believe that the US is not interested in striking an honest compromise but instead wants to keeping Beijing "down." This will make it very hard for Xi to defend any concessions to the US until the situation absolutely warrants it.

All in all, this means that the US is likely to increase its tariffs on China from 10% to 25% on 1 January, as Trump has promised. It also is likely that the US will begin implementing parts of the tariffs it has threatened to add on the remaining $267 billion in Chinese exports to the US. Over time, an agreement between the two parties will become more likely as their economies slow down and domestic populations tire from confrontation. Even then, however, the de-escalation will be incremental as the US will want to ensure implementation by China of its reform commitments before lifting tariffs. The greatest problem, in fact, is that trust between the two capitals has been broken and will be hard to rebuild, which could raise security tensions.

OIL PRICES WILL CONTINUE TO BE UNDERPINNED BY UPWARD PRESSURE

LIKELIHOOD 80% **IMPACT** 75%

Several factors will probably continue to put upward pressure on global oil prices in 2019:

- First, the market will struggle with approximately 1.5 bpd of Iranian crude having come offline since May 2018. OPEC and non-OPEC producers are likely to step in to fill large parts of this void, but this will require time and effort and will remain contingent on political consensus.

- Second, Libya's oil production will remain vulnerable to disruption risks given ongoing violence. The most recent clashes will not directly hurt oil production in the near term, but future shutdowns remain a threat. Still, doubt over Libya's political future and a deteriorating security situation continue to weigh on the prospects for its oil industry. The National Oil Corporation and oil refineries have recently been the targets of threats and attacks. Although these violent outbreaks have not directly interrupted production, pressure on oil refineries from Islamists or militias is likely to reemerge as they make further attempts to undermine state institutions. The security outlook will only improve very slowly. As jihadist groups and militias continue to clash, it will have a negative impact on infrastructure nationwide.

- In Iraq, the appointment of a new prime minister, Adel Abdul-Mahdi, will decrease risks facing oil companies in the south and production from the mega-fields surrounding Basra. Over the long term, risks could resurface if Abdul-Mahdi fails to deliver a substantive improvement of life in Iraq's oil rich provinces. In addition, putting relations between Baghdad and the Kurdish region on a better footing will take time, but prospects for a resumption of Kirkuk exports have also improved. In the meantime, short-term production growth is likely to be limited by infrastructure limitations.

- In Nigeria, supply disruption risks will likely shift from a pre-election issue to a post-election event, especially if President Buhari is reelected.

- Finally, the ability of US shale growth to offset disruptions elsewhere will be limited by pipeline constraints out of the prolific Permian Basin for most of 2019. US shale production growth in 2019 will likely grow at a slower rate when compared with 2017 and 2018.

Nonetheless, Brent's price is likely to remain below the oft-heralded $100-mark, thanks to substantial efforts by OPEC and non-OPEC producers as well as to headwinds from the emerging market slowdown and rising US-China trade tensions. Peak prices in the low $90s and a lower average are more likely than a $100 average in 2019.

THE WORLD WILL FAIL TO EFFECTIVELY MANAGE A NEW ECONOMIC CRISIS IF ONE ARISES IN 2019

LIKELIHOOD 80% **IMPACT** 85%

When the 2008 financial and economic crisis hit, it took most market and government actors by surprise. It then required a tremendous amount of political capacity to manage and, later, overcome. This was no easy task, but it was made possible by strong political leadership in the US and in the EU, as well as relatively positive relations between the world's main poles of power. But if a similar crisis hit in 2019, the world would fail to effectively manage it–at least at first. This means that the next economic or financial crisis may not be as quick to pass and could have repercussions for domestic and international politics that far outweigh those of the 2008 episode.

An economic crisis could stem from three potential scenarios:

- A natural slowdown in the economy, as preordained by the theory of business cycles

- A financial or trade shock similar to the 2008 burst of the mortgage-backed security crisis, or a spiraling of the US-China trade tensions

- A geopolitical shock that could have economic repercussions

The fact that these scenarios are not mutually exclusive makes the overall odds of a crisis or a slowdown that much more likely. Even more problematic, the political world as it stands today would be poorly prepared to effectively manage a crisis for several reasons, including:

US leadership is both highly polarized (in the legislative branch) and more amateurish (in the executive branch) than it has been in decades.

The EU is in the midst of an existential crisis over its identity, both within countries and between Eastern and Western members of the regional body.

China, for all its growth in recent years, has developed an increasingly centralized decision-making process under Xi, which arguably makes it less likely to make effective and sustainable decisions over key policy issues.

Finally, beyond these siloed, national-level considerations, a dearth of trust plagues inter-state relations, which could prevent effective cooperation of the kind displayed when the G20 was revamped during the crisis of 2008–2009.

THE US WILL BE ROCKED BY INTERNAL INVESTIGATIONS AND THE RISK OF IMPEACHMENT

LIKELIHOOD 60% **IMPACT** 75%

The Democrats have a 60% change of taking back control of the House of Representatives in 6 November midterm elections, pointing to a heightened risk that Congress may consider Trump's impeachment in 2019. Republicans are unlikely to abandon the president, thereby likely leaving the effort short of the two-thirds of the Senate necessary to remove him from office, but the effort could deepen market uncertainty about an already unpredictable presidency. Even short of an impeachment process, 2019 will likely be a domestically fraught year in the US.

The most likely source of any impeachment effort will be the results of the Robert Mueller investigation. Revelations from the Mueller investigation that the Trump campaign colluded with Russia during the 2016 campaign could prompt the House Judiciary Committee to draft articles of impeachment. Those articles would likely be approved by both the committee and the full House by a simple majority, sending the matter to the Senate, where conviction and removal would remain unlikely unless accusations are clear enough to alter the political calculus of Republican senators.

The decision by both Democrats and Republicans on whether to move forward with impeachment will likely come down to several factors:

- The severity of the allegations against Trump, and the quality of the evidence for them

- Democrats' political calculation of whether impeachment would help them by firing up their own base, or hurt them by pushing Trump supporters to rally behind the president

- Public opinion which would weigh heavily on Republicans' approach to the issue

Even though Trump's removal is unlikely, the Nixon and Clinton precedents show that an impeachment debate would have a negative impact on markets. Even if the House stops short of trying to impeach the president, various investigations likely to be initiated by Democrat-controlled bodies are likely to make 2019 a tense year for markets and the US political landscape.

2019 COULD BE THE YEAR IN WHICH THE WTO IS FINALLY REFORMED FOR THE BETTER

LIKELIHOOD 40% **IMPACT** 80%

While many observers do not share Trump's approach to pointing out and addressing the WTO's failings, a broad swath of political and market participants–across developed economies in particular–do agree that the organization requires a major rethinking if it is to survive and thrive in the 21st century. There are three main reasons for this consensus:

- First, European decision-makers agree that the WTO's rules on fair competition were written for an era in which the Chinese economy was not a dominant one. Beijing's hybrid model of economic development–neither a market economy nor a command economy–means it is very hard, if not impossible, to ensure fair competition solely by applying today's WTO rules.

- Second, tensions have long been simmering between the US and other WTO member countries over the composition and functioning of the organization's dispute settlement mechanisms.

- Finally, the WTO has not presented populations with any major success in global trading negotiations in several years, which has reduced its legitimacy in the eyes of many observers hoping for a more proactive body.

The US-China trade tensions have kick-started a discussion among the so-called "like-minded" trade ministers, which aims to propose creative solutions for reforming the WTO in 2019. The EU, Japan, and Canada, among others, are shepherding this process and it has the potential to deliver new rules of the road that China and the US could agree on. If that happens, it would not only help ease the bilateral trade tensions between Beijing and Washington but it would also put the global trading framework on a more sustainable footing.

TURKEY WILL ENTER A RECESSION IN 2019

LIKELIHOOD 85% **IMPACT** 70%

The rapid depreciation of the lira since early May 2018 will continue to take a heavy toll on the Turkish economy in the 2019, which will enter a period of recession. While the improvement in Ankara's relations with Washington has alleviated some of the pressure on the lira, geopolitical risks will remain into next year, keeping the economy vulnerable to external shocks.

The economic leadership has taken some measures to address rising unemployment and inflation, but the policies remain ad hoc, unconventional, and insufficient to deal with the problems at hand. Worse, some of these measures will result in distortions in the economy. Throughout 2019, corporates' earnings and balance sheets will remain under pressure, due to the steep currency depreciation and monetary tightening. The banking sector, as a result, will suffer too. Stress tests are currently being performed on the banks to establish how much additional capital they need in light of an expected increase in non-performing loans.

Next year will also be the start of a recapitalization process–and potentially a very politicized one. Facing all these challenges, President Recep Tayyip Erdogan will resist asking for external help from the IMF for as long as he can, particularly before the local polls in March 2019. That said, the changes in global oil prices and Fed rates may put additional pressure on the Turkish economy. It is worth noting, however, that under a "sudden-stop" scenario, where the country's banks fail to rollover their external debt, Erdogan would be more likely to go down the IMF route, rather than impose capital controls as has often been suggested.

MENA POLITICAL PREDICTIONS

THE IRANIAN REGIME WILL BE SHAKENBUT NOT BROKEN

LIKELIHOOD 80% **IMPACT** 75%

In the coming year, the US-led political and economic pressure on Iran will likely intensify and threaten to undermine stability in the Islamic republic. While the revolutionary guard appears committed to demonstrating that Iran is not weak, its plans for attacks in the West have undermined EU support. Yet on the domestic front, even if President Hassan Rouhani faces challenges from parliament, especially given his support for the Joint Comprehensive Plan of Action, Supreme Leader Ali Khamenei will prevent his removal from office as it might further widen political fissures.

The Iranian currency has been depreciating over the last six months and the banking sector is struggling to manage high levels of bad debt. Amid this economic deterioration, the Trump administration has plans to expand US secondary sanctions to target additional sectors beyond banking and oil, to include mining, construction, and engineering–which the previous administration did not specifically target. The US also may implement both overt and covert programs to support an uprising among the Iranian people against the regime. These US efforts would likely be coupled with regional efforts to undermine Iran's political stability, especially in the ethnically Arab-centric Ahvaz province. Additionally, the largest multinational corporations will probably end their business dealings with Iran to preserve the viability of their business ventures in the US.

However, the EU and Russia will open some avenues to ensure that the Iranian economy does not fall apart. While declining oil revenues and difficulties in financial transfers will create substantial problems for the Iranian regime, the risk of a government collapse in 2019 remains low. Protests could emerge as a serious challenge as the economy deteriorates, but the security services retain the capacity to prevent a countrywide revolution.

GEOPOLITICAL TENSIONS WILL REMAIN HIGH

LIKELIHOOD 60% **IMPACT** 75%

In 2018, China was surprised to find itself facing criticism on the Belt and Road Initiative (BRI) from countries that had welcomed the BRI with open arms since its inception in 2013. Presidential elections in Malaysia and Pakistan brought in leaders who began publicly questioning and, in the case of Malaysia, cancelling big-ticket BRI projects. This criticism shows no sign of slowing in 2019, with Chinese investment having been a hot-button issue during election campaigns in Indonesia, the Philippines, and Brazil. As a result, Beijing will likely rearrange the way it continues to unroll its BRI strategy, which will have costs for both China and its partners.

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- Developing more partnerships, when possible, with other developed countries like the EU and Japan
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- Increased transparency and open tenders that become the norm rather than the exception

Over time, an upgrading of standards could make the BRI more sustainable and help its long-term prospects, but both Beijing and its partners will first have to reckon with the possibility of short-term losses. Particularly in places where the BRI is already deeply embedded, such as in Southeast Asia, Africa, the Middle East, and Eastern Europe, challenges are likely to arise for several reasons:

- First, countries in these areas will no longer be able to fully rely on Beijing's deep pockets, as Beijing's SOEs and banks struggle to align with international best practices, slowing investment across the board.
- Second, countries will need to be open for alternatives to Chinese investment. The US, the EU, and Japan all have their own regional investment initiatives–although these usually come with political and governance conditions.
- Finally, many markets previously viewed as key BRI beneficiaries, such as troubled states like Zimbabwe and Venezuela, may not pan out and could be abandoned altogether.

NEW IRAQI GOVERNMENT WILL PURSUE REFORMS

LIKELIHOOD 80% **IMPACT** 75%

Prime Minister Adel Abdul-Mahdi is expected to implement incremental reforms, likely after shuffling the bureaucracy to signal accountability and reduce corruption. On the security front, the state's control should improve with implicit support from the Shia clerical establishment—along with political backing from Hadi al Ameri and Muqtada al Sadr, the two most important Shia leaders who control a significant number of militias. Popular unrest is unlikely to dissipate immediately, but protesters will probably give the new prime minister an opportunity to address their concerns. The relationship with the Kurdistan Regional Government is also likely to improve under Abdul-Mahdi.

Nevertheless, the structural challenges facing Abdul-Mahdi are immense. The mainstream parties will not allow him to introduce deep reforms that undermine their vested interests. Iran has significant influence over different Shia, Sunni, and Kurdish politicians. Abdul-Mahdi will struggle to integrate the Shia-dominated popular mobilization units into Iraq's formal security institutions. The economic challenges over the short term are manageable, but the country's dependence on hydrocarbons revenue could lead to a potential crisis. While the threat posed by the Islamic State has receded, the security environment in many provinces is unstable. Absent considerable investment in reconstruction, the Sunni areas will prove to be a key challenge to government stability.

Iraq will remain stuck between the US and Iran, but Washington's influence will continue to recede. Unlike Iranian officials, who are involved in the details of Iraqi politics at all times, US commitment tends to ebb and flow. The Gulf countries will still try to support the reformist tendencies in Iraq but with the implicit demand for a limit on Iranian influence.

RUSSIA WILL CEMENT ITS PRESENCE IN SYRIA

LIKELIHOOD 80% **IMPACT** 75%

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HAFTAR WILL CONSOLIDATE POWER IN LIBYA

LIKELIHOOD 80% **IMPACT** 60%

The security environment in Tripoli is unlikely to improve significantly in 2019. The fractures in Libyan institutions remain deep, with no one emerging as a strong consensus leader and various militias retaining control over government institutions. As the government in Tripoli faces challenges from militia infighting, General Khalif Haftar will continue building his military power in eastern and southern Libya.

Haftar is increasingly well positioned to cement his presence in the east and expand in the southern areas, moving toward Tripoli in 2019. The coherence of his military forces and their capacity has enabled the Libyan National Army (LNA) to emerge as a legitimate player on both the political and security fronts.

Conditions for a comprehensive political settlement of the conflict will not emerge next year. The country is too divided to agree on a platform to resolve the long-term issues affecting its different regions. However, international pressure could force the different factions to agree to hold elections. Recent conferences held in France and Italy demonstrate competition between the two powers for influence in Libya, but both support holding new elections to legitimize Libyan institutions.

GULF TENSIONS WILL EASE

LIKELIHOOD 60% **IMPACT** 75%

Diplomatic efforts are likely to ease tensions between members of the Gulf Cooperation Council (GCC). The Qatari state and leadership have moderately changed its position as a result of economic pressure and is now more willing to show a measure of compromise in negotiations with the other Gulf States. More importantly, Saudi Arabia is increasingly shifting toward a new position regarding the crisis in Qatar. In October, for instance, Crown Prince Mohammad bin Salman's comments during the Future Investment Initiative summit in Riyadh signaled acceptance of the Qatari state and its strengths despite the differences within the GCC.

The Yemen war is also likely to move toward de-escalation. While a grand bargain might be one approach to the crisis in Qatar, incremental confidence-building measures could also represent a gateway to ensure that a solution to the issue emerges. The Trump administration seeks to see a unified Gulf camp ahead of its announcement of a new peace initiative for the Arab-Israeli conflict. Lastly, while the US can pursue its anti-Iran policy without a resolution to the Gulf crisis, long-term US interests rely on maintaining the coherence of this pro-US camp.

MENA ECONOMIC PREDICTIONS

CHINA WILL EXPLORE EXPANDING THE BRI IN THE MIDDLE EAST AND NORTH AFRICA

LIKELIHOOD 60% **IMPACT** 70%

The UAE and Saudi Arabia will appeal to Chinese officials to expand the BRI. In July, Xi's trip to the UAE marked the first state visit by a Chinese president in 29 years, improving the prospects of strategic cooperation between China and members of the GCC. It was also Xi's first overseas visit since his re-election as China's president in March 2018. Saudi Arabia, meanwhile, is entering into strategic conversations with the Chinese leadership to expand long-term economic and trade links. By building a strong partnership with Chinese decision-makers, the Gulf leaders will aim to prove to China that their relations can bring beneficial assets to the BRI that Iran simply cannot.

Tensions between the US and China on trade issues will encourage the Chinese leadership to explore expansion of the current scope of BRI initiatives and the countries included in these plans. China will also focus on economic partnerships to enhance its regional influence to test out the viability of any alterations to the plans. The Middle East has certainly become a more important part of Chinese long-term planning, both in terms of contract opportunities and energy dependence. China has not yet set a direct or official pathway through the Middle East for the BRI, but it has signaled a willingness to incorporate whatever country has expressed significant interest in the initiative.

At least in the next few years, economics rather than politics will be the driving force of Chinese expansion. China's overall emphasis on economic cooperation as the primary driver of its Middle East relations will take precedence over any political effort to convince China to take sides in the region's different disputes.

GULF ECONOMIC GROWTH WILL ACCELERATE

LIKELIHOOD 80% **IMPACT** 80%

In 2019, governments in the Gulf region will focus on spending to bolster economic growth. Oil revenues are likely to increase and stabilize next year, helping governments feel assured that additional spending will not significantly undermine their fiscal position over the long term. Demand and supply dynamics will still support high oil prices with growth in emerging markets, moderating any upside. In the UAE, expansion in Abu Dhabi's spending will have a broader positive impact on other emirates. In Saudi Arabia, the government is planning an expansionary budget to deal with stagnant growth. In Bahrain, Gulf economic support will help bolster business confidence and spending. Oman and Kuwait will continue following the same direction, with the Qatari government maintaining support to the economy to bolster its potential. A resolution to the GCC dispute would also enhance growth in the Gulf area.

In addition, new regulatory reforms will support an improvement in the economic outlook over the next 12 to 18 months. The Gulf governments are introducing legislation to tackle regulatory issues that have long been hampering the potentials of the local economies. In Saudi Arabia, the leadership will accelerate reform plans to attract investments. The UAE is introducing reforms to attract international talent and retain its position as a regional business and investment hub. Cooperation with China also promises to bring additional opportunities for the Gulf economies, partly through plans to build new infrastructure.

ENERGY SECTOR WILL BOLSTER EGYPT'S ECONOMY

LIKELIHOOD 80%

IMPACT 75%

The reform of the exchange rate regime and fiscal reforms will most likely improve confidence in the Egyptian economy in 2019. But the most significant shift will happen on the energy front, where a rise in natural gas production will support the local economy and the current account picture. In addition to the Zohr field, the discovery of Noor field with an estimated 90 trillion cubic feet (tcf) of proven reserves would take the country's proven reserves from 65.2 tcf to 155.2 tcf. This would place Egypt just behind gas giants Qatar, Iran, Russia, and the US.

In 2019, Egypt will become a net gas exporter and ensure regular supply for domestic power generation. More than three-quarters of the country's energy comes from gas-fired plants, which are key to supporting industrial production in the country. The energy transition and government spending has already increased estimates of growth in 2018 to 5%, according to the World Bank, with likely improvement in 2019. An Israeli-Egyptian agreement in 2018 will allow Israel to use Egypt's liquefaction plant as an outlet for Israel's offshore Leviathan gas field. Long-term energy plans also include a pipeline that would link Egypt, Cyprus, Israel, Greece, and Italy. The cumulative effect of these plans will most likely make Egypt a regional energy hub for gas production and exports in the eastern Mediterranean region.

SAUDI ARABIA WILL INCREASE DOMESTIC SPENDING

LIKELIHOOD 80%

IMPACT 65%

The Saudi finance ministry issued the first preliminary statement for the draft general budget for the fiscal year 2019. Compared to the previous fiscal balance program, government revenue for 2019 have increased from $225 billion to $261 billion. According to the preliminary budget, rises are also projected on the expenditure side, as they could reach $295 billion. The shape of spending will also improve long-term economic dynamics, as officials will be receive guidance on improving the efficiency of spending and achieving savings through the Spending Efficiency Realization Centre.

Spending plans from the Public Investment Fund (PIF) will also improve growth dynamics, with talks for the sale of a "strategic stake" in Saudi petrochemicals giant SABIC to Aramco. SABIC, the world's fourth largest petrochemicals company with a market value of more than $100 billion, is 70% owned by the PIF. Therefore, the PIF would get an influx of cash, allowing further venture capital to advance Vision 2030's transformational plans. As a result, economic growth in 2019 is likely to exceed 2.2%, especially if the government decides to accelerate its local investment plans.

The most significant obstacle to these plans could come from limited private sector investment. While the government has been improving its capacity to manage long-term challenges, some domestic businesses are struggling to cope with the economic modernization plans.

OPEC AND NON-OPEC COOPERATION WILL STRETCH BEYOND 2018

LIKELIHOOD 80% **IMPACT** 70%

Despite rising oil prices, cooperation between OPEC and non-OPEC countries is unlikely to end in 2018. Russia and Saudi Arabia are increasingly interested in maintaining the framework for cooperation between the two blocs and will use their leverage to ensure that they have greater influence over oil markets in the long term. The Russian leadership sent a senior delegation to the Future Investment Initiative forum to demonstrate support for Saudi Arabia and interest in broadening economic cooperation. Confidence between the two governments has been rising over the past two years and tensions with the West will only bolster this trend.

On a strategic level, the two sides will prove committed to managing oil markets to support their national budgets. The oil supply picture in 2019 will be complex, given the headwinds to global trade. As a result, the two countries will rally their allies in the energy sphere to ensure that supply growth is moderated and that prices do not fall. The production restraint agreement is likely to be extended in 2019, but the volumes could be shifted to allow for an incremental shift toward normal production levels. The Gulf countries will most likely work with Saudi Arabia as it remains the producer most able to influence global oil prices. However, any cooperation in the organization will not involve full compliance as Iraqi production will most likely increase next year.

GULF SUPPORT WILL MARGINALLY IMPROVE JORDAN'S FUNDAMENTAL STABILITY

LIKELIHOOD 70% **IMPACT** 80%

The Gulf economic package in support of the Jordanian economy will only marginally improve the stability of the country. The financial aid package provided by Saudi Arabia, the UAE, and Kuwait includes a $1 billion deposit at the central bank, which will limit the risks of financial outflows by local businesses. In addition, it will allow the Jordanian government to adopt a more measured approach to tax increases, which limits the risk of protests against the monarchy. Half a billion dollars in loans to bolster economic growth is also important, but direct budgetary support is not enough to deal with the complex economic challenges facing the country. The budget deficit will still require the government to introduce fiscal reforms in line with IMF recommendations.

Jordan will struggle to bring its debt-to-GDP ratio down from 94% to 75% and will probably need to settle for more modest targets. The reopening of the Jordanian-Syrian border should play a positive role in boosting trade, growth, and government revenue. However, the most meaningful development would be a reconstruction program in Syria that benefits Jordanian businesses. While the EU is likely to seriously consider increasing support to Jordan as it hosts Syrian refugees, any external support will require the Jordanian government to address its structural imbalances.