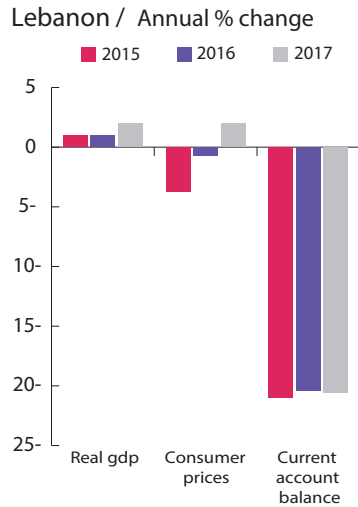




**Aoun's ascent will be positive for Lebanon's economy**

Michel Aoun's recent election as president and Saad Hariri's appointment as prime minister are positive developments for Lebanon's economic progress. Political interaction among the main Sunni, Shia, and Christian parties will improve significantly as they deescalate tensions and focus on governance for the



first time in more than three years. A business-friendly government, probably formed this year, will be well positioned to implement positive macroeconomic policies and relaunch Lebanon's offshore oil and gas licensing round.

**Economic Forecast** Economic cloud in Lebanon will be reinforced and investor confidence will soar as Lebanon's two-year-political crisis comes to an end.

**Geopolitical Forecast** Consolidation and reconciliation of Lebanon's politics will balance relationships with regional powers and help reinstate Lebanon's foreign policy and priorities.

**In Mosul, post-liberation challenges will be severe**

In Mosul, post-liberation challenges will be severe. The Iraqi government will likely retake Mosul from the Islamic State by the first quarter of 2017. But after liberation, local and regional forces will aggressively compete to assume political



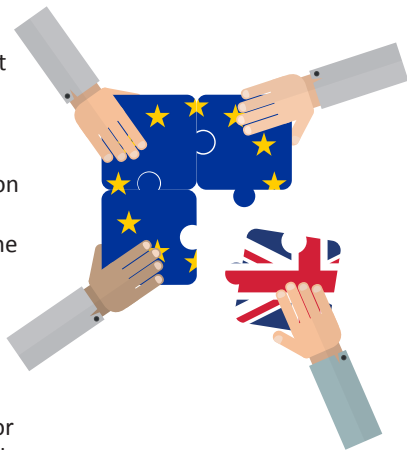
and military control over the city and Ninewa province. Baghdad lacks a coherent vision for post-conflict governance and will struggle to convince Kurdish forces to relinquish control of areas they have captured.

**Economic Forecast** It is very difficult to understand the economic scene in Mosul before the city is liberated and governance is established. Control of the nearby oil fields will be a priority for any governing body.

**Geopolitical Forecast** Due to overcrowding of regional powers on the field, post-liberation of Mosul will prove most challenging. Governance of the city and management of its resources will be the focal point of conflict.

**May's Brexit progress will be slow**

Prime Minister Theresa May attended her first European Council meeting but did not make much headway on Brexit, since neither side can yet find common ground on each other's red lines. The positions of the European Council and the European Commission have coalesced in recent months, allowing for a more coordinated EU27 front.



May faces negotiation pressures at home and on the continent to secure a deal, but a soft consensus is emerging in European capitals to ensure that an end-state agreement remains more favorable than any other arrangement. The process of sounding out acceptable negotiation terms is likely to persist, and talks are not likely to break down given the mutual damage that would cause.

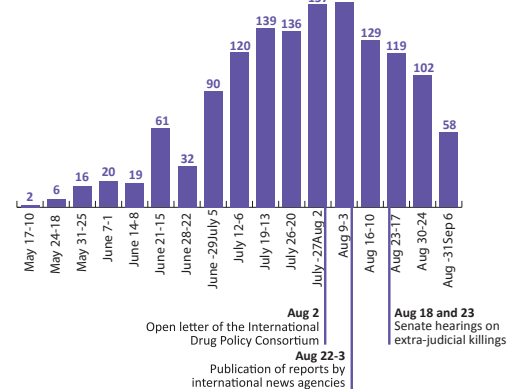
**Economic Forecast** A gloomy economic outlook will persist in the UK as Brexit remains largely in limbo. More business risk and economic uncertainty will add more pressure on the UK government and the EU.

**Geopolitical Forecast** The UK government and the EU will remain at odds until the Brexit is finalized with neither side compromising on their demands.

**Duterte's erratic behavior may threaten trajectory of economic progress**

President Rodrigo Duterte enjoys solid public and congressional support, enabling him to make progress on key agenda items such as advancing stalled infrastructure

Philippines war on drugs Death toll



projects. Duterte probably cannot sustain this trajectory, however, if he intensifies his anti-drug initiatives, attacks more political opponents, and makes more erratic foreign policy statements. An erosion of Duterte's credibility, were it to occur, would likely originate from a combination of alienation by elites (rather than from the general public) and creeping negativity from international markets.

**Economic Forecast** The Philippine's economic forecast will depend on Duterte's delicate balance between his economic and security agenda without further international scrutiny.

**Geopolitical Forecast** Duterte's foreign policy choices will be difficult over the next few months. This is especially true as we witness a greater US interest in the region and his erratic behavior and hostile language towards the superpower.



## Economic focus

### *Aoun's ascent will be positive for Lebanon's economy*

Lebanon's trajectory has improved with Christian leader Aoun's election by parliament and the appointment of Future Movement party leader Hariri as prime minister. Sunni, Shia, and Christian parties will be motivated to focus on governance for the first time in years.

Hariri will most likely succeed in forming a strong government by the end of 2016. That said, he will not accept proposals to assemble technocrats to organize parliamentary elections next year. Instead, both Hariri and Aoun will leverage the building momentum to form a representative government to implement their agendas. It will include either 30 or 24 ministers, similar to that of current Prime Minister Tammam Salam.

Unlike in previous governments, the most important Sunni, Shia, and Christian parties will not only participate but seek constructive engagement. Relations between the Future Movement and Hezbollah will initially be confrontational and eventually improve. While the two will maintain very different positions on the Syrian conflict and regional Saudi-Iranian competition, they are increasingly interested in cooperating on domestic issues. In fact, the Aoun-Hariri agreement was made possible by Hezbollah's pledge to support it. Despite its hawkish rhetoric, the group aims to back the more moderate Hariri as a counterweight to radical Sunni forces. At the same time, Hezbollah is unlikely to disrupt and complicate policymaking in a government headed by Hariri, as doing so would undermine its ally Aoun.

Despite the optimistic outlook, the government formation process remains complicated. First, Nabih Berri, leader of the Shia Amal movement, remains a potential stumbling block, and Hezbollah will not participate in government without Berri. He feels his position as parliament speaker and Shia leader was not respected when Aoun and Hariri struck their governance deal without consulting with the other parties. Berri will insist that a new government is born out of agreement among the three men on the broad contours of governance and policymaking. The second obstacle is that Hezbollah strongly values its Sunni and Druze allies in the March 8 camp and will therefore fiercely resist any efforts to exclude them.

A new government could improve the macroeconomic environment. Political stability would boost investor and consumer confidence, creating momentum behind economic growth. New leadership might likewise prove more effective at handling infrastructure projects and addressing service challenges, such as the garbage collection crisis. Meanwhile, pressure from outward financial flows on the banking sector would decline, enhancing the central bank's capacity to maintain the dollar peg. Lastly, the new cabinet would most likely approve the necessary decrees to delineate offshore oil and gas blocks, along with tax and royalty regimes, resulting in the relaunch of the hydrocarbons licensing round in 2017.



## Geopolitical focus

### *In Mosul, post-liberation challenges will be severe*

On 17 October, Iraqi Prime Minister Haidar al Abadi announced the launch of operations to retake Ninewa province and Mosul from the Islamic State. The campaign will be controlled and managed by Iraqi security forces, though US officials will play a significant advisory and support role, and an array of other local forces will likewise be involved; the government lacks the capacity to conduct the operation without significant military assistance. The composition and conflicting strategic objectives of the different participants in the campaign will prove a toxic mix after the Islamic State's defeat.

The group is likely to lose Mosul in early 2017 and relocate its remaining resources to the areas it still controls in Syria. The Iraqi offensive is well organized, and the sheer number of combatants participating is bound to eventually overwhelm the Islamic State. However, the biggest challenge these forces face will be to provide some measure of protection for Mosul's residents (currently estimated at about 1.2 million). The first attempt to control the city will exclude Shia militias and Kurdish forces (peshmerga) to reassure the Sunni population it will not face retribution. Yet there is a major risk that the government's forces will fail to quickly achieve results, forcing it to increase its reliance on Shia Popular Mobilization Units and Kurdish forces. In this scenario, internal displacement would increase and Mosul's ethno-sectarian balance could change.

The real crisis in Ninewa province will emerge after the Islamic State is dislodged. The area will then be home to forces with conflicting agendas and strategies that are bound to collide. The Iraqi government intends to bring the province back into the national political system, but the Kurds seek control of the Ninewa plains, a vast multi-ethnic area to the east of Mosul. Meanwhile, Shia militias intend to maintain a permanent presence to counterbalance the power of Kurdish, Sunni, and even Turkish forces in Iraq. The Kurdish Workers' Party is involved in the operation and seeks to create a supply line from Iraq to Syria, which would undermine Turkish national security. And Iran seeks to ensure that the central government and its Shia allies do not face a strong Sunni bloc in northern Iraq that can later secede or align itself with Turkish foreign policy. Turkey, for its part, intends to use Sunni groups to exercise influence in both Iraq and Syria (the Hizbullah model). These conflicting agendas will prove toxic after Mosul's liberation.



## *May's Brexit progress will be slow*

North May's communications with European leaders was centered on arguing that she wanted a "strong Britain to be a partner of a strong Europe." That said, British officials' attempts to sound out Europe on a Canada-style mixed free trade agreement with preferential access for certain sectors gained no traction, in comparison to a flurry of diplomatic activity among

the EU27 that has led to a coalescing of thinking on Brexit's strategic guidelines. Furthermore, Europe insists it will not commence negotiations until the UK formally notifies the EU of its wish to leave via the Article 50 process. The strategic rift undergirding this indicates that a Brexit deal is several months' in the making as neither side intends to budge on its red lines.

A soft consensus is also emerging within the EU27 to ensure that any deal put in place is not as favorable as an end-state agreement, to discourage the UK from staying in a halfway-house position with the EU and to incentivize it to reach an agreement as quickly as possible.

The commission has already indicated that the UK cannot buy or bribe itself access to the single market for select sectors, especially autos and financial services, by making large fiscal transfers to Europe while also opting out of free movement and European Court of Justice (ECJ) jurisdiction. Though not averse to the British funds, a deal of this nature would create the "a la carte" Europe that the Germans seek to avoid. Germans find further concessions on free movement unpalatable given the steps already made to accommodate the UK. Any new agreement on movement would resemble the "emergency brake" deal offered to David Cameron, May's predecessor. It is far from certain whether there is support among the Tories for these transfers, but extension of the ECJ's jurisdiction and free movement will be a hard sell for May regardless.

Already, she faces some pressures from her cabinet and parliament, though they are unlikely to amount to much. While she had to concede to the opposition's demand for more scrutiny of the Brexit process, the vote that has been promised to lawmakers will likely be a "take-it-or-leave-it" final offer—which, if rejected, will probably mean an EU exit and reversion to WTO rules.

A total breakdown of Brexit negotiations leading to a WTO-only trade deal for the UK is unlikely because of the mutual damage this would cause. The EU will continue to prioritize the union's long-term stability at the price of short-term economic pain.



## *Duterte's erratic behavior may threaten trajectory of economic progress*

After 100 days in office, Duterte has racked up a notable list of controversial actions. His campaign to eradicate drug-related crime has led to the deaths of more than 3,500 low-level criminals and drug addicts, mainly by police and vigilantes. On foreign affairs, he is making even bigger waves. He vulgarly insulted President Barack Obama, who canceled their first meeting. He called for halting further US-Philippine joint patrols in the South China Sea and for all US troops to leave the country, then walked back his comments to include just Mindanao. None of these threats, including his call for pursuing “open alliances” with China and Russia, has materialized.

Nevertheless, support for Duterte from both the political elite and the public remains strong. In congress, his PDP-Laban party leads a big coalition that collectively holds a supermajority, giving him substantial ability to pass key legislation. In addition, popular backing for Duterte, despite his aggressive and erratic moves, appears to have real roots. He is seen as decisive and prepared to take drastic action to solve festering problems, in contrast to his predecessor.

The combination of robust public and political support and the appointment of several high-quality cabinet advisers has allowed Duterte's administration to implement his 10-point economic plan with little interference.

There are two main headline risks to the Philippines' trajectory, though. First, the president's aggressive and unyielding prosecution of the war on drugs may eventually create opposition among either the general public or the urban elite (or both). This is particularly likely if he takes patently extralegal steps to carry out his plans. Sustained international criticism of Duterte's violent methods, especially from a UN organization, would accentuate concern by political elites. A reduction of US aid to the Philippines over human rights concerns could generate a similar effect.

There is also the risk that Duterte's harsh takedown of perceived political opponents—domestic as well as international—will eventually sour political elites on him. The military's views of Duterte's controversial methods may be an important and heretofore unmeasured variable. Alienation of these critical constituencies would undermine his ability to pass key policy reforms across the board. At the same time, a combination of continued violence at home and further erratic foreign policy statements (especially regarding the US, US-Philippine relations, and China) could lead international markets to lose confidence in Duterte's ability to govern.