# TOP RISKS 2020


Ian Bremmer
*President*

Cliff Kupchan
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1 Rigged!: Who governs the US? 2 The Great Decoupling 3 US/China 4 MNCs not to the rescue 5 India gets Modi-fied 6 Geopolitical Europe 7 Politics vs. economics of climate change 8 Shia crescendo 9 Discontent in Latin America 10 Turkey

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OVER VIEW

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## 2020 is a tipping point.

We've lived with growing levels of geopolitical risk for nearly a decade, but without a true international crisis. Outside of geopolitics, global trends have been strongly favorable. That's now changing.

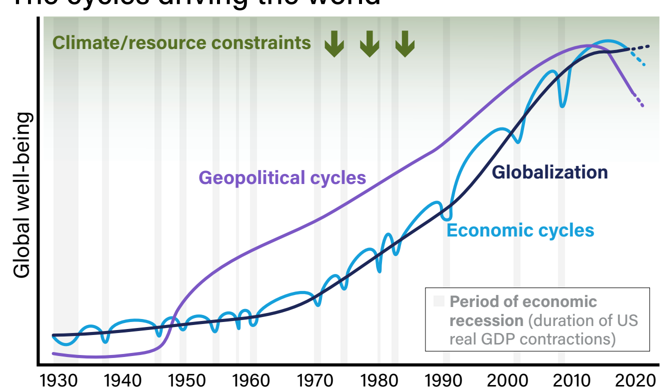
Globalization is key. The most important feature of the post-war era landscape—people, ideas, goods, and capital moving faster and faster across borders around the planet—has created extraordinary wealth and opportunity. It's increased global equality (even as it's created more inequality within many countries), reduced poverty, extended lifespans, and supported peace and prosperity.

But with China and the United States decoupling from one another on technology, a critical piece of the 21st-century economy is now fragmenting in two. Countries across the developed world have become more polarized, increasing the power of tribalism. Add the shrinking of supply chains with changes in the politics, economics, and technology of manufactured goods and services, and suddenly globalization has a split personality.

Then there are the economic and geopolitical trends. Both are now cycling downward. The global economy, after emerging from the great recession of 2008 with the longest expansion of the post-war period, is now softening. More economists expect a recession in 2020 or 2021. And the world is now entering a deepening geopolitical recession, with a lack of global leadership as a result of American unilateralism, an erosion of US-led alliances, a Russia in decline that wants to undermine the stability and cohesion of both the US and its allies, and an increasingly empowered China under consolidated leadership that's building a competitive alternative on the global stage.

Lastly, climate change is beginning to constrain economic growth and to matter on the global political stage as never before. That's only going to increase over time (unlike the cyclical economic and geopolitical trends, which sooner or later will become more favorable). In 2020, we have a combination of negative trend lines that we've not experienced in generations.

### The cycles driving the world




Source: Eurasia Group

This deteriorating environment is much more likely to produce a global crisis. The resources available to governments and the private sector make it easier than in the past to respond. But the scale of the challenges is greater, and the geopolitical recession undermines global cooperation.

For all these reasons, 2020 looks troubling indeed.

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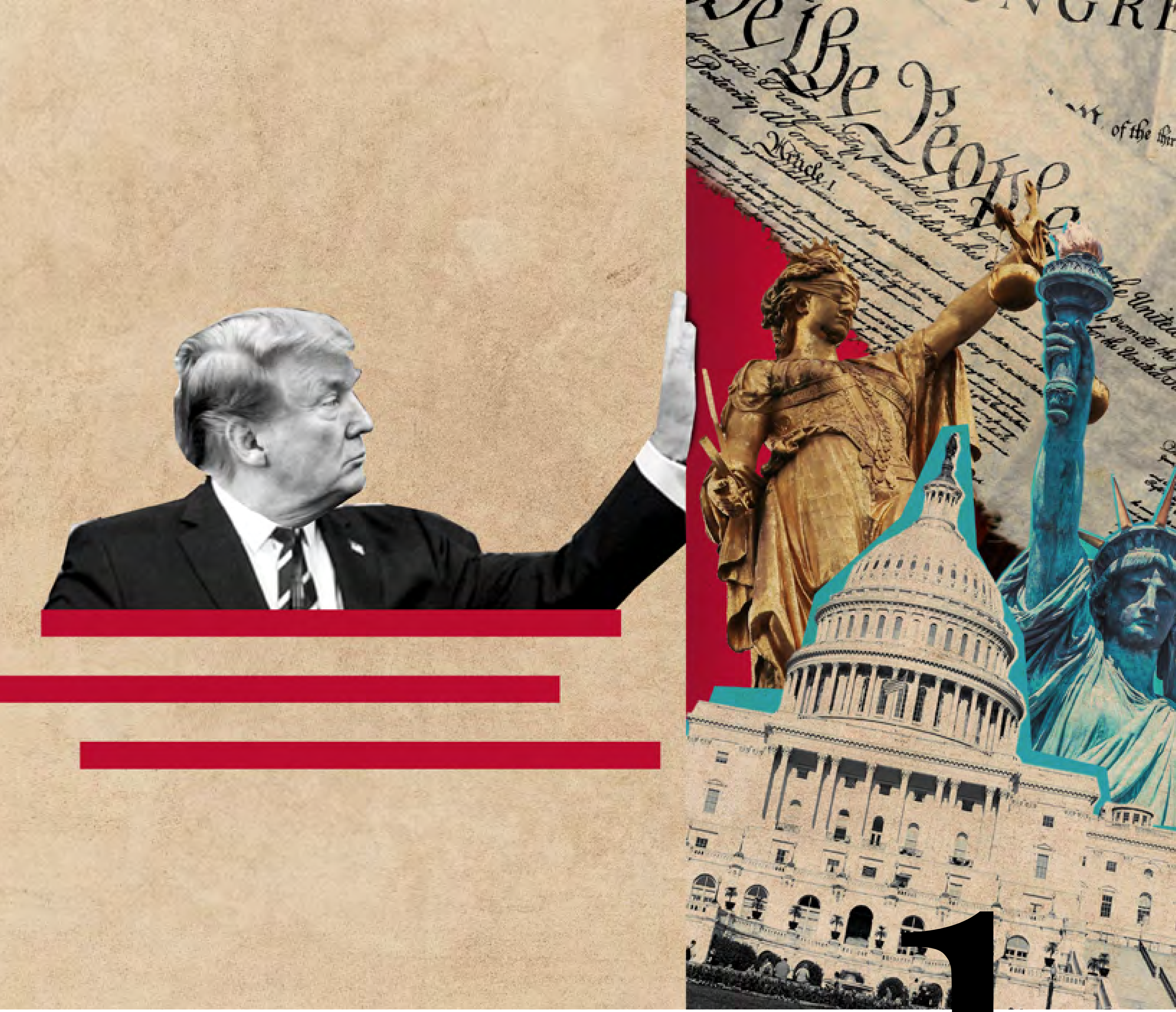


1

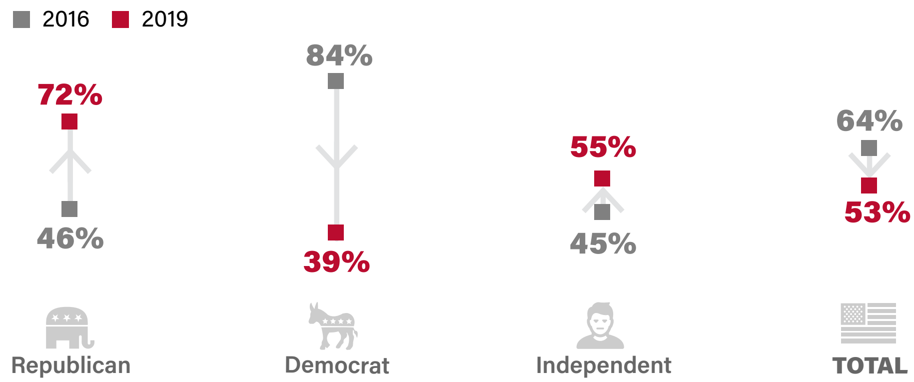
# Rigged!: Who governs the US?

**We've never listed US domestic politics as the top risk, mainly because US institutions are among the world's strongest and most resilient. This year, those institutions will be tested in unprecedented ways. We face risks of a US election that many will view as illegitimate, uncertainty in its aftermath, and a foreign policy environment made less stable by the resulting vacuum.**

Institutional constraints have prevented President Donald Trump from realizing major parts of his agenda (much as they have presidents preceding him), but they haven't stopped him from dividing the nation. Can a country this polarized

How much confidence do you have that the presidential election will be open and fair?

Total percentage of "a great deal" and "a fair amount"




Source: Ipsos September 2019 poll, Pew October 2016 poll

move forward? Trump has been impeached in the House of Representatives, and he will be acquitted by the Senate. This dynamic will delegitimize the November presidential election. Democrats will feel impeachment was politically quashed to place the president above the law, while Trump will feel empowered to interfere with election outcomes, with impeachment no longer a credible instrument of political restraint. At the same time, there will be external interference in US elections, especially from Russia, and the president and the Senate will do little to minimize the damage via tighter election security measures.

**Once the election is over, serious issues will emerge. If Trump wins amid credible charges of irregularities, the election process will become contested. If he loses, same.**

In other words, we'll have an election that—in advance—will be perceived as "rigged" by a large percentage of the population. Public opinion polls already show this risk is on the rise. According to a 2019 poll by IPSOS, just 53% of the public believed the presidential election will be fair. But the biggest drop in confidence has come among Democratic voters. In 2016, 84% of Democrats believed that year's election was fair; the number fell to 39% in September 2019 when asked about this year's election.

Legal challenges, which will likely fail in a conservative-leaning Supreme Court, could even lead to calls from some quarters for the vote to be postponed or boycotted, which would be unsuccessful but further undermine electoral legitimacy. Alternately, if Trump feels he's likely to lose, he could blame external actors such as Ukraine for interference and attempt to manipulate outcomes (especially in existing but vulnerable red states, where Trump allies hold political sway) in the name of ensuring election security. It will be the worst political climate for a national election that the US has experienced since the (effectively failed) election of 1876.

## American Brexit

What happens then? If Trump wins amid credible charges of irregularities, the election process will become contested. If he loses, same. Particularly if the vote is close, and it's likely to be. That would lead to lawsuits reminiscent of the Al Gore-George W. Bush election in 2000 that was ultimately decided in the Supreme Court. But unlike Gore-Bush, it's hard to see a scenario in which the high court rules and the loser graciously accepts the outcome as legitimate, especially if the loser is Trump. In other words, the 2020 election is an American Brexit—a maximally polarized vote where the risk is less the outcome than the political uncertainty of what the people voted for. It's uncharted political territory, and this time in a country where uncertainty creates shockwaves abroad.

Meaningful (France-style) social discontent becomes more likely in that environment, as does domestic, politically inspired violence. Also, a non-functioning Congress, with both sides using their positions to maximize political pressure on the eventual election outcome, setting aside the legislative agenda. That becomes a bigger problem if the US is entering an economic downturn, on the back of expanded spending and other measures to juice the economy in the run-up to the election.

## Pet the dog

The challenge extends to foreign policy as well, because any decisions Trump makes on security or trade questions in that environment would be viewed as lacking authority. Enemies will see the US presidency as the weakest it's been since Richard Nixon was embroiled in Watergate, and this time, there's no Henry Kissinger. Reckless pursuit of diplomacy is safer than reckless pursuit of war—Trump's preference is to "pet the dog" rather than "wag it" (making bad deals with foreign governments rather than launching attacks on them)—but that still means unprecedented efforts by Trump to align US policy with the interests of antagonists and frenemies such as Russia and Turkey. Meanwhile, with allies and partners, Trump's policies coupled with turmoil in Washington will confuse and further destabilize longstanding relationships, with big question marks over countries that already feel particularly exposed: think South Korea, Japan, Taiwan, and Saudi Arabia. And Trump is also more inclined to miscalculate (and increasingly unconstrained by advisers when he does so), making tail risks around those geopolitical confrontations that occur more unpredictable (see Iran) … and dangerous.

More broadly, both US allies and enemies over the past years have come to wonder whether the United States intends to lead—and they've hedged their bets accordingly. In the midst of a disputed 2020 election, many of those countries will wonder whether the US can govern itself. It's a period of unusual geopolitical vulnerability to shock and escalation.

To be clear, we're not worried about the long-term durability of US political institutions. The United States doesn't face the danger of losing its democracy in 2020. Nor are we as alarmed as the markets about a "lurch to the left" in US policy—a Bernie Sanders or Elizabeth Warren presidency remains plausible but unlikely; and more importantly, the next president will face the same congressional and other institutional constraints Trump has (though please see risk #4 on the broader pushback against multinationals). But a broken impeachment mechanism, questions of electoral illegitimacy, and a series of court challenges will make this the most volatile year of politics the US has experienced in generations.

2

# The Great Decoupling

**The decision by China and the United States to decouple in the technology sphere is the single most impactful geopolitical development for globalization since the collapse of the Soviet Union.**

After a series of escalatory US policy moves in 2019, Beijing has concluded that decoupling is inevitable. Caught off-guard by US actions, President Xi Jinping has called for a new “Long March” to break China’s technological dependence on the US. At the same time, China will expand efforts to reshape international technology, trade, and financial architecture to better promote its interests in an increasingly bifurcated world.

**Decoupling will affect not just the entire $5 trillion global tech sector, but a host of other industries and institutions from media and entertainment to academic research.**

This decoupling, already disrupting beneficial flows of technology, talent, and investment between the two countries, will move beyond the handful of strategic technology sectors at the heart of the US-China dispute (semiconductors, cloud computing, and 5G) into a broader array of economic activity. It will affect not just the entire $5 trillion global tech sector, but a host of other industries and institutions from media and entertainment to academic research, creating a hard-to-reverse business, economic, and cultural divide.

In the tech sector, Xi's focus on building "resilient supply chains" will raise the stakes of the US-China technology competition. That's bad news for US tech companies with big China footprints. Huawei has already started manufacturing base stations that will power next-generation 5G mobile networks that it says do not contain US-sourced technology, and this process of the US and China "designing out" each other's technologies will continue. Huawei and other Chinese companies will also develop alternative software ecosystems, chipping away at US leadership in mobile operating systems and enterprise software.

Markets are braced for tougher controls on US technology exports to China and the use of Chinese components in IT systems that help run US critical infrastructure. But they're not prepared for the effects of China's response, a dramatic increase in support for indigenous innovation through initiatives such as its new $29 billion national semiconductor fund and its effort to foster the creation of a new Silicon Valley in the sprawling 100-million-person Greater Bay Area in southern China (including Hong Kong, but that's another story).

The big question: Where will the new virtual Berlin Wall go up? Which side will countries choose?

Taiwan will take on increased strategic importance to China as a key source of non-US-origin equipment, especially the cutting-edge semiconductors that Chinese companies such as Huawei rely on to compete at the global cutting edge. South Korea will increasingly tilt toward China for the same reason. The shift toward China will be most palpable in Southeast Asia, sub-Saharan Africa, eastern Europe, and Latin America, in that order. Countries in all these regions will become battlegrounds where the US and China compete to decide who will supply consumers with tools to navigate the 21st-century economy—not just smartphones and the networks that power them, but mobile payments, e-commerce, and financial services, too.

Lastly, both the US and China have demonstrated they're willing to weaponize global trade and supply chains. For the US, this includes the export ban on Huawei and other Chinese tech companies. For China, it includes blocking imports from trade partners involved in foreign-policy disputes with Beijing (for example, Canada and its canola exports). When the two largest economies politicize their most important trading relationships, innovation and supply chain systems become more regional and less global.

As the rifts widen, they'll risk becoming permanent, casting a geopolitical chill over global business.

### Decoupling driven by three major factors ...

**01** **A trade conflict**
Centered on the USTR Section 301 investigation

**02** **A competition over technologies of the future**
AI, quantum computing, 5G, super computing, semiconductors

**03** **A deeper conflict over core technology issues**
The US-China tech cold war

### ... with wide-ranging consequences

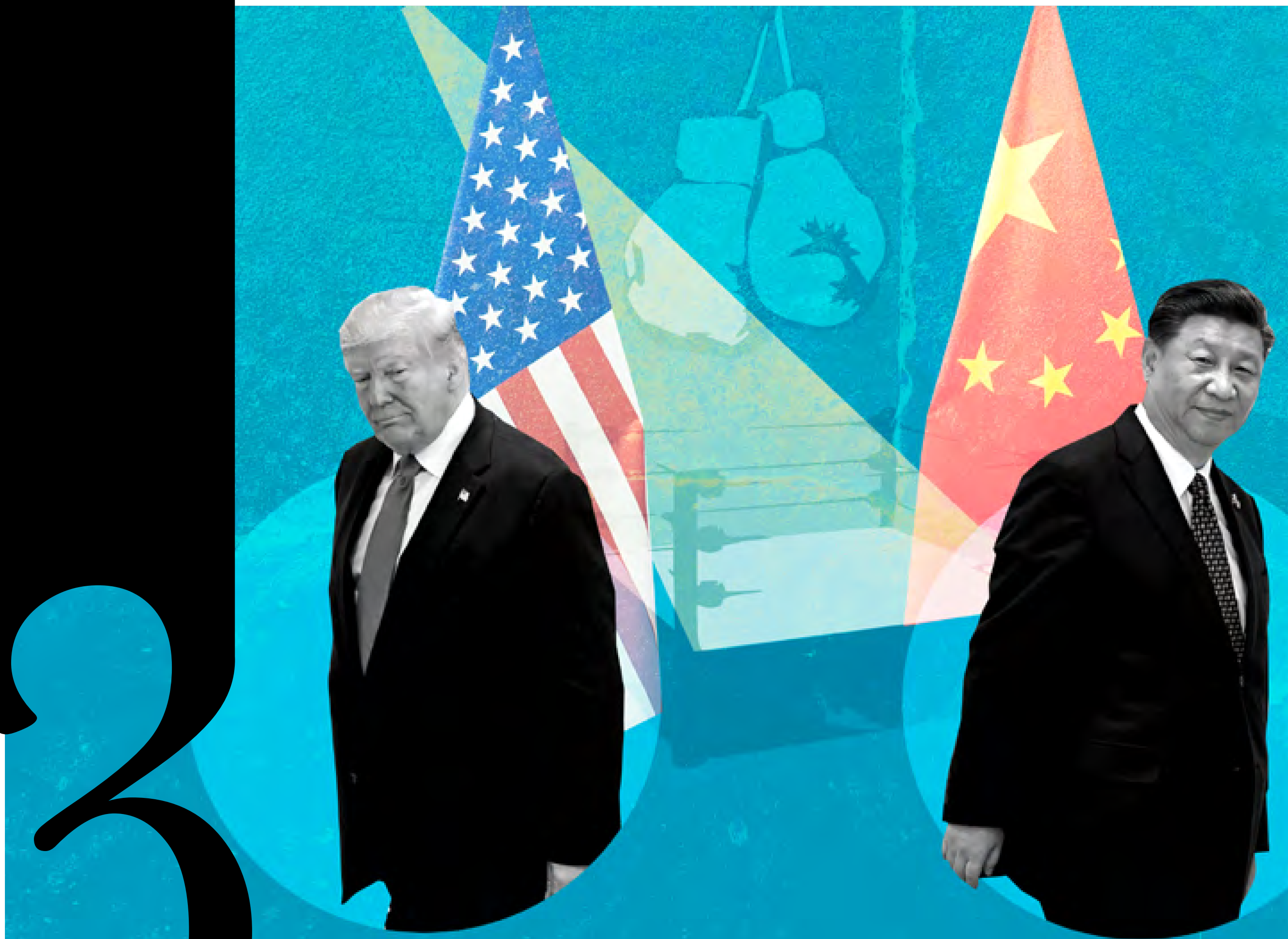
**Product/supply chain decoupling**
US-China trade tensions are accelerating the ongoing restructuring of global value chains

**Talent flows**
R&D decoupling, US actions against Chinese STEM researchers, students, and personnel

**Financial markets**
Falling investment levels, US looking at Chinese companies' US stock markets listings

**Global standards/data governance**
China's data governance regime will be difficult for foreign companies to navigate; lack of global consensus on data flows drives growing risk of separate internets

Source: Eurasia Group



# 3

## US/China

**As this decoupling occurs, US-China tensions will lead to a more explicit clash over national security, influence, and values. The two sides will continue to use economic tools in this struggle—sanctions, export controls, and boycotts—with shorter fuses and goals that are more explicitly political. Companies and other governments will find it harder to avoid being caught in the crossfire.**

This struggle has hard-edged realism—great power rivalry—at its core. It's not yet as starkly ideological as the classic Cold War formulation of capitalism vs. socialism. But as tensions escalate, divergences between the two countries' political structures are bringing irreconcilable differences to the fore. The US-China rivalry will increasingly be waged as a clash of values and animated by patriotic fervor.

The United States sees China as a repressive regime that will use its economic clout to punish its foes and limit criticism from overseas, as we saw in the snap NBA boycott in response to an executive's tweet in support of pro-democracy protesters in Hong Kong. China sees the United States as a hegemon that wants to stunt the growth of, and sow division within, its rival, a narrative that Xi has used to enhance the Communist Party's legitimacy and his own consolidation of power.

The trade war has been fought to a standstill and won't go away, with a truce in place but little chance of a breakthrough. The US foreign policy establishment is focused on how to contain China rather than compete with it, amplifying bilateral tensions. China-bashing will feature prominently in the US presidential campaign, and an already China-skeptical Trump will have mixed intentions and limited capacity to stop his administration from taking tough action against China on national security and foreign policy issues.

Furthermore, Hong Kong's political crisis will persist, while Taiwan's January 2020 vote will likely see a reelection of Beijing's foe Tsai Ing-wen, bolstered by stronger nationalist sentiment within the population. The United States will emphasize military and diplomatic support for Tsai's regime and at least moral support for Hong Kong's protesters (driven by Congress), prompting angry objections from Beijing over interference in its domestic affairs.

As a consequence, the US will take tough measures against China, including financial sanctions (over Xinjiang, Iran, Hong Kong), designation of officials, technology controls, and efforts to limit US capital flowing to Chinese firms. These actions will also create tail risks for an already softening Chinese economy. Meanwhile, China will punish US and other foreign firms viewed as supporting Washington's "containment agenda." The "unreliable entities" list will grow longer, and China will continue to restrict space for foreigners by reducing their ability to get visas. The politicization of China's economic relationships will intensify as Beijing looks for ideological "outlets" to vent over an aggressive Washington and slowing economic growth at home.

Meanwhile, as Trump faces a challenging reelection campaign, Xi may test Trump's willingness to push back aggressively in areas such as Hong Kong and Taiwan, sensing that while trade matters for Trump, he is less interested in security questions. That's dangerous, because the US president is unpredictable.

US turns to China's "core interests"


| HONG KONG | S. CHINA SEA | TAIWAN | XINJIANG | TECH/INDIGENOUS INNOVATION |
| --- | --- | --- | --- | --- |
| "State sovereignty" | "National security" | "Territorial integrity" and "national reunification" | "China's political system established by the Constitution" and "overall social stability" | "The basic safeguards for ensuring sustainable economic and social development" |

Source: Eurasia Group, State Council Information Office, The People's Republic of China

**Divergences between the two countries' political structures are bringing irreconcilable differences to the fore. Thus, the US-China rivalry will increasingly be waged as a clash of values and animated by patriotic fervor.**

4

# MNCs not to the rescue

**Many observers believe multinational corporations (MNCs) will fill the gaps in global governance and the liberal order left by the G-Zero world. Specifically, the private sector will step in to lead in areas such as climate change, poverty relief, and even trade and investment liberalization. We're skeptical. Especially as corporates face a significantly more confrontational regulatory and geopolitical environment in the year ahead.**

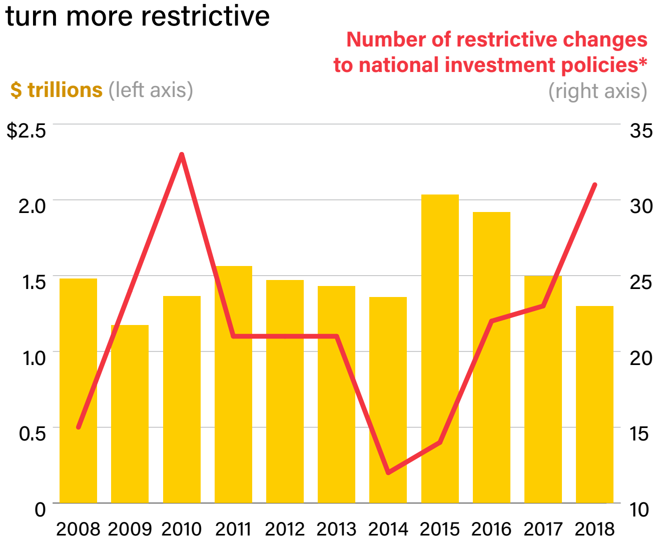
Since World War II, US-led globalization has been a boon for MNCs, as it expanded and entrenched global supply chains based on cheap labor and resource inputs from around the world. They now account for more than 50% of global trade, one-third of global output, and about one-quarter of global employment. MNCs have become influential political actors as governments shaped global trade, regulatory, and tax regimes in their favor. And the firms have in turn exerted influence on policy. Markets overseas where MNCs from the United States invest in manufacturing receive lower tariff rates from the US government. So too, World Bank projects involving MNCs are more likely to get better financing terms because of their ability to influence the bank's largest governmental backers.

But today, nation-states are reasserting themselves, presenting new risks to the capital and assets of corporations. Structural factors motivate governments:

slowing global growth, widening socioeconomic disparity, rising populism and nationalism, and tech competition between the United States and China that makes trade riskier.

In the European Union, governments are turning to industrial policies to promote domestic firms and counter China's statist approach. In the United States, regulating "Big Tech" is an increasingly prominent idea in politics. US national security officials are pushing to protect critical infrastructure and limit foreign investment, including from third-country firms. They are also attempting to compel Western corporates to embrace a Washington-centric view of "trusted vendors" and ownership transparency as part of broader efforts to curtail US market opportunities for Chinese firms. And even as a divided US Congress stalls changes in some areas, individual states are increasingly regulating on issues from privacy to antitrust. In China, decoupling from the United States translates into more aggressive industrial subsidies in the high-tech arena, from electric vehicles to semiconductors.

Global FDI inflows are falling as national policies turn more restrictive




*Changes in national investment policies that put new restrictions on investment, according to UNCTAD
Source: UNCTAD

It's not just the "move fast and break things" tech firms that face elevated risk. In years past, companies succeeded in "capturing" state institutions to forestall or diminish unfavorable regulations. In the US, firms spent $3.5 billion on corporate lobbying in 2018 and were on track for a similar amount in 2019—up from $1.5 billion in 1998. They will face backlash to these efforts from rising anti-trade populist movements, particularly in developed markets. A win for a further-left candidate such as Sanders or Warren is not our basecase in the US, but the resonance of their economic message will influence more centrist policy thinking on issues such as regulating the private equity industry, enforcing antitrust policies, and controlling pharmaceutical pricing. Both sides of the political aisle recognize the salience of anti-corporate sentiment—a recurring theme for Trump and part of his campaign message in 2016.

Multilateral free trade agreements once gave MNCs leverage to reduce regulatory pressures, or at least make regulation consistent across many markets, smoothing compliance costs. No longer in 2020, as governments instead pursue bilateral agreements that are productive in isolation but create new inconsistencies in global regulations and tariff rates.

New regulatory risks will strain corporate reputations and make public and government affairs management more difficult. Government affairs will need to be more involved in strategy and boards more conversant on policy and regulatory risk. Companies can't be all things to all people. They will maximize gains in areas where regulatory pressures align with their core business models (think Apple on data privacy and Tesla on sustainability) while minimizing risks of fallout elsewhere.

The ability of MNCs to generate wealth, growth, and jobs will take a hit. Shareholders will need to adjust expectations. Nation-state pushback comes at a time when earnings projections for next year are already buffeted by geopolitical risk. Investors are balancing the potential for an easing of US-China tariffs against forced technological decoupling and softer economic growth projections in the world's biggest markets. Increasing and more disparate regulatory demands from national governments will add to transaction costs and put further pressure on profits. Data privacy policies in Europe, a digital tax push in the OECD, and an "unreliable entities" list in China are just the beginning of the list of challenges.

And so MNCs won't be as much help with global governance or supporting the global order. Given new headwinds, most will need even sharper focus on their bottom lines. Yet another driver of the G-Zero world.

**Nation-states are reasserting themselves, presenting new risks for corporations.**

5

## India gets Modi-fied

**Prime Minister Narendra Modi has spent much of his second term promoting controversial social policies at the expense of an economic agenda. The impacts will be felt in 2020, with intensified communal and sectarian instability, as well as foreign policy and economic setbacks.**

Modi and his government have been busy in recent months. They revoked the special status for Jammu and Kashmir and implemented a system to identify illegal immigrants in the northeast, stripping 1.9 million people of citizenship. The government also passed a law that, for the first time, makes religion a criterion for migrants from neighboring countries to formally acquire Indian citizenship. Behind these moves is Amit Shah, the former head of Modi's Bharatiya Janata Party (BJP), now home minister.

## Sectarian and religious conflict will grow this year.

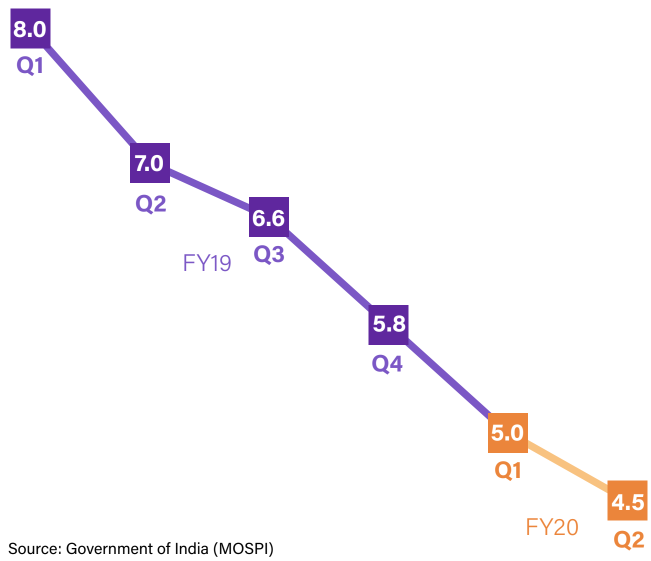
Sectarian and religious conflict will grow accordingly. Kashmir is a powder keg, with political leaders still under arrest and internet access cut off. Protests have already spread around India as many citizens fear the loss of India's secular identity. The government's harsh response, in turn, will provoke still more demonstrations. But Modi will not back down, and as the government pursues its new agenda, state-level opposition leaders will directly challenge the central government.

This focus on the social agenda will also have harmful effects for India's foreign policy. Its actions on human rights will be under closer scrutiny by many nations, and its reputation will take a hit. India's relations with the US, which have been a bright spot under Modi, will face a challenge in 2020. Some members of the US Congress are concerned with India's policies generally, and in particular with its plans to buy the S-400 missile defense system from Russia. Congress could impose sanctions. At the least, the anti-missile system purchase will impede further sales of US military equipment to India, the strongest plank of the bilateral relationship.

The economic spillover is also noteworthy. The social agenda has empowered a key part of Modi's base, the Rashtriya Swayamsevak Sangh (RSS)—Hindu nationalists who oppose market opening and support economic nationalism. The RSS is the ideological parent to Modi's BJP and helped ensure his reelection. An empowered RSS means that Modi has less room to maneuver on structural reforms, just as the economy is starting to sputter, with quarterly growth falling to a six-year low of 4.5% and forward-looking indicators looking softer still. The RSS influence was evident in Modi's decision to drop out of the Regional Comprehensive Economic Partnership negotiations last year and will be a big reason why India is unlikely to rejoin in 2020.

### Sliding growth adds to Modi's challenges

GDP growth, %




Source: Government of India (MOSPI)

India's fiscal situation is also precarious, as the government faces a widening fiscal deficit, marked by the underperformance of the goods and services tax. A weakened economy will in turn feed further economic nationalism and protectionism, weighing on India's troubled course in 2020.


6

# Geopolitical Europe

**For years, Europe has talked a big game about charting its own course on foreign and trade policy. So far, it has proven unable or unwilling to effectively push back where it disagreed with Washington or, increasingly, Beijing. This is about to change.**

The new leadership of the European Commission and the European Union's most powerful leader at present, French President Emmanuel Macron, share a sober view of world affairs. They think the EU has been naive in expecting its main commercial partners to play by the rules and want to equip themselves to react to unfair practices and anticipate further unilateral decisions. European Commission President Ursula von der Leyen and Macron believe the EU should be "the guardian of multilateralism." That such principles are under attack has convinced von der Leyen that the EU should actively defend itself against competing economic and political models.

On regulation, the European Union's top antitrust official, Margrethe Vestager, is battling North American tech giants through the innovative use of EU state-aid law to question their tax arrangements.

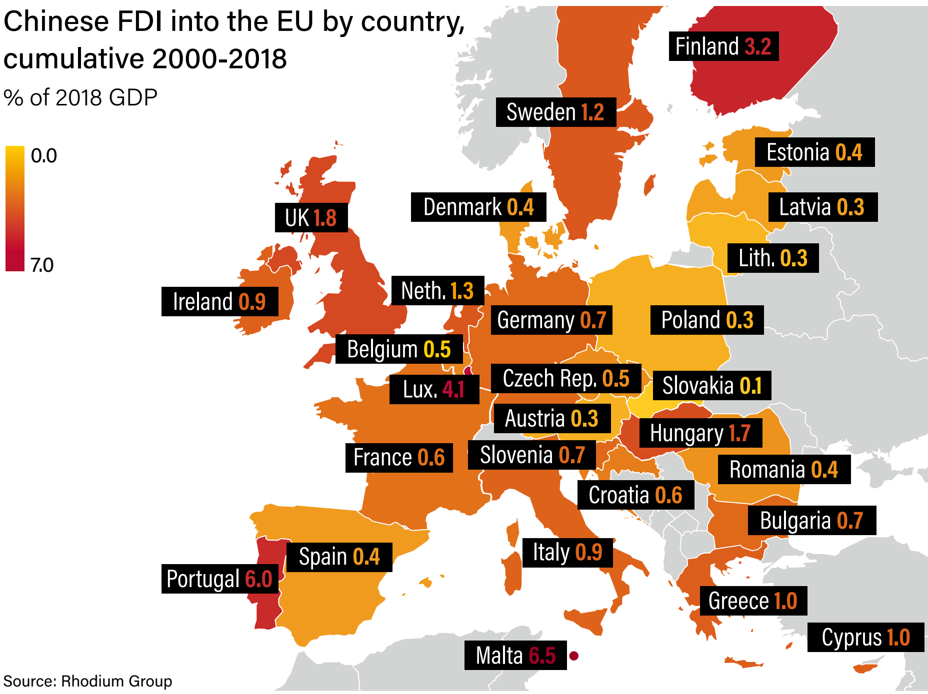
On trade, the EU will bring this more assertive approach to new areas, for instance by making compliance with the Paris climate agreement a condition for new deals and by retaliating in kind against punitive tariffs. Member states and the commission are also putting pressure on China to level the playing field on procurement, with the threat of using new "international procurement instruments" against Chinese firms if European firms don't get improved access to the Chinese market.

On military matters, the EU is not about to stand its own continental army, but it will take steps toward using the world's largest internal market to break down cross-border barriers to military trade and technological development. Seen from the US, this will be an affront, especially since few European capitals have fulfilled their NATO promises on defense spending.

**The EU's new leaders think the bloc has been naive in expecting its main commercial partners to play by the rules, and they want to equip themselves to react to unfair practices.**

Chinese FDI into the EU by country, cumulative 2000-2018

% of 2018 GDP



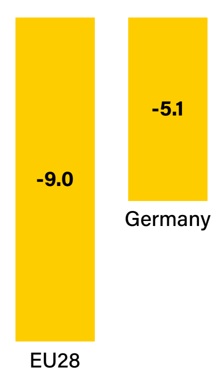

Source: Rhodium Group

This more independent Europe creates risks with the United States. Washington could lash out at Brussels, especially because Trump is no supporter of the European Union. Retaliatory tariffs are no longer taboo, and a Europe-wide digital tax could provoke punitive tariffs on some of Europe's more export-driven sectors, such as automobiles and consumer goods. Data sharing is also at risk. There is growing concern about the EU becoming too aggressive in pushing its regulatory lead, particularly via the so-far successful General Data Protection Regulation (GDPR). As the European Union takes on US tech giants, the United States is likely to pursue a more aggressive approach to countering the GDPR.

A more geopolitically active EU will also create more tension with Beijing. To date, China has achieved many of its goals in Europe: Firms are still welcome to invest in infrastructure and wariness of China's Belt and Road Initiative (BRI) has yet to spread to most member states. But Beijing fears that Macron will push for more binding EU-wide screening of BRI projects. A tougher EU stance on antidumping will exacerbate tensions. EU-China friction over issues such as Xinjiang and the South China Sea will intensify. Much as China insists that the world accept One China, Two Systems, a more geopolitical Europe will try to insist that China accept One System, 28 States. That's not going to sit well in Beijing.

Potential impact of US section 232 auto tariffs against Europe

Billions of Euros




Source: Ifo Institute

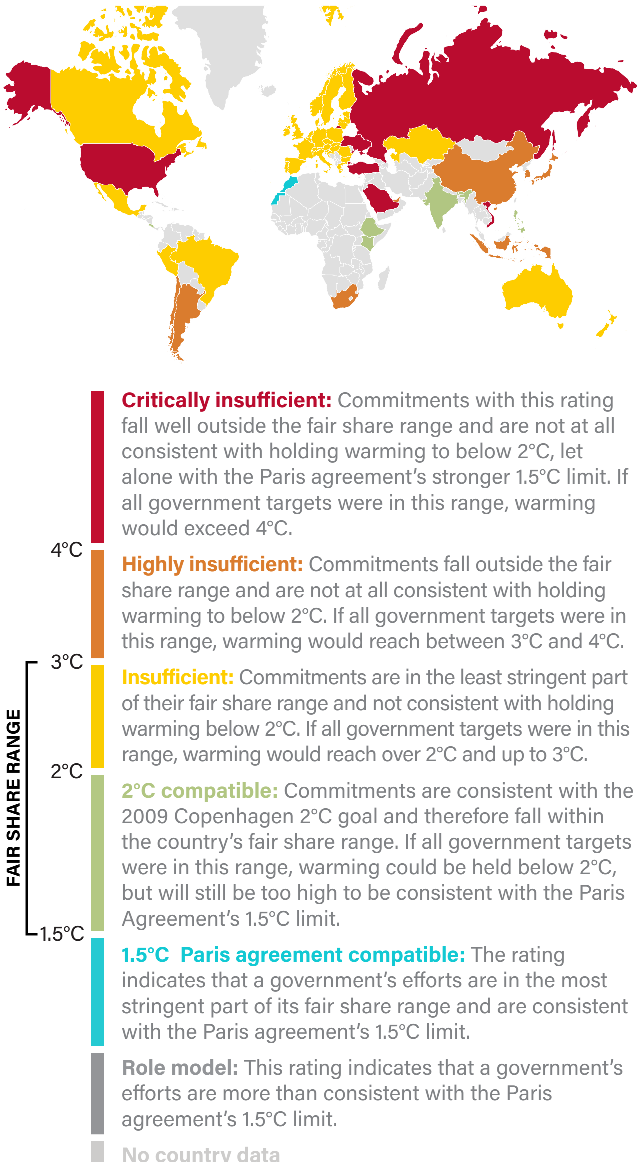

7

# Politics vs. economics of climate change

**The politics of climate change aren't working. Dozens of countries signed on to the Paris agreement five years ago to limit warming to 2 degrees Celsius by the end of the century. But nation-states have to date failed to implement policies that come close to achieving that goal. This year that failure will lead to suboptimal corporate decision-making, operational business disruptions, and political instability.**

The world is currently on pace for a 3.5-degree warming. The world's largest emitter, China, is on a 3-degree path and unwilling to compromise economic growth ambitions on the necessary scale. The US is on a 4-degree pathway that's hard to reverse, no matter who wins the November election. That leaves India as the only country among the top three polluters with a national plan consistent with 2 degrees, though India is already falling behind its targets.

## Progress on intended nationally determined contributions (INDCs) by country




Source: Climate Action Tracker

Even countries whose political leaders have ambitious climate plans won't have it easy. Some will face an anti-elite backlash to climate action, as we've seen in France. Others will struggle to meet existing high-bar targets, as in Germany. In the United States, any Democrat running for president will be a "dark green" environmentalist seeking ambitious change—but even if a Democrat defeats Trump in November, progressive climate action will face high legal, regulatory, and political hurdles in 2021 and beyond.

That puts politics on a collision course with a growing percentage of investors, companies, and society at large, which will carry higher costs this year.

Corporate decision-making will face a squeeze. Over one-third of global capital has some type of environmental, social, and corporate governance (ESG) mandate, and trillions of dollars in investment already exclude companies and countries that won't meet the 2-degree threshold. Faced with shareholder activism and pressure from their own employees, and looking to seize business opportunities that arise from becoming more sustainable, more than 600 global companies have committed to reducing their emissions consistent with 2 degrees. C-suites will feel they have to choose between aggressive ESG mandates and their bottom lines.

Social pressure will create more costly operational and investment-flow disruptions. Civil society will press investors and companies it believes are moving too slowly—particularly oil and gas firms, airlines, carmakers, and meat producers—a trend led by growing grass roots movements such as Extinction Rebellion and Fridays for Future. Related supply chain disruption will become a meaningful risk. In turn, investors will reduce exposures to carbon intensive industries—including critical sectors such as steel and cement—impacting asset prices.

There's also a growing risk of public unrest over climate, with increasingly dangerous actions being taken by protesters. Opposition to cuts in fuel subsidies/higher prices will have a direct impact on climate policy and also trigger heavy-handed responses from governments that could push protests out of control.

All of which is happening as a warming planet makes natural disasters more frequent and more severe. For the first time in history, the Anthropecene is itself creating economic constraints on globalization. That requires mention on any global risks list going forward.

**Politics is on a collision course with investors and society at large.**

8

## Shia crescendo

**US policy toward the major Shia-led nations in the Middle East is failing. That creates significant risks for regional stability, including a lethal conflict with Iran; upward pressure on oil prices; an Iraqi state that is either in Iran's orbit or failing; and a rogue Syria fused to Moscow and Tehran.**

The 2 January killing of Qods force chief Qassem Suleimani, ordered by Trump, escalated already significant US-Iran tensions. This is a #8 risk, not higher, because of strong structural pressures against a major war (see red herring #1). Iran is a committed adversary of the United States but also has a clear understanding of US military power ... as well as (now) a better sense of Trump's red lines and deterrence capacity. Iran further has a history of backing down in the face of an overwhelming military threat. For his part, Trump still seeks to avoid large-scale military entanglements on his watch, especially as the election campaign gears up.

But the US-Iran relationship will be deadly and geopolitically destabilizing. Lethal skirmishes in Iraq between US and Iranian forces are likely. Iran will continue to disrupt tanker traffic in the Gulf. Tehran also has a penchant for hitting adversaries in unpredictable, asymmetric ways, including through its robust offensive cyber capabilities and proxy network across the region with the capacity to target the citizens and assets of the United States and its allies. A more dangerous if still limited US-Iran regional conflict is less likely but possible. Iran tensions will put a minimum of a $5-$10 premium into the oil price this year and increase volatility.

In Iraq, the United States is on its way to persona non grata status, which will leave more running room for an already influential Tehran. US bombings and the Suleimani killing have alienated much of the Shia Iraqi political class. The chance is rising that the government will expel US troops this year. While the US is losing big, Iran is only a relative winner, as protests over poor social services and corruption were also focused on Iranian interference. This popular discontent has outsized importance for the region, as it will strain if not break the fibers of the Iraqi state—OPEC's second-largest oil producer.

Finally, Syria. The US is still a player if it keeps troops in the energy-rich east of the country (though a withdrawal of US forces from Iraq would undermine US supply chains, intelligence, and operational support). But it's played a poor hand; in fact, neither Barack Obama nor Trump has had a coherent Syria policy. Vladimir Putin won the war with help from Tehran. The outcome has led to increased Russian prestige and influence, especially in the Middle East. Significant sway for a country with a poor human rights record and a tradition of hacking into other nations' affairs is not stabilizing. Meanwhile, Iran's interest in Syria is about a land-bridge to Hizbullah, not improving the lives of the population.

Feckless US policy in Iran, Iraq, and Syria will drive regional risk in 2020, to the detriment of the regional political and economic order.

## US policy toward the major Shia-led nations in the Middle East is failing.

Iran's regional reach


Source: IISS

# 9 Discontent in Latin America

**Public anger will keep the risk of political instability high across the region. Voter complaints include sluggish growth, corruption, and low-quality public services. Even worse for governments, new and vulnerable middle classes want more spending on social services, and Latin American societies are deeply polarized.**

This discontent reduces governments' ability to undertake needed austerity measures. The IMF and investors will press for fiscal prudence, but governments across the region will respond half-heartedly. These pressures will generate risks across Latin America: Protests will occur, fiscal balances will deteriorate,

# Discontent reduces governments' ability to undertake needed austerity measures.

election outcomes will be less predictable, populist and antiestablishment politicians will grow stronger, and sentiment will worsen.

The election of right-wing presidents in Argentina (2015), Brazil (2018), Colombia (2018), Chile (2017), and Ecuador (2017) has proven to be a backlash against incumbents and political establishments rather than an endorsement of market reforms.

And examples abound of popular discontent leading to market-negative political change. In Argentina, President Alberto Fernandez was elected by angry and hurting voters. He will increase state intervention and try to boost growth by abandoning fiscal and monetary prudence. Negotiations with private creditors and the IMF will be contentious. Fernandez will try to minimize debt repayments during his term, and he'll balk at implementing pension and labor reforms.

In Ecuador, an angry electorate forced President Lenin Moreno to back down from a fuel price hike he negotiated with the IMF, leaving him severely weakened. He'll struggle to cut spending or raise additional revenue, putting pressure on the fiscal balance and the IMF program. These developments heighten the likelihood that a populist candidate will emerge ahead of the 2021 elections.

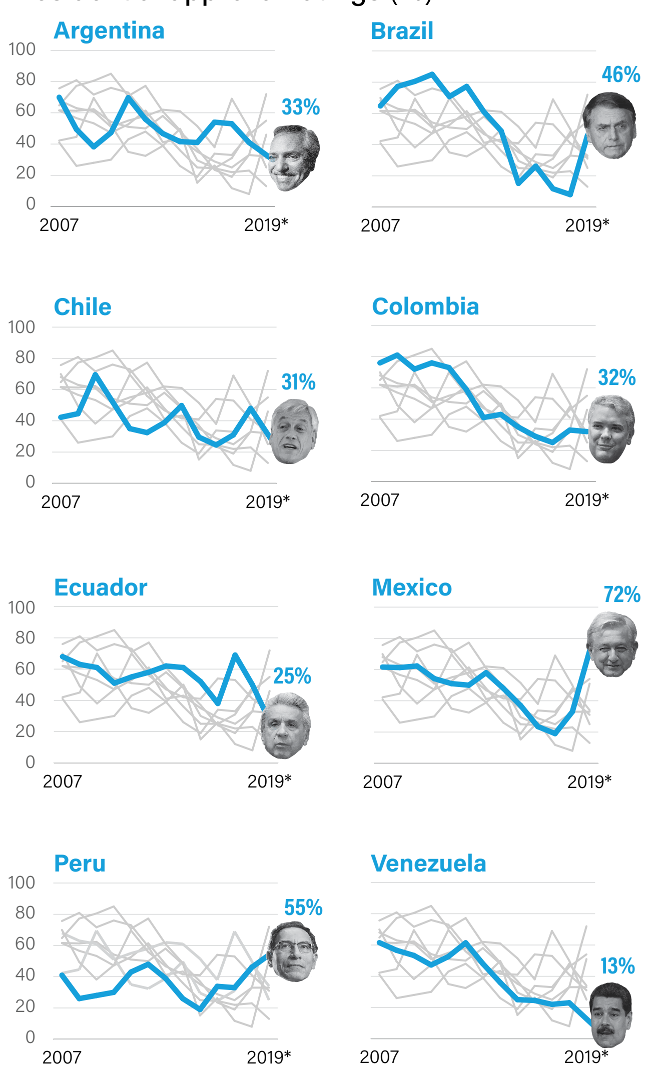
Colombian President Ivan Duque will struggle to maintain fiscal stability. Eighteen months into a four-year term, his approval rating stands at 24%. Without a majority in Congress and facing growing pressure from the streets, Duque will fail to pass meaningful structural reforms, and voter discontent will grow.

Public anger and protests in Chile forced President Sebastian Pinera to dramatically ramp up social spending and start the process of rewriting the constitution in 2019. The unrest was the result of deep-seated discontent with the status quo. Constitutional changes will hurt the economy by triggering higher spending, more regulation, and persistent uncertainty over the substance of the changes.

In Mexico, President Andres Manuel Lopez Obrador remains popular, but his promise to maintain fiscal stability while increasing spending will be difficult to maintain. He's committed to boosting social and infrastructure spending while grappling with a slowing economy and lower oil production. Lopez Obrador will push through austerity measures and raise taxes, but these won't be enough. Security conditions will worsen.

Brazil is the one major economically promising country in the region for 2020. President Jair Bolsonaro, like many of his colleagues, was elected as an outsider. He has passed landmark pension reform legislation and is pursuing other overhauls, including on taxes. His approval ratings are low (44%) but stable, and he has a loyal base. But while the Brazilian economy is trending favorably, public anger will come quickly if current forecasts for a rebound don't pan out. That in turn would limit Bolsonaro's ability to implement reforms, potentially turning his administration toward more overt nationalism and/or helping the return of the opposition in 2022—either way a challenge for the region's largest economy.

Presidential approval ratings (%)




*Average to date
Source: Poliarquia, Ibope, Adimark, Cadem, CID Gallup, Cedatos, Reforma, El Financiero, Ipsos, Datanalisis

10

## Turkey

**President Recep Tayyip Erdogan has entered a period of steep political decline. Erdogan has a long history of provocative behavior in response to threats, sparking confrontation with both foreign and domestic critics. This year, his weakness will lead him to lash out. The response will further damage Turkey's already ailing economy.**

It's in the arena of foreign policy, especially relations with the United States, that Turkey will fall to new lows. US congressional sanctions will likely take effect in the first half of this year, undermining the country's reputation and investment climate for corporates and putting further pressure on the lira. Measures will include a mandatory reduction in

## Erdogan's popularity is slipping, especially among young people.

military sales to Turkey and actions against some Turkish officials. In addition, the trial of Halkbank in New York state will pose major financial risks. It could result in a fine of billions of dollars and will almost certainly involve the release of embarrassing details about Erdogan or those around him.

On the political front, Erdogan's popularity is slipping, especially among young people, and his ruling coalition is shaky. The president is suffering defections from the ruling Justice and Development Party. Popular former party officials are in the process of establishing two new political movements. The partnership with the Nationalist Movement Party may not last given the poor health of its leader.

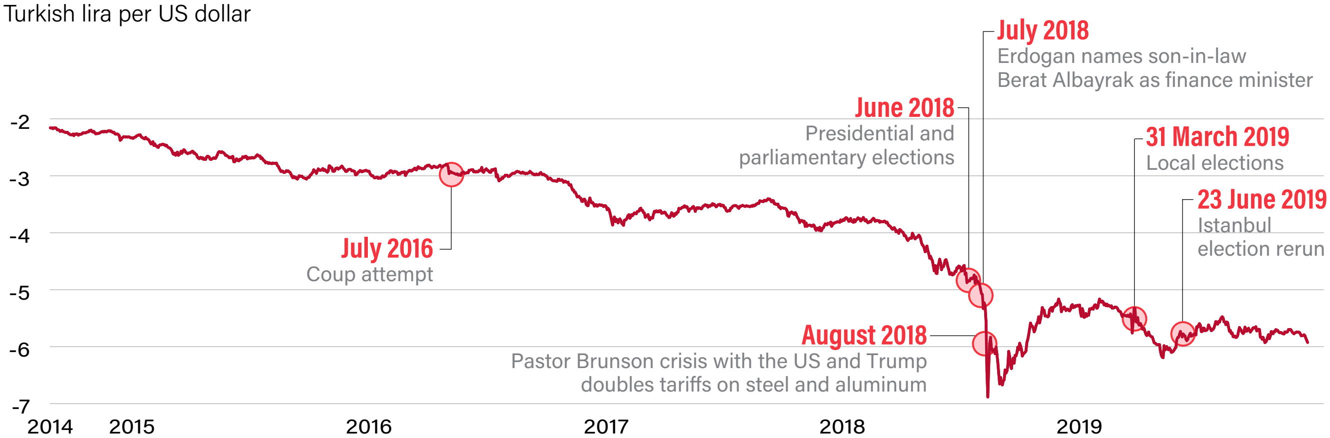
Erdogan will take tough stances to try to bolster his political support. Internationally, he will refuse to cooperate with US authorities if Halkbank is fined, putting Turkish state assets in the United States at risk. He could enact countersanctions on the US, provoking an escalatory cycle. Erdogan may also expand drilling in the eastern Mediterranean, further exposing him to European sanctions and potentially risking military conflict with Greece.

Erdogan's reaction in the economic sphere will lead to another set of risks. As sanctions further strain the Turkish economy, he will turn to his bag of unorthodox economic tools and dig an even deeper hole. Erdogan will use unconventional means to defend the currency, which will backfire and hurt investor confidence. The president is inclined to order state-owned banks to intervene in the market with sales of foreign currencies, and Turkey will face a significant risk of capital controls this year.

Erdogan will maintain high levels of repression at home to undermine the strength of rival political parties and cooperation between them. That in turn will prompt harsher sanctions and further political and economic instability. Turkey gets worse before it gets better.

The impact of politics on Turkey's currency during Erdogan's presidency

Turkish lira per US dollar




Source: Bloomberg, Eurasia Group

# RED HERRINGS

## The new axis of evil

Iraq has graduated from the "axis of evil," but Iran and North Korea remain US bogeymen. Add Venezuela and Syria to the list, and you've got quite a group of committed US adversaries. But unlike Bush's original list, which precipitated US regime change in Iraq, Trump isn't going to do much to topple his antagonists and accordingly the United States is unlikely to open a new war in 2020.

Iran is the biggest challenge. After the US's assassination of Suleimani, the Islamic Republic will need to retaliate. That includes a faster ramp up of its nuclear program, an expansion of its proxy war, and probably even direct strikes against the US and allies. But neither Trump nor Tehran wants war. The US president abhors foreign ventures; a fight with Iran would be a big one that could hurt him during the election campaign. For all their bluster, Iranian elites retain a healthy respect for US power.

Meanwhile US allies (especially Saudi Arabia and Israel) are chastened by a lack of US support for confrontation; Saudi Arabia in particular is looking for ways to ease tensions. A diplomatic resolution remains a longshot, but we'd still bet against a major US-Iran war.

North Korea will play "hard to get" over the coming months. Pyongyang knows that Trump is desperate for a foreign-policy win and that it's better off with him than any other plausible US president. So it will feel safe pushing ahead with headline-grabbing escalation—provocations with the missile program and maybe even a satellite launch or an intercontinental ballistic missile test. Still, that's ultimately about securing sanctions relief, not bringing the US to the brink. We're taking the under.

Compared with Iran and North Korea, Trump cares little about the fortunes of Syria or Venezuela. He'll continue to draw down troops in Syria, despite the inevitable consequences that Russia and Iran will benefit and the Islamic State can reorganize. Venezuelan President Nicolas Maduro will continue to preside over a government that has destroyed its nation but poses little risk to anyone but its neighbors. The odds of Trump taking military action in Venezuela are close to zero.

## Populist policies in the developed world

Populism continues to surge around the world, capturing more media attention along the way. Yet, for all the aggressive rhetoric and colorful characters, the world's most-established democracies remain well-positioned to weather the populist storm for at least the next year … though for different reasons.

In the United States, the policymaking process remains captured both by special interests and the country's professional policy corps (what Trump calls the "deep state" but is actually a "deep bureaucracy"). In Europe, individual countries continue to experience a surge by populists at the national level, but their disruption has been limited by the supranational architecture of the European Union, a durable set of rule-making institutions staffed by the most technocratic personnel on that side of the Atlantic. The United Kingdom—in leaving the EU—is the exception, but under the majority leadership of a maximally unideological Boris Johnson, gets a short-term break (please see our next red herring). For its part, Japan has sidestepped the political phenomenon of populism, the result of a unique combination of low inequality, limited migration, aversion to military adventurism, and the comparatively small reach of "fake news."

This doesn't mean these countries will be insulated from populist policies indefinitely. Slowing global economic growth, climate change, and labor displacement will strengthen populist politicians over time. But for 2020, there's not much policy impact.

## Post-Brexit

Finally, the United Kingdom gets a break. A big win for Johnson and his Conservative Party—and an even more historic loss for Jeremy Corbyn's shambolic election efforts—gives the Brits some much needed breathing room.

The UK will (finally!) leave the European Union on 31 January, putting to rest nearly four years of unprecedented political uncertainty. Johnson's new Conservative majority will vote through the withdrawal agreement and "political declaration" to formalize the UK's exit later this month.

Johnson will lead a "divergence government"—one that prioritizes the UK's regulatory freedom from Europe to do things differently—even if this limits access to the single market and creates substantial headwinds for the UK's economy and its industrial heartlands. Despite this, there is unlikely to be much impact in 2020. The United Kingdom will remain in a standstill transition for all of this year, even as negotiations get rocky (which they invariably will). This will offer investors a degree of certainty through all of the noise, if only for 2020.

And having just won in Brussels, Johnson isn't about to risk the union. So while Scotland will also be noisy, there is no chance this year of an independence referendum. True, Nicola Sturgeon's Scottish National Party's strong showing in December's election has buttressed her claim that Scotland's interests are being ignored. But it is only over time that the UK's creaking economy will reinforce her push for independence.

This is not a top risk year for the UK. But not to worry for those who miss it—there's surely more political trouble down the road.

**In the near term, populist politicians will have little impact on policy.**

We started Eurasia Group back in 1998. It was a simpler time. It was a geopolitically more confident time. Twenty-two years later we find ourselves missing Y2K and the hole in the ozone layer. We're a lot more worried about the future.

But as we ring in the new year and the 2020s, we're also resolved to find more purpose through our global challenges. To be grateful but not overwhelmed. That seems just about manageable. And as our first step this year, we wish to offer our deep thanks to you for being a part of our extended family. We wouldn't be here without you.

With good wishes,

Ian and Cliff





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