



FOR USE BY INSTITUTIONAL INVESTORS ONLY. NOT FOR USE WITH THE GENERAL PUBLIC.

2020 VISION

FIRST PUBLISHED MARCH 2020

Bill Emmott is an author, commentator and former editor-in-chief of *The Economist*. He considers the economic and political outlook, in a year dominated by the US presidential elections, trade tensions and Brexit.

BILL EMMOTT

Bill Emmott was editor-in-chief of *The Economist* from 1993 to 2006. He is now chairman of the International Institute for Strategic Studies, the Japan Society of the UK and Trinity Long Room Hub Arts & Humanities Research Institute. His next book, *Japan's Far More Female Future*, will be published in summer 2020. In 2017, Bill spoke at a Walter Scott Lecture Series event in Japan.

If 2019 was dominated by the uncertainty of trade wars and Brexit, 2020 was shaping up to be a smoother ride – until Covid-19 intervened. Economists were expecting steady if suboptimal economic growth, widely spread around the world, with no serious prospect of generalised inflation, suggesting that major central banks would either cut interest rates and expand quantitative easing or at worst hold steady. And then came the new coronavirus.

This virus, which emerged from China during January, has widened the range of possible outcomes, to say the least. Yet let us keep it in proportion: experience with previous viral epidemics shows that while they may well be very disruptive in the short term, especially to travel and to major international meetings and events, they prove to be an unpleasant interruption rather than a long-term game changer. Unless, that is, they have a political impact, which this one might.

“The places to watch for potential market-disturbing discontinuities look to be the US, China, Germany and, as always, the Middle East. For once, by contrast, Britain might start to look stable and even predictable.”

This fits with 2020’s real theme: politics. Let’s not forget that the year began with something unusual and politically provocative: the assassination by the US of a senior military figure from Iran, while he was visiting Iraq. And the year will end with something highly usual but potentially more consequential than in past cycles: a US presidential election.

Typically, where politics prevails, big discontinuities can occur. This year, the places to watch for potential market-disturbing discontinuities look to be the US, China, Germany and, as always, the Middle East. For once, by contrast,

Britain might start to look stable and even predictable, after three years of Brexit paralysis and confusion.

Following the killing of Qassem Soleimani, the first indications were that this would not lead to a wider or more sustained conflict. The opening Iranian retaliation through missile attacks on US bases in Iraq appeared designed to avoid escalation. It was anyway overshadowed by the tragic shooting down in error of a Ukrainian airliner and resulting unrest against the Iranian regime.

If there was a calculation on the US side that Iran is too weak to risk a major conflict, this appeared to have been borne out. But we should remember that this was an opening retaliation, which may not mark the end of the story. We might also note that Iran has become closer to Russia, with which it has collaborated in Syria.

The contemporaneous backdown by North Korea from its threat to send “a Christmas gift” if the US did not make concessions over sanctions relief carried a similar implication. No matter how often North Korea’s leader Kim Jong Un is pictured riding a symbolic white horse to the sacred Mount Paektu, he is not really in a strong position to act. But again, that weakness needs to be interpreted with caution. Sometimes regimes in a weak position compensate by lashing out to keep opponents off balance. The risk of Iran or North Korea doing so, perhaps in what pundits like to call “an October surprise” to disrupt the November US election, cannot be ruled out.

Nonetheless, President Trump’s foreign policy this year has so far made him look quite strong and successful, or at least not reckless. Moreover, we have witnessed a ceasefire between the US and China over trade. It brings no great breakthrough for either side but reduces risk and kicks the main issues to beyond the November election. With the US-China dispute on hold, some think Trump may turn his trade fire on Europe. But he is unlikely to take

this very far for fear of disrupting his re-election year.

“Conventionally, a second-term president soon becomes a lame duck, unless his party also controls Congress. That convention might have to be put to one side in Trump’s case.”

The November election will be all about legitimacy, not policy: Trump’s legitimacy, that is, in the face of Democratic Party attacks on his conduct and character. The boast of low unemployment and robust economic growth is too important to jeopardise just to poke the Europeans in the eye.

The reason why this year’s US presidential election could be more consequential than on previous occasions arises precisely from that legitimacy question. During his first term, Trump has shown that the only element of democracy he really respects is consent from voters. In 2016 he lost the popular vote to Hillary Clinton, which still rankles, but he has also spent three years fighting off the Mueller investigation into his Russian ties and this year’s short impeachment trial over his efforts to use Ukraine to investigate his opponents. Re-election despite all of that would signify true vindication and legitimacy, in his eyes.

Conventionally, a second-term president soon becomes a lame duck, unless his party also controls Congress. That convention might have to be put to one side in Trump’s case, for victory would embolden him, especially if the Republicans also fare well in the congressional and state polls. He could become even more aggressive in trade and foreign policy, and in the exercise of his executive powers.

Most radical of all, a re-elected, legitimised Trump might attempt to copy Vladimir Putin and promote a constitutional amendment to allow himself to run for a third term.

Although the Republicans are unlikely to have sufficient power in Congress to win the required two-thirds majority in both houses, the alternative route provided for in the US Constitution is not so far out of reach: an amendment can be passed if it has support from two-thirds of state legislatures, which means 33. The Republicans at present control 29 states.

“There is a growing tail risk that forces inside the Communist Party might emerge to try to push President Xi aside.”

Compared with the possible consequences of such developments in the world’s most powerful democracy, events in China, Germany or Britain might seem more prosaic. But they are not, especially in China’s case.

The way in which President Xi Jinping consolidated and centralised his power after he replaced Hu Jintao as Communist Party General Secretary in 2012 left many non-Chinese awestruck. However, such centralisation can incite reaction. Over the past 12-18 months, many things have gone awry for Xi Jinping: the protests in Hong Kong, Taiwan’s presidential election, international outcry over China’s treatment of its Muslim citizens in Xinjiang, a slowing economy, the somewhat inconclusive evolution of the US-China trade war, and most damaging of all, the evident mismanagement of Covid-19.

The best working assumption, given President Xi’s proven power, is that he will remain China’s supreme leader. But there is a growing tail risk that forces inside the Communist Party might emerge to try to push him aside,

especially if the public backlash about the deaths and disruption caused by the coronavirus pandemic gathers strength. Vaccines can be discovered to deal with viruses, but not political change.

In Germany’s case, the issue is also one of a long-serving leader, though in Angela Merkel’s case she is no dictator. But she has been Chancellor for over 14 years, and German politics is in a state of suspended animation waiting for the post-Merkel era to begin. A battle is under way inside her CDU party over who will succeed her. As a result, federal elections may take place sooner than the scheduled date of late 2021. Merkel may simply decide to stand down, conceivably at the end of Germany’s EU presidency in the second half of this year, or her current coalition partners, the Social Democrats, may decide to withdraw. This, at least, could bring a positive discontinuity, for until Merkel has been replaced, little truly constructive change can happen in EU politics either.

“After a lot of huffing and puffing, Boris Johnson’s government is likely to come to a pragmatic settlement.”

Britain’s negotiations over its future trade and security relationship with the EU will occur against that background of political stasis in Germany. That stasis will likely bind EU negotiators to a legalistic, inflexible position. After a lot of huffing and puffing, Boris Johnson’s government is nevertheless likely to come to a pragmatic settlement.

Johnson’s political interests looking ahead to the next general election in 2023 or 2024 lie overwhelmingly in establishing a strong record for economic growth and rising living

standards, and in proving to a divided electorate that Brexit wasn’t really as important as die-hard Remainers or Leavers made out. Consequently, prolonged confrontation with the EU makes little sense as it would simply extend business uncertainty too, depressing investment.

Having “got Brexit done”, Johnson’s new ambition will, in effect, be to prove the banality of Brexit by overshadowing it with other initiatives. He never wants anything to be dull, but in terms of political and policy risk, that may prove to be his goal. The year will be far from banal, but Brexit might well be.

IMPORTANT INFORMATION

This article is provided for general information only and should not be construed as investment advice or a recommendation. This information does not represent and must not be construed as an offer or a solicitation of an offer to buy or sell securities, commodities and/or any other financial instruments or products. This document may not be used for the purpose of an offer or solicitation in any jurisdiction or in any circumstances in which such an offer or solicitation is unlawful or not authorised.

STOCK EXAMPLES

The information provided in this article relating to stock examples should not be considered a recommendation to buy or sell any particular security. Any examples discussed are given in the context of the theme being explored.