What to Watch in 2021

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Kevin Kajiwara (KK): Well, good day everyone. Welcome and thank you for joining today's edition of Teneo Insights. I'm Kevin Kajiwara, Co-President of Teneo Political Risk Advisory in New York City. Well, a long and arduous 2020 is about to come to an end, so what better time to look forward to everything that 2021 holds in store. I would say that while a new American president always portends something of a global reset, never before has that been more true than in the case of this transition. And while the U.S. may be returning to a more normalized presidency, the world and the operating environment has changed dramatically in the last four years, and I think much of the world does not view the U.S. in the same way it had for the last 75 years.

As we head into 2021, there is light at the end of the tunnel for the pandemic, with a number of promising vaccines being deployed imminently. But the current infection and death rates certainly suggest some pretty grim days and weeks ahead. Meanwhile, earlier this week, the OECD cut its 2021 global growth forecast from 5% to 4.2%. So, while the world counts down to the January

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20th transition, today we want to take a quick tour of the world and impart what we're expecting in 2021, and to consider how the Biden Administration will impact each region. To help me do that today, I'm joined by a number of my colleagues in Teneo Political Risk Advisory, who will be familiar to many of you.

Carsten Nickel is a Managing Director and he's our Co-Head of Research. He's also a leader of our European coverage, focusing particularly on Brexit, the EU institutions, and Germany, and he is based in London. Jon Alterman is a Senior Advisor and he heads up our Middle East practice. In addition, he is the Director of the Middle East program at the Center for Strategic and International Studies (CSIS), where he holds the Brzezinski Chair in Global Security and Geo-Strategy. Anne Frühauf is a Managing Director and heads up our Africa practice. She has a particular focus in South Africa and Mozambique, and she is a specialist on minerals and energy policy.

Nicholas Watson is a Managing Director, now based in London. He started his Teneo tenure based in Bogota, Colombia. He's also lived and worked in Mexico, Cuba, and Brazil, where he did field research in violent crime and police reform, so he is now in a much safer job of heading up our Latin America practice. And finally, Gabriel Wildau. He's a Senior Vice President and one of our leading China specialists, now based with us stateside. Gabe spent almost 15 years in China, most recently as Shanghai Bureau Chief of the Financial Times. We're going to go region by region this morning, but if you have any questions, please use the moderator chat icon on your screen and we'll try to get those questions in.

So, Carsten, let me start with you. Let's start with Europe, partially because I think the sort of a reaction from leadership is probably nowhere in the world where we've seen more unvarnished joy, if I could put it that way, from a lot of the major leaders about the election outcome here. And because President-elect Biden has made so much of revitalizing the alliance system, and you've got key administration figures like Secretary of State-designate Tony Blinken, who are avowed Atlanticists. So, what do you think Europe expects of America now and what America expects of Europe? And what do you think is actually possible, given how the two sides and the world at large have evolved over the last four years?

Carsten Nickel (CN): Yeah, Kevin, I think to start with, it's absolutely right to say that the amount of relief across the EU has obviously been huge after this election outcome. Latest evidence of that just recently over the weekend is this commission and European external action service paper that's trying to reach out to that incoming administration in Washington with an agenda for reviving the transatlantic relationship. So that's all positive basically from the European perspective, of course.

But I think we shouldn't forget that, and many in Europe are aware, of the fact that the Trump presidency and the tensions that we've seen in the transatlantic relations over the last couple of years, yes, they were a problem in themselves, but they were also symptoms, symptoms of something bigger, something bigger that is still there. And what I mean by that is basically the wider question of, let's say, the fate of low and middle-class voters in rich democracies under globalization. That has obviously been a problem in U.S. politics, but it has also been a problem here in Europe, and looking into 2021, we should keep a close eye in that regard on elections coming up in the Netherlands, regional elections in France and so on. So, there's a lot of shared problems there on both sides of the Atlantic in the end.

But if that is true, then I think tensions will actually remain in key areas. So, you can look at areas such as public support for specific industry sectors, aviation, Airbus versus Boeing, but also the wider, broader question of tariffs. Questions of business taxation, digital tax, the standoff specifically between the U.S. and France, the search for a solution on the OECD level. And also, something like the fiscal cost of U.S. military engagement of Europe, which of course is a big issue between Washington and Berlin.

And then add to that, on top of that basically, key concerns for, let's say, new middle-class voters in the U.S. and in Europe. So, the whole question of climate, climate change, and the broader question of how do we share the burden of climate adjustment globally, China obviously being the elephant in the room here. So, it's not just a question for U.S./EU relations. If you add all of that, then I think the challenges will remain very real.

I think last word on that, I think one area where some of the reporting that's out there is completely overdone is the idea that there are specific risks from this new U.S. administration for certain leaders in Europe who are sometimes thought to, let's say, resemble Donald Trump a bit in style, so if you think of the Brexiteers here in the U.K., the governments in Poland and Hungary. I think the reality is that from a U.K. perspective, for instance, a trade agreement with the U.S. was always going to be tough and tricky, and that will remain the case. And if you look at Central and Eastern Europe, if the U.S. really doubles down now further on Russia, then that creates problems perhaps for Germany, if you think of the Nord Stream 2 pipeline, but it is certainly very much in line with the strategic interests of a country like Poland.

KK: So, you just brought up Brexit, and to some degree obviously on this call we're speculating on what's going to happen in 2021. But one thing we do know for sure is that on January 1st deal or no deal between the U.K. and the EU, Brexit's happening. So, what does that look like right now? What do you expect between now and the end of the year, and from a practical perspective, from a commercial perspective, what will January 1st onward look like?

CN: Yeah, Kevin, you and I, we've been through this Brexit story over the last couple of years, so we've probably gotten used to that cascade of very serious deadlines with that, which then only end up getting pushed back, crunch time arriving and then crunch time lasting for weeks and months without a decision, and we're again at that point. But as you say, 1st January is really this date that cannot be moved. And I think it is right to say, it's fair to say that we're, this time, right now, days, perhaps hours away from clarity over whether there will be a deal or there won't be a deal. I would expect an announcement no later than at the end of this coming weekend. And that will be good in terms of timeline because we have more controversial legislation coming up here in the U.K. early next week regarding Northern Ireland, regarding questions of tariffs and customs.

So, it would really be, in terms of choreography, would be helpful to go into that coming week with clarity on a deal between the U.K. and EU. I think from what we can see, looking at the talks right now, the sticking points remain the same, and I think that is also positive because it tells us that no new issues have been popping up at this late hour. There's still a lot of back and forth going on over the question of fishing rights. There's still a lot of tussling going on over the question of the level playing field, so these rules for fair economic competition between both sides, and the question of governance for this free trade agreement, specifically which role is the European Court of Justice going to play going forward.

In terms of the relationship post-1st January and when assessing the deal in the moment we get it, perhaps as early as next week, I would focus on two things, one rather technical, one more political. The more technical thing is the question of cumulation, rules of origin. So really any greater clarity on the question which goods actually qualify for the zero-tariff proposal that will be the backbone of any deal? That will be hugely important for global supply chains, for companies that trade between the U.K. and Europe, but also for global supply chains if you think, for instance, of the automotive sector, U.K., Japan, so really for trade relations between U.K., Europe, and the rest of the world. And the second question, the political question will be that of ‘mixity,’ as they call it in Brussels.

So, the question whether there will be any role for national parliaments in the 27 EU member states in signing off that deal, which could perhaps complicate things. Those will be the two things I will be looking for, if and when we get a deal.

KK: So, I want to turn quickly to the pandemic here because obviously Europe may be somewhat passing the latest peak, but they are in the same vaccine rollout scenario that the United States is, essentially. So, between now and then, the fiscal situation, obviously, there’s the EU recovery and reliance fund and you alluded to that earlier, in a sense, of some of the potential Central and Eastern European countries that are at the moment blocking this.

But how do you see that rolling out, and how efficient will the transmission mechanism be in some of the major economies? And what’s the balance going to be in terms of fiscal policy going forward in Europe in terms of support versus kind of investment in future economy? And I guess we can sort of throw in here as well, because the vaccine rollout is going to be handled on a state-by-state basis, how efficient will that be handled?

CN: Yeah, let’s maybe start with the latter because that’s obviously the latest big news here with the U.K., outside the EU now, but moving ahead as of next week with vaccinations and then the EU probably following within weeks. I think the key thing to assess this year going forward is, again, that institutional capacity issue that we’ve been looking at in fighting the pandemic for much of this year. And let’s say from a market perspective, I think it will be crucial again to assess the risks and the opportunities that are coming along with different ways of running state administrations in Europe. So very centralized in some places, very decentralized in others.

And specifically, I would obviously continue to keep on Southern Europe here, those are services, consumption, and specifically tourism dependent economies in many cases. So, the pressure will be there to get ahead with vaccinations in time for the summer season, in time for the summer booking season, probably, already.

Or you can put this the other way around. I think this summer will have to happen like it did this year regardless, pretty much, of whether we have a vaccine rolled out properly in these places or not. And that obviously poses the risk of rushing again towards the exit from the current restrictive regimes, perhaps too soon. And the other aspect is, as you say, beyond that current standoff with Poland and Hungary, of course, the distribution and the absorption capacity when it comes to that new recovery fund. 750 billion euros in support money here coming from Europe, politically unprecedented. Huge expectations there, not least among companies and investors for this money to provide a much-needed push really for the European Green Deal, for green and digital investment that is much needed.

The risk, of course, is that those countries that have already struggled this year with the institutional capacity to control the virus and with the political consensus that is required for that, that the same countries might now be struggling with the drafting and the introduction of viable and effective national recovery plans. That will matter hugely, and I think until that question is resolved, it is very clear that the burden sharing that we've seen in Europe over the last couple of years between fiscal policy and monetary policy, that the focus, at least in the short term, will remain very much on monetary policy.

KK: So, one of the critical events in Europe in 2021 is going to be the leadership of Germany with Chancellor Merkel being replaced. How do you see that playing out at this point, and what's the implications?

CN: Yeah, I think the Germany question to actually start with the implications ties in with that previous topic, of course, of spending investment, monetary policy in Europe. But maybe let's take a step back for one second. The election next year in Germany, that will be a fascinating moment because Germany became a true political risk story, let's say, about a decade ago with the eurozone crisis. Before that, it wasn't really on the radar as a political risk story. And since then, analyzing Germany, and by extension, European politics has meant really focusing on Angela Merkel personally. That comes from any of the commentators out there for businesses, for markets. So, with her departure, the actual working, structural workings of German politics will become much more crucial to understand for everybody who's following Germany.

Let's face it, at this stage we don't have clarity yet on who's going to succeed her. There might be some last-minute entrance into the race. But I will highlight two factors that will matter from a business perspective, structural factors. One is the role of the Greens. The Greens in any scenario, really, will play a crucial role in forming the next government, and that will have all sorts of implications from the areas of foreign policy to the question of green investment and Germany's positioning towards Europe. And then related to that, the second broader question, I think, is the conversation about a new growth model for Germany and again, by extension, for Europe, in a phase of trade tensions, climate change, digitalization, you name it.

And specifically, the question will be what role should the state play in this transition, this economic transition, and the more specific question for Europe is how durable will this German commitment to greater spending and investment in Europe be? That they were currently seeing through the recovery fund. How durable will that be Post-Merkel era? My sense is that this debate is something that we haven't really had yet in Germany. That's certainly something that's going to come up during the campaign. And as the new government starts to settle in, in about a year from now.

KK: And before we move on, I do want to touch on Russia here for a moment. Obviously, Russia has occupied sort of a unique space during the current U.S. administration. How do we see that evolving and what are the implications for Europe relations with Russia?

CN: I mean, what we're watching in Russia of course is the Duma elections in 2021. I think we can already see how the Kremlin is starting to prepare the ground here, with preparing the ground for new repressions against journalists, NGOs, opposition, and so on. Overall, I think from a European perspective, from a Western perspective, I don't think we should think of Russia as being overly reactive to U.S. or Western policy as it has played out over the last couple of years here.

Instead, I think in the post-Soviet space, let's say along Russia's vast borders. I think Moscow has quite consistently over the last couple of years, been driven by, what in international relations, you would probably call neo-realist behavior. Power politics. A geopolitical approach, if you like. That has been remarkably consistent and plain for everyone to see at the latest since 2008, South Ossetia and Georgia. So, I wouldn't expect any major change here on the basis of, let's say a new administration coming in the U.S.

I think two things follow from that. I think a lot of the Western reaction to Russia's antics and what might be ahead next year is in reality, I think for Western domestic consumption. It's geared towards those electrodes in rich democracies, who want to see a stronger response to Putin's illiberalism. So that counts for statements that we've seen in the past, according to which Russia allegedly is just a regional power. Or it also counts for the EU's habit of adding additional individuals, Russian individuals to their sanction lists.

I think the second point in reality is that, let's say 15 years of the low 1990s, since the breakup of the Soviet Union, were really an anomaly. That has been over for a while now. Russia will continue not to accept really any greater Western involvement along its borders, relativity regardless of incoming or outgoing U.S. administrations, or let's say German Chancellors with Russian language skills for that matter.

KK: Right. Well, thanks a lot, Carsten. The Middle East is a perennial foreign policy challenge for the United States. And it's another place where I suspect we are going to see a change in tone, certainly. Although I suspect, Saudi Arabia will not be President Biden's first foreign travel destination, for example. But the question is, what's really going to change here?

Jon, I want to turn to you now, and actually I want to ask first about Iran. Because members of the incoming administration have certainly advocated for a conditional return to the JCPOA Nuclear Agreement, but in light of recent assassinations and other clandestine activities and Iran's own enrichment activities, what do you think is possible on the Iran front, given how everything's evolved?

Jon Alterman (JA): Well, on the one hand, the Iranians want to be engaged in negotiations. They don't want to be too flexible in the negotiations because they're very conscious of their weak negotiating position, and they have a presidential election coming up in June. There's not really a consensus about how Iran should approach negotiations. I think on the one hand, the Biden Administration is going to feel some urgency to deal with Iran, and what the parliament decided yesterday was that they will kick out the IAEA inspectors, unless there's some resolution to this in February. On the other hand, the Iranians, this is a result, as a consequence of the Fakhrizadeh assassination.

On the other hand, the Iranians are going to be very slow negotiating. They're not going to be very compliant. They're going to talk on the one hand, about, we can just go back, on the other hand, the first thing we're going to talk about is you're compensating us for these illegitimate sanctions you put on us. This is going to be one of those issues that divide the administration as it seeks to pivot away from the Middle East, is going to be drawn into the Middle East, and I think the Iranians are going to try to create some sort of crisis in the first three months because they're afraid of being ignored. On the other hand, I don't think the Iranians have a sense of what they really want to get out of this.

KK: Yeah. A lot has also been made of Israel's establishment of new diplomatic relations, most prominently, obviously with the UAE. And now following this meeting between Crown Prince Mohammad bin Salman and Benjamin Netanyahu, there's the tantalizing prospect of relations with the Kingdom of Saudi Arabia. So how do you read the overall changing landscape in the region and what's the implications then for companies, particularly American companies, operating in the region and navigating those dynamics?

JA: Well, it's certainly easier that you don't have the need to separate all your Israeli activities from all the other regional activities. That will certainly be a relief to companies. I think there are going to be a number of companies that are finding it much easier if you can actually have a Middle East regional office that deals with the whole Middle East, and you have that partly because of Israel being brought in, and partly because of what I expect to be a diminution in conflict with Qatar. Not an elimination, but I think things will get better. That will make things easier. I think it's easy to get a little overexcited about exactly what this means in monetary terms. Israel has global investments. The UAE has global investments.

As a percentage of the global market, I think this is relatively small. It also, I think, suggests that we are moving away from the need to justify hostility to Israel to the public. It may herald a more authoritarian politics in the Middle East, where the government says, we're not going to listen to the public and we will silence the public in terms of their opposition.

There also is of course, a greater hostility, greater skepticism for Iran, which is part of what brings the Israelis and the Emiratis together. I think overall, it's a mixed picture. The Emiratis, certainly, want to move this as a we have normal relations with countries that advance our economic interests.

There are a number of countries in the region that think that their economies will be advanced if they're really just interested in normal economic interest. But whether this really represents a liberalization of the region, I'm much more skeptical. I think in fact, you could see this as another sign of countries being interested in the China model. Which is, the government does what the government does. Don't raise a peep and if you behave, you can do okay.

KK: I want to follow up on the economic element of this. Can't talk about the region without talking about the oil price dynamic. Obviously, it's been a wild ride in 2020. We actually had negative oil prices at one point, but now we're back to the mid-forties. What did we learn about Saudi Arabia and the Crown Prince's role in particular in that market? And in the pandemic world, what does it mean for the fiscal positions of the oil producers and frankly, the number of economies around them that are dependent on those producers?

JA: Well, that's right, because I think the Middle East is really divided into oil exporters and labor exporters. Every government in the region, either pumps oil or gets aid and gets remittances from countries that pump oil. So, when oil prices go down to $46 a barrel, that's a big problem not for a few countries, it's a big problem for every country. I think the Saudis got a taste of what, in many ways, the Crown Prince had sensed, as an eventual thing when he promoted Vision 2030. Which is, we have to have a more diversified economy, we have to have a more sustainable development path, but there was a hope that this would be something that would develop over 20 years or more.

I remember when Matt Simmons was talking about peak oil in terms of peak production and how the world would be really short. I think we've seen a taste of peak oil in terms of peak demand. The Saudis really found themselves quite constrained as they tried to restrict production. We're still not out of the woods, restricting production on Nigerians and the Iraqis and others looking for exceptions. And demand hasn't really picked up. So, I think what we've seen is a taste of the world having too much oil, which is a very disturbing prospect for all the governments in the Middle East, who thought that they would have decades, now think they might have mere years. And certainly, for young people, they're going to see the end of the oil age during their careers. And that's a distressing prospect.

KK: Well, great. I know you've got a hard stop here. I'm going to let you go, but thanks very much, Jon. I want to move on to Sub-Saharan Africa, Anne. Obviously, there are a lot of concerns about the pandemic handling capacity in the region, especially given that African States, I think as diffused as they are, are not at the front of the vaccine queue. Given the challenges of the pandemic, how's that playing out going into 2021?

Anne Frühauf (AF): Absolutely, Kevin. There are really two key issues. The first is that the pandemic health impact has not been the worst on the continent perhaps. And the second is really perhaps, the greater concern is, about the vaccine battle going forward. Let me speak briefly on both issues.

The COVID-19 pandemic is playing out somewhat below the radar across Africa, mainly as a result of patchy testing. Effectively you have only 12 of 54 countries, that's less than a quarter that have surpassed the WHO threshold of carrying out 10 tests per 10,000 people per week. So, the picture is very incomplete, and the infection curve has been stabilizing since July, but that's mainly been due to a drop in new cases in South Africa alone which counts for more than half of Africa's COVID cases, but also the highest levels of testing. I think the key concern really going into '21 is fears over a second wave that might hit particularly over the summer holiday in the Southern hemisphere.

At the same time, I think the most important thing to point out is that there's very little political appetite to return to harsh lockdowns. One, because of the obvious concerns over fiscal and economic impact. And secondly, over the ability to implement and force public adherence in a context where you have no social safety nets and very high levels of informal employment. Our expectations for 2021 is that, governments would likely focus on more limited preventions, nighttime curfews, immigration controls. And perhaps South Africa very reluctantly might have to return to some form of restrictions. In relation to the vaccine battle, and I think that could become really the greatest concern. Africa will be at the back of the queue in the global sample for vaccines.

And it needs an estimated 1.5 billion doses of vaccine to vaccinate about 60% of its population in two rounds. So, we're talking about 1.2 billion people over the next two, three years. Most countries have signed up to the COVAX initiative, but the Africa's CDC has warned strongly that they're very concerned about not enough vaccines being available until 2022, as Western countries lay claim to the initial wave of supplies. And one of the effects of that could be that countries, for example, like Kenya, start looking to China to expand their options, which would provide China with a strategic opportunity to engage in vaccine diplomacy. Right?

I think what we'll also see, is at the WTO level, we will see emerging markets like South Africa campaigning for a waiver of intellectual property rights over drugs, and particularly to improve access for poorer countries. I think it's also significant to mention that the WTO's incoming Director General, Nigeria's Ngozi Okonjo-Iweala, former Finance Minister and a very energetic global player, will probably push this proposal. But we're not sure that the EU or the U.S. will necessarily change their stance, even for a Biden administration.

KK: Anne, in many ways, obviously, Africa is highly leveraged to the global economy, dependent as many of the states are on exports of natural resources or agricultural products or on tourism. Let's talk about the economic impact and what resiliencies the continent has and what it can depend on, given what you've said about vaccines, being a later 2021 phenomenon at best, and obviously that has huge implications for the resumption of tourism too. So, talk about the economic situation.

AF: Yeah, absolutely. I think to some extent, that's the biggest headache for policymakers. The region faces its first recession in 25 years, GDP is expected to contract by 3% or more in 2020. And the recovery outlook is also increasingly hopeful. As you've pointed out, Kevin, it's highly, highly leveraged to the global economy, whether we're talking about oil producers, mineral producers, tourism dependent economies, without the global economy accelerating again, it really doesn't stand much hope of a fast recovery.

I think perhaps the only piece of good news, particularly for multinationals, is that the effect of this has been to strengthen government's resolve to push ahead with the implementation of the African Continent Free Trade Agreement, which is the most ambitious FTA on the continent to date and which is due to start trading on January 1st .

But you know, with that little sort of glimmer of hope aside, economic disruption has dramatically sharpened, slowly building fiscal crisis and risks of debt distress in many countries. And really important is the point of resilience. Unlike in response to the global financial crisis a decade ago, most countries now have no fixed firepower to speak of, and the impact of the pandemic threatens to undo decades of economic progress and poverty reduction.

One of the effects of that will be a declining per capita growth. I think to me, it's very concerning that in Sub-Saharan Africa's two largest economies, Nigeria and South Africa, which account for more than 50% of the region's GDP per capita, GDP has been negative. And in Nigeria, since the fourth quarter of 2015. So, one of the important effects of that could be on social unrest and socioeconomic cohesion. And the question that could come up increasingly is, which countries could get to a breaking point in the coming years.

KK: So, you brought up debt and that's an inevitable turn in our conversation here. I think you've got six countries in debt distress already with more to follow. Zambia defaulted last month. What's the optionality here? And talk a little bit about the dynamics between official and private lenders, and the role of China, etc., in the debt picture in Africa.

AF: Oh, absolutely. I think to some extent, it's increasingly clear that a fresh debt crisis looms, accelerated, but not caused by the pandemic, right? Effectively, we'll have a throwback to the debt crisis of 20 years ago, but with a much worse prospect for resolution. The chances of a multilateral approach and substantive debt forgiveness are diminished, because now I have a picture where indebted countries need to negotiate with an increasingly diverse set of lenders in China, and also private creditors, right? We have record Euro bond issuance across the continent over the last decade, for example.

So, the question is, will Africa pay a very heavy price for this. We have seen some limited or modest, I will call them, multilateral initiatives like the G20's debt Service Suspension Initiative, but let's both bear in mind, this is effectively just a payment holiday on bilateral debt only. Currently it runs until the middle of next year, and it'll probably be extended until the end of the year. But even so, the scope of the initiative is pretty narrow to decisively shift the needle. And it's particularly worth thinking about the role of China in this context, and the disagreements between G7 countries and China over how to classify a debt owed to China's main Development Bank, and whether that should effectively fall under the DSSI.

What that means is that most countries at risk of distress face arduous case-by-case negotiations. You may also have seen that the G20 has agreed a new framework for debt treatments beyond the DSSI. It really remains to be seen whether that will be a meaningful template to resolve the anticipated surge in sovereign defaults. The common framework does provide for private creditor participation, but it really only signals a cancellation of debt for the most difficult cases. One such case could be Zambia, as you mentioned, that defaulted in November, and it's not yet clear whether the common framework can offer as a blueprint for a speedy resolution.

Rather it seems to me that we're in for a very messy, drawn-out restructuring process, which will be encumbered by domestic political factors like the president's reelection project and reluctance to clinch a deal with the IMF. So, I think it's important to remember the upshot of this is that neither lender coordination nor the scope of debt reduction initiatives would be anything like what we saw with the Heavily Indebted Poor Countries initiative many years ago. Hopes for debt forgiveness are modest this time around. And one proposal that I think developing countries will probably continue to push in '21 is a fresh allocation of IMF Special Drawing Rights. But again, with uncertain support from the U.S. here, even under a Biden Administration.

KK: Well, thank you Anne, and obviously a debt discussion makes for a perfect segue to Latin America. You can't discuss the faults without thinking of Argentina. So, Nicholas, how's the debt situation playing out in that region?

Nicholas Watson (NW): Well, there's quite a bit of crossover with Africa from what we've just been hearing. I think the first point to make is that many countries in the region were already in very weak positions or in distress when the pandemic hit. Argentina and Ecuador being particularly acute examples of that. The region was hugely impacted by the oil price shock. Most countries, Mexico an exception here, but really almost all the others have spent heavily even as revenues have dropped. And some of the longest lockdowns of the world, meaning that there is real damage and scarring to regional economies, that make the rebound and recovery next year look like it's going to be very slow and really very meager across much of the region, with real recovery not beginning until 2022 or 2023 at the earliest.

And so, most countries have undergone a very important, significant rise in debt to GDP. Their ability to fund debts through growth is very questionable. I don't want to paint too gloomy a picture. There were some positive aspects here; central banks in Chile and Columbia have launched for the very first time quantitative easing programs. There have been some dollar swap programs to reduce strains in global dollar funding markets in Brazil and Mexico, for example. And flexible credit lines extended to various countries in the region. And of course, the likes of Peru, Chile have stronger fundamentals that should enable them to weather the storm.

So, I think it's very easy to say we're inevitably headed towards another lost decade like we saw in the 1980s. I think in reality, it looks like it's going to be a kind of patchier outlook. But really the key question is, are governments in the region prepared to undertake fiscal adjustment to demonstrate that all of this was a one-off to deal with an extraordinary situation, an unprecedented pandemic? And of course, the problem is the electoral cycle will get in the way, but it's difficult to see. For example, in the Argentina case with the midterms next year, with a government that is not a friend of the IMF by any stretch of the imagination. Ecuador, where you have a very uncertain outlook with presidential elections early in 2021. There is real uncertainty about whether there is simply the appetite to undertake austerity.

KK: I want to move to Mexico in a couple of minutes, just because of its proximity to the U.S., and how leveraged it is to the U.S., and the importance of the relationship. But I mean you brought up a couple of things here that I want to unpack a little bit. I mean number one, you're talking about sustained growth deferred until 2022 at best, maybe 2023. And you're talking about the fiscal situation.

So, you've alluded to some of the leadership events that are coming up in 2021, but talk a little bit about government's ability to handle this fiscal situation and pandemic management so that the base upon which they can start to regrow again in 2022 is, I mean, it could be better or worse, right? So, Latin America is one of these areas where we do see this tension between populism and pragmatic leadership. So, talk about this dynamic and how that's going to play out.

NW: Sure. I mean, I would say just to start that the region was hit very, very hard by COVID-19. The first waves were long and plateaued at very high levels for long periods of time. A second wave is evident but is in its early stages in Mexico and Chile, but in others, I would say the second wave has not yet arrived. Vaccines will take time. I think there's going to be a huge logistical challenge, particularly with some of the double dose vaccines that require freezing at very low temperatures. So, there are questions around how long it will take to vaccinate. And the economic picture is very gloomy. And in that kind of context, a region that has a history of falling prey to populist solutions, I think is very, very vulnerable.

Public fatigue is great. There is frustration. There was already frustration with politics before COVID hit the region. We saw that in Chile, Columbia, and Ecuador. So, I don't think it's overstated to say there is a deep frustration, if not desperation, and that makes conditions very ripe for populist solutions. Peru is vulnerable to that with its election process next year. Mexico is already governed by a populist. And this is a completely legitimate concern ahead. And populists, they come along with easy answers to difficult problems. And frankly, their solutions are rarely the right ones. But, when it comes to difficult questions of fiscal adjustment, you have to wonder whether the outlook is really quite complicated for making tough choices.

KK: I do want to turn to Mexico here because obviously it's incredibly leveraged to the U.S. economy. One of the accomplishments of the Trump Administration was the completion of the USMCA. I guess, what do you see as the potential changing dynamic between the United States and Mexico with the new Biden Administration? And in the context of, you alluded to this a moment ago, López Obrador is a populist, and he's an effective one, as we've seen even recently with the

handling of the former Defense Minister and the drug charges and his return to Mexico. Talk about how you see this important dynamic playing out.

NW: Yeah. And I think in your introduction to this session, you used the word, “normalize” to talk about how a Biden Administration will approach foreign policy. And I think that’s a key word for Mexico. I think the Biden approach will be more, again in inverted commas, “normal,” more traditional, more institutionalized. And I think what that will mean is that there will be a focus on much more than just migration, which was really the one-track mind of the Trump Administration over the last four years.
I think relations are going to return to what they were, which is much more complex and more multilayered. The strange thing is that probably Biden is actually much more in tune with AMLO, with López Obrador on migration than Trump ever will. But strangely, AMLO has been reluctant to acknowledge Biden’s victory. And I think what that points to is that what AMLO really wants is freedom and a free reign to do what he wants domestically. And I think he did what Trump wanted, mainly curbing migration northwards under the understanding, tacit or not, that the U.S. would not interfere too much in Mexico’s domestic affairs. And that suited AMLO very well.

With Biden, I think we’re going to see this much more multi-layered agenda on security, a climate change agenda, that will be awkward for AMLO who’s betting so heavily on fossil fuels. And I think congressional Democrats will push to pursue labor rights violations and the USMCA enables them to do so. So, I think we’re going to see a more complex period ahead, perhaps one that AMLO will struggle to manage so effectively as he did under Trump.

But you’re absolutely right. AMLO is a very effective operator. And his approval levels are remarkably resilient. November is actually his best month for his approval ratings of 2020 and that’s despite a huge COVID caseload and the fourth highest death toll from COVID in the world. But looking ahead in 2021, we have midterm elections and a whole host of

state elections that are hugely important to AMLO’s position and for the second part of his presidency. And some of his more authoritarian aspects, gestures and policies could come under pressure and scrutiny from the U.S. under Biden. So, although on paper it seemed like there would be sparks between Trump and AMLO. In fact, there really weren’t that many, and we might see more between Biden and AMLO.

KK: That’s interesting, great. Thank you. Thanks very much, Nicholas. And that brings us to Asia. Obviously, there’s no more important relationship dynamic in the 21st century than that between the United States and China. And it certainly appears that Xi Jinping is not one to let a crisis, be it the U.S. leadership in the world or a pandemic, go to waste.

So, Gabe, what are you expecting as the new U.S. administration emerges and asserts itself? How do you see this playing out in the early parts of 2021? We’ve seen a lot of headlines just in the last few days about a deterioration in relations between China and Australia, pretty nasty. Is this a harbinger of things to come? What do you see?

Gabe Wildau (GW): I think the incoming President Biden is going to be very cautious about any major changes to the basic template for U.S.-China relations that was set during the Trump Administration, even though he, of course, criticized Trump during the campaign. But, the political situation in Washington, where we have this very strong bipartisan consensus in favor of a confrontational approach towards China, I think boxes in the incoming president. And when we saw him say quite explicitly, which we had been telling clients for months leading up to the election, that President Biden, he said this to the New York Times a couple of days ago, that he doesn't intend either to exit the Phase One Trade Agreements or to lift any of the Trump trade war tariffs on China that are still in place.

Even though I think it's fair to say he would not have imposed those tariffs had he been president, but I think he'll be, both for fear of being criticized as soft on China, and also because of the political logic or the diplomatic logic is such that it would be a shame to waste the leverage that Trump has handed him by unilaterally rolling back those tariffs.
I think the situation on export controls is similar where despite pressure from U.S. technology companies and other U.S. businesses that are hurting from export controls, the political risk from rolling them back is going to be pretty substantial.

Both on tariffs and export controls, I think we could see some adjustments around the edges, some minor tweaks. We could see a greater use of the tariff exclusion process where specific products are exempted from tariffs, even as the headline tariffs remain in place. Likewise, with the export controls, administered by the Commerce Department, we could see more licenses granted to individual U.S. technology companies for sales of specific products, whether to Huawei or to other Chinese companies that have been included on Commerce Department's entity list. Again, the headline export controls would remain in place, but it would allow the sale of at least some products that are deemed non-sensitive or whose sale is not considered to be a threat to U.S. National Security.

In terms of Biden's broader approach to Asia, I think he signaled very clearly that he intends to re-engage in Asia. He's saying things like, "America is back," and he has been critical of the Trump Administration seeming to take a more isolationist approach or to pull back from U.S. leadership in Asia. I think what we'll see is, for example, higher level U.S. representatives at regional forums like ASEAN, where not only did President Trump not attend any of the last three ASEAN Summits, but he didn't even send a cabinet minister to the last ASEAN Summit. There's been talk of appointing an Asia czar on the U.S. National Security Council, which I think would be a largely symbolic act, but it would be an important symbol showing that Asia is important to the administration.

There's been a lot of nervousness about whether the U.S. can be relied on to maintain a durable presence in Asia, and I think Biden's goal in the first year will be to reassure allies in that respect. Kevin, you mentioned the sharply deteriorating relations between China and Australia, and we saw the incoming National Security Council, Jake Sullivan, tweet a couple of days ago in support of Australia saying that the U.S. will stand side by side with its ally. I think not only Australia, but other countries in the region are watching statements like that very closely to see whether the U.S. is going to be by its side.

But if we look at the long-term trends, I think what we see is despite whatever symbolic moves the Biden Administration is going to try to take to signal U.S. commitment to Asia, the direction of travel is pretty clear where U.S. economic influence, we basically have a bifurcation between security and economics, where the U.S., under Biden, is going to follow what the Trump Administration did largely in trying to strengthen America's security alliances and partnerships around Asia. But in terms of economic influence, U.S. influence is clearly waning, and China's is growing.

We saw that of course with the signing of RSF and the U.S. withdrawal from TPP, but just in terms of economic growth and the share of imports and exports that China has with these countries in the region versus the U.S., that's a long-term trend that Biden is not going to be able to reverse and U.S. politics are going to be very unfavorable to any attempt by a Biden Administration to rejoin TPP. Even though he and his advisors would probably like to do that, but the political environment in the U.S. is very unfavorable. I think we're going to continue to see, and we've even seen President Xi Jinping talk about maybe China will join, now it's called the CPTPP, the version of TPP that doesn't include the U.S.

The U.S. doesn't really have any viable answer to initiatives like the Belt and Road Initiative from China, where they're using investment in infrastructure to expand their influence. I think we could see some increase in foreign aid under Biden, or at least an attempt to do so, although he may run into problems in the U.S. Congress, but nothing is really going to rival the scale of Belt and Road in terms of development assistance from the U.S. We have a U.S. re-engaging and remaining a strong player in the security arena, but on economics, China is going to probably increase its lead.

KK: Within that context that you've just laid out here, obviously China appears to be the only large economy in the world that will actually grow in 2020, and they will carry that momentum into next year. Given that context, but given that opportunity that China still presents, what's the implications that you see for the business operating environment for American and Western companies trying to do business there? What are you seeing on the supply chain, diversification and resiliency front, and then also within the great power politics of all of this, how is Taiwan playing out?

GW: China laid out a high-level outline of its next five-year plan last month, after its big annual political meeting, the fifth plenum, and the message from the new five-year plan from the fifth plenum is crystal clear. That message is that technological upgrading and self-sufficiency in technology is China's number one priority for the next five years. That is, of course, a response to the crippling impact of U.S. export controls that really exposed and made Chinese leaders aware of China's vulnerability to those export controls where companies like Huawei can be brought to their knees by inability to source advanced semiconductors from the U.S. I think there's a perception that technological self-sufficiency in China means that foreign companies are going to be shut out.

There's of course, an element of truth to that because China trusts its own national champion companies above all, but a big part of the technological self-sufficiency drive involves an extraordinary devotion of state resources into research and development and into subsidizing technology companies in China. That includes, in some cases at least, it will include foreign companies. As a foreign company, if you signal that you're not going to be used as a political weapon by your home government that may have a China containment agenda, there will be opportunities to dip your beak into some of those subsidies and some of those research and development grants and all the kinds of policy incentives that are geared towards helping China achieve self-sufficiency.

The trend I think is for multinational companies to try to gain some of the benefits of that, and on supply chains, we're really not seeing, despite all the talk of decoupling and supply chains potentially migrating out of China, we're not really seeing much evidence of that in terms of the trade and investment data, or in terms of surveys of multinational companies through institutions like the American Chamber of Commerce. I think it reflects so many companies have spent the last two, three decades building up these very complex, very useful and effective supply chains in China, and the market logic of dismantling those supply chains really doesn't exist. To the extent there is an incentive, it's coming from politicians, it's coming from pressure from governments.

What I think we will see, we're not going to see this full scale decoupling that some China hardliners are advocating, we're going to see a selective decoupling in response to U.S. export controls and other policies. What we're going to see, in many cases, foreign companies, multinational companies trying to design out U.S. technology from at least certain parts of their supply chain so that they can maintain access to the lucrative Chinese market. In other words, if U.S. export controls say, "You cannot sell U.S. technology to China," well, we're going to design products that don't have U.S. technology because we want to keep selling to China. That can include U.S. headquartered companies that start developing technology outside of the U.S. borders so that they can escape the boundaries of U.S. export controls.

Those trends on supply chains are selective decoupling, some degree of bifurcation between products that are sold to China versus products that are sold to America. Of course, there's also U.S. import controls where, especially for government procurement and national defense, the U.S. government and perhaps European and Japanese governments don't want to buy Chinese technology. We're going to see some degree of bifurcation, but we're going to see China remaining crucial to global supply chains because there simply aren't good alternatives.

Just to give a sense of a scale here, Vietnam, which has benefited from some trade diversion as a result of the Trade War, Vietnam is about the size of China's Guangdong Province. Even if Vietnam maxes out its ability to benefit from trade diversion away from China, it simply isn't a replacement. The same is true of the other alternatives, whether it's Mexico or Taiwan, or other parts of Southeast Asia, India, it has major infrastructure deficits that make it less than completely viable alternative.

Let me move to the question you raised about Taiwan. I think we will see the Biden Administration continue what the Trump Administration started in terms of trying to strengthen relationships with Taiwan. We could even see, the incoming administration has been a bit coy about this, but there are signs that they may pursue a U.S.-Taiwan bilateral free trade agreement. We're going to see continued arms sales to Taiwan, we're going to see high profile efforts, mainly with symbolic impact, to try to get Taiwan included in international forums, perhaps as an observer in the WHO and other international organizations where China tries to prevent them.

We're going to see Taiwan as part of multilateral efforts that include the U.S., Europe and Japan to multilateralize the U.S. export control regime so that China can't just turn to alternative countries to source the technology products that they are now unable to purchase from the U.S. Those are the basic trends. Again, a lot of continuity with the Trump Administration in terms of using Taiwan as a leverage point against China.

KK: Well, much to my pleasant surprise, we have made it around the world in an hour. But of course, we've only scratched the surface. I do want to emphasize to everybody on the call, we've put out a few pieces of late that go into much more detail on what my colleagues have been talking about, our 'What to Watch in 2021' piece, and of course Teneo's Annual Vision Book 2021. If you would like to see either of those and have not, or if you have a follow-up question for any of my colleagues or myself, please reach out either to your Teneo contact or to teneoinsights@teneo.com.

Our next call is going to be Wednesday, December 16th, and my guest will be Mervyn Davies. He's the Chairman of LetterOne and Corsair Capital, and the former CEO and Chairman of Standard Chartered. He'll be here to discuss Brexit, U.S., Europe, and U.K. relations, and also the lessons learned on corporate governance as we look ahead to the post-pandemic world. I want to thank everybody for joining us. I want to thank, Carsten, Jon, Anne, Nicholas and Gabe. Again, if you have any questions, please don't hesitate to reach out to us. Meanwhile, thank you very much. Have a good day and all best for the upcoming weekend.

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