The KWR International Advisor Macro-Outlook , Vol. 2, No. 13

June 16, 2020

Scott B. MacDonald, Ph.D., Editor

Robert Windorf, Senior Analyst

Keith Rabin, Publisher

Picking up the Pieces

Summary: Political risk is on the rise throughout both advanced and emerging market economies. In the United States, protests against longstanding racial and social grievances were triggered by the police murder of George Floyd in Minnesota, leading to an eruption of civil unrest not seen on such a size and scale since the 1960s. Set to a backdrop of a massive economic contraction, a jump in unemployment, a substantial deterioration in the government's fiscal position, and the COVID-19 pandemic, the protests and riots are forcing a restructuring of the American socioeconomic landscape. In many regards, the American system

has broken down and a new one is being created. 2020 will be a year of reinvention as the country deals with racial, urban-rural and class divisions and looks to new approaches to dealing with old problems. All of this points to the November 2020 elections, which will also have an influence on what type of economic recovery will unfold in 2021 and beyond. Democratic contender Joe Biden currently leads in opinion polls, but November is still far away.

The U.S. is not alone in wrestling with longstanding socioeconomic challenges. The same can be said of Europe, China and much of Latin America. We have concerns about France seeing a long, hot summer for President Emmanuel Macron, while Brazil seems to be heading into deeper medical and political crises. Another issue is the increasing risk of a new Cold War between the United States and China. Markets will also have to consider that Q2 2020 corporate earnings are going to be bloody, mirroring both the COVID-19 economic shutdown and social upheaval. Consequently, we see considerable market volatility ahead, though the trajectory will probably be upwards, pushed along by a supportive Federal Reserve, European Central Bank and Bank of Japan; ongoing hope for medical resolution of COVID-19; and some positive traction stimulated by trillions of dollars of fiscal stimulus from governments around the world. We do not see a V-shaped recovery, but a slower process. Investors should be wearing seatbelts.

The New Cold War in Asia (MacDonald): Although many in the academic world deny that there is a new Cold War, it increasingly appears that the world has entered one. The new global rivalry is between the United States and China, with Russia playing a lesser role as an ally to its Asian neighbor and vital trade partner. Although the U.S.-China rivalry is different from what existed between the U.S. and the former Soviet Union, the new contest also has ideological differences, competing visions of what the world should look like in the future, and both countries are putting pressure on other countries to pick a side. As the parameters of the new Cold War become better defined, there is a risk that Asia's long run of relative political stability will erode. Indeed, political risk in Asia is increasing, something investors need to come to terms with.

The new Cold War had its beginnings during the Obama administration with its "Pivot to Asia" and the Trans-Pacific Partnership (TPP), which was created in part to contain China. China's rising economic and military power, its expansion into Africa, the Caribbean and Latin America, the Belt and Road Initiative (BRI) seeking to connect Asia and Europe into one inter-linked Chinese-dominated Eurasian market, and ongoing cyberattacks on U.S. civilian and military institutions indicated to Washington that Beijing was rapidly emerging as its chief rival. Although the Trump administration backed out of the TPP, it launched a bruising trade war on China in 2018, while U.S. foreign policy followed through with a tougher line in the Caribbean and, most recently, in Africa (with Secretary of State Mike Pompeo's recent trip).

For its part, China has not shied away from U.S. efforts to contain it. As Political Science Professor Thitinan Pongsudhirak at Thailand's Chulalongkorn University noted in May 2020, "The proposition that 'you are with us or against us,' not long ago brandished by Washington, is coming more now from Beijing." The COVID-19 pandemic, which started in Wuhan, has provided an opportunity for the Chinese Communist Party government to make a new diplomatic push, portraying China as a willing partner in making the world a better place. Planting rumors that it was the U.S. military that started the pandemic in Wuhan, China has sent doctors and medical equipment to more than 100 countries around the world, ranging from Dominica and Grenada in the Caribbean to Cambodia and Laos in Southeast Asia.

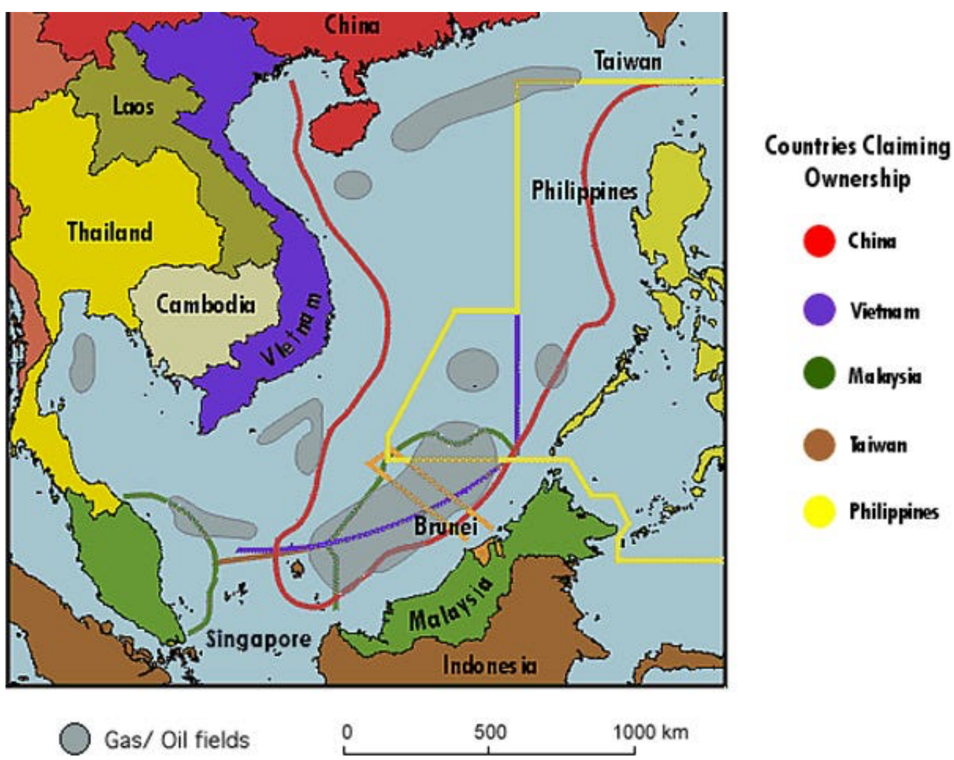
While the world is grappling with the ill-effects of the pandemic, China has taken advantage of COVID-19 to impose a draconian security law on Hong Kong and other measures to bring the city under greater control of the mainland Communist Party. Hong Kong's "one country, two systems" accord with China, which since the 1997 handover from the British helped maintain the city as a special administrative region with a well-respected legal system and place to do business for foreign and Chinese companies, is now being eclipsed. For the Communist Party the virus of a more open political system, with which Hong Kong has been "infected", is too dangerous and must be snuffed out before it spreads to the mainland.

China has also made more bellicose noises in the direction of Taiwan, which it regards as a breakaway province. Indeed, Chinese government spokespersons have stated they would "resolutely smash" any move by Taiwan toward declaring independence. Beijing has increased its military activity around the island. Taiwan, which has an elective government and recently re-elected a pro-independence government, is also seen as an ideological threat to the Communist Party on the mainland. Moreover, as part of China's sense of historical mission of righting the wrongs of former European and Japanese imperial actions, Taiwan needs to be reunified with the mainland and the wishes of most Taiwanese do not matter (and a sizable block would prefer independence). There is growing concern that Taiwan could be next on the Chinese menu after Hong Kong.

But China's more aggressive stance has not been limited to places which it regards as being Chinese. Beijing's claims on the South China Sea are becoming more belligerent, leaving countries such as Malaysia, Vietnam, the Philippines and Indonesia more deeply concerned about Chinese encroachments. China has made a concerted and sustained push into the South China Sea, creating islands, planting military bases, and driving off challengers. At stake is large fish stocks, potential oil and gas reserves and access to strategic sea lanes.

In late April Vietnam lodged a formal compliant following China's announcement that it has created two administrative units on islands in the South China Sea. This followed an incident earlier in the month in which a Chinese Coast Guard ship rammed and sank a Vietnamese fishing boat near the Paracel Islands.

China's more aggressive stance on the South China Sea has also caused an unexpected change of direction in the Philippines, where the government of President Rodrigo Duterte reversed its decision earlier in the year to scrap the 1998 visiting forces agreement with the United States. The Philippine policy shift to maintain this arrangement was "in light of political and other developments in the region." This was clearly a reference to the incident with the Vietnamese fishing boat as well as another incident involving a Chinese ship engaged in a standoff with a Malaysian oil exploration vessel.



India and Australia have also been on the receiving end of a more aggressive Chinese stance. In May Chinese troops marched into an area in Kashmir claimed by India, an action contested by Indian troops. Though it appears that the two sides are talking, Chinese media organs used the occasion to warn India not to get too close to the United States in the merging cold war.

China's pressure on Australia came after Canberra's push for an independent inquiry into the COVID-19 outbreak. Australian goods suddenly faced mysterious regulatory hurdles from its largest trade partner. Beijing then warned there could be a consumer boycott against Australia; Chinese tourists were warned they could face racist attacks if they visited down under; and Chinese students were warned about the same risk. According to the Australian government, Chinese students and tourists collectively brought in more than $18 billion to Australia in 2019. Despite Australia's heavy reliance on China as a trade partner, the country's trade minister's response to the threat of a Chinese boycott was to call such an action an "inappropriate indication of attempted economic coercion."

While some countries, such as Cambodia and Laos, have aligned themselves closely to China, concerns about Beijing's willingness to bully other countries into following its lead has resulted in the formation of a bloc of countries that are increasingly working together. Australia and India in May signed on to strengthen their cooperation in the India-Pacific region by mutual logistics support through reciprocal access to each other's military bases, while Japan has moved closer to both countries in terms of military cooperation. Vietnam has also sought to develop better ties with the U.S. The concern about China also extends to Indonesia, which in January 2020 dispatched warships and jet fighters to drive away Chinese ships around the Natuna Islands, claimed by Jakarta.

The shift into a new Cold War in Asia is occurring. Countries are being pushed to take a side. While the U.S. finds allies in Australia, Japan, India, Taiwan and Vietnam, these countries have questions over the depth of the Trump administration's commitment. This stems largely from President Trump's unpredictability, his willingness to start trade conflicts with allies and his reliance on Twitter to broadcast policy without consultation.

Yet the alternative is to let China freely dominate Asia's destiny, something that does not go down well in the corridors of power in Canberra, Tokyo, Hanoi, or New Delhi. And the Trump administration has been highly focused on containing China's rising influence. The challenge is to find a new equilibrium of power in Asia; no one is entirely prepared to give up all the benefits of globalization and a less confrontational era – at least not yet.

Africa's Challenging Road Ahead (**Windorf)**: The COVID-19 pandemic has created significant economic challenges for every global region, especially sub-Saharan Africa, which contains approximately 1.1 billion people and some of the most at-risk nations in terms of debt burdens and food security challenges. The region has considerable potential, but COVID-19 and the radical downshift in the global economy have hurt prospects due in part to the heavy dependence on commodity exports. We expect that Sub-Saharan Africa will rebound. However, the challenge will be the pace at which the recovery resumes and how governments will balance medical and economic needs.

According to the Johns Hopkins University and Africa CDC (Centres for Disease Control as of June 7th), there were approximately 184,000 confirmed positive cases across Africa and 5,060 persons have died since the outbreak. The heaviest concentrations of the virus are in South Africa and increasing.

From the beginning of the virus outbreak in Africa in early March, the Africa CDC's quickly-assembled Africa Joint Continental Strategy for COVID-19 program has trained hundreds of experts from 43 African Union member states in various aspects of COVID-19 prevention and control. The WHO and U.S. CDC have continued to meet the rising demand for additional virus test kits from several countries.

Since April, important PPE supplies have been donated by several private organizations such as the Jack Ma Foundation in China across the sub-Saharan region, and emergency funding from the Africa 50 Infrastructure Fund has gone to support necessary equipment purchases and to mobilize front line responders.

COVID-19 also threatens African food security. The U.N.'s World Food Program (WFP) has made frequent deliveries of needed provisions and supplies to many affected areas with major donations and transportation provided by several countries including Germany and the United Arab Emirates. According to new WFP reports, 265 million people in low and middle-income countries face acute food insecurity during 2020. This is an increase by 130 million from 135 million registered in 2019.

IMF researchers believe the COVID-19 pandemic will present a notable economic impact on sub-Saharan Africa in three significant ways:

• 1) Measures crucial to slowing the spread of the virus will negatively affect economies. Quarantine measures have resulted in reduced wages, less spending, and unemployment. Closed international borders have caused shipping, trade, and tourism to suffer.

• 2) Dramatic slowdowns among the major global economies have begun to spill over into the region with notable disruptions to production and global supply chain operations. Tighter global investments has resulted in shelved development projects across the region.

• 3) Sharp declines in global commodity prices have already affected prospects for export-dependent countries like Botswana, Gabon, and Nigeria. The IMF estimates that each 10 percent decline in oil prices will, on average, lower growth among oil exporters by 0.6% and increase overall fiscal deficits by 0.8% of GDP.

African Sub-Saharan Sovereign Debt Ratings:

	S&P	Moody's	Fitch
Angola	CCC+	B3	B-
Benin	B+	B2 ↑	B
Botswana	BBB+	A2	
Burkina Faso	B		
Cameroon	B-	B2	B ↓
Cape Verde	B		B-
Rep. of Congo	CCC+↑	Caa1	
Cote d' Ivoire		Ba3	B+
Dem. Rep. of Congo	B2 ↓	Caa2	CCC
Ethiopia	B ↓	B2	B ↓
Gabon		Caa1 ↑	CCC
Ghana	B ↓	B3 ↓	B
Kenya	B+	B2 ↓	B+
Lesotho			B
Mali		B3	
Mauritius		Baa1 ↓	
Mozambique	CCC+	Caa2	CCC
Namibia	Ba2 ↓		BB
Niger		B3	
Nigeria	B-	B2 ↓	B ↓
Rwanda	B+	B2	B+
Senegal	B+	Ba3	
Seychelles			B+
South Africa	BB-	Ba1 ↓	BB ↓
Swaziland (Eswatini)		B2 ↓	
Tanzania		B1 ↓	
Togo	B	B3	
Uganda	B	B2	B+
Zambia	CCC↓	Ca	CC

Source: Trading Economics.

In light of current global economic trends, we believe the above listed African sovereign ratings are subject to downgrade pressures.

The IMF's April 2020 report on sub-Saharan Africa projects regional real GDP growth to contract by 1.9 percent in 2020, the lowest level on record. The picture is not pretty: the less diversified economies will suffer the greatest setbacks, reflecting lower commodity prices, severe contractions in tourism revenues, and large capital outflows combined with tighter financial conditions. The bottom line from the IMF is that Sub-Saharan Africa faces a tough period ahead and there are considerable questions about governments finding the political will to impose tough policies and maintain the institutional integrity necessary to successfully implement the key measures.

The IMF now projects global growth to plunge from 2.9% in 2019 to -3.0% in 2020, a steeper decline than during the 2008-09 global financial crisis (which was brutal). Among the sub-Saharan region's key trading partners, the Euro area is projected to contract from 1.2% in 2019 to -7.5% in 2020, and China's growth is expected to decline from 6.1% to 1.2%. The gloomy outlook for sub-Saharan Africa is reinforced by a new World Bank report (June 2020) that notes the average developing country economy will become eight percent smaller after five years than it would have been without the pandemic. Moreover, World Bank President David Malpass recently stated that effects from the pandemic could last for a decade, warning that approximately 60 million people could be pushed into "extreme poverty" (living on less than $2.00 per day) by the pandemic's numerous effects.

Important African Economic Data: **Source: IMF (April, 2020)**

	Real GDP Growth (Pct.)		**External Debt/ GDP**		**External Reserves (Mos. G&S)**	
	2019	**2020f**	**2019**	**2020f**	**2019**	**2020f**
Angola	-1.5	-1.4	58.0	85.4	11.5	9.3
Benin	6.4	4.5	22.8	22.9	n/a	n/a
Botswana	3.0	-5.4	11.0	8.8	11.8	10.2
Burkina Faso	5.7	2.0	22.4	22.9	n/a	n/a
Cameroon	3.7	-1.2	30.2	34.5	n/a	n/a
Cape Verde	5.5	-4.0	98.7	106.6	8.6	8.4
Rep. of Congo	-0.9	-2.3	38.9	56.4	n/a	n/a
Cote d' Ivoire	6.9	2.7	26.6	31.5	n/a	n/a
Dem. Rep. Congo	4.4	-2.2	12.6	13.1	0.8	0.9
Ethiopia	9.0	3.2	28.4	29.9	2.3	2.1
Gabon	3.4	-1.2	39.0	48.8	n/a	n/a
Ghana	6.1	1.5	30.2	36.0	3.4	2.7
Kenya	5.6	1.0	31.3	31.3	6.0	4.7
Lesotho	1.2	-5.2	34.1	40.5	4.9	3.9
Mali	5.1	1.5	26.3	28.6	n/a	n/a
Mauritius	3.5	-6.8	13.9	16.8	16.4	7.9
Mozambique	2.2	2.2	93.0	105.1	3.2	2.4
Namibia	-1.4	-2.5	18.3	20.9	2.8	2.9
Niger	5.8	1.0	25.3	29.3	n/a	n/a
Nigeria	2.2	-3.4	15.5	17.4	6.1	3.9
Rwanda	10.1	3.5	45.1	47.7	5.5	3.6
Senegal	5.3	3.0	47.1	48.6	n/a	n/a
Seychelles	3.9	-10.8	26.9	32.3	5.3	2.0
South Africa	0.2	-5.8	21.4	22.0	8.9	7.6
Swaziland (Eswatini)	1.0	-0.9	11.7	18.3	2.8	3.3
Tanzania	6.3	2.0	27.4	28.1	4.9	4.6
Togo	5.3	1.0	23.5	26.2	n/a	n/a
Uganda	4.9	3.5	26.6	29.0	4.1	3.7
Zambia	1.5	-3.5	50.5	70.7	2.2	1.1

As if COVID-19, food insecurity and economic contraction were not bad enough already, sub-Saharan Africa faces heavy debt repayment pressures. Fortunately there has been a concerted multilateral effort to head off a major debt crisis. On April 13, IMF Managing Director Kristalina Georgieva announced the Fund had approved immediate debt service relief to 25 member countries under the revamped Catastrophe Containment & Relief Trust (CCRT) to help address the impact of the pandemic. CCRT can provide about $500 million in grant-based debt service relief, including a $185 million pledge by the United Kingdom and $100 million provided by Japan as immediately available resources. The Sub-Saharan countries represent 19 of the 25 recipient countries. This assistance plan covers IMF debt service obligations for the next six months with potential extensions up to a maximum of two years.

Other measures are also being put in place to avert an African debt meltdown. The World Bank announced plans to provide a $14 billion package of fast-track financing to assist countries especially to fortify health systems capacity. The African Development Bank recently sold a record $3 billion three-year Fight COVID-19 Social Bond to raise funds to support the Africa CDC's front line activities. Rounding out the picture, the IMF raised $77 billion from global bond markets in April and May to offset the $100 billion of reported capital that had left emerging markets during March. Central banks' bond buying and the US Federal Reserve's swap lines have encouraged investors back into emerging markets.

China is the sub-Saharan region's largest individual sovereign creditor. According to the Brookings Institution, the UK's Jubilee Debt Campaign (a coalition of organizations dedicated to developing country debt relief) determined that in 2018, 20 percent of all African debt was due to China. In light of the current environment many analysts believe Beijing is probably unlikely to adopt a unilateral approach to debt forgiveness, particularly on commercial loans (albeit often at lower-than-market rates), which comprise the majority of African debt owed to China. Traditionally, China has forgiven zero-interest loans for economically-fragile African states. In 2005, such forgiveness reportedly totaled $10 billion. And, in 2018, President Xi Jinping granted forgiveness of all intergovernmental zero interest loans for the least-developed African countries.

However, Africa still owes a lot of money to China. According to researchers at Johns Hopkins University, from 2000 to 2017 China granted $143 billion in loans to African governments and their various state-owned enterprises. In light of the substantial scale of Chinese debt on the African continent, researchers estimate that even with some form of potential partial forgiveness conceded, China will suffer major financial losses. That has to be balanced with what China wants to extract from its Belt and Road Initiative (BRI) ventures that include important projects across Africa. Beijing may will wish to absorb painful setbacks (at least temporarily) as opportunity costs to solidify existing international partnerships for future benefits related to its overall intricate geopolitical gains vis-à-vis a more stingy U.S. and Europe.

Looking ahead, sub-Saharan Africa's economic outlook is challenging, with considerable downside risk. COVID-19 has helped derail the region's growth trajectory (which had earlier been complicated by the Sino-American trade war and slower global growth). While the real GDP report cards in the months ahead are going to provide grim reading, there has been a sustained and coordinated effort to buffer some of the worst downside risks. Like the rest of the world, Africa faces the dilemma of having to balance medical needs with the necessity of reviving economic growth. The problem for Africa is that it has fewer resources to draw upon, and in many countries there are problematic institutional weaknesses that hinder implementing the right policies. This underscores the importance of ongoing multilateral support. For investors, sub-Saharan Africa represents a challenge; while there are worthwhile assets, investing in this market requires a strong tolerance for volatility and extra due diligence.

COVID-19 and the Cayman Islands (MacDonald): COVID-19 has hit the Caribbean hard. This comes from a heavy dependence of many of the countries on tourism. In the Cayman Islands, the pandemic has been a savage blow to the economy, which was doing exceedingly well. According to the IMF, the economy of the Caribbean and Latin America is expected to contract by 5.2 percent on average, with individual Caribbean countries and territories contracting by anything from 5.6 percent to close to 14 percent.

In 2019, the Cayman economy expanded by 3 percent, unemployment stood at 3.5 percent, and inflation was at 5.7 percent. Government finances were seen as in robust shape. The first three months of 2020 saw a continuation of these trends. However, as the coronavirus spread it eventually came to the Cayman Islands. As Joanna Boxall wrote in the *Cayman Resident* (June 10, 2020), “Then, in April, the pandemic reached Cayman and life as we knew it screeched to a halt.”

COVID-19 has meant that a large segment of the Cayman economy has shut down. With foreign travel restricted and cruise ships no longer showing up, much of the local economy has come to a halt. It is hoped that local restrictions will be lifted in July and some businesses can reopen. The government is looking at a GDP contraction of between 11-12 percent this year. Unemployment could be close to 20 percent. Government finances in 2020 have shifted from a surplus to a deficit. To cover the deficit and help the territory wade through the pandemic, the government has established a $500 million line of credit.

The Cayman Islands government implemented a stimulus package to buffer the downturn and set the stage for an economic recovery. It is envisioned that foreign visits and tourism will resume in late 2020, though much will depend on how quickly the pandemic is resolved (as much as it can be) in North America, source of most of the territory’s tourists.

The Caymans, like other heavily tourist-oriented Caribbean economies, is likely to look back upon 2020 as one of the worst years in its history. Although the economic outlook is bleak for 2020, prospects for 2021 should be better. The main variable will be if there is a significant second wave of coronavirus. If there is, 2021 could also be a challenge. We see the Cayman Islands’ Aa3 sovereign ratings from Moody’s as under pressure, but the government has been proactive in dealing with its challenges. Indeed, Moody’s affirmed the rating in April 2020 and left the outlook at stable. However, if a second wave of pandemic hits and keeps global tourism in limbo, we could see mounting pressure on both government finances and the ratings.
