



Covid-19: Political And Geopolitical Risks

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Structure Of Presentation

- Short Term (Current + Next Few Months)
- Medium Term (Late 2020)
- Long Term (2021 And Subsequent Decade)

Covid-19: Current Political Stability Likely To Be Short-Lived

- Postponements of elections by many months mean reduced risks of imminent governmental change
- Most countries are on lockdown, meaning that public gatherings (e.g. protests) are banned
- Even if lockdowns were not in force, fears of virus would deter mass public gatherings (e.g. Hong Kong)
- Governments are unveiling massive fiscal spending packages and support measures to cushion the impact of rising unemployment

However, Some Countries Could See Instability Sooner

- Lockdowns may be difficult to enforce in cities with large informal settlements, where government support measures are weak
- If food starts running out, there could be pockets of unrest in supermarkets, etc.
- Prolonged lockdowns could have unpredictable psychological consequences

ELECTIONS POSTPONED

- Bolivia
- Chile (referendum)
- Cyprus, Turkish Republic of North
- Ethiopia
- Germany (CDU leadership)
- Indonesia (local)
- Italy (referendum + regional)
- North Macedonia
- Poland
- Russia (referendum)
- Serbia
- Spain (Basque and Galicia)
- Switzerland (EU movement ref.)
- United Kingdom (local and big city)

Source: Fitch Solutions

Covid-19 To Exacerbate Medium-Term (H2 2020-2021) Political Stability

Recovery Phase Will Pose Substantial Risks To Governments

- Governments are already being exposed to greater retrospective criticism of their handling of the crisis
- Political 'blame games' will intensify – what could or should have been done, and when?
- Tensions between central and regional governments have been exposed (e.g. Brazil, China, Italy, Spain, USA)
- As people return to work, unemployed could become more restive
- Italy and Spain, among worst-hit countries in Europe, were already the most politically unstable
- Iran, with worst MENA death toll, also faces instability risks... especially with oil price collapse

The Most Vulnerable Countries Will Be Those That Had Already Seen Unrest, Pre-Coronavirus Crisis

- 'Thawing' of unrest to see more protests
- Covid-19 will have exposed even more shortcomings of hitherto ineffective governments

World Facing Multiple Sources Of Discontent, Even Before Covid-19

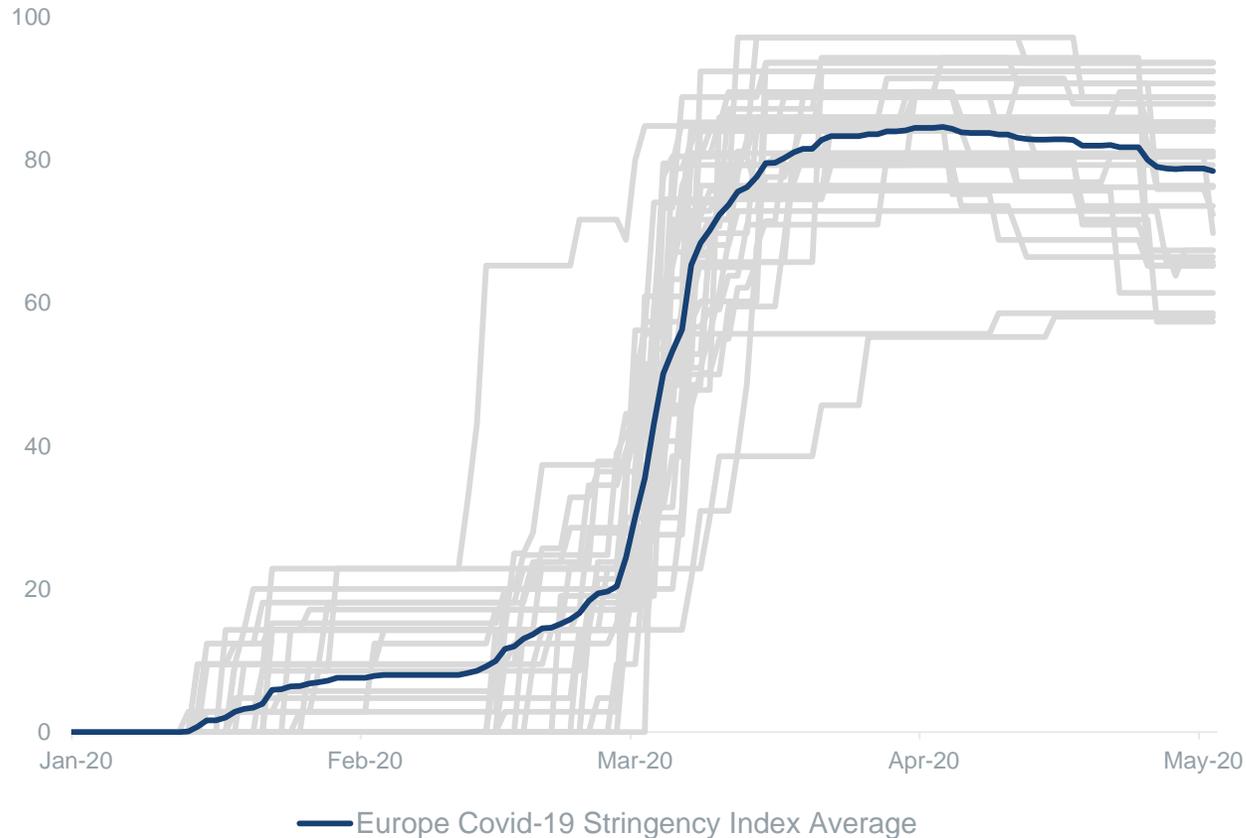
- The year 2019 saw major protests in many countries around the world
- A deep recession in 2020 or beyond could amplify protest movements, further weakening economic reform momentum

Source Of Risk	Description	Additional Thoughts	Markets Most Affected
Political ‘Legitimacy’ Grievances	Government and/or political system is no longer seen as legitimate by the public, because of perceptions of electoral rigging, corruption or other malfeasance	Protests concerning political legitimacy could be the most intractable, and could re-emerge over a number of years	Algeria, Bolivia, Egypt, Guinea, Hong Kong, Iraq, Sudan, Venezuela
‘Bread And Butter’ Protests	Deterioration in people’s livelihoods, such as a reduction in subsidies that results in higher food, fuel, or transportation costs, is an especially sensitive issue in emerging markets	Governments can often quickly defuse such protests by backtracking on price hikes, but at the risk of reform progress	Chile, Ecuador, Iran, Jordan, Lebanon, Zimbabwe
Discontent Over ‘Identity’ Issues	Identity issues are partly driven by rising levels of nationalism or separatism and are often linked to political legitimacy	This reflects multiple structural factors, such as language, religion, socioeconomic status	Cameroon, Ethiopia, Indonesia, Nigeria, Spain (Catalonia)
Protests Over Environmental Issues	The rise of climate change protests in developed states, aimed at pressuring governments to adopt greener policies	Protests underscore how climate change has been steadily rising up the political agenda	Mostly developed countries, but increasingly likely in emerging markets too

Europe Emerging From Lockdowns (Next Few Months)

European Exits From Lockdowns Gradual And Uneven

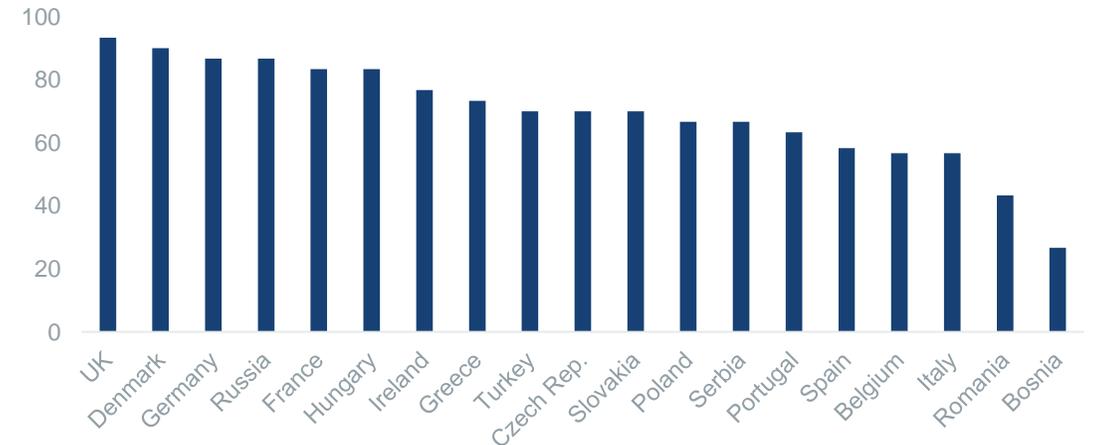
Europe – Covid-19 Stringency Index, 0-100 (100 = strictest)



- European countries are on course to fully or almost-fully exit lockdowns by the end of August
- Northern and Central Europe lead the way, trailed by Southern and Eastern Europe
- Gradual phase-out of social spending and fiscal support will likely follow, with difficult decisions ahead
- Second wave risks: public discontent and opposition from sub-national governments could undermine re-imposition of lockdowns despite greater preparedness

Effective Governments Better Placed For Difficult Phase-Out

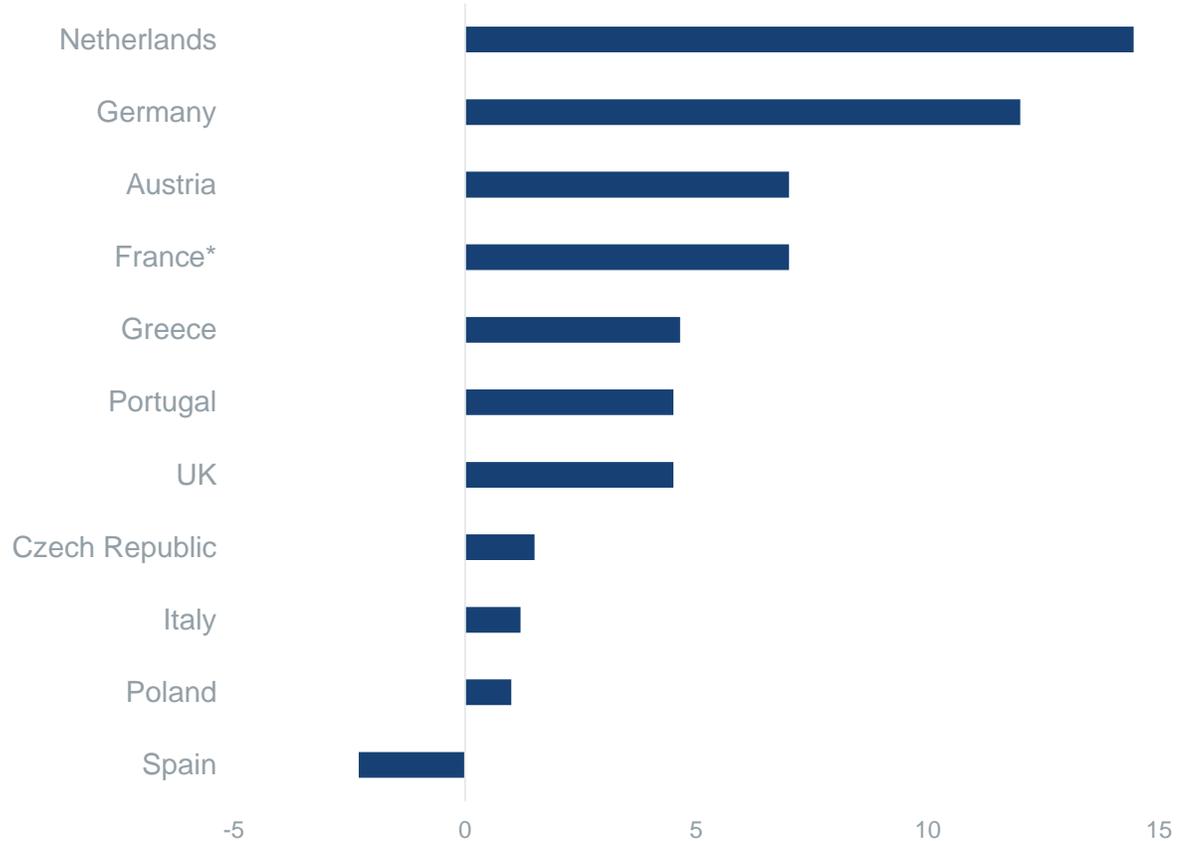
Selected Countries – Policy-Making Process Score, 0-100 (100 = lowest risk)



Government Instability, Policy Risk In Europe Will Rise (2020-2021)

Most Incumbents Temporarily Benefit From Covid-19

Selected Countries – Change In Support For Ruling Coalition/Party March-May 2020, pp



- Some of Europe's most affected states by Covid-19 are led by unstable governments with a high risk of collapse, including Belgium, Italy, and Spain
- Some policy changes likely on a case-by-case basis
- Infighting within several ruling coalitions to rise amid probable disagreements over phasing out of Covid-19 social spending support and subsequent fiscal consolidation
- Unemployment and economic inequality will increase between states and individuals within states, with negative implications for government stability in the coming years

EU Initiatives Will Be Affected Across The Board

- EU 2021-2027 budget and European Green Deal implementation will be delayed, reviews of competition and trade policies affected by Covid-19
- National governments will likely lead on reforms, leading to discrepancies across the EU, such as on conditionality of state aid around climate change goals

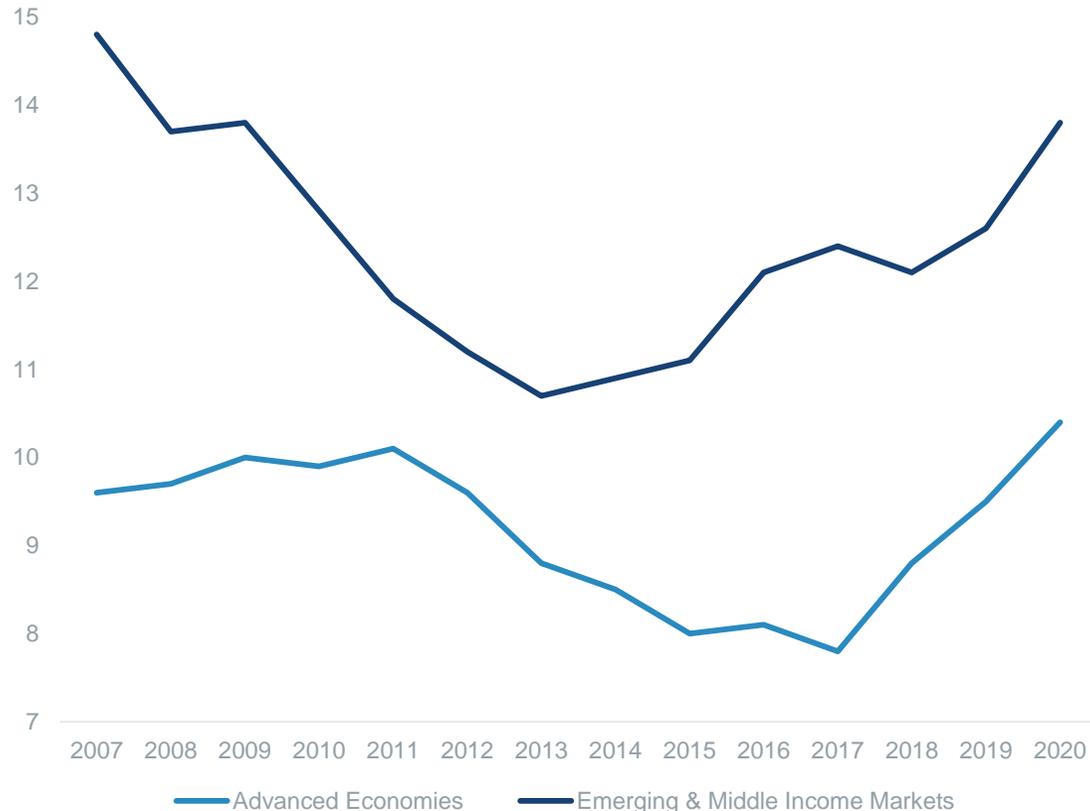
Several Downside Risks Looming Over Europe (2020-2022)

Date	Country	Events	Details
June 30 2020	EU, UK	Deadline for a possible extension of the transition period	
July 1 2020	EU	Germany assumes EU presidency	Covid-19 has reshuffled German priorities for its six-month chairmanship of the Council of the EU
June-July 2020	Poland	Presidential election	Pandemic poses moderate downside risks to government-aligned candidate
September 13-15 2020	EU, China	Summit	Rising backlash against China around Covid-19 derails chances of a trade deal
October 2020	EU	Informal deadline for the EU to agree on its 2021-2027 budget in time	
December 3-5 2020	Germany	Leadership election (CDU)	The ruling Christian Democratic Union (CDU) will elect its next leader and likely successor to Angela Merkel as Chancellor
December 31 2020	EU, UK	Post-Brexit transition period due to expire	Covid-19 amplifies political and time pressure on both sides to reach a compromise deal in time
<i>TBC</i>	Italy	Leadership election (M5S)	The Five Star Movement (M5S) will elect its next leader, with some implications for government stability
March 2021	Netherlands	Legislative election	Centre-right coalition will face two right-wing populist challengers in the aftermath of Covid-19
Autumn 2021	Germany	Federal election	Wide-ranging implications for domestic and European policy
April 2022	France	Presidential and legislative elections	

Covid-19 A Challenge To EU Frameworks (2021 Onward)

Policymakers Face Rising Debt Servicing Costs

Global - Interest To Tax Revenue, %



- Governments will face trilemma of high public debt burden, unpopular austerity measures, or difficult reforms
- Ongoing strategic reforms in the EU will be delayed, including single market reform, review of the ECB mandate, or the Conference on the Future of Europe
- Fiscal union and debt mutualisation likely to remain taboo, thus testing limits of EU fiscal rules and monetary policy
- Benefits of EU integration will remain static and could fall in relative importance as sectors without deep integration become more prominent (such as digital economy)

Some opportunities exist, but taking advantage will be difficult

- EU emphasis on green investment will likely grow, but political backing is uneven across the bloc
- Most right-wing populist parties fell in opinion polls, which could catalyse reformist movements, but trend likely to be short-lived and also invites challenge from left-wing populists

Covid-19 And Global Trade: Protectionism Could Rise Amid Stalled Talks

- Several trade-related flashpoints will re-ignite in the next 12-18 months, most of which will be difficult to resolve

Date	Country	Flashpoints	Details
June 2020	US, EU	Boeing-Airbus dispute	The World Trade Organisation (WTO) is due to allow the EU to place tariffs on the US as part of the long-standing dispute
July 1 2020	UK, EU	Post-Brexit talks	The legal deadline to extend the UK's transition period will likely lock in a limited UK-EU trade deal if the date passes without an extension
2020/2021	Global	Digital services tax dispute	Many European states have implemented a digital services tax, prompting threats of tariffs from the US as OECD-led mediation efforts have stalled
2021	EU	Carbon border adjustment mechanism	The EU will likely move ahead with its carbon tax plans in 2021 as it seeks to enforce labour and environmental standards more robustly, possibly adding to tensions with US, China, and others
2021 onwards	US-China	'Phase 2' deal talks	Should President Donald Trump be re-elected in 2020, the US would likely seek a 'phase 2' trade deal with China, possibly under the threat of fresh tariffs
2021 onwards	Global	Global trade reforms	The US-EU-Japan trilateral could ramp up pressure on China to agree to subsidy and other WTO reforms, while the EU will seek a resolution to the US-induced blockage of the WTO Appellate Body

Covid-19 And Brexit: Outbreak Amplifies Time Pressure

- Covid-19 restrictions and recession raise risk of 'no deal' outcome
- London resists extension despite legal deadline of July 1 2020, but a short 'technical' delay at the last minute appears plausible
- Progress in H120 will likely prove insufficient to seal an agreement and provide clarity to businesses, paving the way to another cliff-edge threat in Q420.
- Some form of trade deal remains most likely outcome, but limited time for negotiations translates into administrative costs, delays to supply chains, and possible tariffs or quotas





China: President Xi Jinping Faces Significant Challenges

China Appears To Have Brought Covid-19 Under Control...

- China is engaged in reputational damage control, portraying itself as in recovery and ready to assist other nations
- However, US intelligence has cast doubt on official death toll and cases
- Internal tensions could rise over whether Covid-19 should have been revealed and dealt with earlier
- Tensions could rise between central and provincial/local governments over 'blame games'
- Economic fall-out could have political repercussions

Uncertainty Over Sustainability Of US-China Phase One Deal

- China is unlikely to be able to meet its commitments to buy US goods

Hong Kong's Continuing Uncertainty

- Hong Kong's September legislative elections could be a flashpoint
- Resurgence of protests could lead to Chinese intervention

Belt And Road Delays And Backlash

- More countries were already becoming concerned about being indebted to China
- Future concerns about Chinese workers' health could delay projects



US 2020 Election: Trump More Vulnerable To Defeat

Factors Favouring Trump's Re-Election (Pre-Crisis)

- The US economy was fairly robust and unemployment was low
- Incumbent presidents usually win second terms, unless there is a recession (George H.W. Bush, 1992) or a geopolitical disaster (Jimmy Carter, 1980)
- Democrats faced a dilemma over whether to nominate traditional 'centrist' candidate such as Joe Biden, or left-wing populist such as **Bernie Sanders** or **Elizabeth Warren**, or newcomers such as **Pete Buttigieg**
- Trump is a formidable candidate whose surprise victory in 2016 showed that he should not be underestimated

Factors Against Trump's Re-Election (Current)

- Trump's approval ratings have struggled to break above 45-50%, suggesting low ceiling of support
 - Trump initially downplayed seriousness of Covid-19 threat
 - Severe economic recession and rising unemployment will hurt Trump
 - High Covid-19 death toll and cases could expose weaknesses in US healthcare, an area that traditionally favours Democratic Party
 - Americans electing Biden would not be as high-risk as electing Sanders, due to Biden's centrism and experience
-
- Regardless of who wins the presidency, trade protectionism is likely to persist
 - Even a 'globalist' president would struggle to reassert US leadership and bolster liberal international order



Covid-19 To Exacerbate US-China Geopolitical Tensions



- Trump already blaming China to divert attention away from US economic woes and high death tolls
- China's difficulties in meeting 'Phase One' commitments could prompt Trump to turn up pressure on trade
- China's provision of assistance to worst-hit countries could lead to US seeing its leadership challenged
- Even if Trump is defeated in November election, next president is likely to be tough on China
- Covid-19 does not alter likelihood that US-China rivalry in Indo-Pacific will be a defining feature of early 21st century
- US may deploy new missiles in Pacific after leaving Intermediate Range Nuclear Forces (INF) Treaty in 2019



Pre-Covid-19 Geopolitical Tensions Could Resurge Quickly



US-North Korea nuclear talks to remain in deadlock

- Neither side is keen to rush into talks, especially with US election looming in November
- Next US president may take tougher approach



US-Iran: Neither side has any interest in confrontation right now

- Iran is the worst-hit country in MENA



India and Pakistan tensions rose sharply in 2019...

- But both countries need to prevent Covid-19 crisis expanding to European levels



Russia seeking to integrate Belarus more deeply into its political structures

- Belarus could become next flashpoint in Russia-West relations



Trump still keen to withdraw from New START Treaty on nuclear arms in Feb 2021

- Fears likely to rise over new nuclear arms race



Key Risk: As Covid-19 eventually eases, 'frozen' geopolitical tensions could flare up simultaneously!

Emerging Markets Face Similar Risks To DMs, But With Fewer Resources

Latin America

- Central vs Regional government tensions (e.g. Brazil, Mexico)
- Central America vulnerable to falling remittances

Middle East And North Africa

- Oil price collapse brings additional downside risks in GCC
- Bahrain and Oman most vulnerable; UAE, Qatar, and Kuwait best insulated
- Rising unrest in Iraq and Lebanon

Sub-Saharan Africa

- Poor financial resources and weaker public health systems
- Food security concerns in East Africa (earlier problems with locust swarms)
- Concerns about 'power grabs'
- Anti-Islamist militancy operations less of a priority

Asia-Pacific Region

- Uncertainty about future relations with China amid rising Sino-US rivalry
- Central and South Asia vulnerable to falling remittances

Economic contraction

Higher unemployment

Lower consumption

Reduced demand for exports

Reduced demand for commodities

Rising anti-incumbency

Fiscal loosening

Reduced scope for reforms

Covid-19 To Have Highly Variable Long-Term (Beyond 2020) Risks

Unsustainability Of Fiscal Stimulus Measures Suggests That There Will Be Substantial Austerity Later

- This will exacerbate inequality and increase social discontent

Healthcare Is Likely To Increase As A Political Issue

- Ageing populations, even in Emerging Markets, will ensure public health sector gains importance

Universal Basic Income (UBI) Will Become A More Mainstream Political Idea

- Automation and AI were already slowly bringing this idea into policy debate

Some Countries Could See Growing Public Acceptance Of 'Strong' Governments

- Lockdowns, emergency measures, and more surveillance may be deemed more acceptable to counter future threats...
- ...but many countries will demand that emergency measures are rescinded

Populist Leaders Will Face Mixed Fortunes Overall

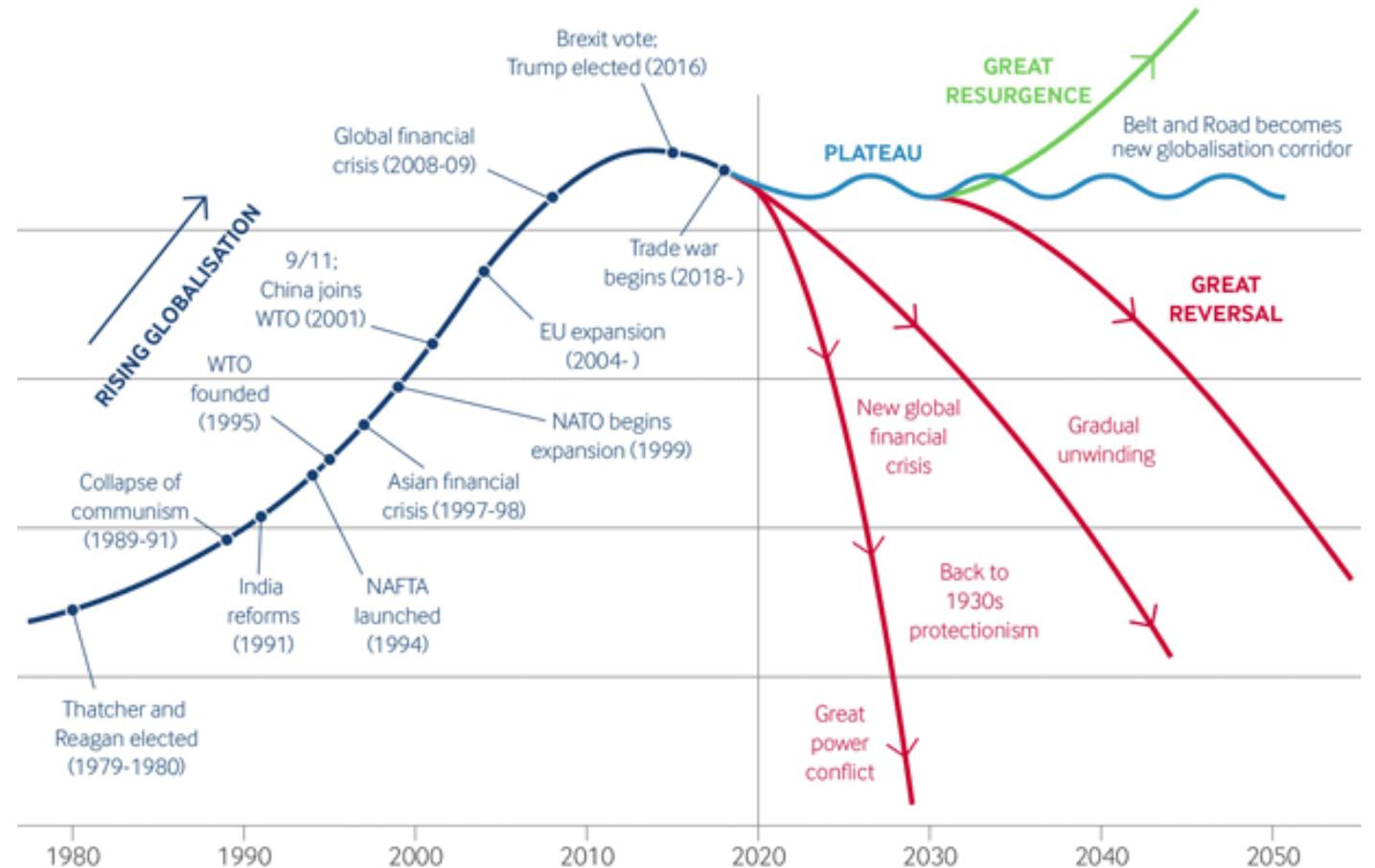
- Trump, Bolsonaro, others appeared slow to take Covid-19 seriously and could thus lose support
- Future populist leaders could run for office on UBI and improved healthcare platforms

Climate Change To Remain Major Political Issue

- Northern hemisphere warming could bring more tropical diseases to temperate zones

Covid-19 Another Blow For Globalisation

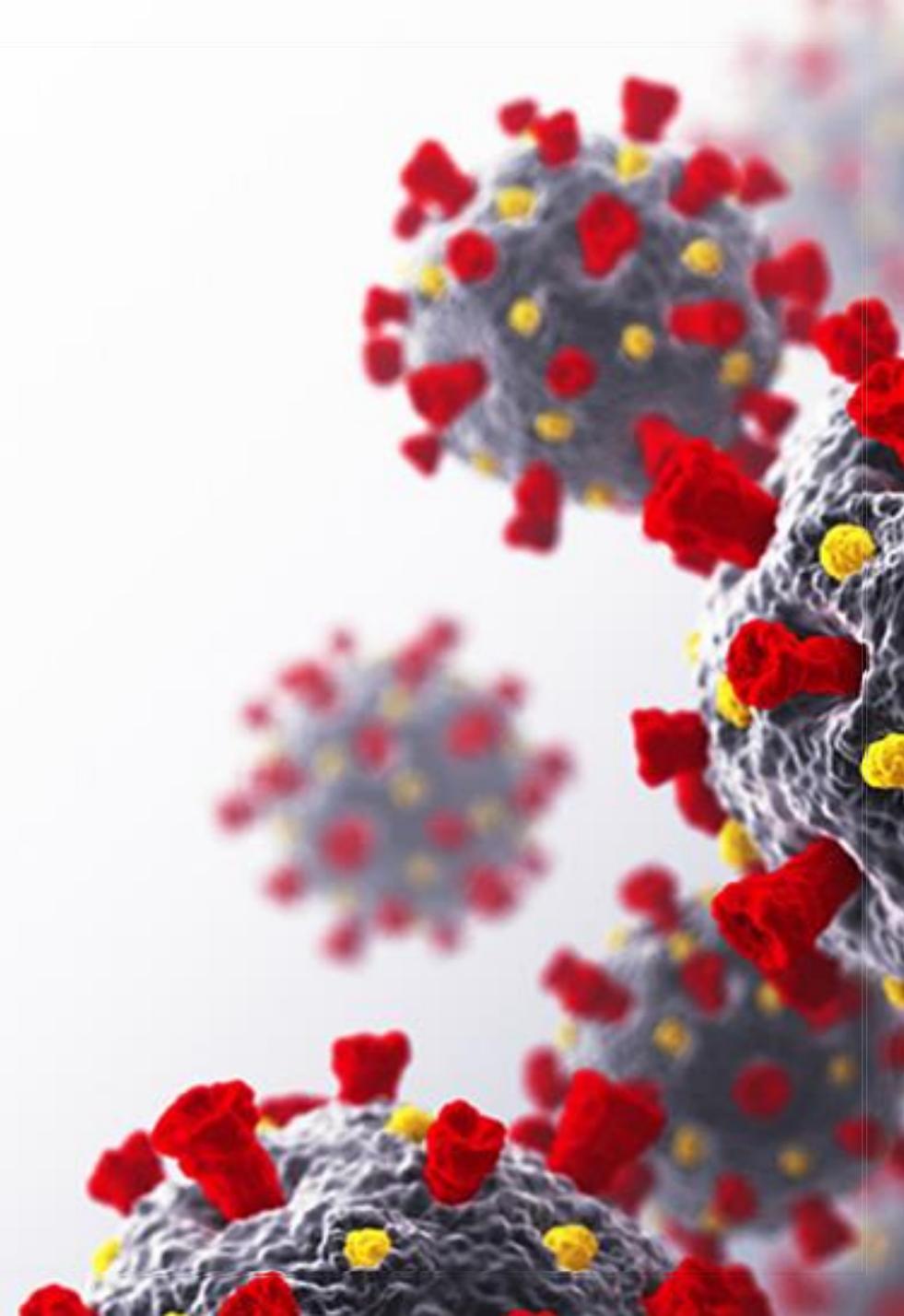
- Covid-19's spread will make border control a more important political issue
- There has been a lack of international coordination in dealing with the virus
- Even EU states have acted unilaterally rather than in coordination
- Most countries are prioritising their own health needs
- The crisis will underscore the risks associated with long global supply chains, especially to and from China
- There will be greater emphasis on being more self-reliant; regionalism will supplant 'globalism'



Connected Thinking in Challenging Times

Coronavirus research from Fitch Ratings, Fitch Solutions Country Risk & Industry Research, and Fitch Solutions Leveraged Finance Intelligence is now available to all on Fitch Connect.

Find out more at fitchsolutions.com/coronavirus



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