CURRENT MARKET NEWS

Geopolitics and the pandemic: An expert weighs in

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Geopolitics was a hot topic before the COVID-19 pandemic, but the past several weeks have only magnified many of the preexisting tensions. It's no wonder the monthly Global Economic Policy Uncertainty Index is at an all-time high.

I recently spoke with Matt Gertken, Geopolitical Strategist at BCA Research, a Montreal-based global investment research firm. We discussed a wide range of areas that have been impacted by the pandemic—including the U.S. elections, U.S.- China relations and emerging markets—and what it all means from an investment and economic perspective.

Following is a summary of our discussion.

U.S. fiscal stimulus

It's widely believed additional fiscal stimulus across the globe will be necessary to help repair the economic damage caused by the pandemic. While the House of Representatives recently passed a $3 trillion stimulus bill, it's not expected to be approved by Senate Republicans in its current form. So where does Congress go from here?

"I think we will see some hiccups based on the fact that the Senate GOP and some other Republicans are trying to take a pause," Gertken said. *"But the endgame here is for another round of massive stimulus. It may not be $3 trillion, but $2 trillion is totally believable."*

The issue of providing funding to state and local governments, however, remains a stumbling block. Some estimates cite a state budget shortfall as high as $400 billion, which raises concerns over the creditworthiness of municipal bond issuers. Democrats and Republicans are divided on how much funding should go directly to states.

But Gertken noted that policymakers have learned some lessons from the 2008-2009 global financial crisis when they were reluctant to use fiscal policy, resulting in significant state and local budget shortfalls. Now, he said, policymakers are trying to plug that gap. Also, President Donald Trump is motivated by *"trying to do the impossible"*—that is, get the economy firing on all cylinders again as quickly as possible—while bidding for reelection.

"We have a Democratic House and a president who's trying to get reelected," Gertken said. "That's going to create the combination where you'll end up with providing state and local governments with upward of $500 billion."

While Senate Republicans will have their own concession demands—such as ensuring stimulus money isn't used for bailing out blue state pension funds—Gertken believes a stimulus bill will ultimately pass. *"In the end, the House controls the purse strings, and the president is going to lean with the House on getting stimulus [passed]."*

Whatever the final package looks like, Gertken said the U.S. economy will find itself in unchartered territory, with this year's total stimulus relief possibly representing as much as 20% of GDP.

Europe and Emerging Markets

From a fiscal perspective, it's clear that southern Europe—particularly Italy—needs more help than their northern European counterparts. The question at the heart of Europe's economic recovery prospects is how far Germany will go to support its more heavily indebted southern neighbors. They recently partnered with France to propose a 500 billion euro ($547 billion) recovery fund. And Gertken noted that despite Germany's reputation for being financially thrifty, the country passed a significant fiscal package at the end of 2019 in response to global slowdown, setting the stage for being more open to other stimulus measures.

"The policy setting had shifted, so when COVID hit they surprised with a blowout of spending," Gertken said. "*So Germany is playing an incredibly proactive fiscal role. On top of that, you have this north-south divide, and in order to save the European project, the Germans need to spend more to help rebalance demand on the continent. The fact that Germany and France are combining to do debt issuances shows that the European project has a lot more momentum than investors tend to assume."*

COVID-19 has enacted a heavy toll around the world. But as Gertken pointed out, while developed countries can deploy massive fiscal tools without the risk of devaluing their currencies, emerging markets don't have that advantage. Gertken listed Turkey, the Philippines and Brazil as representing significant risk, given that these are countries that have been severely impacted by COVID-19 and have had underlying economic problems. Malaysia, Russia, China and Thailand, on the other hand, are in better shape, but even they come with caveats.

"Even the countries that score highest on our index are still in big trouble," Gertken said. *"Russia got hit by the oil market collapse and they were already seeing a bit of discontent bubbling up domestically. China looks better than others, but they're also having their first*

recession since the 1970s. That's another place where you could see some surprising negative news that would have global ramifications."

U.S. elections & policy implications

In a normal presidential election year, the economy would top the list of voter concerns. Of course, 2020 is not an ordinary year. The economy is still number one according to polls, which Gertken said should be a positive indicator for Trump's reelection prospects. But he noted that this year is the rare case where a noneconomic issue—the pandemic—could be the decisive factor.

"That, to me, seems like it could be the issue that defines the election," Gertken said. *"I think Trump is favored if the economy is the number-one issue in the swing states, and I think he's disfavored if the issue is the pandemic or health care more generally."*

As far as the potential market response to the eventual outcome, Gertken said Trump's reelection will likely result in both houses of Congress retaining their current majority parties. *"You basically have the same policy configuration, which ultimately is not that bearish for the capital markets, and many would argue is very bullish."*

Conversely, a Biden victory would likely result in Democrats regaining control of the Senate, giving the party control of both the executive and legislative branches. "If the Democrats win, it could be quite jarring for the markets at least initially, because you get a full reversal of policy," Gertken said. *"Democrats would be able to raise taxes, raise minimum wage, and impose more regulation across the board. With the Senate in their pockets, they'd be able to do a lot of their bigger agenda, and that would surprise the markets."*

Gertken did note that a Democratic victory wouldn't necessarily result in an immediate, aggressive tax hike, but he said investors would be wise to prepare for it anyway. *"The only consolation there is Biden will not raise the corporate rate back to where it was before Trump took office, it will be somewhere in between."*

It is also worth noting that new presidents tend to focus on getting a signature policy passed in their initial days in office. For Biden, Gertken said it's restoring and expanding the Affordable Care Act. Second-term presidents, on the other hand, tend to govern without constraints. In Trump's case, trade and foreign policy will be at the forefront. *"We saw the good cop Trump in the first term, in the second term we'd see the bad cop,"* Gertken said. *"I think his signature issue has been trade, so I think Trump would be much more likely to start a trade war with China, and that would be the definitive action of his second term."*

U.S.- China relations

Trade tensions between the U.S. and China were high before the pandemic, and those tensions have only ramped up in the last several weeks. Noting that the tariffs levied on China were enacted during a bull market, Gertken said the current environment makes an escalation in the trade battle more precarious.

"My concern is if Trump is unable to put [the economy] back together again, he'll try to lock in strategic gains in confronting China, and that for me is a substantive risk this year," he said.

Gertken believes we've entered a new chapter in U.S.-China relations. Along with the risk of a full-blown trade war is the possibility of China responding aggressively, given that it's in a recession. And Biden, Gertken said, would represent *"a change in style, not substance"* over Trump regarding relations with China.

"It's the risk that on the other side of the election, investors will find out that this is an ongoing issue—it didn't really all depend on Trump," he said.

Lightning round

I posed 10 questions to Gertken to elicit his gut responses to some of the key geopolitical issues of the day.

When will the U.S. pass the next round of stimulus, otherwise known as package number four?

First week of June.

Will Phase 1 trade deal with China be torn up by end of 2020?

Yes.

Who will be Biden's running mate?

Michelle Obama.

Who will win the presidential election?

I used to say Trump, but after COVID I would say Biden.

What party will win the Senate majority?

Democrats will pull out a squeaker.

What industries are most at risk from this outcome?

Fossil fuels, coal especially.

What industries are most likely to benefit?

Consumer discretionary.

Will the European Union still exist in five years?

Yes.

What will happen with Brexit in 2020?

My guess is the U.K. will get an extension. But if push comes to shove, they may just leave.

What country is likely to generate the next crisis that no one is thinking about at the moment?

Saudi Arabia.

We covered all of the topics mentioned in the article in greater detail. You can listen to a recording of the full conversation here. [Replay: Politics of the pandemic.]

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