



# Geopolitics Outlook 2018: Zeihan's Big Three Predictions with Extra-Regional Consequences

We recently caught up with Peter Zeihan, author of *The Accidental Superpower*, to ask his thoughts on the top geopolitical shifts to watch in 2018. He shared his predictions on everything from anti-trust concerns for Silicon Valley and the dire consequences for the United States if we exit NAFTA to why he expects North Korea to back down this year. In the following Q&A, we share a recap of that conversation. Peter kicked off the outlook 2018 discussion with his top three major predictions with extra-regional consequences.



*Geopolitical Strategist Peter Zeihan*

## **KLC: What's your #1 big prediction for 2018?**

PZ: There is a US-Mexico crisis on the horizon that has the potential to send both countries into deep recession, and it will probably manifest fully by this summer. Canada is trying to get Mexico to join in pushing a delay of NAFTA negotiations until after the mid-term elections in the United States (November 2018). Now if this is the position presented to Trump, I predict he'll shut down NAFTA negotiations entirely.

All of this is going to come together this year as the violence on the border and social instability in Mexico (from the drug war) blows up. There are also economic issues. When Mexico liberalized pricing, one of the first markets they opened was gasoline distribution. Gasoline in Mexico City is almost \$5 a gallon now, so the average Mexican is already furious at the government, and the Mexican presidential election is next summer. Politically, Mexico can't agree to anything that is Trump's idea right now -- it would be toxic. That's the beginning, because if the Mexican political system evolves the way it looks like it might, and if we get a president Obrador, we get somebody with a view of foreigners like Trump, with a blind ideology like Ted Cruz, with the shrillness of Elizabeth Warren, with the corruption of Hillary Clinton, and the pathological unwillingness to do math of Bernie Sanders -- all in one person. If that becomes Trump's partner on the other side of the border, you can imagine how horrible relations are going to get. Then everything that is already tenuous in American-Mexican relations just goes straight downhill whether it's water rights, cooperation on the drug war or immigration. I would also expect the peso to crash.

If we walk away from NAFTA, we are at a minimum going to have a recession in the United States. There will be a depression in Mexico, and a very deep, very painful adjustment in Texas. Mexico is our largest trading partner, and the interconnectedness of the supply chain across the borders is very deep.



Ironically, the places where it's deepest are Trump states, so that'll be an interesting political conversation to have. California, the Pacific Northwest, New York and New England will be affected the least, and Texas, the Great Plains, and the Mid-South will be affected the most.

### **KLC: What's big prediction #2?**

PZ: Trouble for the European Union. It will be obvious midway through 2018 that there's not going to be a Brexit deal between the UK and the EU. That means hard Brexit, leaving the EU without a deal in place. In my opinion that is unavoidable. To have a meaningful deal on Brexit, and to have a meaningful deal on anything that involves the Eurozone, you have to have a German chancellor that can make deals. Which is a problem right now. Angela Merkel has already come out and said that Germany will be taking no position on anything related to Europe at all. If you want to have a deal on Brexit, that's a bad thing. If you're cheering for the end of the Eurozone, it's great. But I don't think the Germans want to end the Eurozone. This has been the longest period of peace and prosperity in their history. They would really rather not go back to the old European competition that involves bullets. They're good at it but they're not good enough. If you look at all the problems the EU has dealt with since 2006, they've all been solved by German political leadership and German money -- whether it's the next Greece renegotiation, an Italian banking crisis or Brexit. And there's another swell of migrants about to come through this winter from Libya. The Russians and Syrians are on the march in Syria, and that could generate another half million refugees. The Greek situation is now such that food shortages are the norm. It's not Venezuela-style, but it's close.





**KLC: Your third big prediction for 2018 is ... ?**

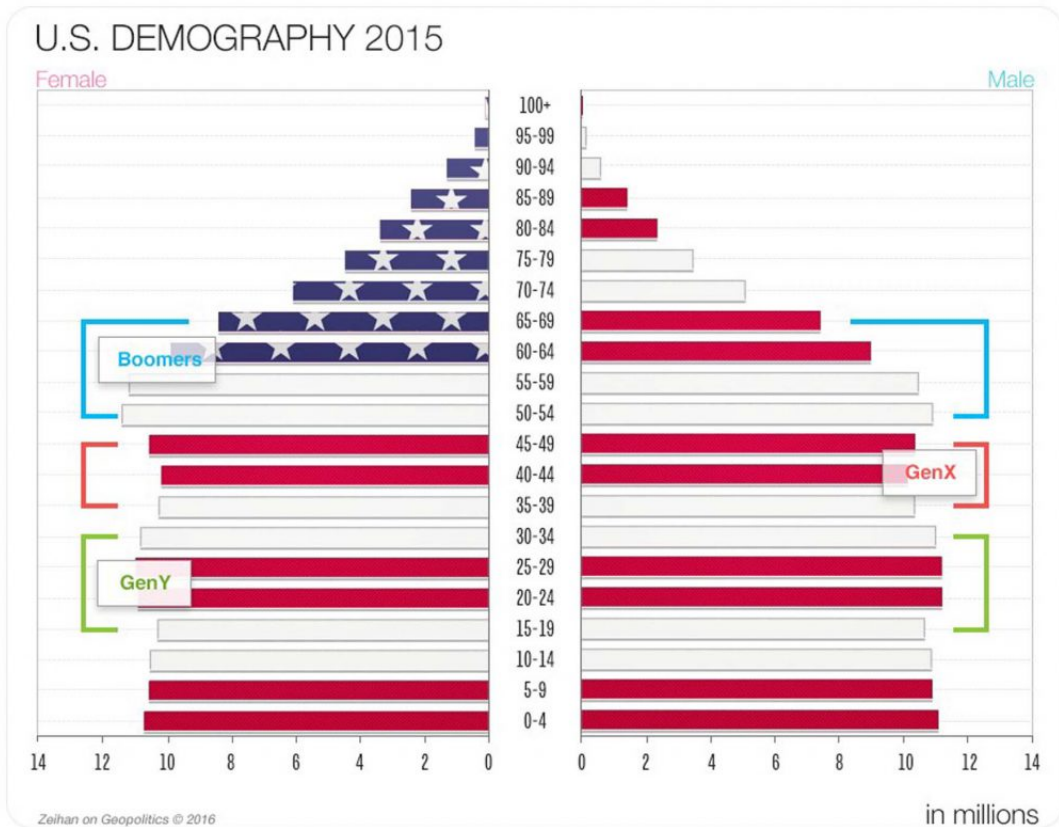
PZ: Russia moves into Ukraine. They've already started the electronic warfare in Kiev. People talk about Syria, where there are 25 million people? There are 50 million in Ukraine, and it's flat in between, so you don't have to get on a boat ever. You just go west on the plain. The Russians will pull out of Syria because they've achieved what they wanted. With Merkel having no power, Brexit removing the Brits, Trump wanting to buddy up with Putin, and NATO on the rocks ... everybody's deployments are basically petered out. This is a great time. This might be the time for Russia to move into Europe. Why? Because, who's there to stop them? All the countries that given time would be able to push back are in complete disarray right now. If I were Putin, I'd do it at the height of Brexit negotiations. Oh, yeah, and Russia has (chuckle) elections coming up this year in 2018. Putin's running again...





**KLC: In the United States, will we see growth or recession in 2018?**

PZ: The US just had a quarter of 3% productivity growth. It would appear we're on track for normal growth, but this isn't what normal feels like. Normal is more like the last five years, in my opinion. And throw in an aging US demographic situation, building deflation, automation and everything that goes with that, and it begins to feel like we're in a bubble. I don't want to say that a recession is imminent. In fact if I just look at the United States by itself, it doesn't look all that frothy. But when I look at Europe, or China, or Japan, and for all of them to be growing at the same time, that makes me suspicious, because that just doesn't happen all that often. The United States is tightening policy, albeit slowly. But if it took a decade for us to get the rest of the world to meager growth, and then all the growth happens at the same time while the United States is tightening policy, it feels like we're ripe for a recession. I know the macro-stats in the United States do not support that at all, and I can't point to anything in the United States that looks particularly worrying, but none of the problems that the Europeans had for the last three recessions since 2007 have been addressed. There has been no restructuring of the financial space to take account for the fact that the European banks, to be perfectly blunt, are insolvent. And in a situation like Europe's, where the labor market is so moribund and so old and so inflexible, when you get growth, that means you immediately get overheating. Not as bad as Brazil, but pretty close. So I can't help but be concerned about global growth in general in 2018, including the US.





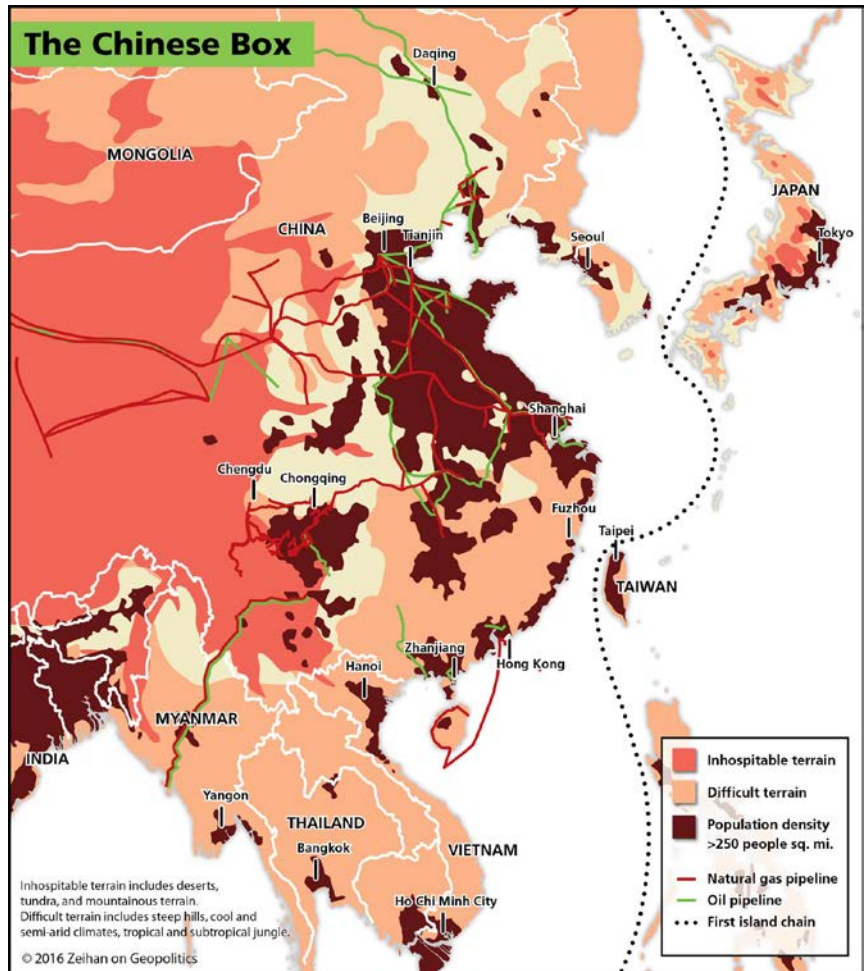
**KLC: We've heard some good things about growth in France lately. What are you hearing?**

PZ: France is doing its own thing. With the venture capital culture, there is an entrepreneurial Renaissance going on. If Macron is able to do 5% of what he says he wants to do, it will be good for the French. Remember that of the major European states, France is the one least involved in European trade. They're not as isolated as the United States, but they're close. If the Euro goes away, obviously France will still hurt like hell, but they'll be the ones that fall the least and bounce back the fastest.

**KLC: We noticed none of your big three predictions for 2018 included Asia.**

PZ: OK here's what I see happening in Asia in 2018. In China, Xi has appointed himself dictator for life. He's nominated himself to be his own successor and eliminated absolutely everyone from the politburo who is not a close political ally. Now he's going to start working on his political opponents in the Chinese regions to bring them under Beijing's direct rule. When dynasties die, they often die of internal factors, and this is how it happens. In China for the last 3,000 years, there has been fight between the imperial center and the regional capitals, because in a country that broad and that large there's no set of policies at the center that can

effectively rule the regions. So, you get this pendulum swinging between a) extreme centralization, with Beijing occupying the entire country, in which case it's not economically dynamic, and b) extreme regional autonomy where policy is set by the locals, and that is economically dynamic, but it's incredibly corrupt. What has been magical since 1980, is China has gone with option b in an environment where there's no international involvement. So China has removed the need for centralization while granting most of the benefits of regionalization. One of the few downsides is that growth wave landed China with a mountain of debt, and now it's headed for a centralization strategy – in





part to counter that debt -- that will most definitely slow growth. Calendar year 2018 is when the centralization starts, and it will take at least a decade. During this time, the rest of the world is not such a big factor. This is one of the reasons I think the Chinese have been so willing to work with the Trump administration on North Korea. They don't want the Trump administration to look at China because if the Americans start to play hard ball with China, we could easily tip this all over.

**KLC: Do you think Trump is going to back down on US-China trade policies?**

PZ: I think the Chinese have figured out that when Trump asks for something, and you can find a way to give him at least a part of it, then you ensure China is not what annoys him most on any given day. If the US picks a fight with China, the US might actually get some large-scale reindustrialization, and then China will definitely implode – so why give the Trump administration a reason to pick that fight? You've noticed the South China Sea has gotten kind of quiet in the last six months? This is why. Fighting in the South China Sea is one of those things that might make the Americans think of you as a problem on any given day. The aggressive Chinese marine patrols shooting at Filipino fishing boats has pretty much stopped. China is still fortifying those atolls but they're not really doing anything nearly as aggressive as what they were doing a year ago.

**KLC: What happens in Japan this year?**

PZ: In Japan, 2018 is a year of consolidation where Abe basically crushes the opposition at the national level. We now get to find out what post-democratic Japan looks like, without a war. That's a rare and precious thing. We should all be very happy with that. They're offloading more and more of the industrial base. One of the beautiful things about having an industry that doesn't rely on human labor is that you can put all those non-voting robots anywhere, particularly in the United States, which allows you to seal a political security alliance because you invested in America. It's a good play for us and Japan.

**KLC: How does North Korea figure in?**

PZ: I think the worst is over with North Korea's active missile and nuclear detonation tests. If Kissinger were in the government, he would use North Korea to beat concessions out of China, and that's a good play. Trump won't do that, or if he did, it would require him turning over a new leaf that we've not seen yet. In North Korea in 2018, I see two things. Number one, missiles: they've tested an orbital missile and it worked, so they can say rhetorically they can hit anywhere in the United States. Also they've tested a plutonium bomb, a fusion bomb, so they can say they've checked that box too. Now they have to wed them together, and that's a lot harder. North Korea's weapons program is now at the height of 1947 America: that's when we first had a ballistic missile but before we could put anything on it. Even in the most aggressive weapons program which combined those two, you're still talking about several years before the next meaningful test. At this point, they've taken these two technological trees as far as they'll go. Now it is all about device mounting, re-entry survival, accuracy and miniaturization – all of which are far more difficult than what they've already achieved.

Second, on the political side, the North Koreans did a full-court press diplomatically across Europe in November. They asked: does Trump mean it (when he threatens to destroy North Korea)? And, is he



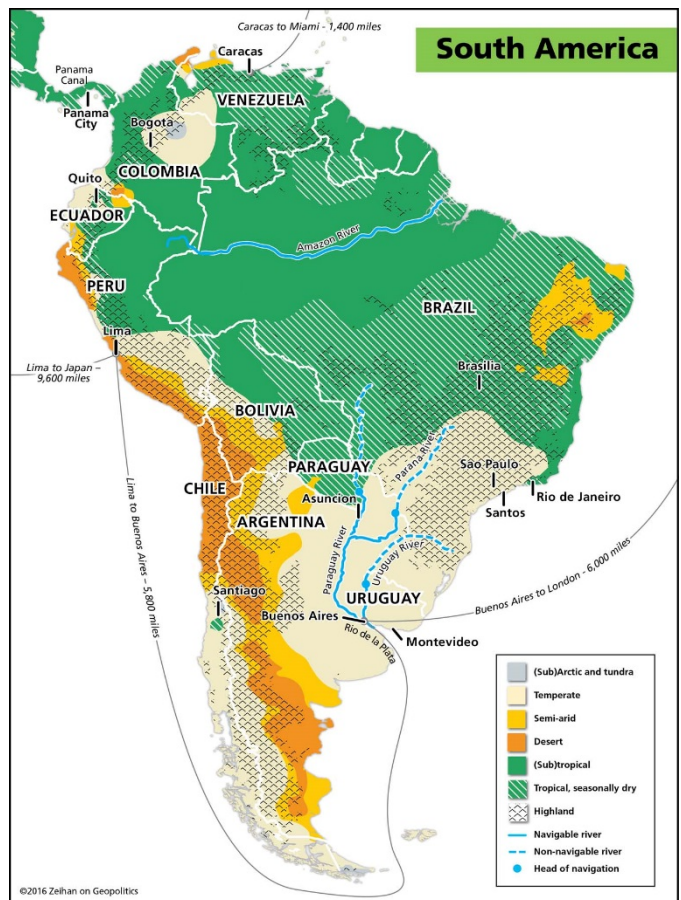
actually nuts? To see the North Koreans, who created the initial vintage of paranoid delusions as a national security strategy, blink and admit that they weren't the crazy ones in the room was very telling. Apparently the feedback they got from the Europeans is, "yes, Trump just walked away from a 70-year alliance that has been the bedrock of American national security for all of our lives." Word is the North Koreans went home thinking, "OK, we'd better cap this off." I think the crazy wave has passed in North Korea.

**KLC: What do you make of predictions of global food shortages due to global warming?**

PZ: They should be taken seriously. There are two sides to it. First of all, if I'm right about global supply chains and trade breaking down, you're looking at a pretty catastrophic reduction in the ability of most countries in the world to be able to grow grain-based crops in the first place. In the Western Hemisphere that really only hits Brazil, but in the Eastern Hemisphere it hits pretty much everybody outside of northern Europe. Think about the modern agricultural supply chain: the seed part is the easy part. Fuel is the big issue here. If you have an energy crisis that hits the producers – and remember oil gets refined into naphtha, then pesticides, fertilizers and herbicides -- that multi-stop international supply chain could get scrambled. We're looking at the prices of those items reliably tripling, probably more. That will have a big impact on food supply.

**KLC: What's your outlook for South America?**

PZ: OK, let's start in Venezuela: their debt problems could be solved in a day if they wanted to, that's the frustrating thing. They are already in nationwide famine, so the next step is state collapse. The mismanagement and the corruption extends so high up, it looks like the top echelon is going ride this regime into the ground, and the democratic opposition is so absolutely incompetent that I have no hope that, regardless of what happens with elections, they will be able to turn this around this year.





Argentina looks better. They have the potential for not just agricultural self-sufficiency, but also massive exports. Argentina has good land. Their infrastructure is decent, and if they start dredging the river again, they've got some of the cheapest transport in the world. They've stopped the backslide. I wouldn't rush in with a billion-dollar investment – it's still Argentina – but the soy farmers have started full operations again because they're now allowed to export without huge tariffs. They export mostly to China. I don't think they will see massive gains in 2018, and they don't have any big elections until 2019.

Chile has a presidential election this year. The only thing that really matters for Chile – and they're debating these laws in the presidential campaign -- is what to do with their mineral reserves. Right now, 10% of the revenues from Chilean copper go directly to the armed forces, and the government maintains a monopoly over the production and sale of the copper. That's in the constitution, left over from Pinochet. They want to amend that, because the money is just going into the generals' pockets. They've decided, with reason, that perhaps they should update that.

**KLC: Can you help us understand what's going on in Saudi Arabia, with MBS arresting all the rich and powerful Saudis and detaining them at the Ritz Carlton?**

PZ: He's gotten most of what he wanted so far. MBS – you're referring to Mohammad bin Salman, the Crown Prince of Saudi Arabia and son of the current king, Salman. MBS rounded up everyone who was against him and put them all in prison at the Ritz Carlton until they gave up all their money, or at least enough of their money that they were no longer powers within the kingdom. But let's back up. Salman, the king, ascended to the throne already in diminished mental capacity in 2015. His son MBS is crown prince and for all practical purposes, king, and has been for over a year now. Interestingly, they're preparing to jump generations: appointing MBS king will skip over about 500 other heirs to the throne.

**KLC: The ones that just got locked up?**

PZ: Right. MBS has literally hundreds of potential rivals to the crown. By age, and by position they are in line before he is. So if MBS is going to ascend to the throne, he's got to make sure that all of the people who have loud opinions no longer have loud opinions. So he got them all together at the Riyadh Ritz-Carlton and interrogated them until they recanted publicly, and part of that involved giving over a percentage of their assets commensurate with their strength as a challenger. Conservatively, MBS will collect about \$100 billion out of this. That will plug the gap for at least three years, but will there be a second wave of arrests, detentions and interrogations as the first round of people implicate other people? Yes, and that's all very interesting politically, but it doesn't really move the needle on Saudi Arabia's Vision 2030, which is all about having the economy untethered from energy. If the Saudis are serious about that, they need to hire about 10,000 technical university professors, relocate them to Saudi Arabia to start up a national university and actually train up the Saudis to work. Until they do that, none of the rest of it matters. Education in Saudi Arabia is religious indoctrination, and even the religious education in Saudi Arabia is not as good as you might think. It's mostly just an excuse to get on Tinder and get high. I don't have a very high opinion of the Saudi workforce.





**KLC: What does that do then for the Saudi's aspirations to have an IPO for Aramco, or to have a big capital-raising event to try to monetize its oil wells?**

PZ: It doesn't necessarily scrap it. You can have an IPO without a workforce. And if your goal is to bring in foreign money and foreign tech, granting slivers of foreign ownership to specific assets makes sense.

Now, I think the most likely outcome is that they will split Saudi Aramco into different pieces. You'll have a production piece, one that actually is a holding company for the reserves, one that handles the refining, one that handles shipping, so you don't have to give foreigners a slice of the actual reserves. And I think most foreign investors would be okay with that, as long as they get access to the production chain somewhere. The Saudis have been very clear that they would like to move up the value-added chain with refining and transport, so there will be interest.



*Riyadh, Saudi Arabia*

**KLC: What do you think happens this year at the mid-term US elections, will it be a huge wipeout for the Republicans?**

PZ: In fact, no. All of the most competitive races are in places where the Democrats are weak. Of the 33 seats that are up for grabs in the Senate, 25 of them are Democrats. Half of those are in states that Trump won.

**KLC: So, you're saying Trump won't pull out of NAFTA before the mid-terms and crash our economy going into an election?**

PZ: You're assuming a degree of logic and connection of issues that we have yet to see out of this president. And keep in mind that Trump is now in the process of getting out-flanked to the populist right by Steve Bannon. So it's not all in his hands anymore. Steve Bannon is running candidates that are anti-NAFTA and anti-immigrant in every race where there's a main-line Republican running. So the centrist Republicans, what's left of them, not only are a lot of the big names retiring, all the others will get challenged on the right rather than the left. Ultimately, I don't see the Democrats picking up a significant number of seats. In fact, I think they lose seats in the Senate. All the Democrats that are used to reaching across the aisle and actually governing are gone, which has left a constellation of extremists. I'm talking the Elizabeth Warrens, the Bernie Sanders. The Democratic centrists are now being challenged by younger, extreme left populists, a lot of whom are single-issue voters – women's issues, abortion, racial issues, the environment -- and almost none of whom could possibly carry a general election. The problem the Democrats' extreme candidates are creating is that by picking one issue, you can gear up your potential electorate and ride it to the primary because it really revs people up. But if you get the nomination, you can't possibly sell it to a general audience. That's why the Democrats have been crashing and burning for years now, and so far it appears they are doubling down on a strategy that has done nothing but fail. The reason the Republicans have been more successful with this strategy is that the group of people they're riling up are people who traditionally have not voted. The people who came out of the woodwork to vote for Trump hadn't voted in the last three presidential elections.

From my point of view the Republican party is just as broken as the Democratic party, so it's not so much that the Republicans win, it's that the Democrats lose. The Republican party itself is no longer a unified entity either. You have the Freedom Caucus, which is kind of the Tea Party faction, the centrist Republicans, which is now the smallest faction, and we are about to have the Bannon Republicans, who are much more extreme than the Tea Party.

**KLC: What's your Trump prediction for 2018?**

PZ: Mueller is probably the best investigative agent that the FBI has generated in the last 30 years. If after six months, all he has is charges of lying to the FBI, there's nothing there. Let's assume for the moment that Trump did have conversations and contacts with the Russians. That's not illegal. It's unethical. It's unwise. It's not particularly patriotic, but it's not illegal. I think the Russia probe probably continues as long as Trump is president, I just don't think it achieves anything. I predict Trump finishes out his term. Unless he gets bored and leaves, and I think if he was going to do that he would've done it already.



**KLC: Have you been to Silicon Valley lately? What's going on in the tech community?**

PZ: Yes, and the tech community is starting to get scared. Washington is dusting off the anti-trust laws, and the tech companies have yet to admit that they're actually not just part of the problem, they are the problem. I have two thoughts here. First, any company in American history that has gotten to the degree of economic concentration and political strength that Silicon Valley has in today's world, has ultimately been crushed by the government -- broken up, like AT&T. Now, whether or not that takes the form of a nationalization, a regional breakup, turning into the public utilities, it's unclear. There are a lot of different models that could be followed, but it's going to happen.

Second, what's interesting is this is not coming from the left or the right, it's coming from everywhere. So while the right used to think of Silicon Valley as the ultimate expression of American capitalism -- of what you can do in a low-regulation environment -- the left used to think of tech as a big piggy bank for leftist progressive causes. Both sides have now turned, in part because of Facebook and the Russia ads, and in part because they don't like the tech elite's politics. So if you've got mainline Republicans and mainline Democrats cooling on Silicon Valley at the same time that the populist left and the populist right are turning outright hostile, that's it. It's over. Breakup laws could even be passed in 2018. In the "techlash," the anti-trust laws will be updated to deal with information technology. This includes social media companies like Twitter and Facebook. I think semiconductors, software and manufacturing companies will be outside the circle because they don't have nearly the overwhelming presence in social media. Then I would look at Amazon. Amazon is the greatest job destroyer in American history, and people are starting to now think of it that way. They're doing to Walmart what Walmart did to small mom-and-pop stores. I think this movement is much farther along in state capitols and in Washington than they realize in Silicon Valley.

*Tesla Model 3*

It's also not good news for Tesla. Their volumes are down, and the Model 3 is not going to happen. Tesla is going to crash, and the question is when. I think the first time that the investment community really got honestly scared and was willing to take a harder look at this is when Elon Musk said he was going to start diverting





money away from the Tesla production lines to finalize his replacement rocket for the Mars shot. And also that he was going to abandon the other rocket lines, the ones that actually had orders. So that we could all go for this giant rocket that can make it to Mars, and everything was going to be funneled toward that. So if you were investing in anything but the space program, you're like, "what?" And if you were investing in the space program, what you hear is that Musk is going to take away something that we've spent ten years working on that works, and replace it with something that will never have an economic payback. I'm not saying 2018 is the year that Tesla goes away, but I am betting Tesla will go away, and when it happens, it will happen fast.

### **KLC: Which crashes first, Tesla or Bitcoin?**

PZ: I have no idea, but it's a great question because psychologically, they're similar in a lot of ways. Tesla is a bet on the future, and Bitcoin is a bet on fear. I think you have two different sets of investors for the most part. Bitcoin's primary use is for capital flight, and for smuggling across international borders. That's the whole idea behind it. There's definitely some activity from people who've gotten really excited in the last six months, but those are more the day traders. As of three months ago, I was 100% sure Bitcoin was mostly being used for illicit transactions. With all the new accounts that have been opened up, I don't know who has the majority anymore. There is a lot of fresh dumb money in Bitcoin. It reminds me of subprime in 2006. I think Bitcoin is going to pop. I think it will lose 90% of its value in a matter of a week. Now the encryption is still the encryption. The blockchain has a very bright future in ways that we're only beginning to understand.

*Peter Zeihan is the author of "The Accidental Superpower" and "The Absent Superpower." Find him online at Zeihan On Geopolitics. The report is for informational purposes only and should not be considered investment advice. The views are expressly those of Mr. Zeihan and are not necessarily the views of Knowledge Leaders Capital or its investment professionals. Mr. Zeihan provides consulting and research to Knowledge Leaders Capital and is compensated for those services.*

