The sixth round of renegotiations of the North American Free Trade Agreement (NAFTA) ended on 29 January 2018. The round included negotiations by 30 technical groups. An agreement has been reached on anti-corruption-related issues and information technology. There were also negotiations on sanitary and phytosanitary measures, telecommunications, and technical barriers to trade. Negotiations continue on the most difficult negotiation points, particularly rules of origin, and the next round of renegotiations has been scheduled for 26 February–6 March in Mexico City. The probability of the renegotiations extending through 2018 and beyond is high.

- The United States faces a challenging series of complicated accountability problems and changing priorities. Although legally unclear, the chief US negotiator, United States Trade Representative Robert Lighthizer, will probably need to gain approval from the legislative branch for any major amendments to the trade agreement. Although some items in the negotiations will enjoy broad congressional support, such as bolstering US firms’ market access and building a modern framework for the digital economy, others will prove far more contentious, such as surrendering “Buy American” clauses for local procurement. US President Donald Trump’s administration seems split on how hard to press its trade partners, with the president, Lighthizer, and National Trade Council Director Peter Navarro insisting on significant revisions on dispute settlement mechanisms and tariff exemptions for Canada and Mexico. Conversely, Secretary of State Rex Tillerson, Economic Adviser Gary Cohn, and Agriculture Secretary Sonny Perdue appear likely to favour only modest regulatory revisions to the existing agreement to avoid damaging the US equity markets or overall US economic growth.

- Canada aims to save the agreement, while diversifying its trade partners. NAFTA has been a success for Canada, garnering the country an extra 2.5% GDP growth per year since its launch. Canada would prefer to update the agreement to account for new sectors such as e-commerce; Canada also aims to protect its manufacturing sector against increasing demands for US content, particularly in automotives. On 20 December 2017, Canada launched a complaint at the World Trade Organization against US trade practices; although the government was probably aware that this would delay negotiations, it was probably viewed as necessary. Canada probably hopes to secure a bilateral trade agreement in the event of NAFTA’s collapse, which IHS Markit assesses is highly likely to be agreed. Canada reduced the pressure it faces from a deterioration of trade with the US by agreeing on 23 January to join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), along with Mexico and 10 other countries, likely resulting in a stronger negotiating position regarding the US.

- With 80% of Mexico’s exports destined to the United States, the outcome of renegotiation will have implications across all sectors of its economy. The sectors most affected by the renegotiation will be automotive, manufacturing, and agriculture, and the government is currently aiming to diversify export partners should the United States decide to withdraw from NAFTA. Mexico is party to free trade agreements that comprise 45 countries and 31 bilateral investment treaties, which should help the country diversify trade partners. However, a US withdrawal will nonetheless affect economic growth and investment because it would take time to build new trade relationships worldwide. The points of contention for Mexico have been rules of origin, labour regulations, as
well as Chapter 19 (dispute settlement), and its government has said that it would leave the renegotiation table if the United States decides to initiate its withdrawal process as a renegotiation strategy.

- **Tracing issues surrounding rules of origin in the automotive sector are a key area of dispute between the parties.** Parts not specifically identified in the 1994 NAFTA document are not counted as being either of North American origin or imported and consequently are not considered in country of origin criteria. With increased use of electronics including touchscreens and supporting hardware in vehicles, the fact that these parts are not counted can have a substantial effect on the balance between imported and domestically produced parts. Mexico has opposed the US demand to increase rules-of-origin requirements from the permitted 62.5% to 80.0%, of which 50.0% would need to be from the United States.

**Indicators to watch**

- Resignations of important members of Trump's staff, especially from the trade team, would suggest that the US administration will take a softer stance on the negotiations.
- A significant economic downturn will place a burden on all negotiating parties to reach a quick conclusion to the talks.
- Mexican left-wing presidential candidate Andrés Manuel López Obrador politicising the renegotiations by reiterating his desire to delay any agreement until a new Mexican government takes office.
- Increasingly open discussion by Canadian government sources on background of how a bilateral trade agreement might work would be a strong indicator that the government is preparing for the agreement's collapse.

**Turkey's Operation Olive Branch**

24 Jan 2018 Country Risk | Strategic Report

On 20 January, Turkey launched a cross-border military operation, Operation Olive Branch, targeting the Kurdish-majority district of Afrin in Aleppo province, northwest Syria.

- **Operation Olive Branch is being carried out against the Yekîneyên Parastina Gel (YPG).** Turkey-backed Syrian opposition groups, rather than the Turkish ground forces, are so far conducting the bulk of the fighting, with Turkish offensive air support. The YPG has close ideological and organisational ties with the Partiya Karkerên Kurdistan (PKK), which has been waging a 40-year insurgency inside Turkey. Turkey sees the elimination of Kurdish autonomist and separatist ambitions in northern Syria, in Afrin and farther east, between the border towns of Kobanê and Hasakah, as essential to Turkey's national security.

- **There is an elevated risk of 'blue-on-blue' incidents taking place between Turkish, Russian, and Syrian government aircraft and ground forces.** Given that Russia controls all Syrian airspace west of the Euphrates River, Turkey almost certainly obtained at least tacit acquiescence from Russia before the operation, as indicated by the redeployment of Russian military personnel away from Afrin. However, Russia is likely to restrict Turkey's airspace access, with a view to controlling Turkish penetration of Syrian territory and the operation's tempo, synchronising it with the Syrian army's advances in Idlib province, south of Afrin. This would enable Russia to give the Syrian army more time to consolidate its territorial control in Idlib, with a view to having it eventually take over the remaining YPG-controlled areas in Afrin. The scope for 'accidental' incidents is illustrated by the case of
Operation Euphrates Shield, during which either a Russian or Syrian government aircraft killed three Turkish soldiers in an airstrike.

- If, as threatened by President Recep Tayyip Erdoğan, the operation is expanded to target Manbij, the United States will be forced to choose between its NATO ally Turkey and its trusted Syrian proxy, the Syrian Democratic Forces (SDF). The YPG represents the backbone of the SDF. Despite the YPG controlling Afrin being the same organisation as the YPG at present in the Kobanê-Hasakah strip farther east, Afrin's geographical separation from the latter, combined with Russia's control of its airspace, means that the US is left a bystander to Operation Olive Branch. Manbij, however, belongs to the US's zone of influence, with the US having previously prevented the expansion of Operation Euphrates Shield towards Manbij by deliberately placing US military personnel in harm's way around the town between Kurdish and Turkish forces.

- President Erdoğan will likely seek to exploit a high level of domestic public support for Operation Olive Branch to enhance his prospects at an early election in mid-2018. Despite there being no reliable public survey available yet, the precedent of the consistently high level of public approval ratings during Operation Euphrates Shield, which never dropped below 70%, indicates that the Afrin operation is likely to enjoy similar levels of support. Erdoğan is likely taking a gamble that Operation Olive Branch can be presented as a successful projection of Turkish power; a long, inconclusive campaign with heavy casualties would be damaging to his domestic standing.

**Indicators**

**Increasing risk**

- Turkish armoured forces concentrated on the Turkish side of the border are committed to the operation and cross into Afrin, indicating an intention to take control of built-up areas, where the YPG would be likely to put up a much stronger resistance, benefiting from its expertise in urban warfare, acquired by fighting the Islamic State, as well as the heavy civilian presence.

- Preparations being conducted by the Turkish army and its Syrian proxies for an offensive on Manbij, despite US warnings. This would risk inflicting casualties among the US Special Forces working with the SDF, while increasing pressure on the US to make a hard choice between its NATO ally Turkey and its trusted Syrian proxy force, the YPG.

**Reducing risk**

- A UNSC meeting on the Turkish intervention leads to a UNSCR calling for Turkish withdrawal or desistance from further offensive operations.

- Russia retains tight control on the airspace over Afrin, forcing Turkey to limit the scope of its operation, probably to the establishment of a 30-kilometre buffer zone along the border.

- The US and Turkey agree on setting limits on Operation Olive Branch, including the extent of Turkish penetration and the duration of the operation, which would reduce the risk of a direct stand-off between Turkish and US forces.
South Africa's leadership battle

24 Jan 2018 Country Risk | Strategic Report

New African National Congress president Cyril Ramaphosa is taking steps to bring about a premature end to South African President Jacob Zuma's term in office. Ramaphosa is isolating Zuma and prompting the National Prosecuting Authority to begin investigations relating to state capture in order to pressure the head of state to resign by 8 February. That would allow Ramaphosa to make the State of the Nation address at the reopening of parliament and set a new tone for South Africa.

- In the shortest time, and certainly by the time of the State of the Nation address, Ramaphosa will aim to take over as national president so he can set out his vision for South Africa's economic recovery in order to boost investor confidence and prevent further sovereign rating downgrades after slides to junk status in March and November 2017. This will be the first step to lifting economic growth and ultimately boosting the ruling African National Congress's (ANC) chances of retaining the presidency and a parliamentary majority at next year's general election due in May. Ramaphosa told his audience at the ANC's birthday celebrations in East London on 13 January that he would be prioritising a social pact between government, labour, businesses, and communities to reignite growth and accelerate the process of transformation. Ramaphosa also emphasised the need for the intelligence services, police, and prosecutorial authorities to be strengthened because they had to be "at the forefront of the fight against corruption and state capture". He can only make those necessary personnel changes, including a cabinet stripped of Zuma loyalists, once the president has stepped down.

- Zuma is under no obligation to resign, but he now looks highly unlikely to survive more than a few weeks at most, as his position has been critically weakened since the ANC elective conference, when Ramaphosa won the crucial 18 December 2017 vote over Zuma's preferred candidate, Nkosazana Dlamini-Zuma. Since then, the Constitutional Court has ordered the National Assembly to put in place a mechanism to impeach Zuma over failure to repay public funds used to upgrade his private home; Zuma was forced to agree on 9 January to a judicial inquiry into state capture; and the National Prosecuting Authority on 15 January began investigations into companies involved in allegedly fraudulent government contracts. Many of these cases centre on entities controlled by the Gupta family, but will also implicate companies of international standing that have done business with them in diverse sectors such as computing, banking, and management consultancy. Businessmen the Guptas have denied the allegations.

- If the president cannot be satisfied over the terms of his departure, then it is likely the ANC's National Executive Council (NEC) will call on Zuma to resign, and may even issue a recall notice. Some guarantees could be offered to Zuma to persuade him to go, but there is a limit to what Ramaphosa can pledge, due to political and legal constraints. Constitutionally, Zuma does not have to obey an NEC recall, and he may believe he could leverage a better deal by threatening to force a no-confidence motion at the National Assembly. The ANC would want to avoid this, as it would allow Zuma to deliver the key annual address and highlight populist policies that Ramaphosa probably would not want to emphasise, and trigger a vote that would highlight for a final time the party's inability to bring Zuma to heel by any other means.

Indicators of changing risk environment

- Confirmation that the NEC will be holding a no-confidence vote on Zuma.
- Open calls from Ramaphosa or senior figures close to him that Zuma should resign.
Information being leaked on possible conditions that could persuade Zuma to step down.

Who Ramaphosa decides to appoint as a new state prosecutor, who will rule on whether to reinstate 783 corruption charges against Zuma.

Further cases being opened by the NPA against companies implicated in state capture allegations.

Outlook for US-North Korean confrontation

24 Jan 2018 Country Risk | Strategic Report

On 17 January 2018, North Korea and South Korea released a joint statement following their first official high-level talks since December 2015. The talks began on 9 January 2018 with the aim of agreeing terms for North Korean participation at the PyeongChang 2018 Olympics and Paralympics. The statement confirmed that several hundred North Korean cheerleaders, committee delegates, and taekwondo demonstrators would travel to South Korea via a land route for the games in February and March 2018.

South Korean President Moon Jae-in and US President Donald Trump’s agreement on 4 January 2018 that US-South Korea joint military exercises would be delayed so as to not coincide with the Olympics and Paralympics was probably a North Korean precondition for the talks. The talks are important because they are a positive indicator for bilateral relations. Although the talks are still in progress, points of agreement include North Korea sending a delegation of athletes, a cheering squad, officials, and reporters to the games, as well as the two countries marching together in the opening ceremony. North Korea ignored a similar request in July 2017. The talks will probably be used as an opportunity to discuss broader bilateral issues, including economic and security issues.

The postponement of the US-South Korea joint military exercises until after the games and the attendance of a North Korean delegation would reduce the likelihood of North Korea taking deliberately provocative action, such as a further missile test, during the games. Although the likelihood of a provocative incident would be reduced, North Korean Supreme Leader Kim Jong Un's probable options would include a cyber-attack, an incursion over the maritime boundary, fire over the de facto land border, or a missile test. Specifically, a satellite imagery analysis by 38 North indicates that North Korea may well be preparing for an engine test or launch of its "Kwangmyeongseong" satellite, whose technology supports the development of longer-range missiles. North Korea routinely launches short- or medium-range missiles in response to US-South Korea military exercises, criticising them as training to attack North Korea.

Apart from Kim’s highlighting of his personal authority to launch North Korea's nuclear weapons, his New Year’s address on 1 January 2018 did not indicate a substantial shift in policy relative to previous addresses that Kim has given since 2013. Building on statements in 2016 and 2017 highlighting North Korea's status as a “nuclear power” and its need to develop its "self-defence" capabilities to carry out pre-emptive strikes, Kim's 2018 address emphasised the readiness of North Korea's nuclear forces to deter or retaliate against any US first strike. In contrast to his offer of bilateral talks with South Korea, Kim showed no readiness to engage in talks with the United States on North Korea's nuclear weapon/missile programmes. This approach is probably an
attempt to drive a wedge between South Korea and the United States, drawing on the allies' contrasting attitudes to dealing with North Korea.

- **China is unlikely to support a full oil embargo on North Korea, although United Nations Security Council consensus will probably coalesce on sanctions that impose further restrictions on oil exports and on measures that reduce the illegal smuggling of commodities and weapons.** China has not responded to the US's calls to halt crude oil shipments to North Korea, emphasising instead support for UN resolutions and the goal of denuclearising the Korean Peninsula. Deteriorating relations between China and North Korea since Kim succeeded in December 2011 have increased China's willingness to increase pressure on Kim and bring North Korea to the negotiating table. However, co-operation from China will most probably stop short of meeting US expectations.

- **South Korean authorities in particular will probably step up their seizure and inspection of vessels, focusing on those either with Chinese or Russian flags or with predominantly Chinese crews.** Specifically, authorities will probably target vessels suspected of ship-to-ship transfers, which are relatively difficult to eradicate because of the large number of North Korean “fishing” vessels around the Korean Peninsula and because of the ambiguity caused by foreign-flagged vessels turning off their transponders to stop transmitting location data. As the United States and its northeast Asian allies seek to improve sanctions enforcement and put pressure on North Korea to negotiate over its nuclear and missiles programmes, these enhanced security practices will probably disrupt maritime cargo around the Korean Peninsula. Beyond the six-month outlook, further sanctions focusing on the interdiction of cargo vessels are probable.

**Indicators of changing risk environment**

**Increased risk**

- Ongoing talks between North Korea and South Korea break down or end without finalising an agreement on North Korean participation in the PyeongChang 2018 Olympics and Paralympics.
- North Korea stops using the ministerial hotline between North Korea and South Korea, which it reactivated on 3 January 2018 for the first time since February 2016.
- Wholesale deportations of North Korean workers from China – more than just isolated factories shutting down and sending workers home, as reported by South Korean media in November 2017.
- China taking action to substantially reduce trade with North Korea – for example, the "Friendship Bridge" that accounts for about 80% of trade between China and North Korea remains closed for more than three months.
- The United States and its allies, Japan and South Korea, carry out demonstrations of their ballistic missile defence (BMD) capabilities, PAC-3, Aegis, and Terminal High Altitude Area Defense (THAAD).
- South Korea or the United States changes its defence readiness condition (DEFCON) level.
- North Korea announces or indicates a mobilisation of its military.
- North Korea demonstrates further progress towards a nuclear-capable intercontinental ballistic missile, such as firing one on a flatter trajectory into the Pacific, carrying out an above-ground nuclear test, or demonstrating duplication of viable re-entry vehicles.
- China increases military deployments to its border region.
- South Korea and the United States announce an increase in the scale, or ratio of command-post to air/ground/maritime manoeuvres, of the next routine US-South Korea joint military exercises, scheduled for the first quarter of 2018.
Reduced risk

- North Korea and South Korea hold official talks at the vice-minister or minister level (for the first time since December 2015). *(Comment: Indicator triggered on 9 January 2018.)*
- North Korea and South Korea reinstate the ministerial hotline formerly used for regular contact at least daily before the closure of the Kaesong Industrial Zone in February 2016. *(Comment: Indicator triggered on 3 January 2018.)*
- North Korea and South Korea resolve technical issues preventing the full use of a military hotline cut in 2016, on which maintenance began again in January 2018.
- Talks between North Korea and South Korea secure the participation of a North Korean delegation at the PyeongChang 2018 Olympics and Paralympics, the holding of cross-border family reunions, and/or the broadening of talks to include security on the Korean Peninsula. *(Comment: Indicator triggered on 9 January 2018 – a joint statement released at the end of the day that North Korea and South Korea had agreed to hold "military talks".)*
- Back-channel talks between North Korea and the United States (either through the New York channel at the United Nations or hosted by a third country) gain traction.
- The United States offers talks without the precondition of agreement to, and action on, denuclearisation and formal negotiations beginning.
- Release of one or more of the remaining three US citizens detained in North Korea.
- Increased diplomatic engagement by China reduces confrontational US-North Korean rhetoric.
- North Korea announces the temporary suspension of missile launches/tests, or more than six months pass without further launches.
- South Korea and the United States announce the reduction in scale, or ratio of command-post to air/ground/maritime manoeuvres, of the next routine US-South Korea joint military exercises, scheduled for the first quarter of 2018, or their postponement. *(Comment: Indicator triggered on 4 January 2018 – South Korea and the United States agreed to ensure that the exercises would not start during the PyeongChang 2018 Olympics and Paralympics.)*

Houthi threat to target international shipping indicates growing marine risks in the southern Yemeni Red Sea

12 Jan 2018 Country Risk | Headline Analysis

On 10 January, the Saudi-led coalition stated that it had destroyed a Houthi unmanned marine vehicle-borne explosive device (UM-VBIED) targeting a Saudi oil tanker near Hodeidah port on 6 January. The announcement was made three days after Houthi Supreme Political Council president Saleh al-Samad, during a discussion with UN Special Envoy to Yemen Ismail Ould Cheikh Ahmed, had threatened to close international shipping through the Red Sea should the Saudi-led offensive on Hodeidah continue. The stalled offensive to recapture Hodeidah was resumed on 7 December 2017 by forces nominally supporting the internationally recognised government of President Abdu Rabu Mansour Hadi, following the collapse of the Houthi alliance with former Yemeni president Ali Abdullah Saleh in Sanaa on 4 December. Al-Samad's comments were made in the context of the apparently increasing economic isolation of the Houthi in Sanaa, with credible reporting of raids on money exchanges in the capital indicating cash shortages emerging in recent weeks. Al-Samad's threat to commercial shipping is an indicator of a growing intent to raise the cost of sustained intervention in Yemen for the Saudi-led coalition.
Significance: As previously assessed, by killing Saleh, the Houthi have turned the former president's party, the General People’s Congress (GPC), which still enjoys significant grassroots support in North Yemen, against them. Saleh's death, and his son aligning with the coalition, also assures that the Houthi have lost any means of negotiating a viable political settlement with Saudi Arabia. By expanding their target set to include commercial vessels in the Red Sea, the Houthi hope to deter further escalatory action by the coalition near Hodeidah and potentially force a compromise. Commercial flagged vessels from countries participating in the Saudi-led coalition are at highest risk. Outright closure of the strait, even temporarily, likely remains beyond Houthi capabilities. Although commercial vessels are at high risk of Houthi UM-VBIEDs off the coast of Hodeidah, this risk is likely to be somewhat mitigated by coalition naval escorts. The main risk is likely to be nearer to Mocha port. There is also a growing risk of the Houthi attempting to deploy sea mines beyond contested coastlines near Mocha and Midi, and potentially off the waters of Zubair archipelago and the Hanish islands.

Attack on deep-water oil facility highly likely as Nigerian militant group loses patience with failing negotiations

19 Jan 2018 Country Risk | Headline Analysis

The Niger Delta Avengers (NDA) renewed a pledge yesterday (17 January) to attack oil facilities in Nigeria in "a few days". A statement on the militant group's website followed a previous threat issued on 3 November 2017, and specifically identified deep-water operations run by energy multinationals as their main target. The NDA named Shell's Bonga and EA fields, Chevron's Agbami oil field, the indigenous-run Britannia-U field, and the Akpo operation in which Total, China’s CNOOC, Brazil’s Petrobras, and Nigeria’s Sapetro are stakeholders. As with the previous message, there was a specific threat against Total’s new Egina Floating Production and Storage Offshore platform, warning it should stay outside Nigerian waters. The NDA said that following its 3 November statement, "elders" had intervened to allow more time for talks with the government but the lack of any "meaningful results" meant the group’s patience had run out (see Nigeria: 6 November 2017: High risk of attacks on Nigerian oil and gas infrastructure as frustrated militant group ends ceasefire).

Significance: The reiterated threat makes it highly likely there will be at least one major attempt at sabotage in the next two weeks, if the NDA is to maintain credibility as a serious militant threat. The group's track record of cutting Nigeria's oil output by around a third to 1.4 million barrels per day in May 2016, three months after attacks commenced, reinforces its intent and capability. At this point, the government would have to make a major concession over one or more key demands, including federal restructuring to reallocate oil revenue shares and increased levels of indigenous oil-block ownership, to avert further attacks. However, the lack of any meaningful progress well over a year after the Pan Niger Delta Forum originally presented militants’ 16-point list of demands on 1 November 2016 suggests concessions will only be made after attacks resume (see Nigeria: 10 January 2018: Stalled negotiations make resumption of militant attacks on Nigerian oil infrastructure increasingly likely as 2019 election approaches). Although an isolated example, the 4 May 2016 attack on a Chevron valve platform, 40 kilometres off Warri in Delta state, suggests militants do have the capability to reach deep-water facilities, using connections with pirate gangs which regularly operate long distances from shore (see Nigeria: 6 May 2016: Attack on offshore platform underlines economic sabotage capability of new Nigerian militant group in Delta region).

Risks: Terrorism; Death and injury; Civil war; Infrastructure disruption

Sectors or assets affected: Marine cargo; Oil and gas; Defence and security forces.