



An Extraordinary Geopolitical Moment

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Four geopolitical risks, with global consequences

War in the Middle East

- *A regionally contained crisis, but tail risks for markets that could have material effects on oil prices, risk appetite, and government stability*

Russia-Ukraine war

- *The war remains "stuck" with uncertainty about the scale and shape of western support for Ukraine contributing to a debate over the possibility of talks*

US political dysfunction, recession, and the 2024 election

- *New House speaker faces multiple challenges; a shutdown and sequester remain material risks*
- *The 2024 election appears set to be a close contest; Trump leads in recent polls, underscoring Biden's challenge making his case.*

US-China

- *A weak Chinese recovery remains a headwind to global activity*
- *Taiwan election remains a top risk for 2024*
- *US-China relations remain on a deteriorating path*



An extraordinary array of geopolitical and supply shocks facing the global economy—creating near-term volatility and longer-term uncertainty about what follows

MENA Crisis: The conflict is relatively contained so far

- **The war has been largely contained to Israel and Gaza so far, and its broader market impact has been limited**
 - Ground operation has started and will likely focus on northern Gaza
- **Numerous sources of potential escalation**
 - Iran
 - Hizbullah
 - Iraqi Shia militias
 - Houthis in Yemen
 - Militias in Syria and Lebanon
- **EG's basecase is a limited-scale military crisis (70% odds)**
 - Netanyahu is unlikely to seek a multi-front war
 - Limited participation from anti-Israel groups is likely, with skirmishes and localized conflict
 - The US and regional leaders are focused on deterrence, Israel is focused on Gaza, and Iran has not engaged directly and overtly
 - Limited broader market impact



Source: Source: Ocha, Israel Defense Forces



MENA Crisis: But escalation risks are substantial

30% probability of a broader regional conflict

Multiple possible triggers for escalation

- Hizbullah militias and other actors in the region could be more significantly involved if:
 - Israeli ground incursion triggering **humanitarian crisis in Gaza** ✓
 - If Hamas looks close to being eliminated
- Houthis in Yemen actively entering the war ✓
- Intensification of violence in **West Bank**
- Israeli or **Hizbullah attacks** in Northern Israel or Lebanon
- **Israel striking Iran**
- **Escalation is less likely to be triggered by an Israel-Iran conflict**
 - Despite rhetoric, Iran has not engaged in direct conflict in the region
 - The US threshold for a direct strike on Iran is very high
- **Hizbullah's full entry into the war would carry more of a risk to the region**
 - This would not automatically draw in Iran, but risk is considerable as Tehran would not want pro-Iranian groups in the region destroyed
- Attacks from Shia groups in Iraq and Syria resulting in **a large number of US casualties, and subsequent US response**



US—A House Divided – risks around shutdowns, sequester and Ukraine aid



Scenario	Odds
Short-term funding bill passes in November	65%
Ukraine aid is likely to pass in some form	55%
Sequester (by April)	40%

- The Congress is likely to pass a **short-term funding bill in November** to avoid shutdown (65% odds)
 - May debt ceiling deal: for FY24 caps increase in defense spending at ~3% and non-defense ~0% (nominal); for FY25, both are increased 1%.
- **The risk of a 1% across-the-board funding cut is substantial**; the deadline to act and avoid locking in cuts is the end of April. A sequester would worsen recession risks next year, with implications for the presidential race
- **Current battle over aid could spill into Q1**
 - Both Johnson's \$14.5bn Israel aid proposal and McConnell's \$106bn total aid proposal are unlikely to pass
 - **Aid is unlikely to move until late this year or early next. \$20-30bn is likely the limit for Ukraine aid .**
 - **Next aid package will likely be the last until after 2024 election**, potentially longer if Trump elected



China--Managed decline is the base/best case for US-China ties

The backdrop—Rising questions about future Chinese growth

Short-term thaw in US-China ties thanks to recent diplomatic progress. Slowing Chinese growth is also increasing Beijing’s desire for external calm.

The recent addition of new Chinese companies to the US entity list is unlikely to derail Biden-Xi meeting at APEC. But another move to significantly enhance or expand US export restrictions on semiconductors to China could be detrimental to bilateral engagement plans.

But risks will drive a **steady decline in US-China relationship**

- Technology restrictions
- US electoral politics and congressional pressure
- Ukraine
- Unintended military incident – China’s wants “no guardrails”
- Cold war between intelligence and security services

US China strategy (three tier approach: strategic competition, confrontation, cooperation) **will not stabilize** the deteriorating **US-China** relationship...

...While **Taiwan elections** presents a material risk for 2024

US-China Relations in 2023	4 Aug	14 June	11 May
Stabilizing efforts continue	70%	60%	55%
Serious deterioration	25%	35%	35%
Substantial improvement	5%	5%	10%



War in Ukraine: A long-lasting conflict



Scenarios until 30 November 2024

Scenario	Description	Probability
Stalemate	Russia and Ukraine fail to make decisive military gains. Missile and drone strikes on each other's territories cause economic damage, with potential market effects from Russian targeting of Ukrainian grain exports. Western military aid drops but Ukraine can defend itself. No long-term ceasefire or political settlement is reached.	65%
Escalated attacks	Russia and Ukraine escalate militarily. Heavy Russian attacks on Ukrainian infrastructure near NATO states increase the risk of unintended escalation between Russia and the alliance. Weakened Western support leads to more aggressive Ukrainian attacks on targets in Russia.	25%
De-escalation and talks	Russia and Ukraine de-escalate fighting and conduct substantive negotiations. Outside powers use a cease-fire to mediate talks but they cannot facilitate a political compromise. The environment for reconstruction in Ukraine improves. Sanctions against Russia remain in place.	10%



- The war is likely to continue well into 2024
- Limited progress in the counteroffensive make a standstill the most likely scenario.
- Military aid to Ukraine will not be jeopardized....
-but Western nations will more seriously explore the possibility of negotiations



Where do we go from here?

The Post-Covid Economy

- *Significant long-term changes in how we work, what we produce, how we trade and invest*
- *The end of the 'Great moderation'?*
- *Unwind of extraordinary support and the risk of crisis in 2024*




G-Zero World

- *Who leads?*
- *The rise of the 'Southern Swing States'*



Top calls focusses on the Eurasia Group calls that could have the biggest impact on the economy and markets

This [edition](#) deep dives into two of our Top Calls and looks at the politics of central banking

▶	China economic policy	Beijing will maintain its incremental approach to supporting the economy unless its hand is forced. It will avoid bailing out developers and shadow banks for fear of moral hazard but intensify local debt resolution efforts. Tail risks include misjudgment of the scale of the debt problems, which would lead to increased defaults and undermine market sentiment.	Risk  Increase  Decrease  No change
▶	China-US Taiwan	US-China relations will continue on a path of managed decline (a 70% probability), avoiding a serious deterioration (25%) and immediately disruptive impact. In Taiwan, if William Lai of the ruling party wins January's presidential election (a 65% probability), cross-strait tensions will probably intensify soon after. Lai might provoke China, leading to familiar coercive responses. China would take strong measures against perceived provocations, while the US would keep fortifying Taiwan's defenses through unprecedented actions.	
▲	Middle East crisis	The basecase is a limited-scale military crisis (70%), but there is a significant risk of a large-scale regional war (30%) that could have a significant global impact. The odds of Hizbullah fully entering the conflict are at 35%, while those of an Israeli attack on Iran are just 10%. In the basecase, a prolonged war contained in Gaza carries limited market risks: Business and consumer confidence would dip, tourism flows would plummet, and state budgets would come under strain in many countries of the region.	
▲	Oil	The odds of an oil supply disruption resulting from the immediate conflict in Gaza are low (less than 10%). Fears of an Iranian or Arab oil embargo stemming from the conflict in Gaza are unfounded. A large-scale curtailment would inflict as much—if not more—damage on producers as on consumers, alienating key customers in Asia and accelerating demand destruction.	
▲	US elections and politics	Donald Trump will win the GOP presidential nomination (85%), and Joe Biden, the Democratic nomination (90%). Biden has 60% odds of winning reelection, while Republicans are favored to regain the Senate (60%). Congress will avoid a shutdown in November by keeping overall funding flat (55%), avoid a 1% cut in spending next year (60%), and provide \$25 billion-\$30 billion in ongoing aid to Ukraine (55%).	
▶	Russia-Ukraine	Amid a stalemate in the war (65%), the probability of an escalation of the conflict that carries an increased risk of an unintended confrontation between Russia and NATO remains significant (25%). Ukraine will not become a full NATO member in the next 18 months (95%), EU accession negotiations will begin in December (85%), and bilateral security agreements will be made by July (90%). Russian military actions will not cripple Ukraine's grain exports (60%).	
▲	Argentina	Sergio Massa is likely to win the presidency (55%) in a runoff against Javier Milei. If Massa wins, he will be under pressure to make politically costly policy adjustments after the election but may well continue with his ad hoc strategy rather than implementing a comprehensive stabilization plan. Milei is committed to radical economic plans that would prove hard to implement and create uncertainty in the near term.	
▲	Brazil	A change in the 2024 fiscal deficit target is now likely before the end of 2023. However, keeping the zero target in the budget for now will remain an option if Finance Minister Fernando Haddad convinces the president of the merits of delaying a change until 2024. In that case, a change in the target at some point next year would be highly likely.	
▲	Italy	Bond investors' attention is increasingly focused on Italy; should the spread with German bunds widen to unsustainable levels, the ECB will face difficult political decisions. Should the need arise, Italy is likely to be considered eligible for the deployment of the Transmission Protection Instrument, exposing the ECB to both internal tensions for deviating from its price stability mandate and external political pressure.	
▶	Turkey	Economic officials will probably take further steps toward policy normalization as part of a middle-of-the-road economic adjustment (70%), though the scope for changes will be constrained as March's municipal elections approach. President Recep Tayyip Erdogan appears likely to perform reasonably well in the local elections; a strong performance would increase the odds of a more sustained policy shift.	





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