



Navigating geopolitical uncertainty and its impact on markets

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Geopolitics through a market lens

- The era of the peace dividend is over
- Global conflicts driving uncertainty and volatility
- Politics increasingly influencing economic policy
 - Economic fragmentation
 - More activist industrial policy



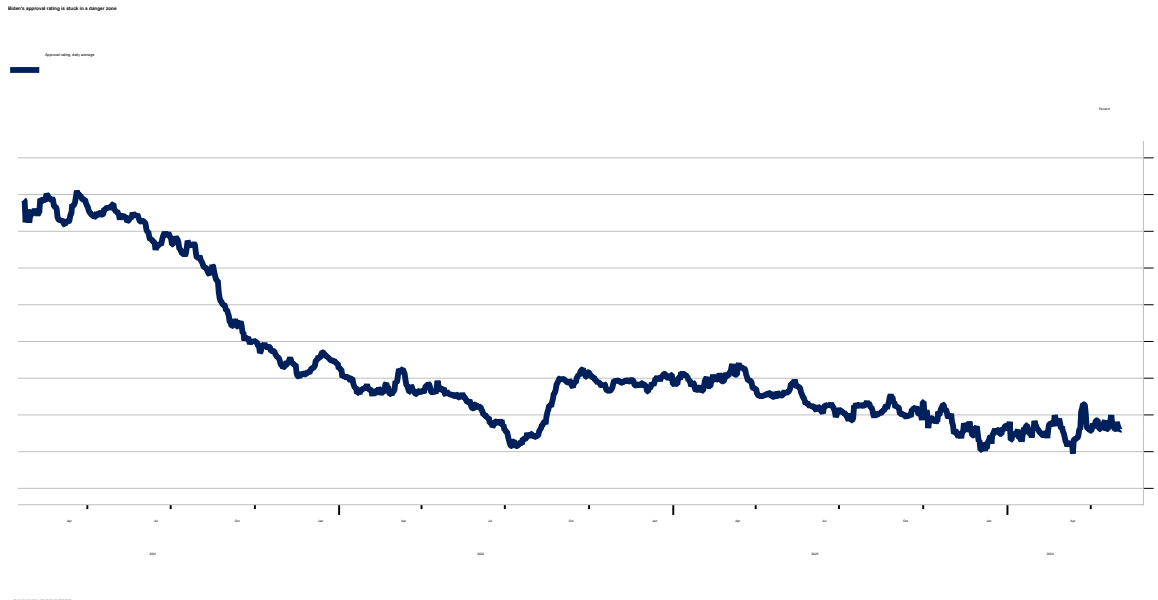
Geopolitics in the year of the election, and a year of conflict...

Key geopolitical risks and their macro impact:

- **The US election**
 - Outlook for the race, what would Trump 2.0 mean for global trade, security and U.S.-China ties?
- **The Israel-Hamas war and its global spillovers**
 - The risk of further escalation remains high
- **The war in Ukraine**
 - Attacks on Russian oil assets contribute to geopolitical risk premium for oil
- **China: Security over growth**
 - Incrementalist economic policy response will be a headwind for global growth

Mapping out scenarios and economic implications

US election: Trump is the early frontrunner (60% probability)

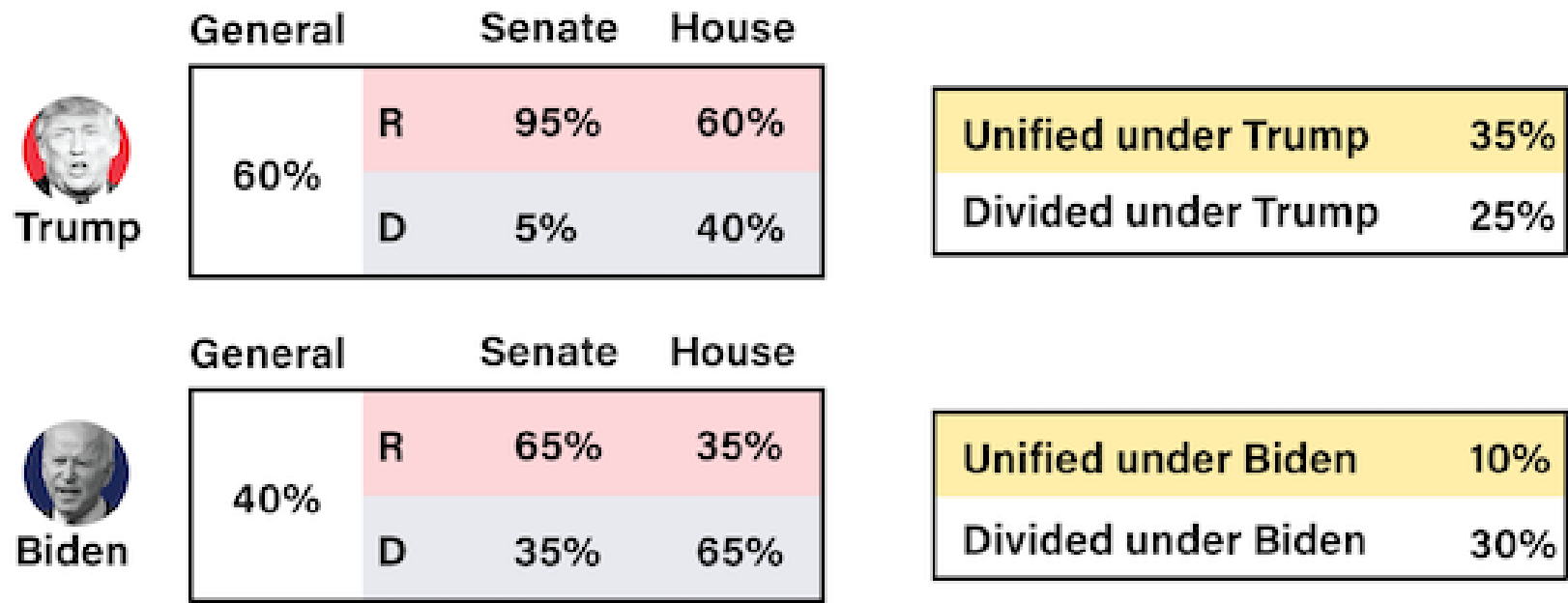


Estimated relationship between incumbent approval and odds of election victory

	Approval rating six months before election (using binary approval polls)	Probability of Victory	
		Incumbent	Successor
Change elections	5	0%	0%
	10	1%	0%
	15	2%	0%
	20	4%	0%
	25	8%	0%
	30	19%	1%
Middling elections	35	36%	3%
	40	58%	6%
	45	78%	14%
	50	90%	28%
Continuity elections	55	96%	49%
	60	98%	71%
	65	99%	86%
	70	100%	94%
	75	100%	97%
	80	100%	99%

- **Biden's approval rating** and **top-issue polling** suggest Trump is the favorite
- But the **margins are narrow** and the outcome in **swing states will be key**
- **Biden's age** is a major risk, while **Bidenomics isn't resonating with voters** and **the Gaza conflict and campus protests hurt Biden**
- But **Trump's legal challenges, the abortion issue**, and the fact that he is a **deeply polarizing** figure mean this is still a close race
- **Third-party candidates** remain a potential spoiler

US election: Divided government is basecase, but rising odds of Republican sweep



Source: Eurasia Group

- Republicans remain favored to win the Senate (85% odds)
- While House remains a coin toss

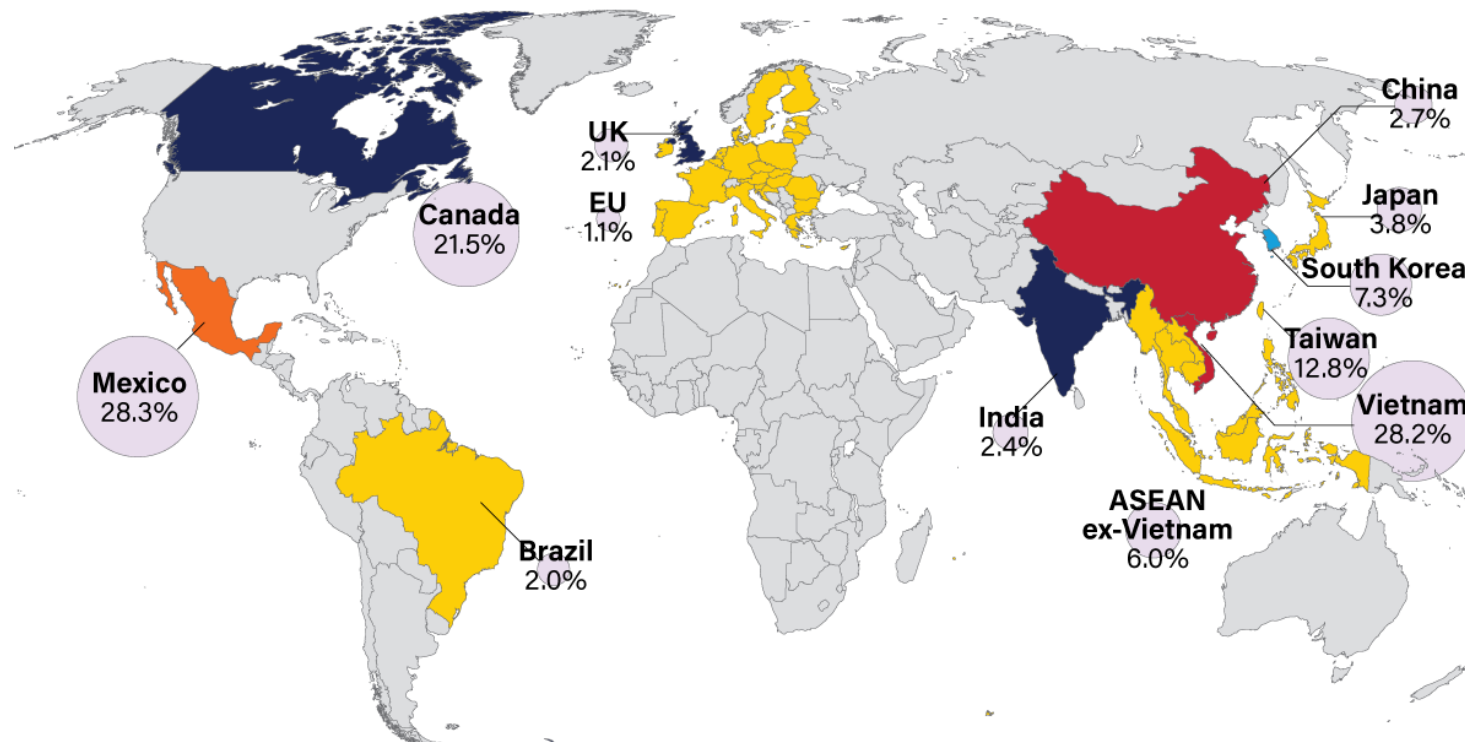
China, Vietnam among the most exposed to higher tariffs under Trump

Trump tariff risk hot spots

Eurasia Group assessment of risk of significant tariffs

High ← → Low

US exports
as % of GDP

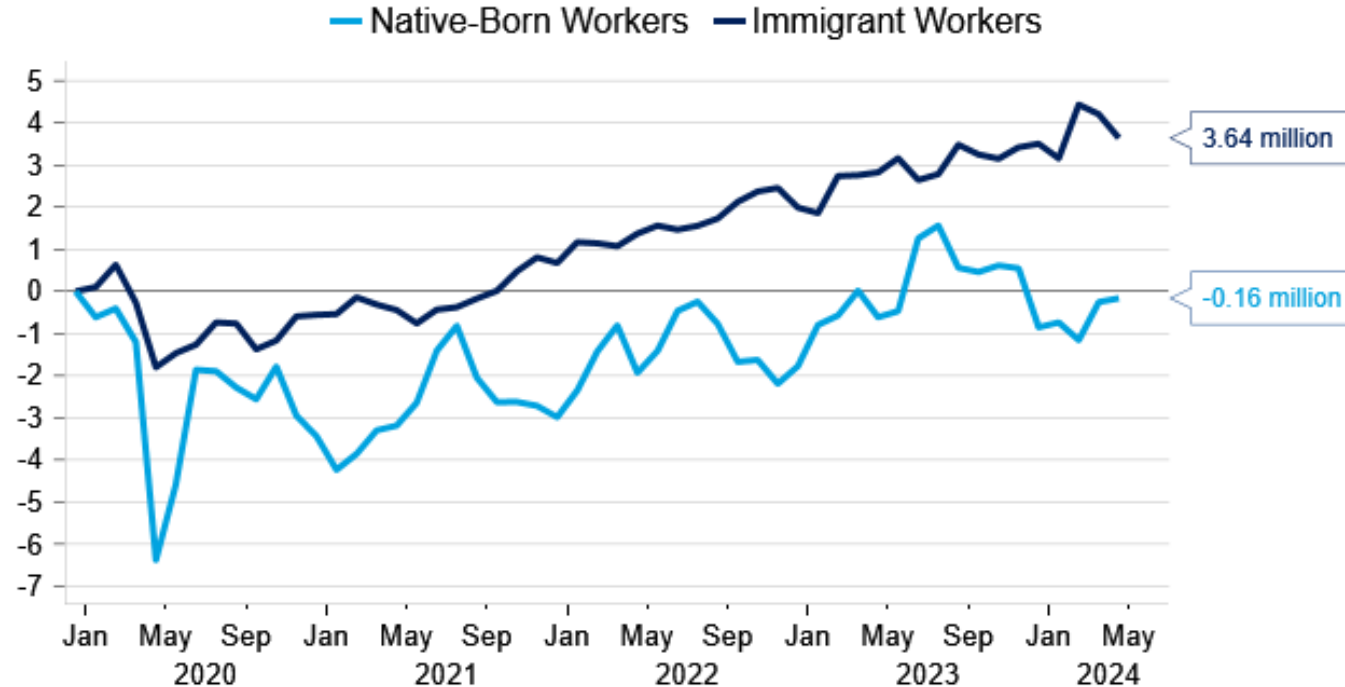


Source: IMF, World Bank, Eurasia Group

- A bilateral approach to trade negotiations is likely, with the threat of tariffs used as a bargaining tool to extract policy concessions in other areas (e.g. Mexico – the border, the EU – NATO spending)

Trump would tighten immigration policies

Change in the US labor force since December 2019



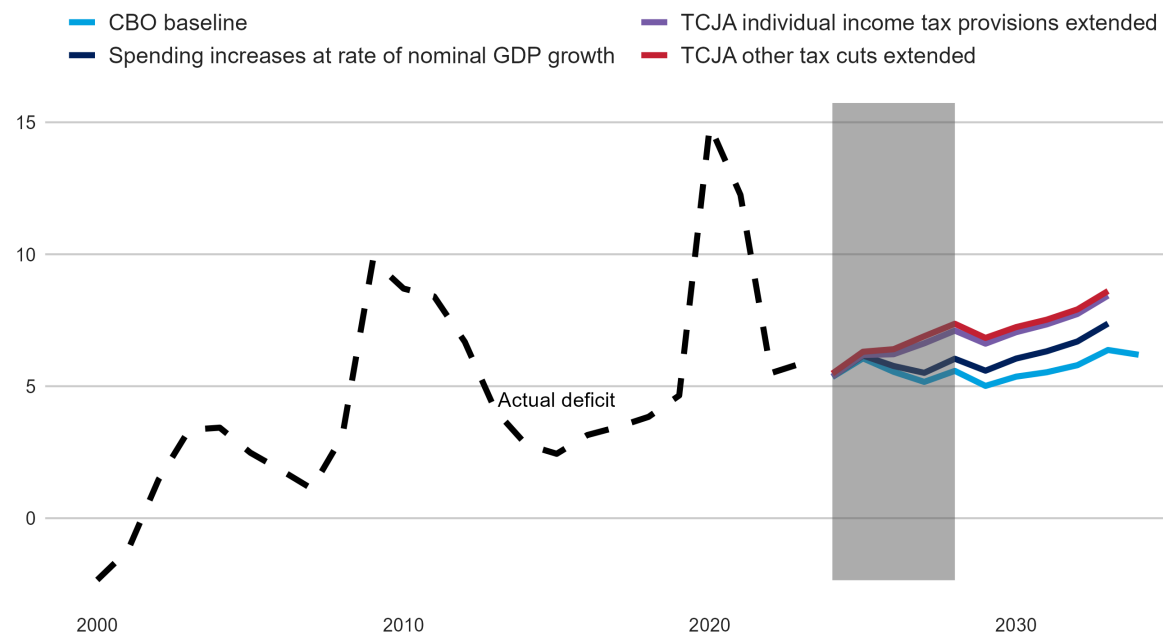
Source: Eurasia Group, Macrobond, BLS

- Tighter border controls could reduce number of foreign workers entering labor force, which could increase inflationary pressures

Fiscal outlook would deteriorate under Biden and Trump

Full tax cut extension would significantly widen deficits

Federal deficit, annual, percent of US GDP



Source: Congressional Budget Office, Eurasia Group
Note: Spending scenarios are cumulative

- **Trump:** likely extension of 2017 tax cuts, and curtail some of IRA spending
- **Biden:** likely extension of most of 2017 tax cuts, but partially offsetting cost with tax hikes on wealthy individuals and corporates

The Fed: policy continuity through 2026

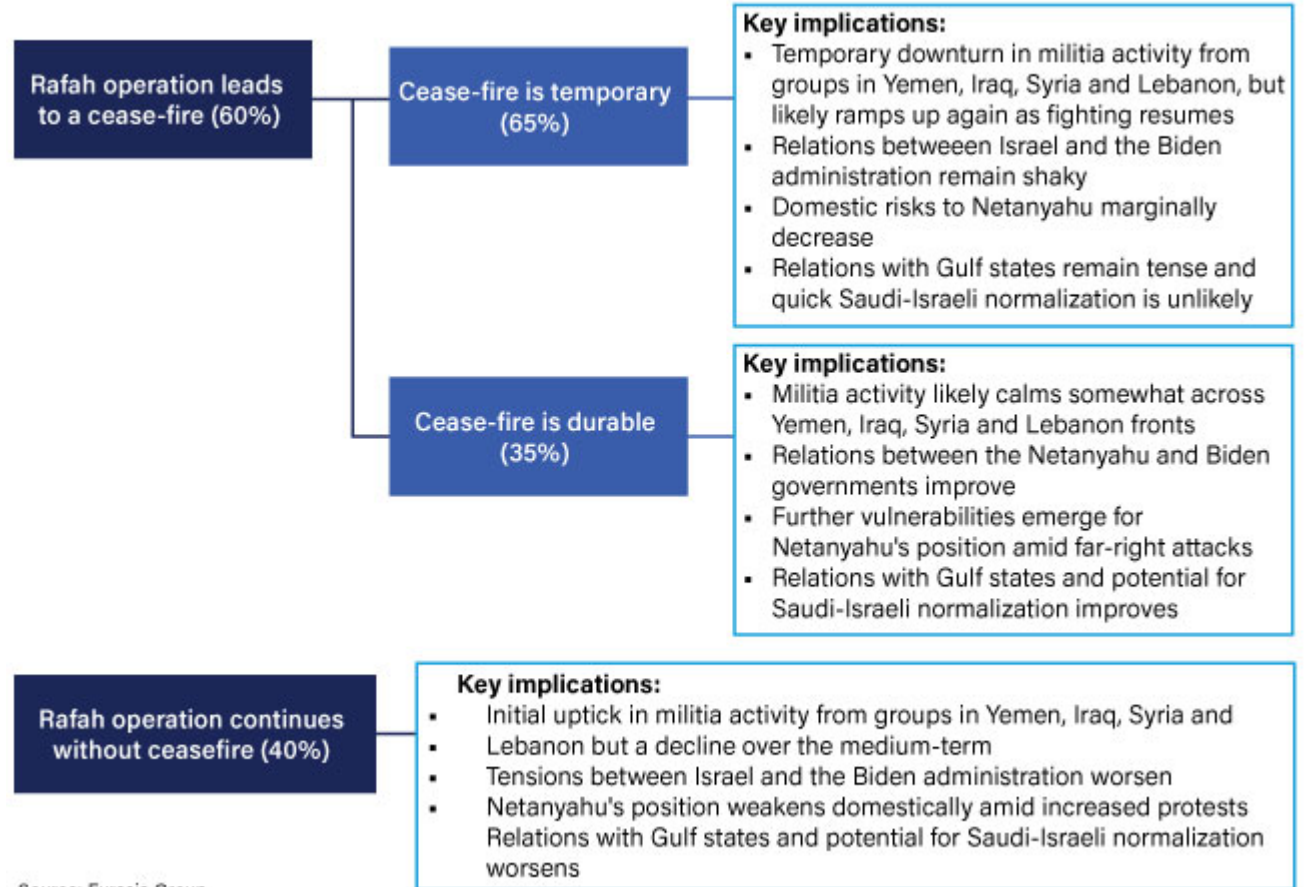
- The next president would be able to nominate a **new Chair in May 2026 when Powell's term ends**, as well as new Vice Chairs in July '26 and Sep '27;
 - **Biden** likely to pick Lael Brainard
 - **Trump**: risk of unorthodox picks, ex-Fed governor Kevin Warsh market positive
- Anonymous proposal on Trump 2.0 Fed policy should be treated with large pinch of salt – but **Powell's replacement would struggle with market perceptions**
- **Implications for monetary policy: Gradual** – would be constrained by the need to build consensus and market volatility
- **Regulatory policy**: Could see early move by the new vice chair to unwind some of the current (post-SVB) regulatory tightening and roll back supervisory oversight of climate change and other emerging risks

Fed's Board of Governors and selected FOMC members	Party	Term expires
Jay Powell (Chair)	R	May 15, 2026 (as Chair) January 31, 2028 (as Governor)
Philip Jefferson (Vice Chair)	D	September 7, 2027 (as Vice Chair) January 31, 2036 (as Governor)
Michael Barr (Vice Chair for Supervision)	D	July 13, 2026 (as Vice Chair for Supervision) January 31, 2032 (as Governor)
Adriana Kugler (Governor)	D	January 31, 2026
Chris Waller (Governor)	R	January 31, 2030
Miki Bowman (Governor)	R	January 31, 2034
Lisa Cook (Governor)	D	January 31, 2038
Loretta Mester (Cleveland)	-	June 2024
Patrick Harker (Philadelphia)	-	June 2025
Thomas Barkin (Richmond)	-	January 2028
John Williams (New York)	-	June 2028

Middle East crisis: Rafah offensive will progress further before renewed diplomacy

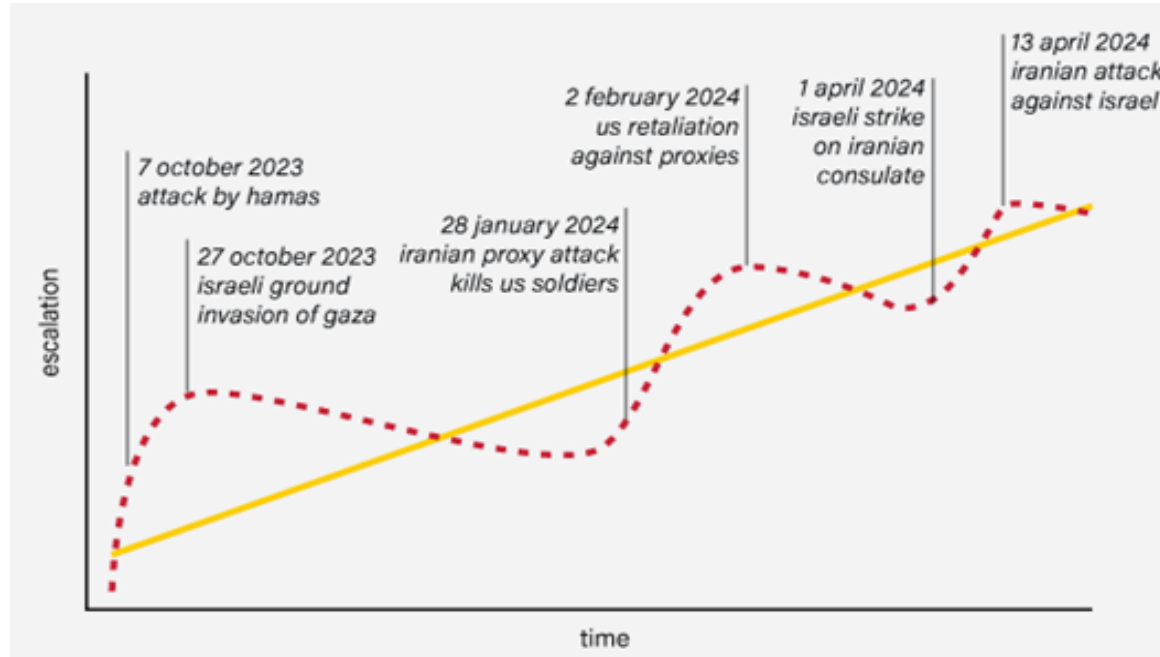
- **Israel's Rafah offensive will progress further before any renewed hostage and ceasefire efforts**
 - Serious discussions can emerge once Israel has pursued more of its military objectives in Rafah.
 - **A cease-fire is still likely over the next three months, but would likely prove temporary**
- **The Rafah offensive will lead to some uptick in militia activity** from groups in Yemen, Iraq, Syria, and Lebanon. **But is unlikely to trigger a broader regional war, with wider market impact**

Rafah-related odds over the next three months



Source: Eurasia Group

Middle East crisis: near-term confrontation contained but significant escalation risks



- The war is unlikely to end once Israel deems it is time to wind down its Rafah operations
- The next phase of the war - dealing with Hezbollah and Iranian proxies – will also pose substantial escalation risks
- **International pressures have helped to contain further escalation risks between Iran and Israel after the Israeli strike on the Iranian consulate and Iran's direct attacks on Israel. But direction confrontation has raised the stakes for future escalation**

Major disruption to oil supply is unlikely. Grand bargain remains elusive

Scenarios through the end of second quarter 2024

Scenario	Probability	Description
Limited-scale security crisis	50%	Limited-scale security crisis with Gaza as the main theater of confrontation; Hizbullah in Lebanon, Shia militias in Iraq and Syria, and the Houthis in Yemen participate with limitation
Significant Middle East security crisis that creates a more material impact	45%	25%: Limited-scale risks to oil supply and tangible impact on regional markets
		20%: Major risks to oil supply from the region and contagion risk to the global economy
De-escalation	5%	Significant decrease in the intensity of Israeli military operations that comes with decreased regional risks from pro-Iranian groups

Source: Eurasia Group



Rising costs/risk premia

- Higher shipping/insurance costs, with impact on corporate margins and/or inflation
- Higher risk premia given uncertainty

Dislocation

- Red Sea shipping disruption impacting consumer goods and/or oil and gas flows
- Suez Canal disruption

Disruption

- US tightens Iran sanctions
- Iran closes Strait of Hormuz

- **US-Israel-Saudi grand bargain:** key obstacle remains concrete pathway to Palestinian state. Some bilateral Saudi-US deals could move pre-election

War in Ukraine: Ukraine will be forced on the defensive



Scenarios until 30 November 2024		
Scenario	Description	Probability
Stalemate	Russia and Ukraine fail to make decisive military gains. Continued missile and drone strikes on each other's territories, and potential Russian targeting of Ukrainian grain exports.	55%
Escalated attacks	Heavy Russian attacks on Ukrainian infrastructure near NATO states increase risk of confrontation between Russia and NATO. Ukraine launches more aggressive attacks on targets in Russia.	35%
De-escalation and talks	Fighting de-escalates but negotiations cannot facilitate a political compromise. The environment for reconstruction in Ukraine improves. Sanctions against Russia remain in place.	10%



- **The material balance (manpower and military production) has shifted in Russia’s favor this year**
- On the battlefield, **Ukraine will be forced on the defensive as Russia takes the initiative.**
- US aid helps Ukraine’s ability to stabilize situation in the eastern region of Donetsk, but **Ukraine can’t launch counteroffensive this year**
- **Major risks:** Ukrainian asymmetric escalation targeting oil, Black Sea shipping, credibility hits to the transatlantic alliance and US

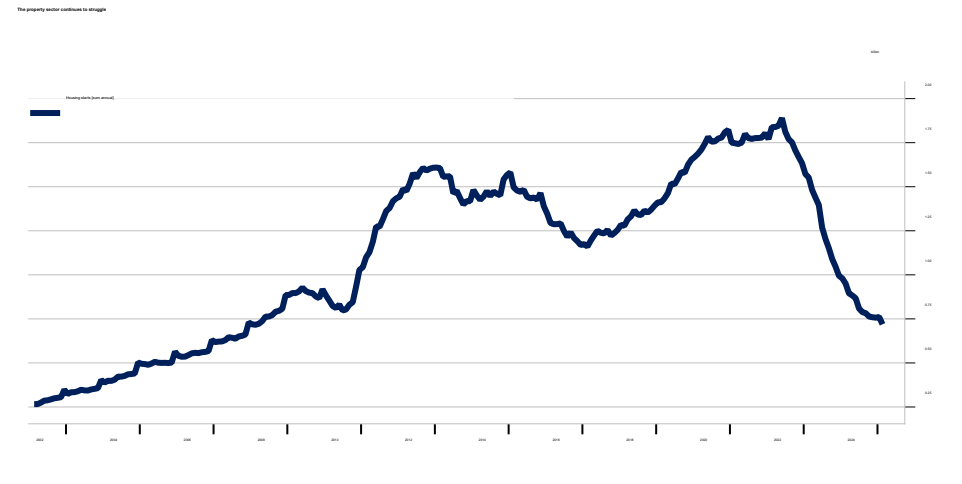
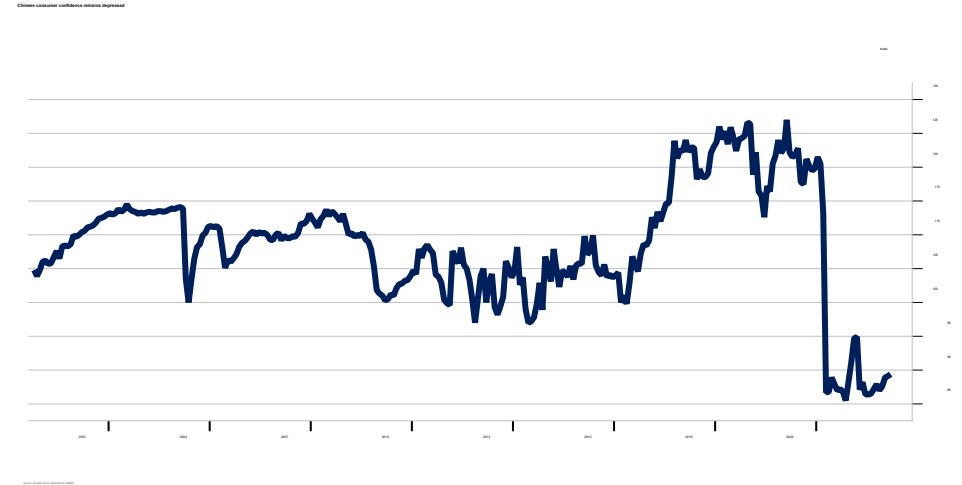
Partitioned Ukraine, diminished Russia

- **Ukraine will be de facto partitioned this year** and could “lose” the war as early as 2025, ceding more territory and forced to accept worse terms.
- **But Russia still can’t “win”**: Its geopolitical position has deteriorated sharply since the invasion. Economic crisis has been avoided but long-term potential growth and sustainability undermined
- **The odds of the EU backing the US proposal to collateralize future profits from Russian frozen assets has risen (40%).**
- Movement toward full seizure of Russian frozen assets is unlikely (30% odds).

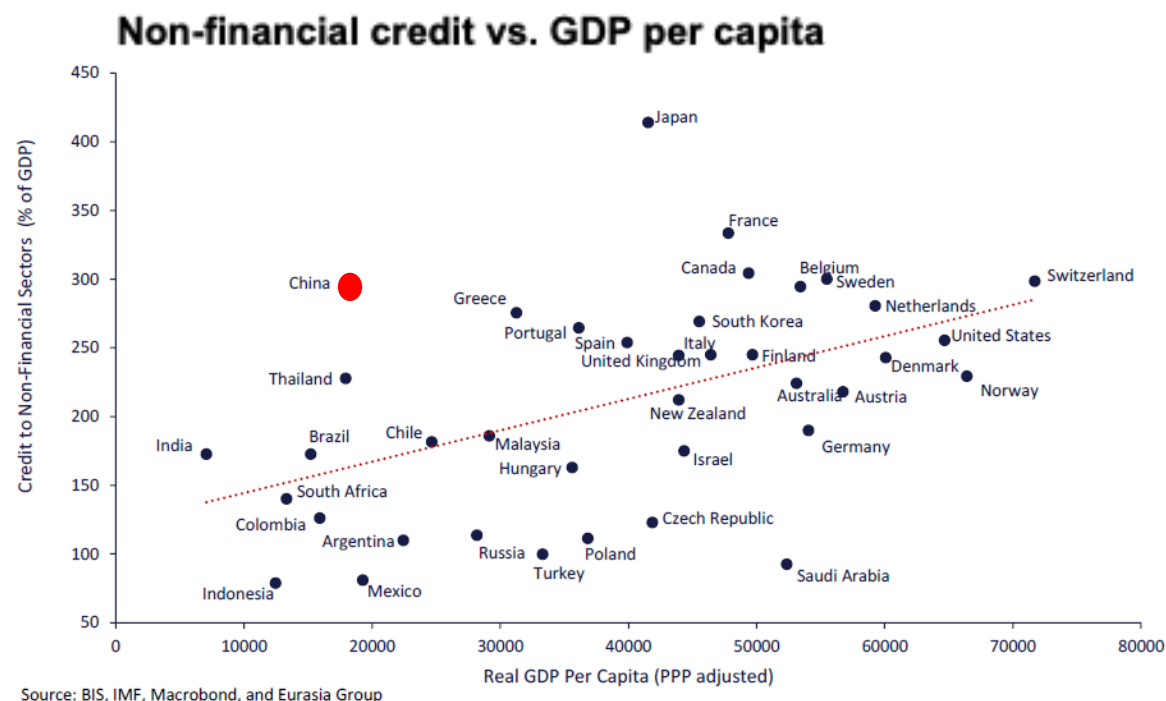
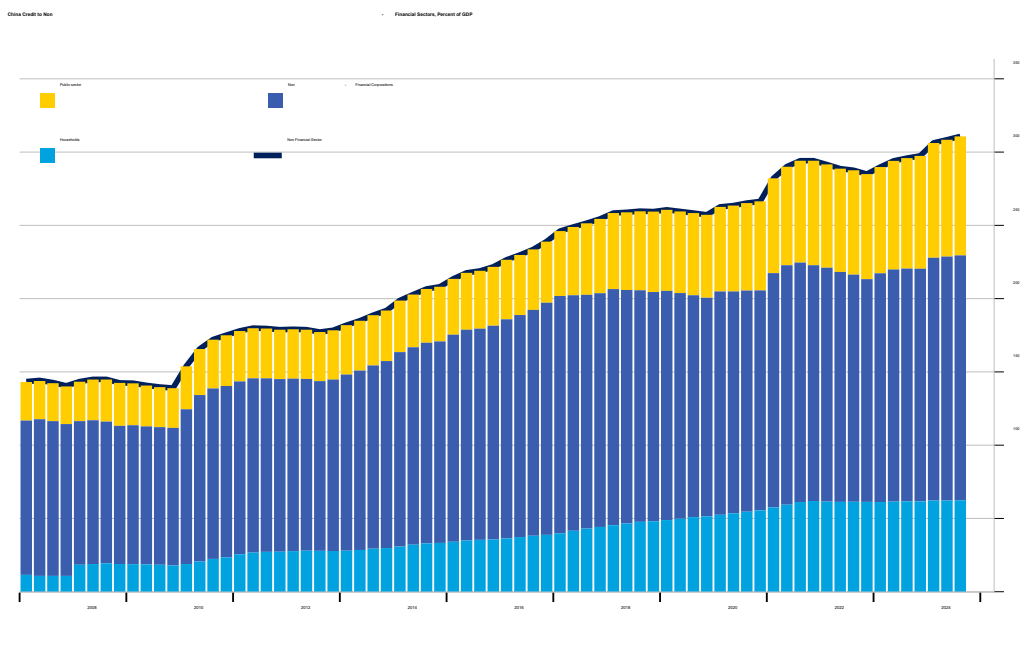


China: Focus on security over growth is a headwind to the recovery

- **Positive Q1 data, a pickup in exports and a rebound in equities** has driven some positive economic momentum at the start of the year
- However, **continued property sector woes and weak consumer confidence** remain a headwind for the economy. The government is reluctant to stimulate domestic demand growth
- **“Maximum Xi”**: concentration of power and continued **prioritization of security over growth**
- **Incrementalist approach toward economic policy**
- **Triggers of change of heart**: threats to Xi perceived legitimacy or to China’s security, more than disappointing macroeconomic performance. A Trump win may also prompt a rethink
- **Net impact that a persistent Chinese growth resurgence is unlikely, with China imparting weak global growth impulse**



China: Structural challenges in local finance, housing and financial sector

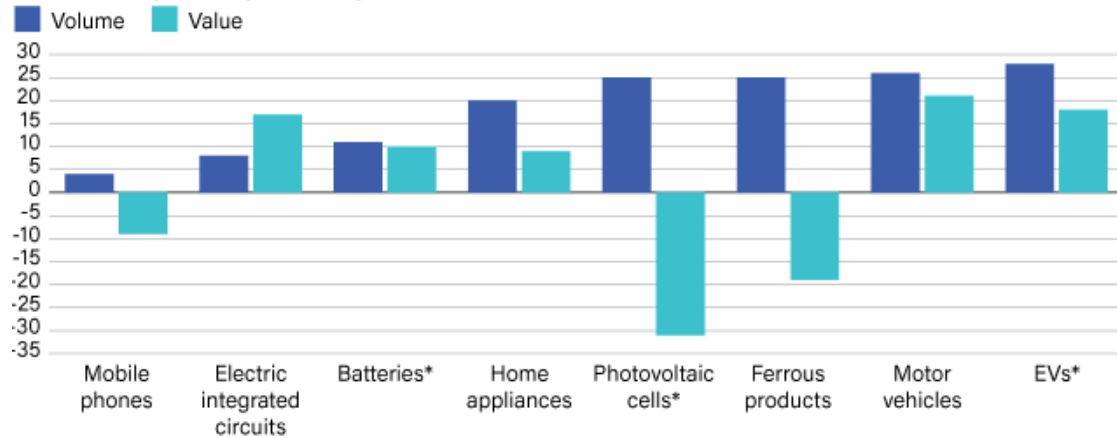


- **Structural impediments to growth** include: oversupply in property market, excessive financial leverage, local government fiscal crisis, unfavorable demographics, and eroding labor cost advantages

China: Overcapacity will increase trade tensions with the US and Europe

Chinese shipments of green manufactures surge

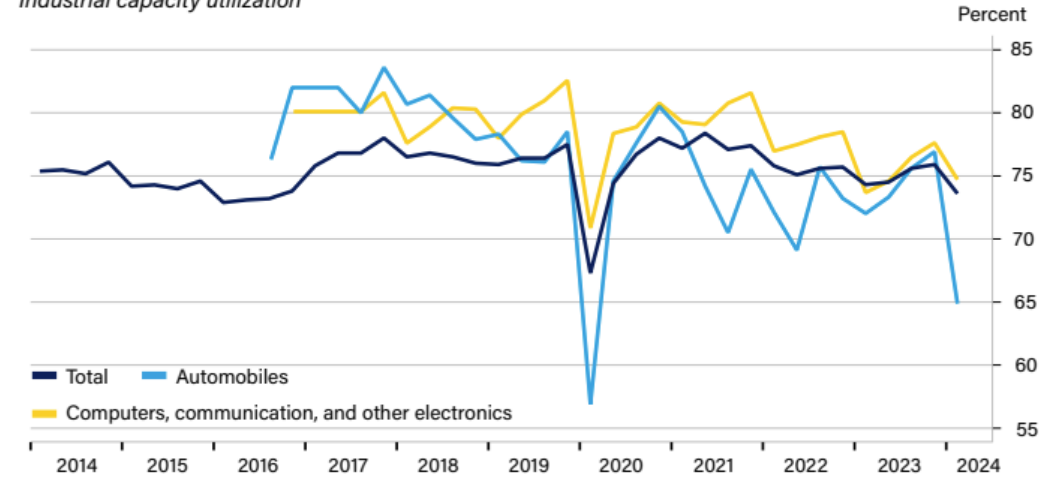
Year-to-date year-on-year change (%)



*Data through March; other series through April 2024
Source: General Administration of Customs, Eurasia Group

Overinvestment in autos and weak demand driving idle capacity

Industrial capacity utilization



Source: Eurasia Group, Macrobond, NBS

- **Continued reliance on directed investment and aggressive industrial policies** will increase tensions with West, with retaliation intensifying the negative impact of western 'de-risking efforts'

Managed decline is the expectation for US-China ties

US-China ties are on a trajectory of managed decline

- Trade: overcapacity, EVs, steel, shipbuilding
- Technology restrictions: TikTok
- Regional security:
 - Taiwan – Lai inauguration: likely sparks but no fire
 - Philippines: Second Thomas Shoal
- Ukraine
- US electoral politics and congressional pressure

Risk of a serious deterioration is substantial. Significant risk of an unintended military incident (Second Thomas Shoal, Taiwan)

However, **China’s domestic economic issues motivate its desire for external calm.** On the US side, the election will be the key driver for the pace of decline.

US-China Relations through end-2024	3 Apr	17 Nov
Managed decline	70%	80%
Serious deterioration	30%	20%
Substantial improvement	0%	0%

How do we take account of (geo-)political factors?

Why is this hard?

- Political indicators/geopolitical indices are (by nature) not forward-looking or susceptible to statistical analysis
- Rules-of-thumb do not capture complexity, source of shock, persistence, and structural impact
- A big difference between “tail risks” (e.g. oil shock) and base case (e.g. economic fragmentation)
- Econometric modelling is hard, and gets harder the more global and important the risk

What do we do on the (geo)politics?

- Gather intelligence to shape political calls—invariably qualitative
- Analyse the political and economic policy consequences of calls
- Extensive use of probabilistic statements and scenarios
- Can be applied to events, policy and longer-term structural calls

And then finally, turning to the economics and market

- Map into policy, economic and market outcomes – for events, shocks, macroeconomic policy
- Form (broadly speaking) cyclical and structural views—with risk/uncertainty and tail risks as factors
- ‘Scenarios’ rather than point forecasts
- Assess “what is priced” or “where is market awareness”

Key scenarios for major geopolitical events and conflicts

US election:

- Trump is early frontrunner (60% odds), divided government is basecase but unified government more likely under Trump.
- Trump's policy priorities would be trade and immigration, but PNTR repeal or 10% across-the board tariffs are unlikely.

Middle East crisis:

- Rafah operation set to continue, broader regional war with major disruptions to oil markets is unlikely (20% odds). But Houthi disruption likely to continue, risk of escalation is significant, and a political solution remains elusive.

War in Ukraine:

- A de facto partition of Ukraine is likely. Despite recent progress, seizure of Russian frozen assets is unlikely this year.

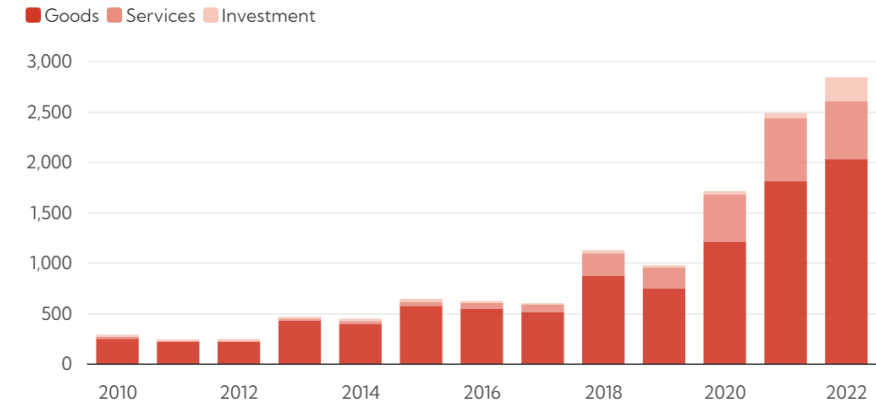
China and US-China:

- Xi's prioritization of security over growth will weigh on economy, largescale stimulus is unlikely.
- Basecase is a continued decline in US-China relations (70%), risk of a precipitous decline is at 30%.

How do these map into longer-term trends?

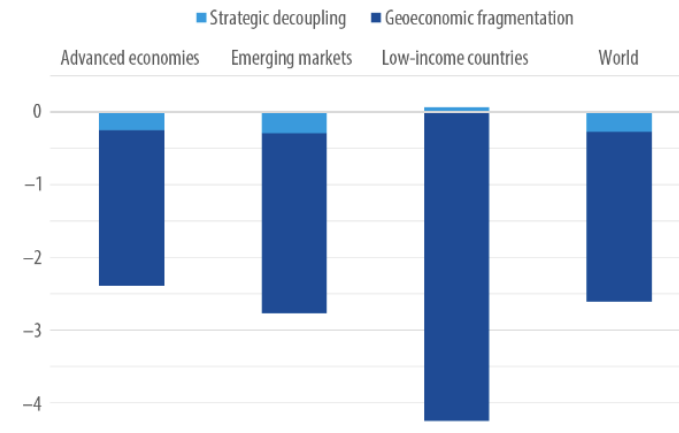
- **Strategic and national security concerns increasingly influencing policymaking over economic concerns**
 - Rising trade protectionism – tariffs, subsidies
 - Supply chain nearshoring, friendshoring
- **Increased government intervention in key policy areas**
 - Climate
 - Industrial policy
 - Inflation Reduction Act, CHIPS Act
 - EVs, critical minerals, semiconductors
- This creates **winners and losers** across sectors and countries
- **It also requires fiscal and financial capacity**, while economic fragmentation dampens global growth outlook... With implications for interest rates and inflation outlook – what will be the new normal after the end of the Great Moderation?
- Big unknown: potential for productivity gains from **AI** – **regulation will lag the pace of advancement**

Number of trade restrictions imposed annually worldwide



Source: Global Trade Alert and IMF Staff calculations

IMF estimates of permanent real GDP losses under decoupling scenarios



Source: Bolhuis, Marijn A., Jiaqian Chen, and Benjamin R. Kett. 2023. "Fragmentation in Global Trade: Accounting for Commodities." IMF Working Paper 2023/073, International Monetary Fund, Washington, DC.

Geopolitics, changing economic policy priorities will continue to shape the macroeconomic outlook

- Will US economic resilience continue in the face of rising global conflict and deteriorating US-China ties?
- How would a second Trump presidency impact that?
- How is Europe adapting to more activist US industrial policy, the rise of China, and the climate transition?
- Could politics further fuel sticky inflation and higher rates for longer interest rates?

Understanding geopolitics will be key to managing exposure to tail risk scenarios and conflict, and being able to take advantage of the longer-term trends that politics is influencing





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