



Calculating risk in a time of war, drones and fire

A snapshot of the key geopolitical risks for institutional investors this year

The new year is always a time for reflection of the past year and predictions for the next. At the beginning of 2024, institutional investors have much to review and assess in terms of geopolitical risks that are likely to impact their portfolios – from the ongoing war in Ukraine and the new/old conflict in the Middle East, to the elections that will take half of the world to the polls this year, to the growing impacts of climate change.

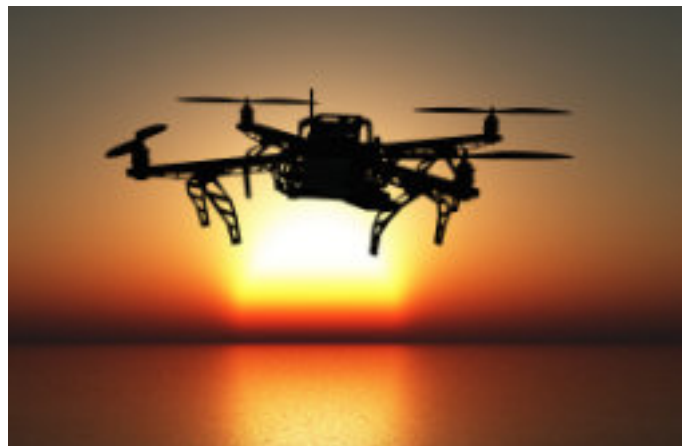
Here is a snapshot of the key risks and some predictions of how they might impact economic indicators and financial markets:

Mayhem in the Middle East

The October 7 attack by Palestinian group Hamas on Israel sparked a swift retaliation that has reverberated throughout the world. The conflict threatens to further destabilise the region and draw in other countries.

The financial impact depends on how far the conflict spreads. The main risk is how far Iran is drawn in. If Lebanon and Syria – which host Iran-backed militias – get involved and turn the conflict into a proxy war, oil prices could go up by 10%. If Iran comes into direct conflict with Israel, oil could reach \$150 a barrel and global growth drop to 1.7%, taking \$1 trillion off global output, according to Bloomberg Economics.

This could also trigger increased tensions in nearby countries suffering economic and political stagnation. A repeat of protests like the Arab Spring would increase risk aversion in markets. Together, those impacts could slow global growth and hinder the fight against inflation.



Attack of the drones

So far, the main economic impact from the Israeli-Palestinian conflict has been on world trade moving through the Suez Canal into the Red Sea. In support of Palestine, the Yemen-based Houthis have been attacking Israeli ships, or those headed to Israeli ports, with drones.

At least 10% of global sea trade passes through this area and already four of the five largest shipping companies have stopped operating there. Traffic is down by more than 40%, increasing shipping and insurance costs and disrupting global supply chains. This has already affected companies including IKEA, Tesla, Danone and Electrolux.

This could have a particular impact on Europe, as nearly 15% of its goods imported from Asia and the Gulf – including 21.5% of refined oil and more than 13% of crude oil – come by this sea route, according to S&P Global Market Intelligence.



Russia-Ukraine quagmire

The conflict in the Middle East has diverted focus from the ongoing crisis in Ukraine. However, the two-year war with Russia is still having a profound impact on global energy and food markets.

While the energy shock of 2022/23 is fading, Europe is now more dependent on oil from Qatar – and therefore more vulnerable to the impact of slowed trade through the Red Sea.

Russia and Ukraine are major global suppliers of grains and edible oils, creating a significant impact on food commodities. And the fact that Russia is the world's largest exporter of fertiliser is having an indirect effect on food production. It is projected that higher energy prices combined with export restrictions increased food costs in 2023 by 60–100%, according to *Nature*. This continues to feed broader measures of inflation, making it harder for central banks to lower interest rates, which could act as a drag on growth.

Election fever

More than half the world's population will go to the polls this year – in the US, UK, India and many others – but all eyes are on the possibility of a Trump comeback in the US.

The Economist has stated “Donald Trump poses the biggest danger to the world in 2024”. Concerns include how his lack of support for Ukraine and uncritical support of Israel could lead to continued conflict in both countries; that tax cuts would feed inflation, not growth as they did in his first term, as the US is running huge budget deficits and the cost of servicing debts is higher; and a mooted universal 10% levy on imports would increase prices for Americans and renew a trade war with China – with implications for the global economy.

His isolationist stance could also contribute to the weakening role of US dollar. With the BRICS (Brazil, Russia, India, China and South Africa) becoming BRICS+ (adding Argentina, Egypt, Ethiopia, Iran, Saudi Arabia and the UAE) in 2024, the group will control 25% of global exports and 42% of the oil trade. The yuan is already used by Brazil and Russia to transact with China and by Iran to bypass sanctions in selling oil to China; Argentina paid off IMF debt using yuan swaps. If Saudi Arabia and the UAE conduct BRICS+ oil trade in yuan, and Brazil adopted it for trading with Argentina, the dollar's dominance as the global reserve currency would be significantly diminished.

Crouching tiger, deflating dragon

However, the yuan's rise could be dampened by China's slowing economy. It grew just 5.2% in 2023, the lowest rates in decades, hit by a property-sector collapse. The government's skyrocketing debt-to-GDP ratio is hampering its ability to provide bailouts and invest. In response, it is compelling banks to extend loans to insolvent firms at below-market rates – kicking the can down the road and weighing on banks' own prospects. Although China is shifting focus to green energy and electric vehicles, property and infrastructure still account for more than 30% of GDP.

The World Bank warns that China's decelerating economy will weigh heavily on East Asia and more widely, as the world's second-largest economy. Its ageing population and stifling of entrepreneurship, along with its geopolitical rivalry with the US, are spooking foreign investors. And then there is the wild card – and the prospect of a Chinese invasion of Taiwan – hanging over the global economy.



This changes everything

Hanging over not just the economy but the entire globe, is the growing threat of climate change. While countries have pledged to keep global temperatures to less than 1.5°C above pre-industrial levels, there is a 66% chance of breaching that – this year. As temperatures grow, so do the threats to industries such as agriculture to tourism, consumer goods, logistics, construction and more.

Beyond the obvious physical threats from drought, flooding and fire disrupting production and supply chains, climbing temperatures will make more work, both outdoors and indoors, more difficult. Baking conditions have already led to industrial action at firms like UPS and Amazon.

The reality of the myriad impacts of climate change will likely lead to rising insurance premiums, effectively making more places uninsurable, with implications for homeowners, businesses and governments.



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