

MARKET SIGHT LINES



Outlook 2023 Spotlight No. 4: Geopolitical Risk Dashboard: Tensions Rising

By Michael O'Keeffe, *Chief Investment Officer*



Earlier this month, my team and I released our [outlook report](#), *Outlook 2023: Finding Balance*. Through the month of January, we've focused a spotlight on [a full report summary](#), our [base case outlook](#), important [signposts](#), and [our bear and bull scenarios](#). In this Sight|Lines, we shine the final outlook spotlight on some of the global trends and risks discussed in the article, "Geopolitical Risks Dashboard: Tensions Rising."

THE TAKEAWAY: WITH A COUPLE OF KEY THEMES IN FOCUS, EVEN EARLY IN 2023 SOME RISKS ARE IMPROVING, AND OTHERS WORSENING

Two important themes have been developing globally: *Increased Localization and Protectionism* and a *More Divided World*. And January has proven to be an important month for dashboard risks like the *Russia-West Conflict*, *European Fragmentation*, and *U.S.-China Competition*. In summary:

- Given global challenges like strained supply chains, military conflicts, and energy dependencies, countries are seeking to be more independent, leading to *Increased Localization and Protectionism*.
- With China's continued emergence as a global economic leader and military threat, we're beginning to transition from a unipolar world, with the U.S. exhibiting dominant military and economic power and social and cultural influence, to a multipolar one, with China having greater influence. We're in a *More Divided World*.
- The tragic war in Ukraine has been hard fought, with Ukraine winning back some conquered territory, and NATO providing increased military support.
- A milder winter in Europe has meant a lower demand for energy, so costs have fallen and the strains of disrupted energy supply chains from Russia have eased some.
- China has recently shifted dramatically away from a "zero-Covid" strategy to spur economic growth, which had fallen to its lowest level in many years.

IN-DEPTH: OUR BULL AND BEAR SCENARIOS HAVE "FAT TAILS" THIS YEAR, SO WATCHING FOR SIGNPOSTS WILL BE IMPORTANT.

We see trends and themes developing when we define and monitor risks like the *Russia-West Conflict*, *European Fragmentation*, and *U.S.-China Competition*. Two such themes are *Increased Localization and Protectionism* and a *More Divided World*. Interestingly, these themes and many of the geopolitical risks we monitor are interrelated with progress or setbacks in one area influencing others. Going deeper:

- Given ever-improving technology and the flow of information, the world is global, but we are seeing *Increased Localization and Protectionism* given strained supply chains, military conflicts, and frustrations with energy dependencies:
 - For example, U.S. firms reshored about 350,000 jobs in 2022, a 25% increase over 2021.
 - A buildup of U.S. manufacturing is contributing to a reduction in its share of shipments originating in Asia, which is forecast to fall 40% by 2030.
- *A More Divided World*: China's continued emergence as a global economic leader and military threat means we're shifting from a unipolar to a multipolar world, with China having greater influence:
 - China's Belt and Road initiative shows its effort to build stronger economic partnerships globally.
 - While the majority of countries voted in favor of a United Nations resolution condemning Russia's claims of annexation in Ukraine, five countries (Russia, Belarus, Nicaragua, North Korea, and Syria) voted no and 45 countries, including China and India, abstained or declined to vote.
- Our defined risk, *Russia-West Conflict*, highlights the importance of finding peace in Ukraine. An update:
 - After conquering 25% of Ukraine's territory at one point, Russia now controls about 16%.
 - Ukraine wants more NATO support, and the U.S. will be providing approximately 30 M1 Abrams tanks, while Germany will send 14 Leopard-2 tanks and authorize other European countries to send more.
 - Escalating conflict and NATO involvement remains a potential source of market volatility.
- A milder winter in Europe has eased some pressures there related to energy consumption and dependence on Russia:
 - While 40% of EU natural gas was from Russia in the past, that figure has fallen below 15%.
 - Berlin aims to halt any remaining Russian flows by the summer of 2024, fast-tracking the development of infrastructure and relationships to be able to do so.
- China has recently shifted dramatically away from a "zero-Covid" strategy to spur economic growth, which had fallen to its lowest level in many years.
 - Quarantine restrictions were removed for inbound and cross-country travelers.
 - Work and local factory production cannot be halted unless the area is designated as high risk.

CONCLUSION

Through the month of January this month, we've focused spotlights like [a full report summary](#), our [base case outlook](#), important [signposts, and our bear and bull scenarios](#) of our full [outlook report](#), **Outlook 2023: Finding Balance**. Geopolitics plays an important role in this work, as highlighted in the outlook article *Geopolitical Risks Dashboard: Tensions Rising*. And even in January, we've seen meaningful shifts in the drivers of these risks, both positive and negative.

Michael P. O'Keeffe, CFA 

Chief Investment Officer

michael.okeeffe@stifel.com

www.stifelinsights.com

GEOPOLITICAL DASHBOARD

EVENT	LIKELIHOOD	MARKET IMPACT	DESCRIPTION
U.S.-China Competition	10	7	Competition for global leadership will impact markets; tech will continue to play an important role. The U.S. Department of Defense sees China as the "most consequential strategic competitor."
The New Cold War	8	7	The Russia-Ukraine war is solidifying alliances among competing geopolitical blocs. U.S.-China and U.S.-Russia competition for influence are increasingly hostile.
Emerging Market (EM) Political Uncertainty	7	5	Many EM countries are facing COVID-related challenges, including higher food and energy prices. These can lead to increased inequality, political interference, and continued rise of populist ideas.
Cyberattacks	7	5	As society becomes more digitized, the world is more prone to cyberattacks. The risk of cyber warfare is increasing significantly.
Middle Eastern Tensions	7	5	Tensions in the region remain heightened. Iran nuclear talks are at a standstill, and the country is undermining stability by continuing to support terrorist groups and proxies.
Washington D.C. Gridlock	6	6	A divided Congress likely means limited prospects for significant legislation. The degree of political uncertainty may not be fully priced into markets.
Climate Change Stalemate	6	4	A U.N. climate agreement was reached where developed countries would pay for climate damage costs of developing nations. Still, major hurdles remain.
Major Terror Attacks	6	4	Unpredictable terrorist attacks may create disruption. The U.S. withdrawal from Afghanistan has amplified the risk of a resurgent terrorist threat.
South China Sea Military Conflict	5	7	China maintains a strong air and naval presence in the area, even as the U.S. upgrades airfields and other strategic infrastructure. There is potential for a military clash.
European Fragmentation	5	6	The energy crisis and resulting economic damage from the Ukraine war may test European solidarity. France and Germany are increasingly at odds on several key issues.
North Korea Conflict	5	3	North Korea continues to improve and expand its nuclear missile capabilities. In November, it test-fired an intercontinental ballistic missile (ICBM) with a range sufficient to reach the U.S. mainland.
Structurally Higher Inflation	4	8	The effects of the pandemic, the war in Ukraine, U.S.-China competition, and climate change could lead to a prolonged period of structurally higher inflation.
Russia-West Conflict	4	8	Russia has threatened retaliation in response to Western military support of Ukraine. Finland and Sweden have applied to join NATO, a potential doubling of the Russia-NATO land border.

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