A geopolitical lens: July 2019

By Ian Bremmer, President, Eurasia Group

What's our current (geo)political trajectory?

I've been asked a lot lately if trade wars and geopolitics are leading us into an economic recession. That's not my base case, but I do think that tail risks which could spark an economic meltdown are growing. That's true for trade, like the numerous international confrontations with the United States (China and Mexico most clearly, but also potential U.S. tariffs on the EU and Japan) or Brexit (and, indeed, a no-deal Brexit). Tail risks are also growing on military conflicts in geopolitical hotspots, like Iran and North Korea, or between military rivals in proxy wars, like the United States and Russia over Venezuela, or between Turkey and Russia (or Turkey and the United States, or the United States and Russia...) over Syria.

Although these risks are growing, they're also generally overstated. We've seen quick climbdowns from escalatory rhetoric on a number of issues, as the costs of actual conflict became clear and institutional backstops kick in. The U.S. and Mexico reached a quick 'deal' on migrants-for-tariffs in the face of strong Republican and cabinet opposition to tariffs in the U.S. and strong incentives for the Mexicans to relent. The fire-and-fury bluster on North Korea died down quicker than most expected because strong institutional forces were generally underestimated; in the United States, among its allies, in China (North Korea's principle supporter), and likely, though less knowable, even around Kim Jong-un. It's also true for Iran, where I've consistently maintained that the risk of direct military conflict is low, even with Iran violating some terms of the nuclear agreement. Yes, Iran's under massive economic pressure and there are elements of the U.S. cabinet pushing for a maximum pressure strategy. But the Iranians really don't want to give their enemies an excuse to attack (so their moves towards breaking the nuclear deal are cautious and incremental), while President Trump has since offered to talk with Tehran "without preconditions."

Ian Bremmer
President, Eurasia Group

To be sure, when you add all these tail risks together, it's likely that one or two of them eventually "hit." Given the nature of these risks, if I were a director, I'd be looking to see if the executive team is doing scenario planning and stress testing, rather than hedging or divestment. Aside from these tail risks, there are two other structural trends in geopolitics that I'm more concerned about because they impact business planning and oversight even more.

The first is the deterioration of international governance. Support for global rule-making and enforcing bodies has fallen dramatically in the last few years. That manifests itself in all sorts of ways; greater budgetary pressure on the United Nations, greater fragmentation inside the European parliament, less functionality of the World Trade Organization, the U.S. withdrawal from agreements—the Intermediate-Range Nuclear Forces (INF) Treaty with Russia; the Trans-Pacific Partnership (TPP); the Paris climate agreement; the Human Rights Council. When institutional governance deteriorates, policymaking is more transactional, and that's bad for business planning. When leaders don't view alliances as strategic, they're more willing to undermine existing ones (the Turks buying military equipment from the Russians thus undermining NATO, the Brits refusing to side with the Americans on Huawei, the Italians joining China's Belt-and-Road Initiative) and less willing to form new agreements (we're nowhere close to a global approach on the ethics of artificial intelligence or coordination on quantum computing or arguably climate change). This means less efficient operating environments, more friction in doing business globally, and harder to plan more than a couple years out.

Ultimately, a decline in global governance increases volatility and should lead to a "risk off" investment tilt, away from growth and towards stability.

The second structural trend—and arguably the most important change in the political risk environment in the last decade—is the reduced ability of the international system to effectively respond to major shocks when they occur. Yes, we've had Brexit, a wave of populism and nationalism across virtually every major economy, and increased authoritarianism, but no truly global crisis that required a coordinated response (like say, the 2008 financial crash or 9/11) and most importantly, economic conditions have been generally good. Hard to say what the next crisis will be (I'm most concerned about the consequences of a cyberattack—most likely Russian, but potentially from a nonstate actor—on critical infrastructure that isn't easily contained, especially on a major, say, European economy), but when it comes, the cracks in the global order are going to fail to contain the fall-out. And that's the hardest to game out economically—absent knowledge of what or when the next crisis is going to be, planning against reduced resilience is something few executive teams are prepared to do. But understanding how to shorten supply chains, reduce fixed costs, decrease reliance on potentially distressed or suddenly hostile partnerships, and related decisions are all important exercises in this environment.

What's driving the current trend(s)?

I wrote in 2011 that we had entered a G-zero world (as opposed to a G-8 or G-20)—a world with no global leadership. That was driven by a number of trends that have since accelerated and led us to the geopolitical recession we're experiencing today. These include a U.S. with less interest in assuming leadership responsibilities; U.S. allies, particularly in Europe, that are weaker and looking to hedge bets on U.S. intentions; and two frenemies, Russia and China, seeking to assert themselves as (limited) alternatives to the U.S.—Russia primarily on the security front in its extended backyard, and China primarily on the economic front, regionally, and, increasingly, globally.

The roots of G-zero are structural, but its current course and speed are determined by the actions of key leaders unwilling to uphold the global liberal order, with some even bent on bringing it down. I'd certainly cast Trump and his America-first posture in this category, but others in this 'coalition of the unwilling' include Italy's Matteo Salvini, Brazil's Jair Bolsonaro, Russia's Vladimir Putin, Turkey's Recep Erdogan, Saudi Arabia's Mohammed bin Salman, Israel's Benjamin Netanyahu (for now anyway) and even North Korea's Kim Jong-un. This band of leaders by and large don't act in direct concert and don't salute a common flag, but their actions in aggregate have sped up the erosion of the international system and have an increasingly disruptive effect on the global order. And most of them aren't going away anytime soon.

What should you watch out for in the next quarter?

Much of what I've said is structural and long-term in nature, which I hope is helpful for long-term business planning and analysis. To that end, here are some quick hits on key geopolitical events in the next few months to watch out for. On U.S.–China, the G20 meeting in Osaka produced a cease fire; both sides have taken a step back from further escalation (on trade). This will bring the U.S. and China back to the negotiating table and likely keep further tariffs at bay, although somewhat counter-intuitively, might delay the lifting of current tariffs as both sides try to resolve fundamental differences without a hard deadline to reach conclusion.

However, expect little break in technology and geopolitical tensions in the short to medium term as difficult questions over Huawei and other Chinese technology champions become enmeshed with trade and make a stable, let alone cooperative relationship between the two sides ever harder to achieve. Across the Atlantic, worth paying attention to the next UK prime minister, more for signals of where the UK is headed domestically than on Brexit (since whoever wins will inevitably have to negotiate another extension with the EU past the October deadline and still face the same constraints on the deal onoffer from the Europeans.) Elsewhere in Europe, wouldn't be surprised if both the German and Italian ruling coalitions have broken down by the fall. And major developing economies generally trending positive—Bolsonaro is likely to have pension reform approved in Brazil (although with lower total savings than the initial proposal), a compromise cabinet in South Africa under Ramaphosa starting to reverse nearly a decade of freefall under Zuma (but expect a strong fightback from the Zuma state capturists), and a Modi 2.0 in India with a strong mandate for further reform (although don't expect big-bang measures of the first term like demonetisation).

Feel free to write to me, **bremmer@eurasiagroup.net,** if you want to go deeper on any of this or talk about a topic I didn't have space to cover.

The views and opinions expressed herein are those of the author and do not necessarily represent the views and opinions of KPMG LLP.

About the KPMG Board Leadership Center

The KPMG Board Leadership Center champions outstanding governance to help drive long-term corporate value and enhance investor confidence. Through an array of programs and perspectives—including KPMG's Audit Committee Institute, the WomenCorporateDirectors Foundation, and more—the Center engages with directors and business leaders to help articulate their challenges and promote continuous improvement of public- and private-company governance. Drawing on insights from KPMG professionals and governance experts worldwide, the Center delivers practical thought leadership—on risk and strategy, talent and technology, globalization and compliance, financial reporting and audit quality, and more—all through a board lens. Learn more at kpmg.com/us/blc.

Contact us

kpmg.com/us/blc
T: 1-800-808-5764
E: us-kpmgmktblc@kpmg.com

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities.

kpmg.com/socialmedia