

GEOPOLITICS

'The Great Diversification' is underway

We are now firmly in the riskier, messier, more factious world we [predicted](#). **While the US president is not the cause of the geopolitical shifts underway** over the last few years, **his administration is accelerating some drivers**. For example, tariffs are intensifying economic friction, while the reduction of US commitments to Europe's security and ambitions in space are contributing to a new arms race. The US, under Trump, has also emerged as an additional disruptor.

Geopolitics is changing the macro and market environment

As investors, we need to look at geopolitical risk like we look at debt. High debt levels do not need to result in a debt crisis, but they increase vulnerabilities. Geopolitics is also changing the macro and market environment. **The current level of US domestic political uncertainty alongside geopolitical risk alters how companies, consumers, and investors make decisions**, which then has economic, and again political, implications. This uncertain backdrop will shape the next twelve months.

Politics will continue to hit global investors where they are most exposed: in US assets. Concerns over the US's fiscal position will linger, alongside doubts over how the US will weather the changes underway. **Domestic politics will remain volatile** as Trump will double down on societal issues that rally the MAGA base as mid-term elections approach.

After Trump's tariff ambitions faced pushback from financial markets and the courts, many leaders will be reluctant to cede much ground in negotiations. This will likely cause **more tariff-related pressure**. Negotiations will take time and trigger retaliation, if unsuccessful. Our current economic assumptions are based on an average US tariff rate of 15%, but this rate is likely to remain in flux.

Governments, companies, and investors will diversify away from the US

As a result, 'The Great Diversification' will play out as governments, companies, and investors diversify away from the US. Governments will seek to sign new trade and security deals while central banks will continue to diversify their currency reserves. **Companies will wait to see how tariff negotiations play out to decide how to adjust their supply chains and final manufacturing destinations** and how to get away with doing the bare minimum to satisfy Trump's demands for on-shoring in the US.


The diversification trend is playing out across asset classes & geographies

- Central bank reserve managers expect the share of the USD in global reserves to fall to around 55% in the next decade, while the renminbi's share is expected to increase to 5.6% ([OMFIF](#)).
- The renminbi has now surpassed the USD in China's cross-border transactions.
- Payment systems and platforms bypassing the USD and SWIFT are mushrooming in Asia and are being developed by BRICS members.
- Gold prices are at an all-time high.
- Demand for Eurozone bonds has been steadily increasing while European assets are attracting more capital flows.
- 64% of Chinese FDI was allocated to emerging markets in 2024, but 53.2% of China's investment in high-income countries was allocated to Europe.

Source: Amundi Investment Institute, Bloomberg, OMFIF, Mercator Institute for China Studies

'Winners and losers' will not be clear until tariff negotiations and the re-routing process are completed but Europe is likely to remain a net winner from US uncertainty. **While political risks remain, Europe is growing more united**, as leaders understand they are stronger together than as individual member states. Improving EU-UK ties is a case in point. Upcoming elections in Hungary in April 2026 could also bring a power shift, possibly removing one of the EU's biggest political hurdles as Viktor Orbán's party is trailing in the polls. The EU is amplifying its trade relations, as recent deals with the UK and Mercosur, and progress on a trade deal with India, illustrate. **There is momentum towards single and financial market integration and creating an environment that could make the euro more attractive.**

However, the EU will have to provide more clarity on how spending needs (e.g. defence, infrastructure, technology) will be funded despite constrained fiscal space. Reforms and reducing bureaucracy are essential to further integration, **but political hurdles are abundant.**



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Developments in the Russia-Ukraine war will only emphasise the need for Europe to step up its own defence. A continuation of the conflict alongside talks is the most likely scenario for the next several months. Putin's and Ukraine's war aims do not overlap and there is no easy landing zone. If a ceasefire is achieved, it most likely will leave the door open for further Russian military activity. Most scenarios lead to Europe having to do the heavy lifting for its own and Ukraine's security.

The US-China relationship will continue to decline for as long as China poses a strategic economic, military and technological threat to the US. **Our analysis comparing the US and China in various categories** ranging from technology to industrial and military capabilities **suggests that China is 'catching up'** with the US in many areas and leading in others (e.g. rare earths). **Some of Trump's actions**, like undermining research institutions and expelling migrants, are **eroding some of the US's competitive advantages over China**: attractive demographics and research innovation.

The US and China will likely stay in a scenario of 'tense understanding' for the next several months. Both sides will avoid further escalation but also accept that the Great Power Competition does not allow much space for ties to improve significantly. **The US will continue to try and squeeze China economically, meaning there is a low likelihood of a grand bargain, which would see tariff levels come down sharply.** This doesn't mean there could not be 'mini deals' – for example, even if fentanyl tariffs come down as part of talks, the US would likely impose additional tariffs or export controls in other areas to maintain economic pressure. **China in turn is growing more confident on the global stage**, openly challenging the US, as recent deals in the US's 'backyard' – Latin America – demonstrate.

The Middle East will continue to see significant changes, but much will depend on how the recent escalation between Iran and Israel develops. There are various scenarios, one in which diplomacy resumes as Iran realises its regime stands the best chance of surviving by seeking a deal. There is a range of escalation possibilities, with Iran retaliating, kicking off a broader regional war involving other powers and the US. Israel may also decide that now is the time to force political change in Iran once and for all. At the time of writing, our view is that diplomacy will likely resume after retaliations between Iran and Israel play out.

Despite sanctions relief, **Syria** will remain volatile given the difficult domestic situation and various competing geopolitical interests. Equally, the ceasefire with the Houthis will remain fragile, sustaining concerns for shipping in the Red Sea.

We expected **Saudi Arabia** to have more political influence in the region under Trump and this has played out. While Saudi Arabia fears Iran, the Gulf is first and foremost interested in political stability to achieve its economic objectives.

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Currency abbreviations: USD – US dollar, BRL – Brazilian real, JPY – Japanese yen, GBP – British pound sterling, EUR – Euro, CAD – Canadian dollar, SEK – Swedish krona, NOK – Norwegian krone, CHF – Swiss Franc, NZD – New Zealand dollar, AUD – Australian dollar, CNY – Chinese Renminbi, CLP – Chilean Peso, MXN – Mexican Peso, IDR – Indonesian Rupiah, RUB – Russian Ruble, ZAR – South African Rand, TRY – Turkish lira, KRW – South Korean Won, THB – Thai Baht, HUF – Hungarian Forint, COP – Colombian Peso.

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