GEOPOLITICS

Transitioning to a riskier, messier – and diversifying – world

KEY TAKEAWAYS

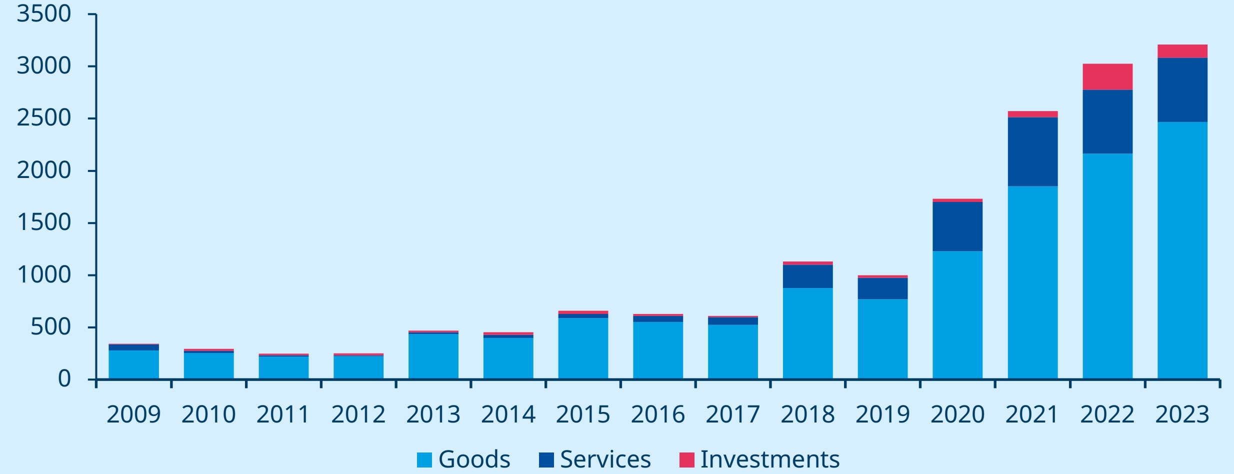
We expect geopolitical tensions to continue to rise in 2025. Economic frictions are likely to intensify and 'hot' conflicts to continue. Global powers will aim to expand their spheres of influence, while others will seek to improve their military and nuclear capabilities.

As geopolitics increasingly shapes the economic backdrop, companies and political leaders are adjusting by lowering their dependencies and diversifying their relationships. Investors must consider the impact of both short-term developments and longer-term trends on their portfolios.

Our analysis suggests that **the level of geopolitical risk will rise over the next few years.** The trends that lead us to this conclusion are likely to also play out in 2025. Our Geopolitical Sentiment Tracker shows that more countries now have poor bilateral relations, while Russia's ties with Iran, North Korea and China are deepening. **The 'Great Power Competition' between the US and China will persist.** Protectionism, sanctions, export controls and tariffs will create more **economic friction**. Even though we have not yet observed a slowdown in global trade, this could change if US President Donald Trump implements a plethora of tariffs. Diversification efforts will grow, with exports taking different routes to their end markets. **New multi-currency payment systems are being set up to lower dependencies on the US dollar-led system.** Similarly, efforts are being made to join alternative alliances to the West, such as BRICS[1]. Companies and political leaders are having to adjust to this new operating environment. Companies are dealing with political risks by enhancing their capabilities and altering their strategies. For example, Chinese and European, but also US Electric Vehicle (EV) firms are entering new partnerships to sidestep political pressures while ensuring access to materials, technology and markets. Some companies are relocating their headquarters or focusing on less politically fraught markets.

As tensions grow, companies' diversification – or 'coping' – strategies will become more apparent.

The number of global trade restrictions has been rising steadily



Source: Amundi Investment Institute. Global Trade Alert data as of 24 October 2024.

[1] Brazil, Russia, India, China, South Africa, Iran, Egypt, Ethiopia, and the United Arab Emirates.

GEOPOLITICS

Most **political leaders will continue to avoid choosing sides for as long as they can to maximise their bargaining power.** For example, India is now allegedly the second-largest supplier of restricted critical technologies to Russia. However, this strategy will be made more difficult if the Trump administration forces countries to take a stance in exchange for relief from tariffs or security protection. Nevertheless, **the countries benefitting from geopolitical changes will become more apparent** in 2025, for example, due to a surge in exports as they sit on new transit routes. Beyond these trends, today's geopolitical hotspots will remain in focus. US foreign policy will focus on the Middle East, either because the current conflicts are continuing and expanding, or because the involved parties are willing to negotiate: kicking off nuclear talks with Iran, attempts to achieve a two-state solution between Israel and Palestine, and efforts to normalise relations between Israel and some Arab states. A combination of both dynamics – ongoing hostilities and talks – is most likely.

The odds of a ceasefire between Russia and Ukraine next year are higher, even though there are still many avenues for a continuation of the conflict. Nevertheless, a ceasefire is a possibility under Trump. While this would be a positive development for Europe, as local firms stand to benefit from Ukraine's reconstruction, concerns would loom over the longevity of such an agreement and Russia's aspirations. **US efforts to 'contain' China's economy will aggravate tensions between the two powers.** Although trade issues will likely be the main focus, tensions in the East and South China Seas will grow.

Key **Investment** Implications

Geopolitical developments are increasingly shaping the background against which leaders make market-moving decisions and the reasons behind trends affecting asset classes.

Economists must reflect geopolitics in their projections, and investors should work with forecasters and forecasts that do so, and consider position adjustments and hedging options.

Geopolitics is also responsible for the strong performance of safe haven assets, such as gold.

The EU will struggle with opposing dynamics: demand for more spending on defence and the green transition clash with the desire for fiscal prudence; calls for more political integration clash with nationalist tendencies; and the need for global EU leadership faces the reality of weakened political leaders. On top of this, the **EU faces political pressure to distance itself from China, while having to manage a likely trade war with the US.** The EU will also face anxieties over the US's willingness to provide military protection; Trump's attitude towards the EU, and the EU's response, will likely erode the transatlantic relationship. However, Trump has the potential to lower the dial on some geopolitical risks. For example, as a condition for a ceasefire in Ukraine, **renewed relations between the US and Russia could erode Russia's ties with Iran and North Korea.**

Higher oil volatility due to geopolitics is unlikely to offset weaker fundamentals

Outages due to strikes on Iran's oil infrastructure are a plausible outcome, as both Israel and Iran become accustomed to direct confrontations. Such risk will come and go and implies a premium of about USD 5, far below a 'broad-contagion' premium reflecting threats to regional oil infrastructure, lower availability of spare capacity and, as a last resort, a blockade of the Strait of Hormuz.

Following Trump's election, the negative impact on the price of oil from higher domestic output is likely to be offset by pressure on Iran's crude exports, and delayed energy transition legislation.

We see more frequent volatility spikes in oil markets in 2025, but supply should remain the driving force. Saudi Arabia's willingness to accept lower prices to restore OPEC credibility and regain market share, and growing non-OPEC output, both point to a weaker price equilibrium, in the low range of our USD 75 to USD 80 Brent target.

16 out of **20**

oil-shocks since the 60s only had a temporary effect on supply, with exceptions in the late-70s and early-80s

Source: Amundi Investment Institute. Analysis of 20 oil shocks. Temporary effect defined as a shock in supply reduction lower than 5% of supply overcome in less than one year.

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DEFINITION ABBREVIATIONS

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.

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