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Political risk outlook

Geoeconomics: the new context for doing business in the world

Geopolitical risks were very much in the mind of global corporate leaders and investors gathering at this year's annual meeting of the World Economic Forum. A survey published by PWC, the consulting firm, reported that 74 percent of global CEOs worry that geopolitical uncertainty posed a threat to their organisation's growth prospects.[1] And indeed, the disintegration of large parts of the Middle East and the rise of transnational terrorism, the increasing isolation of Russia, faltering transatlantic relations, China's more assertive foreign policy, the decreasing willingness of the U.S. to project power abroad, and others, are putting tremendous stress on the global economy. The IMF repeatedly quotes geopolitical tensions as an essential risk to the global economic outlook.

In a way, the fragmenting geopolitical space catches globally operating corporations and investors off-guard. Most of them have placed a long-term bet on political integration following market integration. But whilst the global economy has been integrating over the past two decades, fragmentation has become the dominant trend in international politics. Even more worryingly, economic interdependence has become something that governments are more proactively using to pursue their foreign policy interests. Economic statecraft, trade and financial warfare have turned into powerful foreign policy instruments. This paradigm shift, the tensions between past economic integration and current and future political fragmentation, creates an environment that investors and corporate leaders find difficult to navigate.

The rise of geoeconomics, as we call this phenomenon, provides the macro narrative in which more specific political events have very concrete consequences for businesses and financial markets. Russia's ambitions in Eastern Europe and more precisely Ukraine have caused the U.S. and the EU to impose financial sanctions in form of asset freeze measures on Russian institutions and individuals, and – amplified by the fall of the oil price - sent the Russian rouble into a tailspin. Eroding transatlantic relations have made it difficult to find a balance between data protection and privacy on the one and security concerns on the other hand or to smoothly move forward with the negotiations of the Transatlantic Trade and Investment Partnership (TTIP). Diverging opinions about the principles of freedom of thought have made it difficult for Western content providers to deliver their services into the Peoples' Republic of China. The massive fall of the price of oil is not least a consequence of the

[1] PWC, 2016. PWCS' 19th Annual Global CEO Survey, Davos.

competition between Saudi Arabia and Iran for hegemony in the Gulf region and begins to represent a true threat to the global economy and investor confidence. The political stability of many emerging economies suffers in consequence. Last year, the European sovereign debt crisis was only resolved because European leaders believed in the geostrategic importance of an integrated euro zone. More recently, the disintegration of the Middle East has brought about a refugee crisis that threatens the resilience of the EU and one of its most important pillars, the free movement of citizens across Europe's borders. And we have not even started to talk about a possible Brexit, or the crisis of the established party system across Europe.

All this begins to resonate with corporations and investors: according to PWC, they believe that nationalism, multiple economic models, regional trading blocs, and multiple rules of law and value systems are going to dominate the future configuration of the global economic and financial space. What they still have to do, however, is to respond to this paradigm shift not merely in a responsive, opportunistic manner, but much more systematically and strategically, identifying ways to succeed in a politically more fragmented world economy.

The challenge for corporations will be to determine how political and geopolitical risks are going to affect the way in which they operate across fragmenting jurisdictions, how they drive market access, the preferences and purchasing power of consumers, what threats they pose to supply chains and business continuity, branding and reputation, or corporate governance.

Investors will need to systematically factor in geopolitical risks in their investment decisions, their preferences for asset classes, ideally resulting in geopolitical risk adjusted investment portfolios. They need to ensure that they give preference to those who have a strategy to deal with political uncertainty, and factor in the political risk exposure of those who don't. What appears to be sure is that those who acknowledge geopolitical risk as a key driver of commercial success will have a competitive edge and be better off in the end.

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About

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