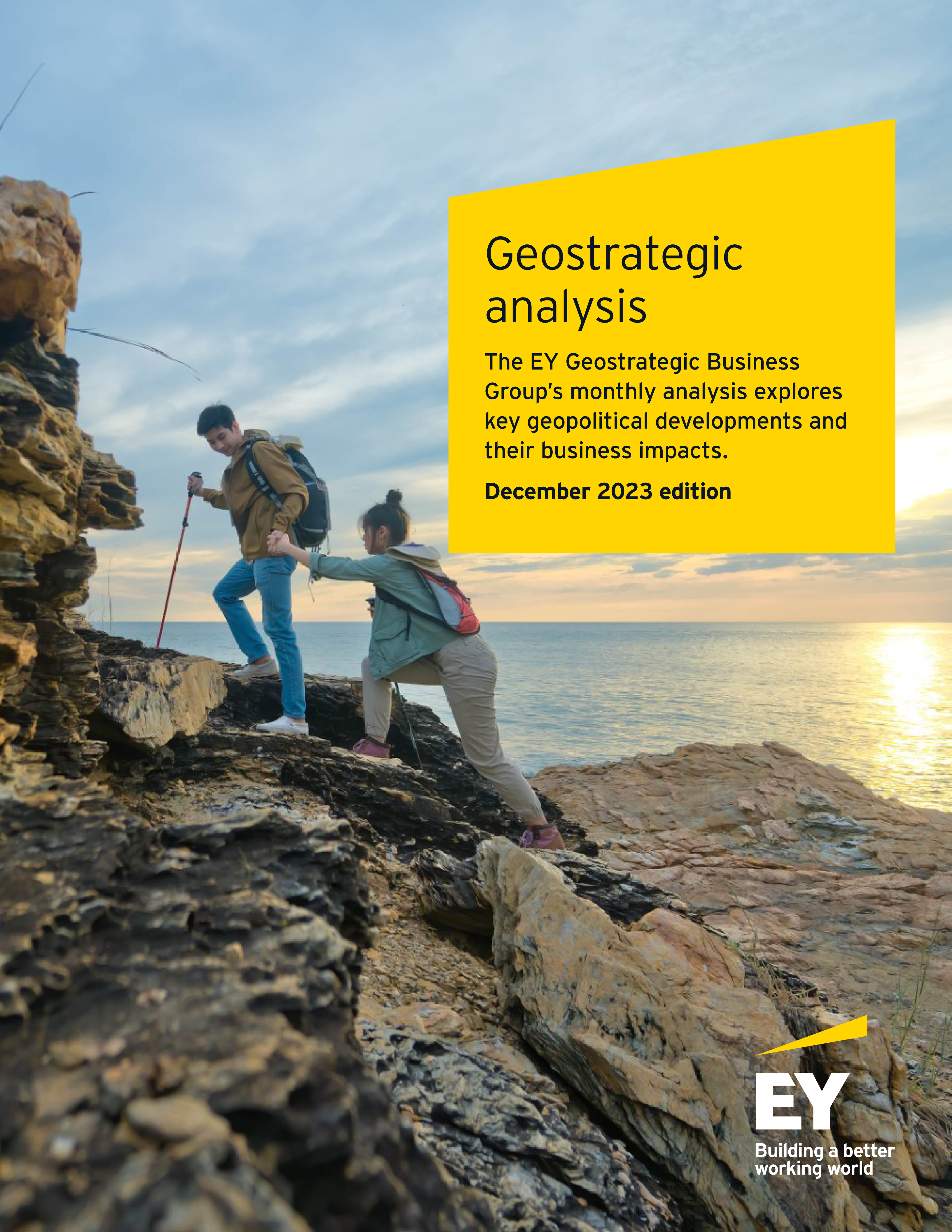
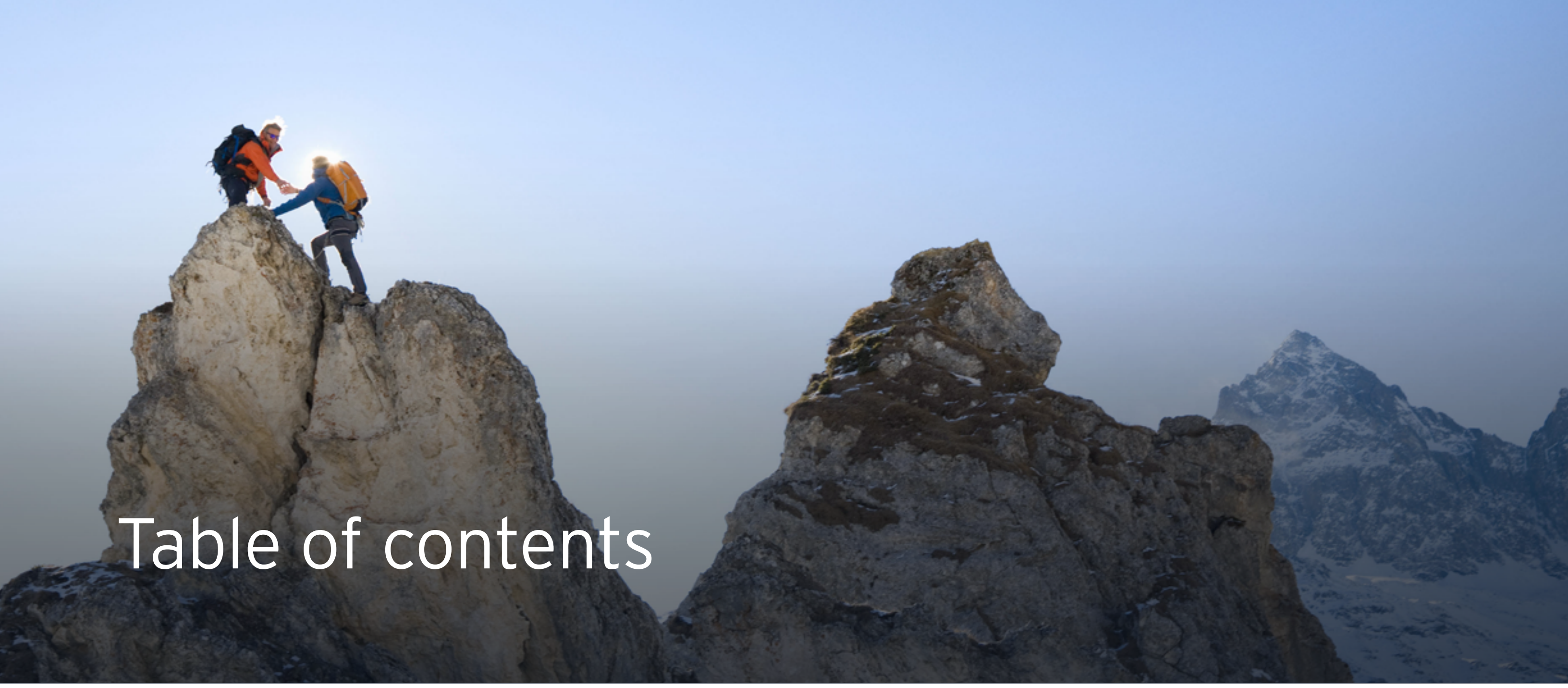


Geostrategic analysis

The EY Geostrategic Business Group's monthly analysis explores key geopolitical developments and their business impacts.

December 2023 edition

Building a better working world



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EY Geostrategic Business Group (GBG)
Translating geopolitical insights into business strategy

Read more.

Top development

Middle East conflict heightens regional uncertainty.

What happened

In the aftermath of the Hamas attack in Israel on 7 October, the most significant local conflict in decades has begun and it is unclear how long it will continue.

While violent incidents have also occurred in Iraq, Lebanon, Syria and Yemen, the conflict has not significantly escalated throughout the region.

Global and regional powers have engaged in diplomatic efforts to contain the conflict, including through intensive bilateral engagement and at multilateral summits held in Egypt and Saudi Arabia.

A temporary ceasefire took effect on 24 November, during which both parties released hostages and prisoners, and international aid was delivered to Gaza.

What's next

In the near term, the violence is likely to continue and could elevate tensions among various communities throughout the region.

Regionally, the conflict will test the durability of recent Abraham Accords normalization agreements between several Arab states and Israel, as well as stress other relationships such as between Turkey and Israel. It may also continue to delay or even derail US-backed negotiations on formalizing relations between Israel and Saudi Arabia.

Regional conflagration would become more likely if Iran or its proxies increase engagement on Israel's borders or further target US assets, or if Israel dramatically intensifies its military campaign.

Globally, other countries or non-state actors may seek to launch campaigns to redraw boundaries, while the US, Russia and others are focusing their attention elsewhere. The continued dispersion of geopolitical power may limit the policy options and diplomatic influence of global powers such as the US, EU and China if and when other regional conflicts emerge.

Business impact

Major sectors affected include government and infrastructure, energy, consumer, and technology, media and telecommunications.

Companies operating in the area, particularly small and medium-sized companies, are likely to face talent shortages as employees serve military duty and in other national security support roles. Some foreign companies may also seek to relocate some of their Israel-based staff to other countries.

Companies reliant on regional suppliers may face downstream impacts in the form of lengthier delivery times and reduced service levels. And regional shipping costs and delays may increase, putting pressure on global supply chains. Companies should consider improving real-time monitoring, resiliency and traceability of logistics and supply chains.

The conflict could disrupt natural gas production in the Mediterranean as offshore gas terminals are shut, which would likely pose significant implications for Europe as it heads into a second winter of the war in Ukraine. Gas consumers should prepare for higher costs and possible delivery delays.

Currency volatility could increase costs for companies with operations or business relationships in the region. Companies should revisit foreign currency holdings and hedging strategies.

Global oil prices would rise more significantly should the conflict spread, which would raise the cost of energy and other goods for both companies and households. This could lead to reduced consumer demand overall, given global inflation fatigue, at least on a short-term basis.

For more information, contact Ben-Ari Boukai and Courtney Rickert McCaffrey.

Additional reading: Top 10 geopolitical developments for 2024

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Sector in focus: government and infrastructure

China's global infrastructure strategy shifts toward green and digital investments.

What happened

China convened its third Belt and Road Initiative (BRI) forum in October, marking the tenth anniversary of its global infrastructure initiative, with a reported near 200 agreements in 140 countries and an estimated total investment value of approximately $1 trillion.[1]

BRI funding has declined in recent years and Western governments continue to raise concerns about its governance, lending practices, and sustainability credentials.[2] But China reaffirmed at the forum its commitment to support development in the Global South through investing in infrastructure networks.

What's next

The BRI's future strategy is expected to focus on smaller-scale projects in areas such as green energy and digital transformation that will provide new service opportunities for Chinese firms and secure critical resources such as green minerals from Latin America, while supporting Beijing's efforts to influence global geopolitical and economic security.[3]

Western governments are also recommitting to infrastructure investment as a foreign policy strategy, including the EU's Global Gateway initiative,[4] the G7 Partnership for Global Infrastructure, and the new India-Middle East-Europe Economic Corridor.[5]

Business impact

Seizing new opportunities for green and digital infrastructure investment will require government and public sector organizations to revisit their infrastructure strategies and determine where their objectives align with different international funding programs.

Investors will need to balance opportunities for financial returns with heightened political, economic and potential reputational risks. Infrastructure investors and construction firms should assess their sustainability and ESG capabilities in order to respond to multiple stakeholders and meet increasing reporting requirements.

For more information, contact Jay Young and Adam L Barbina.

Additional reading: How governments in developing countries can close the digital divide

[1] The Belt and Road Initiative: A Key Pillar of the Global Community of Shared Future (scio.gov.cn) http://www.scio.gov.cn/zfbps/zfbps_2279/202310/t20231010_773734.html
[2] China's Road to Ruin: The Real Toll of Beijing's Belt and Road (foreignaffairs.com) https://www.foreignaffairs.com/china/belt-road-initiative-xi-imf
[3] The path ahead for China's Belt and Road Initiative, economist.com, 6 September 2023. https://www.economist.com/china/2023/09/06/the-path-ahead-for-chinas-belt-and-road-initiative
[4] Global Gateway Forum: Stronger Together through Sustainable Investment. (europa.eu) https://global-gateway-forum.ec.europa.eu/index_en
[5] FACT SHEET: World Leaders Launch a Landmark India-Middle East-Europe Economic Corridor | The White House https://www.whitehouse.gov/briefing-room/statements-releases/2023/09/09/fact-sheet-world-leaders-launch-a-landmark-india-middle-east-europe-economic-corridor/

3 Other issues we are watching

EU-US cooperation, Biden-Xi summit and EU-China summit

EU-US cooperation even as trade talks stall

In October, EU and US leaders met in Washington DC, to advance transatlantic trade talks but did not deliver any significant outcomes.[6] A decision to permanently abolish US tariffs on European metals (including steel) was postponed. Agreement still needs to be reached on the potential exemption of US steel exports from the EU's Carbon Border Adjustment Mechanism (CBAM) and an EU anti-dumping investigation into Chinese steelmakers. The EU and US did, however, make progress on a critical minerals agreement.

Business impact: The proposed critical minerals agreement would enable European companies to access the tax credits and subsidies for electric vehicles (EVs) in the US Inflation Reduction Act. Once an agreement on metals is reached – potentially by year end – transatlantic trade will benefit from lifting US tariffs on metals and EU-US cooperation on carbon levies. In contrast, Chinese steelmakers may face 10% to 25% tariffs to access the EU market. Companies should ensure their supply chain strategy incorporates policies that favor trade with governmental allies and partners.

For more information, contact Famke Krumbmüller.

Biden-Xi summit positive for diplomacy, more neutral for business

China's President Xi Jinping met with US President Joe Biden on the sidelines of the Asia Pacific Economic Cooperation (APEC) summit in the US in mid-November. Tangible outcomes that had been widely expected were announced, including the resumption of military-to-military communications, cooperation to combat illicit drug manufacturing and trafficking and establishing government-to-government talks on artificial intelligence (AI). The two leaders also reportedly discussed geopolitical conflicts, US export controls and the situation in Taiwan – without resolving any of the underlying disagreements, as evidenced by the official readouts from China[7] and the US[8] highlighting different aspects of these conversations.

Business impact: The "candid and constructive" meeting between Presidents Xi and Biden followed months of high-level official bilateral engagement, and both sides committed to continue such dialogues. This diplomacy helps to establish a floor for US-China relations, reducing geopolitical uncertainty for businesses. The resumption of military-to-military communications will also reduce the risk to companies' supply chains and logistics in the South China Sea. But companies should not expect policy changes regarding export controls, investment restrictions, market access or intellectual property rights.

For more information, contact Courtney Rickert McCaffrey.

EU-China summit likely to reinforce economic de-risking, climate change cooperation

On December 7–8, EU leaders will meet Chinese President Xi Jinping and Prime Minister Li Qiang in Beijing to call for increased cooperation on tackling climate change and complying with Russia sanctions.[9] The EU will likely also raise a lack of access to the Chinese market for several European industries, such as renewables and telecom equipment. Chinese leadership may try to dissuade the EU from placing more restrictions on critical inputs to China's technology industry and will warn of potential disruptions to global supply chains due to the EU's carbon border tariffs and EV subsidy investigations.

Business impact: With this summit occurring during the COP28 summit, the EU and China may highlight opportunities to cooperate on biodiversity regulation, zero-emissions targets for the construction sector and carbon pricing initiatives. While European EV producers may temporarily benefit from potential tariffs on Chinese competitors as a result of the subsidy investigation, Beijing could in response limit exports of more critical raw materials, disrupting battery supply chains in Europe. Chinese technology companies could face supply chain and investment challenges due to expansion of EU economic security policies to more sectors such as AI, quantum, biotechnologies and semiconductors.

For more information, contact Famke Krumbmüller.

[6]U.S.-EU Summit Joint Statement (europa.eu) https://ec.europa.eu/commission/presscorner/detail/en/statement_23_5198
[7]President Xi Jinping Meets with U.S. President Joe Biden in Bali (fmprc.gov.cn) https://www.fmprc.gov.cn/mfa_eng/zxxx_662805/202211/t20221114_10974686.html
[8]Readout of President Joe Biden's Meeting with President Xi Jinping of the People's Republic of China | The White House https://www.whitehouse.gov/briefing-room/statements-releases/2023/11/15/readout-of-president-joe-bidens-meeting-with-president-xi-jinping-of-the-peoples-republic-of-china-2/
[9]EU-China summit – Consilium (europa.eu) https://www.consilium.europa.eu/en/meetings/international-summit/2023/12/07-08/

Geostrategic indicator of the month

EY Sustainable Value Study 2023

The indicator

EY research based on a survey of 520 chief sustainability officers (or equivalent sustainability leaders) of large public and private organizations worldwide indicates government actions accelerate companies' sustainability agendas more than they inhibit them. Most notably, 52% of organizations view the availability of government subsidies and incentives as an accelerator to their sustainability programs. About one-third of organizations also see government regulations and geopolitics as accelerators of private sector sustainability efforts.

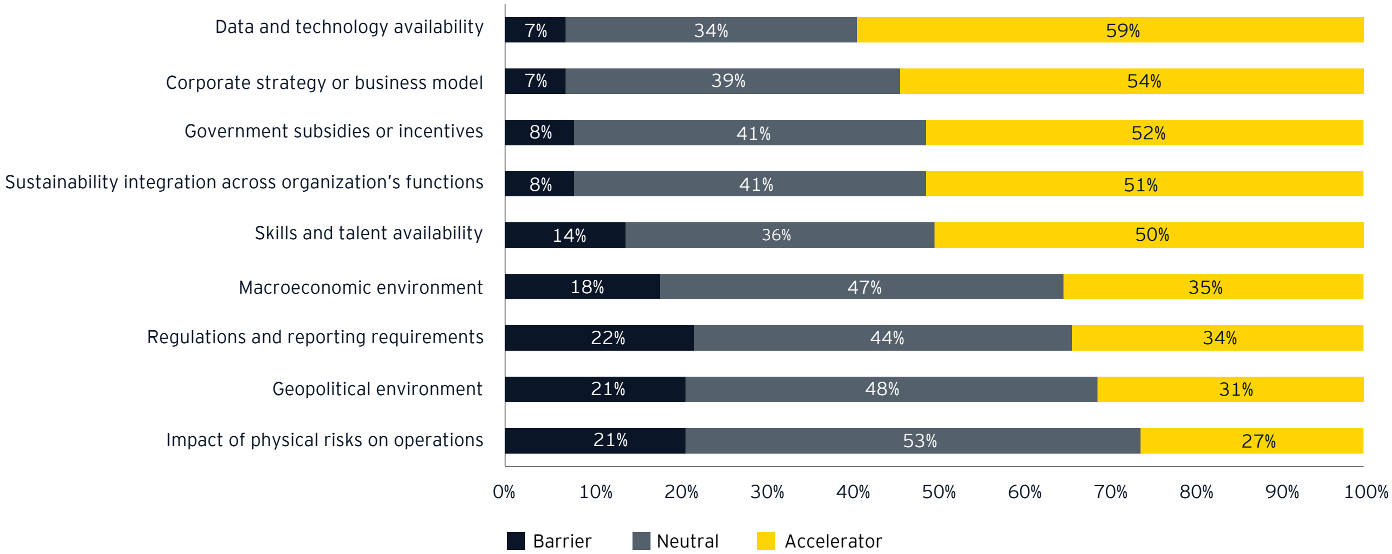
Business impact

The ongoing 2023 United Nations Climate Change Conference (COP28) summit will include the conclusion of the first Global Stocktake, an assessment of the world's progress toward achieving its climate goals. This assessment could motivate governments to take more climate actions in the years ahead. While some climate regulations may lead to higher short-term costs for companies, they could also help to reduce reputational risks and are likely to present more sustainable growth opportunities for the long run.

Additional reading: How can slowing climate change accelerate your financial performance?

Leading companies are using government incentives and regulatory requirements to accelerate sustainability programs

Assessment of how factors influence organizations' sustainability initiatives



Source: Source: EY Sustainable Value Study 2023

Contacts

Oliver Jones
London
oliver.jones@uk.ey.com

Angelika Goliger
Johannesburg
angelika.s.goliger@za.ey.com

Mary Karol Cline
Washington DC
mary.k.cline@ey.com

Courtney Rickert McCaffrey
Washington DC
courtney.r.mccaffrey@ey.com

Adam Barbina
New York
adam.l.barbina@parthenon.ey.com

Ari B. Saks Gonzalez
Mexico City
ari.b.saks.gonzalez@mx.ey.com

Ben-Ari Boukai
Washington DC
ben-ari.boukai@parthenon.ey.com

Jay Young
Dallas
jay.young1@parthenon.
ey.com

Famke Krumbmüller
Paris
famke.krumbmuller@
parthenon.ey.com

Takeshi Konomi
Tokyo
takeshi.konomi@
parthenon.ey.com

David Kirsch
Houston
david.e.kirsch@ey.com

Nobuko Kobayashi
Tokyo
nobuko.kobayashi@
parthenon.ey.com

Alessandro Faini
Paris
alessandro.faini@
parthenon.ey.com

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