The new era of geopolitical volatility

By Tina Fordham

Trusting Truss: Although popular, Liz Truss's promise of tax cuts seem unlikely to materialise

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Russia's invasion of Ukraine has entered its sixth month, marking a second de-globalising shock to the international system following the COVID-19 pandemic. The Russo-Ukrainian war shows no sign of resolution; indeed, the prospects of Putin delivering a "September Surprise" are rising. At the same time, tensions between the US and China over Taiwan are not de-escalating. Quite the opposite, with military exercises between the US and its allies in the region stepping up and China engaging in more aggressive incursions, even as Chinese President Xi contends with a slowdown at home.

With economists predicting a global recession and amid the transformation of the geopolitical landscape, investors need to prepare themselves for a more volatile period, where politics are leading the economic and policy response, and not the other way around.

As part of our underlying assumptions, we should expect the conflict in Ukraine to continue into 2023, and possibly longer, with sanctions against Russia lasting indefinitely. My expectation is that US and EU unity in countering Russia's attack on Ukraine will endure, as the tide has gradually turned to the view that Ukraine needs to emerge victorious from the war. Hopes for a negotiated settlement or ceasefire are unfounded, given that neither side is anywhere near ready to surrender. Even in the face of what promises to be a very challenging winter in Europe, with blackouts, rationing and factory closures, there will be no return to reliance upon Russia as an energy supplier. In the best-case scenario, the end of reliance upon Russia will help to accelerate Europe's green energy transition. But the coming winter of discontent will put immense pressure upon policymakers already challenged by recession and inflation, and lacking experience managing either.

Against this backdrop of recessionary pressures, inflation challenges and geopolitical volatility, 160,000 UK Conservative party members will elect a new party leader to replace Boris Johnson,

Prepare for volatility: A period where politics are leading the economic and policy response

Italy will go to the polls to elect a new government following the withdrawal of support for Mario Draghi's caretaker government coalition, and US Midterms will take place in November. Each of these political contests is significant for markets, and each will be influenced by the polarisation, populism and post-truth politics that have gained momentum since the Global Financial Crisis. While there will be no change in government in the UK, the next British prime minister will take office at a time when one forecast by a leading investment bank suggested that UK inflation could skyrocket to as high as an eye-watering 18 per cent.

Above: The US midterms in November may defy tradition

The current favourite for the job, Liz Truss, owes much of her popularity over her rival, former chancellor Rishi Sunak, to a promise of tax cuts that seem unlikely to materialise. In Italy the neo-fascist inclinations of Giorgia Meloni's I Fratelli party have been smoothed over in a Marine Le Pen-style makeover that point to Ms. Meloni becoming Italy's next prime minister. Unlike her fellow far-right party leader, Matteo Salvini of Lega Nord, she has insisted that her government will maintain support for Ukraine and she has not campaigned on an overtly Euro-exit platform. Nevertheless, it is difficult to imagine markets rewarding her government with the same degree of confidence as was enjoyed by the previous Italian PM, former ECB Chief Mario Draghi, and reports of Kremlin influence upon European far-right parties should be taken seriously.

In the US, the longstanding conventional wisdom has been that the party in power in the White House tends to get a bloody nose from voters during the Midterms; indeed, most pundits have long predicted Democrats would lose both chambers of Congress in November. But the recent string of legislative successes President Biden has enjoyed plus the easing of US inflationary pressures may mean it is time to revisit this assumption. My

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biggest source of concern when it comes to global political risk remains the US Presidential election in 2024. With its combination of low trust/high degree of belief in conspiracy theories, outlier status as the only developed country with deteriorating health and wellbeing indicators, rising inequality plus high and rising tolerance for political violence, I expect that 2024 is going to test the US polity and political system to a degree not seen since the Civil War. As long as Wall Street performs, US investors have typically dismissed US political risk; I predict we are now approaching a tipping point.

With so many risks and concerns to track and monitor, I am often asked about the good news. The best news is that many of these negative trends are reversible and the drivers of risks can be alleviated with sound policy choices and social cohesion. Geopolitical risks are not like seismic activity or hurricanes - true forces of nature - but rather the interplay of mainly human-led decisions. Part of what is required to improve the outlook is for us all to become more active citizens, and by doing so, acknowledge that the age of being able to afford the luxury of ignoring politics has come to a close.

18%

Citi Bank's prediction for inflation in 2023

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