Geostrategic Business Group

2020 Geostrategic Outlook

Global rebalancing raises uncertainty for business

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Building a better working world

A transformative age in geopolitics

Contents

Note: Unless otherwise noted, all figures are in US dollars.

geostrategy

ge·o·strat·e·gy
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(geo)politics + strategy

Foreword

Volatile. Unpredictable. Risky. Challenging. These are just a few of the words business leaders use to describe the current political environment in a recent survey on managing political risk that we conducted. More than half of respondents told us the effect of political risk on their company is higher than it was two years ago. Accordingly, 58% of respondents told us that their board is spending more time on political risk.

We are living in a transformative age of geopolitics, a time when both a fundamental growth driver for global business — globalization — and the balance of power among the world's largest economies are changing.

Change brings uncertainty. As this transformation unfolds, a more fragmented global economy may emerge, marked by higher levels of political risk and greater uncertainty associated with cross-border transactions. This uncertainty and pace of change challenge leaders to craft long-term, global business strategies. Dynamism, agility, resilience and new ways to manage risk will all be required to thrive amid this geopolitical disruption. Companies need to incorporate geopolitics into their strategy. This is what we call "geostrategy."

To strategize and, ultimately, to act, executives need to understand the deeper forces at work in this transformative age of geopolitics. It is imperative to go beyond the headlines to understand how the primary interconnected forces of change impact the geopolitical environment in which companies must navigate.

In this outlook, we dive into these primary forces of change and look at how they are unfolding, geopolitically, around the world in 2020. We analyze how emerging shifts in globalization, technology, demographics and the environment affect geopolitics and, ultimately, how these shifts are changing the reality in the key markets in which businesses operate.

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The geopolitical landscape

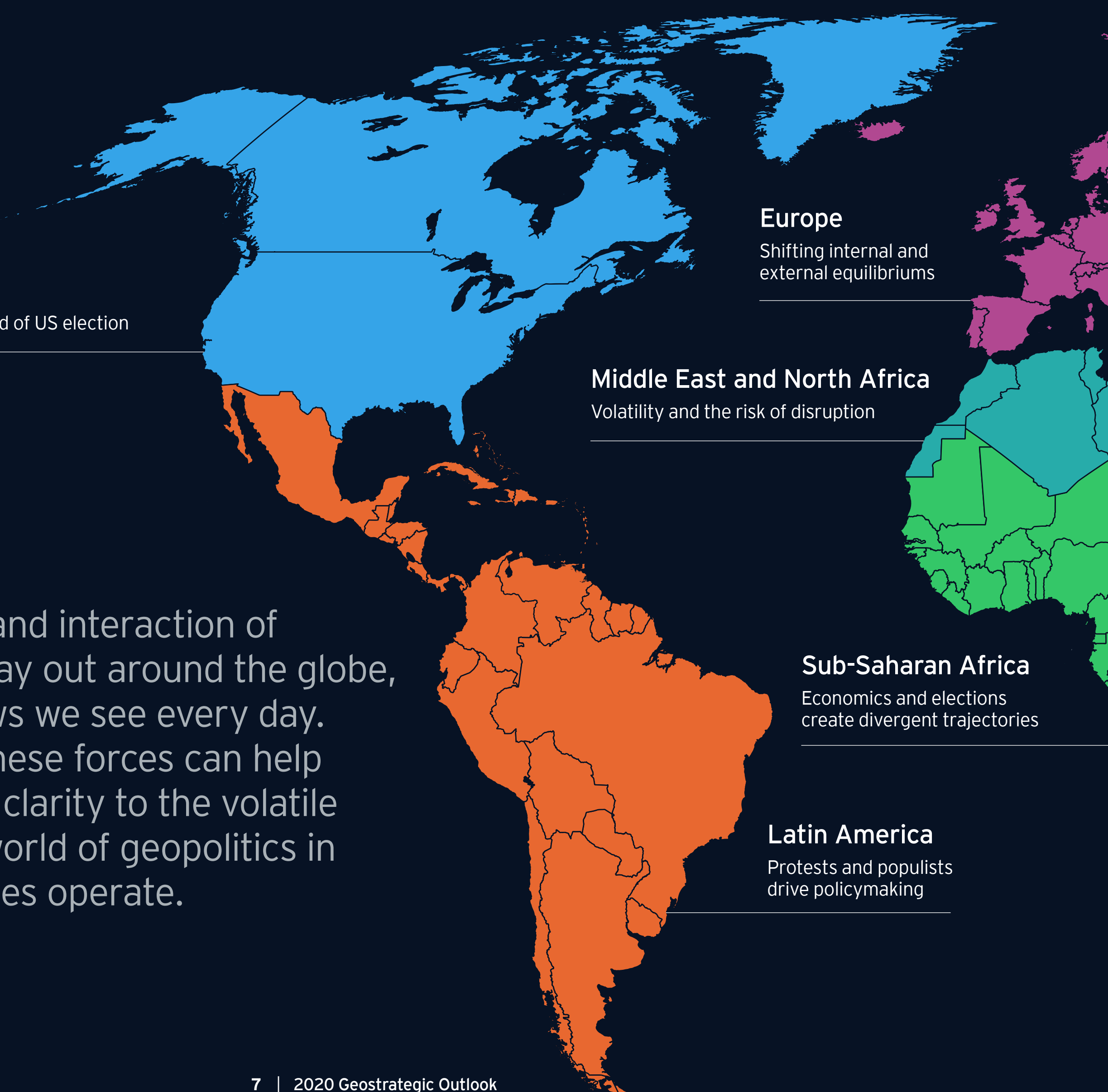
The geopolitical landscape

Scanning the geopolitical environment is the first step in navigating the transformative age in geopolitics. In this outlook, we offer our scan of the geopolitical landscape in 2020.

The geopolitical outlook in 2020 will be shaped by what we see as the primary forces of disruption: globalization, technology, demographics and the environment. These forces have existed for millennia but are now evolving in new ways.

These primary forces manifest themselves in key issue areas, as well as regionally, shaping the operating environment for companies. In this report, we explore how these four forces play out within each region. We also spotlight two cross-cutting geopolitical issues — global trade and US-China relations — critical to the business environment in 2020.

Geopolitics in a world of regions



> The evolution and interaction of these forces play out around the globe, driving the news we see every day. Appreciating these forces can help bring strategic clarity to the volatile and unstable world of geopolitics in which businesses operate.

Primary forces

Globalization

The shift from ever-expanding globalization toward rising regionalization of the global economic and political systems is accelerating.

Technology

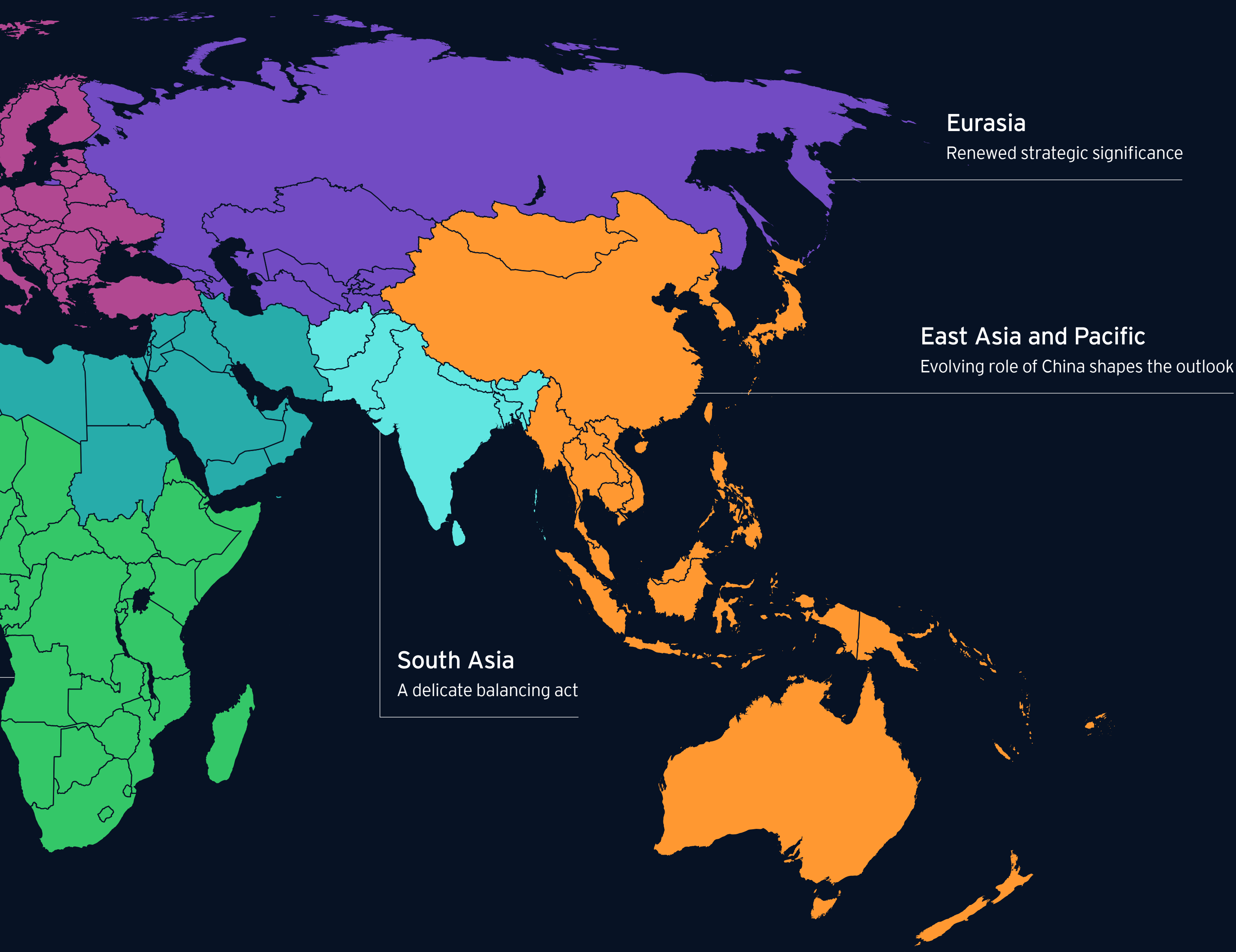
The fourth industrial revolution promises long-term gains in productivity yet is accelerating geopolitical competition and exacerbating social and economic grievances at the heart of populist movements.

Demographics

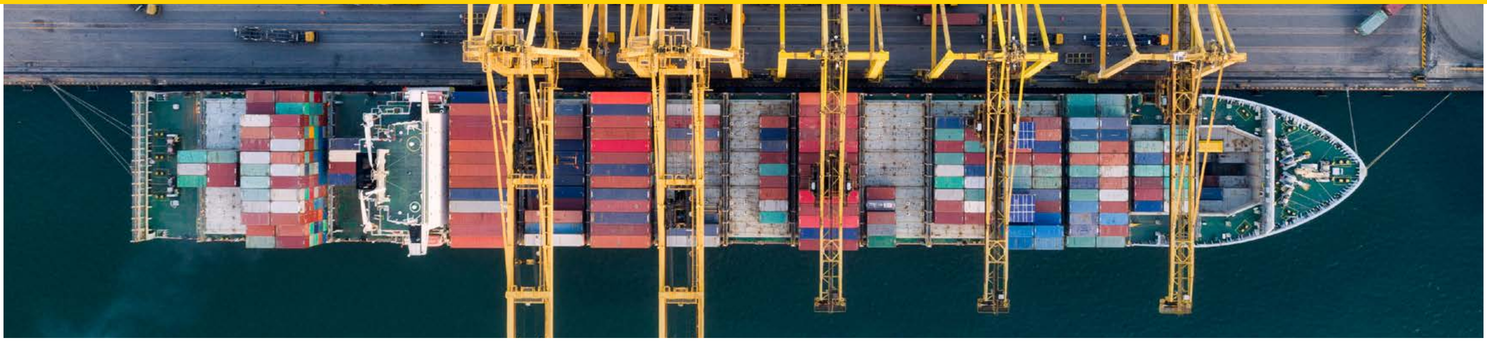
Risks to political stability are rising in countries with very old or young populations, even as the geopolitical balance of power shifts in favor of economies with sustainable working-age populations.

Environment

Climate change is becoming a race against time for government, business and society to develop solutions that prevent the worst consequences of this pre-eminent global risk to materialize.



Primary forces



Globalization

Emergence of a new regionalism

The assumption that globalization would continue to expand helped drive global expansion over the past 30 years; **companies tied their economic fortunes and strategic outlook to a relatively predictable global system.**

That is not the world that companies face today. The rise of populism has unleashed strong anti-globalization sentiments in countries around the world. As governments respond, policymakers are now prioritizing regional organizations and alliances. **This has resulted in a shift toward rising regionalization of the global economic and political systems.**

On the one hand, the new regionalism reflects a continuation of cross-border economic integration. East Asia is a key driver of this trend, first with the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) and now with the Regional and Comprehensive Economic Partnership (RCEP).

On the other hand, regionalism represents the increasing fragmentation of the global economy into smaller blocs. The ability to effectively conduct business across certain regions is likely to decrease as these geo-economic blocs integrate more fully internally. This is clearly visible in the declining influence of the World Trade Organization (WTO) to govern cross-border trade. Technology is another area in which the interoperability of competing regional systems will increasingly affect companies' ability to conduct cross-border business.

This global rebalancing is also creating new economic blocs and political centers of power. **This emerging multipolar system is anchored by the US, China and the EU.** Each of these economies has smaller regional economies within their orbit. And the governments of each bloc will accelerate their efforts so their standards and systems are adopted throughout their spheres of influence. Witness, for example, the intense competition between the US and China in the development of 5G wireless networks. The EU's leadership in technological regulation offers another case in point.

As the emerging blocs consolidate their power, relations between them will be volatile. The US is retreating from its international leadership, China is playing a bigger role in geopolitics and Europe is seeking a more cohesive projection of its own power. The US and China are being challenged to form a new relationship under the more confrontational approach to bilateral relations pursued by the US administration. And although transatlantic cooperation anchored global stability for 70 years, the US and EU are beginning to see each other as competitors. The EU and China relationship will continue to be complex, characterized by both further economic integration via the Belt and Road Initiative (BRI) and rising levels of competition and distrust.

Complicating geopolitics further is that while these poles are consolidating power, the nature of power is changing. Economic clout is becoming a, if not the, dominant dimension of power, competing with military and political capabilities. Also, **asymmetric conflict — most notably cyber threats — allows countries with lower levels of traditional geopolitical power to wield outsized influence** on the global operating environment.

As these dynamics play out, the rules of the game are shifting, creating new uncertainties around global strategies. **The proliferation of bilateral and regional trade pacts, declining influence of the WTO, rising use of sanctions, intensifying competition between major economies and expanding political restrictions on investment all shift business calculations and strategy around global growth opportunities and risk management.** The new regionalism will require multinational companies to develop regional supply chains and tailor products for regional consumer markets.

Primary forces

Technology

Accelerating global competition

The technologies of the fourth industrial revolution promise long-term gains in efficiency and productivity, but they also have disruptive geopolitical and social consequences. Transportation and communication costs will drop, while logistics and supply chains will become easier to manage. These technological improvements hold the potential to diminish the cost of international trade, open new markets and drive economic growth.

At the same time, technology catalyzes geopolitical competition. This is especially true in an era of emerging regionalism in geopolitics. Governments are seeking to ensure that they — or companies headquartered within their borders — develop the capability to build the crucial technologies of the fourth industrial revolution. **Such technological sovereignty is even more important today because artificial intelligence (AI), 5G wireless networks and other digital technologies form the backbone of the entire 21st century digital economy.**

Countries that dominate these digital technologies will occupy a stronger position relative to their less technologically advanced competitors. This is true not only in terms of economic competitiveness and military power, projected through cyber war or remote-controlled drones, but also for expanding geo-economic zones of influence. Technological prowess enhances the ability of a government to exercise control over zones of economic and political influence and to determine the "rules of the road" of political and economic cooperation. **The US, China and the EU are at the forefront of this competition.** None wants to be dependent on technologies that could be controlled by foreign political influences. This sits at the heart of the current debate about which country will dominate the rollout of 5G technology.

Although technological advancement is crucial for economic and geopolitical competition, it also creates domestic political risks. One of the most notable risks is technology's effect on the labor market. While estimates of the number of jobs that will be destroyed by new technologies vary widely, many economists and policymakers are concerned about robotics and AI generating large-scale labor displacement. This is particularly salient in an era of populism and anti-globalization sentiments, as technology risks coming under fire for contributing to underlying economic woes, such as inequality. **To maintain domestic political stability in the coming years, governments will need to manage these tensions and collaborate with companies to retrain workforces to help them keep pace with new technologies.**

Another area in which domestic politics and technology will increasingly collide is digital privacy norms and regulations. As social media, connected devices and other digital technologies play an increasingly large role in people's lives, public concern about the use of their data and necessary safeguards is rising. **Governments are taking action in various ways, including data localization requirements and new digital privacy laws.** These privacy regulations represent another area of geopolitical competition, with the EU currently setting the global standard with the General Data Protection Regulation (GDPR). The US and China will not simply follow the EU's lead, however, so companies will likely face competing privacy regulations in the world's three major geo-economic blocs in the coming years.

Primary forces

Demographics

Aging catalyzes global rebalancing

We are in the midst of transformative demographic change. Even though the global population is set to climb to almost 7.8 billion in 2020, the growth rate is slowing significantly, forecast by the UN Population Division at just 0.98% annually during the next five years. Even more notably, the global population is getting older, with the worldwide median age set to surpass 30 years for the first time in 2020. As a result, the global working age population as a share of the total peaked in 2015. **But this aging is not equally distributed, creating risks to domestic political stability in countries with either very old or young populations and shifting the geopolitical balance of power in favor of economies with sustainable working-age populations.**

Europe, where 19% of its residents are 65 years of age or older, is the region with by far the oldest population. Japan has the highest elderly population in the world, though, at 28%. Other G20 economies must also contend with elderly populations that exceed 20% of their total population, among them Italy, Germany and France. China, Russia and South Korea are also aging at a rapid rate.

Aging populations present political and economic challenges. Domestically, aging populations weigh on economic growth prospects. With fewer working-age people, governments will need to combat economic stagnation and ensure the sustainability of pension systems. This includes measures such as raising the retirement age, encouraging greater workforce participation, welcoming immigrants and increasing the fertility rate. Each of these policies comes with political risks and require significant fiscal resources, making implementation difficult and, in some cases, unlikely. **Aging could reduce many countries' economic clout on the global stage, resulting in corresponding shifts in geopolitical power.**

The youngest region in the world is Sub-Saharan Africa, where the median age is just 18.7 years. South Africa, in fact, is the youngest G20 country, with about 45% of its population under 25 years old. More than 40% of the population in India, Mexico, Indonesia and Turkey is similarly young. Countries that harness the economic potential of this youth bulge may see their stature on the geopolitical stage rise in the coming years.

But successful integration of large youth populations into the workforce requires government policies that both promote education and skills development and foster entrepreneurship and private sector job growth. Without such supportive policies, a youth bulge increases political risk. Countries with a large number of economically inactive or disadvantaged young people are prone to social unrest. Witness the large protests that erupted in Chile, Lebanon, Iraq and elsewhere in 2019.

The aging global population is also affecting geopolitics through generational dynamics in two ways. First, is an escalating inter-generational conflict over key policy issues, such as the environment and the social safety net. Younger generations are taking to the streets, afraid that their economic future and the ecological environment in which they will live are very much at risk. Second, is an emerging generational handoff in political power. French President Emmanuel Macron and Saudi Crown Prince Mohammad bin Salman are just two notable examples of this trend. **We could see a shift in geopolitical relations as the collective experience of the world's leaders ceases to include the height of the Cold War, the pre-9/11 era and other defining moments.** In this interim period in which multiple generations are in power, the likelihood of misunderstandings or miscalculations is higher, creating greater uncertainty and volatility in geopolitics.

Primary forces

Environment

Racing against the clock

Just 30 years after the International Panel on Climate Change issued its first warning that human activities were substantially increasing the atmospheric concentrations of greenhouse gases, we are beginning to see significant impact today. Greenhouse gas emissions have risen at a rate of 1.5% per year over the last decade,[1] and global mean surface temperature is increasing. **The economic consequences of climate change are already significant.** The International Labour Organization estimates that nearly 1.2 billion jobs rely directly on the effective management and sustainability of a healthy environment. And climate-related disasters have cost the world an average of almost $200 billion annually over the last 10 years, according to Munich RE.

Climate change is a transnational issue that requires a globally collaborative policy response. It is a race against time for government, business and society to develop solutions that prevent the worst consequences of this pre-eminent global risk from materializing. **But the global rebalancing from a unipolar to a multipolar world complicates efforts to mitigate climate change because no single country can lead the world on this issue.**

Making global governance even more challenging are the populist, anti-globalist sentiments in the US, which led to the American withdrawal from the Paris Agreement. This decision left the rest of the signatories at a loss for how to affect global change without the world's largest economy and second-largest polluter.[2] The way forward is likely to be determined by coordination between the EU — which in December 2019 agreed on a Green Deal that would make Europe the first climate-neutral continent by 2050 — and China, which is both the world's largest emitter of greenhouse gases and its largest renewable energy producer.

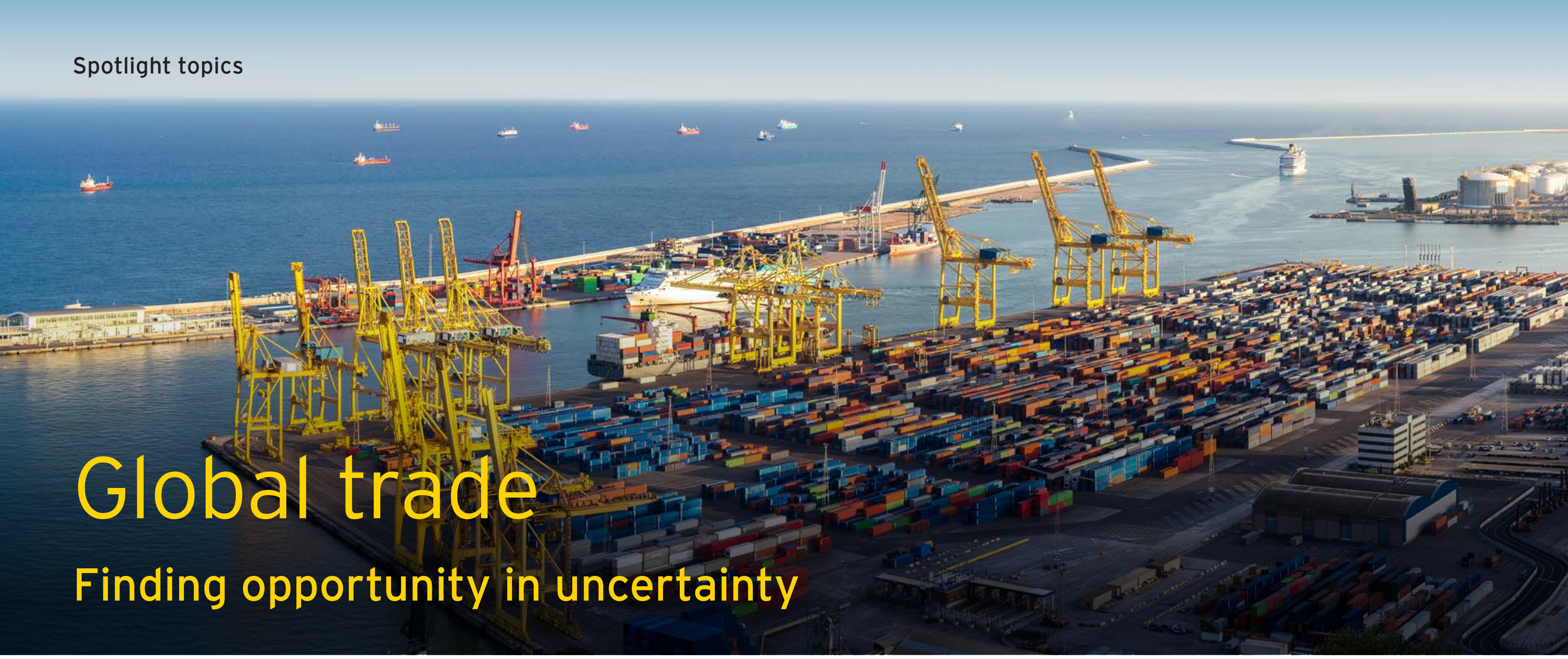
Further complicating the geopolitics of this issue is the fact that the distribution of climate change impacts is not equal. Countries with warmer climates, which are primarily emerging and frontier markets, suffer more from rising global temperatures. The International Monetary Fund estimates that a 1° C increase in the median emerging market economy lowers economic growth by 0.9 percentage points, and by 1.2 percentage points for frontier markets. Natural catastrophes caused by a changing climate also have a particularly dramatic effect on people's livelihoods in less developed economies, as mitigation and response efforts are likely to be less robust. **Climate change could, therefore, shift the geopolitical balance of power, disadvantaging countries that receive the brunt of its consequences.**

Climate change may also affect geopolitics by increasing the likelihood of armed conflict or causing large-scale migration flows in the future.

The fight against climate change is not just about governments; civil society and companies are also engaged. A rising number of companies are incorporating sustainability into their core business models, and many companies are also reporting their climate change risks and mitigation strategies to investors. Such actions not only make sense for the long-term viability of companies, but also for short-term performance as customers increasingly demand more environmentally sustainable products. Civil society is engaged in climate change more broadly as well. This has been most visible recently in the Fridays for Future movement, catalyzed by Swedish teen climate activist Greta Thunberg, in which young students worldwide strike during school on selected days to protest political inaction on climate change.

Spotlight topics

Global trade and US-China relations



Global trade

Finding opportunity in uncertainty

There is a new normal in global trade. Trade policy now finds itself in the unprecedented role as both the driver of macroeconomic and geopolitical events and subject to geopolitical considerations as geostrategic competition and rivalry between the three major economic blocs increasingly trumps the rules-based trading system. In this new reality, global economic governance will be more competitive and less cohesive, providing a greater role to players besides the US. These developments are likely to become a semi-permanent fixture, prompting companies to reconsider how to manage cross-border activities.

Trade policy today is driven by larger concerns over competition between countries, national security and the role of technology. Populism and nationalism in key markets have also led to changing trade relationships. The US, in particular, has used trade policy as its tool of choice to address concerns with other countries' economic models and trade practices.

While the current tensions between the US and China may have started on the trade front, for instance, **trade policy is only one part of US-China tensions**. China and the US are seeking to effectively decouple bilateral technology linkages through efforts to prohibit the acquisition of each other's technology products. Although China and the US have paused the escalating tariff war with the recently signed "phase one" agreement, the structural nature of the conflict and the mutual lack of trust mean it is unlikely the two sides will resolve their fundamental differences through some form of "grand bargain." The new normal, therefore, sets the stage for a fundamentally unstable economic relationship between the world's two largest economies for the foreseeable future. The resulting uncertainty has already contributed to the slowdown in the global economy and is likely to continue to provide headwinds for growth.

Brexit and its impact on the EU and the UK also continue to disrupt international trade and the global economy. While the December 2019 UK election brought some measure of political clarity, the ability of the UK and the EU to negotiate a fully formed trading relationship by the end of 2020 seems unlikely, if not impossible. This will continue to create considerable uncertainty for cross-border trade of goods and services between the UK and the EU. Supply chain disruptions have affected growth prospects for the remaining members of the EU.

The increasing weakness of the WTO compounds these disruptions. This vulnerability stems from the realization that the organization has been unable to rein in measures that were incompatible with WTO rules by its largest member (the US) nor address market-distorting actions by its second largest member (China). Moreover, the recent expiration of the WTO Appellate Body eviscerates the WTO's dispute settlement mechanism, which calls into question WTO members' ability to manage the inevitable tensions that will arise. This is problematic for companies and countries across the globe, particularly smaller nations that have relied on this rules-based system to even the playing field.

These developments will continue to impact growth and create tremendous challenges for business. There are some positive trade developments, however, in the form of regional trade agreements and the emergence of potentially new global economic governance models.

The United States-Mexico-Canada Agreement (USMCA) is a prime example. **Although it provides little in the way of new liberalization, it does reconfirm the commitment to the North American trade bloc — no trivial outcome in the case of the US trade policy.** Trade agreements in Asia (CPTPP and RCEP) also demonstrate that regional models for economic integration can move forward, even without US participation. And the EU continues to negotiate high-standard agreements across the globe, notably with Japan, Vietnam and the Mercosur nations. Given the new EU Commission's emphasis to combine regulation with industrial

Various developments will affect the level of trade policy uncertainty that companies face in 2020

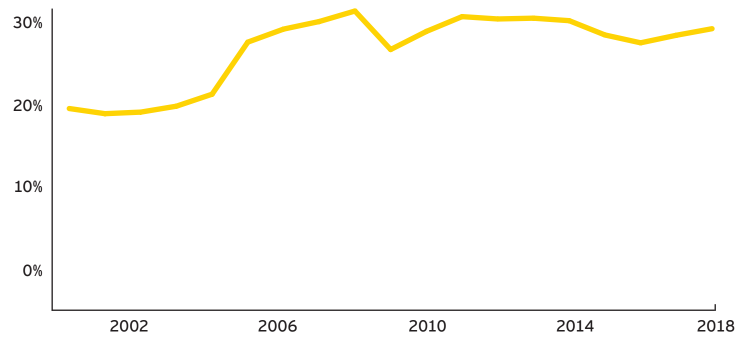
▲ Increase ▼ Decrease ■ Neutral

Trade development	Impact on uncertainty
Ongoing US-China tensions	■ ▲
Brexit	■ ▲
USMCA	▼
WTO dispute settlement and reform	▲
Conflicts over digital taxes	▲
CPTPP and RCEP trade agreements	▼

Source: EY analysis.

Exports have stagnated as a share of the global economy since the global financial crisis

Goods and services exports as percentage of global gross domestic product (GDP)



Source: EY analysis; UNCTAD; WTO and ITC secretariats' calculations; World Bank.
Note: Services data included 2005–18.

policies that promote competitiveness, it would appear that Europe is seeking to provide an alternative economic model to the US and China. An EU that avoids the excesses of US unilateralism and China's state intervention would help to stabilize the rules-based trading system.

Business implications

Strategy
Companies need to monitor global trade developments and work through the impacts on their business. Given the inherent uncertainties, this becomes less of an exercise in forecasting than in building resilience and flexibility into their strategic planning process. Capacity needs to be developed to manage this challenge across the different corporate functions.

Finance and tax
Both the imposition of new tariffs and the reduction of tariffs through regional trade integration have a significant effect on company finances. Executives should use systems and data tools to understand how this will impact margins and revenues and then use tax and supply chain mitigation strategies to maximize those within the context of corporate and operational strategies.

Operations and supply chain
Global supply chains continue to characterize the world economy, but companies are re-examining them as they respond to new protectionist measures. For many companies, this means assessing landed costs and optimizing sourcing, production and distribution in a more complicated and fluid environment.

Reputation and compliance
High tariffs in certain sectors incentivize efforts to misrepresent origin, leading to heightened levels of enforcement and potential negative effects on growth. The cost and complexity of compliance will also rise as new export control regimes and further restrictions on cross-border investments are put in place. As a result, companies will need to continue elevating and prioritizing their compliance functions and integrate them into the companies' political and business risk management.

Issues to watch

- Can the world's two largest economies, the US and China, define and establish a new economic relationship, or will their relationship continue to engender bilateral and global uncertainty?
- Will the US focus its more protectionist-oriented policies on Europe and seek to rebalance its relationship beyond existing contentious issues (e.g., aircraft manufacturing)?
- What will be the supply chain and regulatory implications of Brexit?
- Will major countries develop a process for addressing WTO reform that will restore that organization's role in the rules-based trading system?

US-China relations

Navigating strategic interdependence

Over the past few decades, US-China rapprochement and cooperation created one of the world's most highly interdependent economic relationships. Since 2000, the year China joined the WTO, two-way foreign direct investment (FDI) has reached nearly $385 billion.[3] In 2018, China was the US' largest trading partner with goods and services trade totaling an estimated $737.1 billion, according to the Office of the U.S. Trade Representative. In addition, the U.S. Department of the Treasury estimates that China holds approximately $1.1 trillion in U.S. Treasury securities, representing 16.2% of foreign ownership of U.S. treasuries.

Politically, however, the US-China relationship is increasingly strained. Beijing seems to see the US as a declining power that is attempting to maintain its political, economic and military dominance through preventing China's inevitable rise. Meanwhile, in Washington, a political argument is being made that China needs even more efforts to move toward a more open economy and to demonstrate a commitment to the rules-based international system.

Efforts to describe this relationship as a new "cold war" or as moving toward "decoupling" are inaccurate, however. While decoupling may help to describe the process of unwinding some elements of the US-China relationship, it is not the full picture. **Bilateral economic interdependence remains strong.** Economic impact, loss of growth markets and increase in trade in services all provide very real disincentives for the complete decoupling of these two economies. The more accurate characterization of the Sino-American relationship is, therefore, strategic interdependence.

Locked in strategic interdependence, US-China relations are increasingly defined by growing competition. It has become clear that **the relationship between these two powerhouses will shape the course of the global economy, geopolitics and the global business environment for decades to come.**

The primary areas of contention are trade, market access, intellectual property, currency and Chinese industrial policies. And encompassing aspects of many of these areas of economic contention is technology competition. In addition, non-economic areas of contention between the US and China are broad and deep. These tensions cut across the entire spectrum of bilateral political and military relations, including technological security, maritime territorial claims, human rights, the supply of fentanyl and conflicting views on Taiwan and Hong Kong.

The US and China have taken a piecemeal approach to addressing these issues, signing a limited "phase one" deal in January 2020. The modest "phase one" deal relates primarily to trade — removing some US tariffs on Chinese goods and committing Beijing to increased agricultural purchases. **But the shadow of the future will weigh on the US-China relationship in 2020.** The US Government has a time horizon of less than 11 months (i.e., until the presidential election); the Chinese Government, at least a decade or more, with President Xi Jinping's term limits removed. These diverging time horizons will keep the US-China relationship in a constant state of imbalance and volatility.

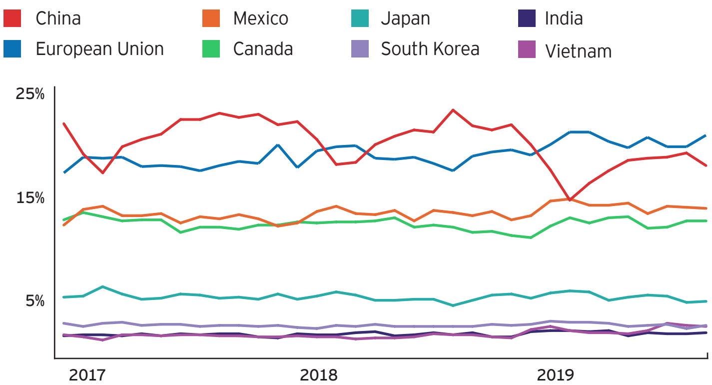
Business implications

Strategy

Entering into or expanding in the Chinese market requires business strategies that take into account what the US considers China's industrial policies that favor domestic firms over foreign firms, including subsidies, tax breaks, low-cost loans, foreign trade and investment barriers, technology transfer and joint venturing mandates, and perceived discriminatory IP and technology policies. This policy landscape is shifting, though, with the new Foreign Investment Law that came into effect January 1. It further opens the Chinese market and levels the playing field for foreign businesses competing with domestic companies, potentially creating new opportunities.

Despite trade tensions, there has not been a structural transformation of US trading relationships

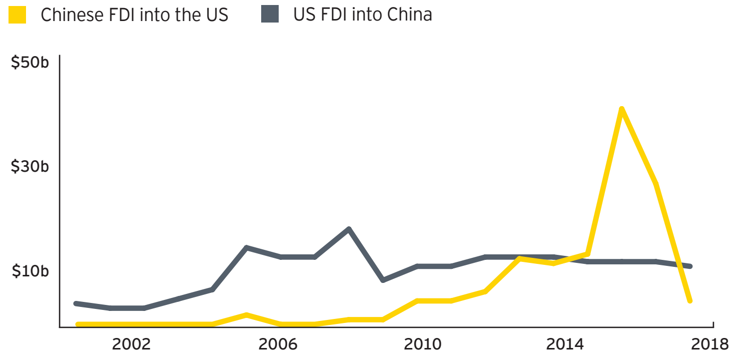
Share of US goods imports, monthly



Source: US Census Bureau.
Note: Not seasonally adjusted. Data includes eight largest import partners as of 2018.

US foreign direct investment (FDI) in China has remained consistent in recent years while Chinese FDI in the US has plummeted from 2016/2017 highs

US-China FDI flows



Source: Rhodium Group.

Finance and tax
Tougher US screening of Chinese investments will continue to challenge firms in 2020. The U.S. Treasury reports that the number of notices filed at the Committee on Foreign Investment in the United States (CFIUS) increased 265% from 65 in 2009 to 237 in 2017, and remained at a similarly high level in 2018. While the US has yet to finalize the lists of technologies that will be subject to export controls pursuant to the US Export Control Reform Act, these lists are expected to expand CFIUS's investment review authority. Chinese and other foreign companies considering investment into the US need to monitor such rules and enforcement trends carefully.

Operations and supply chain
Despite the "phase one" deal, trade tensions will continue to impose costs on supply chains between the two countries. Perhaps most notably, the US and China are both expanding restrictions on certain technology exports or exports to specified companies in the other market. Executives should continue to monitor tariff and non-tariff barriers to trade and evaluate supply chain vulnerabilities more broadly. Paying higher costs, passing costs along to consumers or shifting supplier locations are among the options companies should consider.

Data and intellectual property
The "phase one" deal includes a provision on intellectual property addressing areas such as trade secrets, pharmaceutical-related intellectual property, geographical indications, trademarks and enforcement against pirated and counterfeit goods. This provision is unlikely to resolve US executives' long-standing concerns about effective intellectual property rights in China, however, so companies should continue to implement safeguards.

Reputation and compliance
US and Chinese firms face increasing pressure to support their home countries and uphold the values of their respective governments and societies. Where Western and Chinese policy goals and values diverge, firms will face pressure to remain neutral — or pick a side. Either strategy poses reputational risks, so executives should consider the likely risks and rewards of various scenarios before deciding on a course of action.

Issues to watch

- Will the "phase one" deal hold? Will there be a "phase two" deal this year?
- What will be the US-China policy position of the leading US presidential candidates? How will electoral politics impact the Trump administration's negotiating tactics?
- How will the performance of the Chinese economy in 2020 affect Beijing's negotiating position?
- What will the U.S. Department of Commerce's formulation of lists of "emerging" and "foundational" technologies subject to new export controls signal about technological decoupling?

Around the world

Geopolitics in a world of regions

East Asia and Pacific

Evolving role of China shapes the outlook

The rise of China has dominated the Asian narrative in recent decades. But Beijing's tightening control of its economy, the continuing slowdown in economic growth and recent trade tensions with the US have triggered a strategic reassessment of the broader footprint many companies have in Asia.

Under President Xi Jinping, Beijing no longer follows the "hide your strength and bide your time" approach in foreign policy. This will be on greater display in 2020 in various arenas. At the same time, **Beijing's "redline" topics, such as the continuing protests in Hong Kong, are growing, which could further complicate the business environment in China.**

The fierce trade dispute that erupted between Japan and South Korea in 2019 creates the potential for another geopolitical disruption in Northeast Asia. This dispute has highlighted how the region's complex political history still affects the business environment today. Though tensions receded somewhat by the end of 2019, bilateral relations will remain volatile. Elsewhere on the Korean peninsula, risks are increasing that the constructive, but tentative, dynamic created by the high-level engagement between the US and North Korea will cease. Pyongyang may assume a more confrontational position in 2020, raising the risk profile for South Korea and other neighboring markets.

The role of the US will continue to loom large in the region. **Many countries, notably Australia and several Association of Southeast Asian Nations members (ASEAN), are seeking to balance their political and economic interests between the US and China.** One consequence of the US-China trade tension is that other Asian markets often benefit as companies diversify supply chains beyond China. Vietnam, Thailand, Singapore and Malaysia are among the most prominent examples. RCEP, which brings together 15 countries of the Asia-Pacific region in a free trade agreement to be signed in 2020, is likely to further reshape geopolitical and economic relationships within the region.

Primary forces

Globalization

Playing a central role

Arrangements such as RCEP will solidify Asia's position in the global economic order. Given the region's strong economic growth and increasing economic integration, Asian markets will remain increasingly attractive trade and investment partners for countries around the world.

Demographics

Beyond the demographic dividend

East Asia is aging at a rapid rate thanks to dramatic declines in fertility rates in recent decades, creating challenges in maintaining economic growth. In China, the demographic dividend that helped to propel its rapid economic growth is going into sharp reverse. Others are further along this curve. Japan's population is already shrinking, while South Korea's is forecast to start shrinking in 2025.

Technology

Competing in the global technology race

China, Japan, South Korea and other Asian countries continue to take the lead in building and deploying leading technologies. Among them are 5G wireless networks, which will accelerate the economic impact of other fourth industrial revolution technologies. Their success in exporting such technologies will largely depend on their ability to set and control the standards that will enable their products to compete successfully.

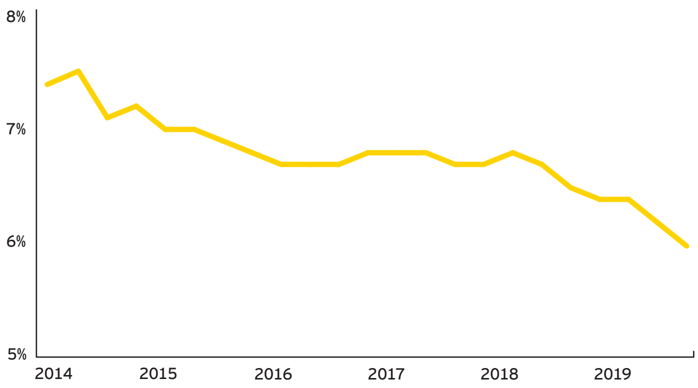
Environment

Sharing global responsibility

China is the world's largest source of carbon emissions, but also the largest renewable energy producer, anticipated to account for 40% of the total global clean energy mix by 2022.[4] Now that the US has left the Paris Agreement, China will play a major role at the 2020 UN Climate Change

China's GDP grew 6% in the third quarter of 2019, a 27-year low

Chinese year-on-year GDP growth, quarterly



Source: National Bureau of Statistics of China.

The Regional Comprehensive Economic Partnership signatories account for $24.8 trillion, or 29%, of global GDP

RCEP signatories

- Australia
- Brunei
- Cambodia
- China
- Indonesia
- Japan
- Laos
- Malaysia
- Myanmar
- New Zealand
- Philippines
- Singapore
- South Korea
- Thailand
- Vietnam

Source: EY analysis; World Bank; Association of Southeast Asian Nations.

Conference, as its leadership is needed to maintain momentum toward achieving a robust global climate policy.

Business implications

Strategy
East Asia and Pacific will continue to be among the key anchors of the global economy for the foreseeable future. Many economies in the region are experiencing robust growth. Combined with the emergence of a more integrated regional economic system, global companies should continue to consider the region as a central part of their business strategies.

Data and intellectual property
The US-China trade tensions have accelerated Beijing's push for economic self-sufficiency in select sectors. The most notable of these is technology. Rather than risk isolating its economy, Beijing is seeking markets for its indigenous technologies abroad. Such efforts may enable China to build spheres of technological and economic influence within Asia and further afield. Executives should monitor where Chinese technologies gain market share, and adapt their technological and data operations in those markets accordingly.

Operations and supply chain
Despite the recent "phase one" deal, US-China trade tensions will continue to impose costs on supply chains between the two countries. Given the risk that the trade tension may ramp up again, companies should continue to explore ways to diversify their production and sourcing locations in the region. The planned signing of RCEP later this year should help facilitate cross-border flows among its 15 members.

Reputation and compliance
Executives should closely monitor new regulatory announcements from Beijing and how they are enforcing existing regulations. Executives must be cognizant of the reputational risks that may arise in their home market as they comply with regulations in both mainland China and Hong Kong.

Issues to watch

- How will the "phase one" trade deal between the US and China affect investment, trade flows and geopolitical dynamics across Asia?
- To what degree will economic interdependencies between Japan and South Korea help to stabilize bilateral political relations?
- How will North Korea's nuclear ambitions play out in 2020 and beyond?
- To what extent will RCEP consolidate regional economic relations and create a more unified market across the region?

South Asia

A delicate balancing act

As economic growth slows in most South Asian countries in 2020, governments will need to balance public spending programs with fiscal pressures driven by ongoing budget deficits. At the same time, the foreign policies of most South Asian governments will continue to be dominated by the need to strike a balance between India and China.

Even though Prime Minister Narendra Modi governs with a commanding majority following the 2019 elections, **India's political environment will likely remain volatile in 2020.** Slower economic growth is one reason for this, particularly given persistent high levels of inequality and unemployment. The mass protests that erupted in the wake of the government passing the Citizenship Amendment Bill in December 2019 also cloud India's political outlook.

Sri Lanka's political outlook largely mirrors that of India's after an election fraught with violence brought Gotabaya Rajapaksa, the former defense chief during the country's civil war, to the presidency in November 2019. Both countries now face growing concerns that policies emphasizing majority rights will intensify sociopolitical tensions between ethnoreligious groups.

In Pakistan, the domestic political **environment will be shaped by tensions between the civilian government, the military and the judiciary after the Supreme Court in November 2019 blocked the prime minister's bid to extend** the army chief's term. **And Pakistan's ability to continue to attract foreign investment will be an open question.** Moody's rating agency recently upgraded Pakistan from a negative to stable outlook, but investments in Pakistan will still carry risk if the country continues to be included on the Financial Action Task Force's gray list for money laundering and terrorist financing.

On a broader scale, geopolitics in South Asia will continue to be dominated by the tenuous balance of power between the region's largest country, India, and its northern neighbor, China. **India remains wary of Chinese influence throughout South Asia and will keep a close eye on BRI infrastructure projects in Pakistan, Bangladesh, Sri Lanka, Nepal and the Maldives.** These countries also have close political and economic ties with India and will likely attempt to play China and India off one another. Pakistan is the exception, remaining firmly aligned with China.

Primary forces

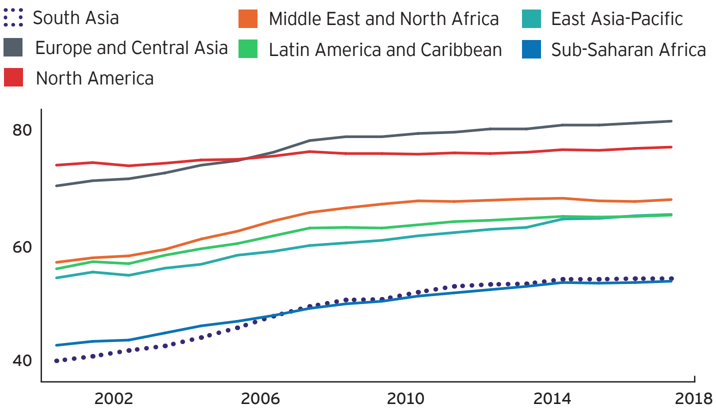
Globalization
Opting out of integration
India will continue to pursue its independent and somewhat protectionist policy stance with respect to international trade and investment. This posture is clear from India's decision to opt out of the RCEP. Even within South Asia, regional integration is minimal. According to the KOF Globalisation Index, South Asia is the second-least globalized region of the world, behind only Sub-Saharan Africa.

Technology
Focus on data privacy
The most significant technology policy issue in India in 2020 will be data privacy. Policymakers and the public will continue to debate the privacy and protections citizens should have for their data and when it is acceptable for apps to share data with the government. This issue is supercharged by the fact that most Indians' mobile phones and computers are imported from China, leading to suspicions that Beijing is monitoring their activities.

Demographics
An underutilized youth bulge
Almost half of the regional population (45.6%) will be under 25 years old in 2020. Such a youth bulge can be a boon for economic growth, if new entrants to the working-age population are educated and there are jobs to be had. This is currently not the case in much of South Asia, however. In India, the International Labour Organization estimates that almost one-third of youth are not in employment, education or training.

South Asia remains one of the world's least globalized regions

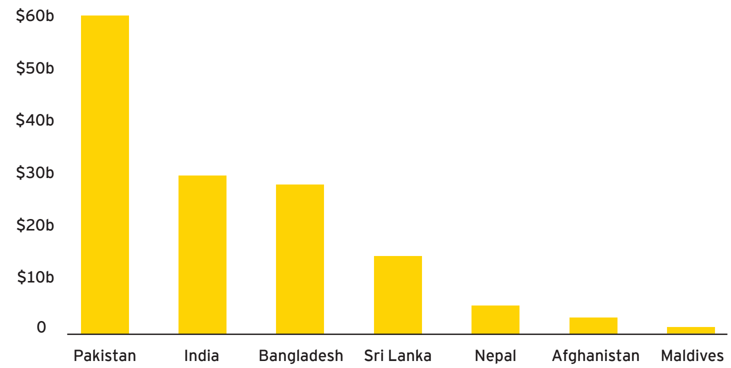
KOF Globalisation Index



Source: Savina Gygli, Florian Haelg, Niklas Potrafke and Jan-Egbert Sturm, *The KOF Globalisation Index – Revisited*, Review of International Organizations, 2019, 14 (3), 543-574.

Pakistan accounts for more than 40% of Belt and Road Initiative investment in South Asia

BRI investment by country



Source: "China Global Investment Tracker," *American Enterprise Institute website*, (https://www.aei.org/china-global-investment-tracker/), accessed 2 January 2020.
Note: Data is the total investments in US dollars from 2005–19. Full year 2019 data was not available at time of publication.

Environment

Increasingly unpredictable monsoons

The annual monsoon is perhaps the most important driver of economic growth in South Asia, as all countries in the region depend upon it for agricultural production. Global climate change, however, is making the monsoon season increasingly erratic. In 2019, the rains arrived late and with such intensity that they caused massive flooding in India, Nepal, Bangladesh and Pakistan. In 2020 and beyond, governments throughout the region will face challenges in dealing with the economic and humanitarian aftermath of unpredictable monsoons.

Business implications

Human capital

South Asia enjoys an abundance of labor, making the region an appealing location for labor-intensive manufacturing. Companies should proactively mitigate any socially driven political risks by engaging with employees and the communities in which they operate. One such strategy is to locate production in economically disadvantaged areas, while another is to partner with local educational institutions to ensure a strong pipeline of talent.

Data and intellectual property

Data privacy will be a hot issue in India in 2020. Executives should closely monitor the evolution of the debate surrounding data privacy. This could have implications for cross-border data flows, data localization and foreign technology company access to the Indian market.

Operations and supply chain

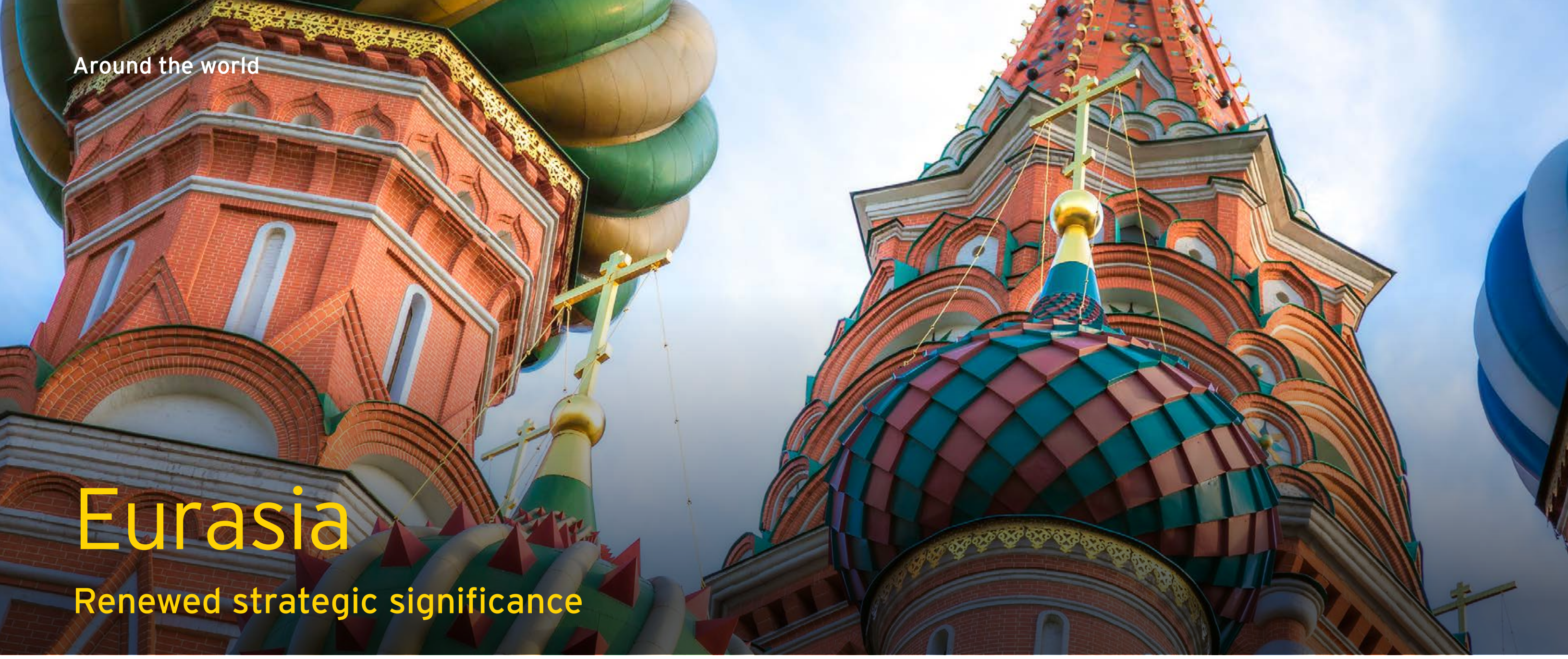
With India opting out of the RCEP, South Asia will not be integrated into the East Asian supply chain in the foreseeable future. Sourcing from the region, therefore, may continue to be less competitive than what is available from alternative locations. Logistics could improve, however, if BRI and other infrastructure projects continue to move forward.

Growth

Despite the slowdown in regional economies, South Asia will remain one of the fastest-growing areas in the world. Middle-class consumers in India and beyond enjoy greater purchasing power than in the past, and this should grow in the coming years. Regulatory barriers to these markets could remain high, however, and executives should evaluate whether the long-term growth potential outweighs these costs.

Issues to watch

- Will India enact a new data privacy law? How will it affect foreign technology firms' access to the country?
- Will governments be able to stabilize or reignite economic growth?
- How will BRI projects be viewed by the local populations affected by their construction?
- Will India's budget for 2020, due to be presented in February, reveal anything new about the agenda of the second Modi administration?



Eurasia

Renewed strategic significance

As the bridge between Asia and Europe, Eurasia will continue to gain in strategic importance, both politically and economically, in 2020 and beyond.

After the end of the Cold War, the post-Soviet countries appeared destined to become less significant actors in a global economic system created by and dominated by the West. **The rise of China, and Asia more broadly, has shifted that political and economic outlook.** China has emerged as a viable commercial alternative to the West, with Russian exports to China multiplying tenfold since 2001, making it Russia's largest export market behind the EU. With a new gas pipeline that opened in December 2019, Russia's exports to China are set to grow even further.

China's BRI, the vast infrastructure network connecting East Asia with Europe, is strengthening Eurasia's geopolitical clout. The success of the BRI ultimately depends on the proactive support and involvement of Eurasian countries, notably that of the dominant regional power, Russia.

The US–China rivalry and the eroding transatlantic relationship also provide Russia with more geopolitical room to maneuver for influence. Moscow will continue to use its more prominent position on the world stage to move into policy arenas in which the US, with its current inward focus, has left a vacuum. Russia will also continue to build its influence across Western and Central Europe.

Domestically, politics in many Eurasian countries continue to be characterized by autocratic rulers, corruption and a strong role for the military. In addition, several rulers have been in power for decades and are now seeking to transfer power to their chosen successors. Kazakhstan, Tajikistan and Turkmenistan are notable examples. And in Russia, President Vladimir Putin has been in power for 20 years. Although the constitution currently requires him to step down in 2024, Putin's recent state of the union address included proposed changes to the constitution that could enable him to remain in power for longer.

Primary forces

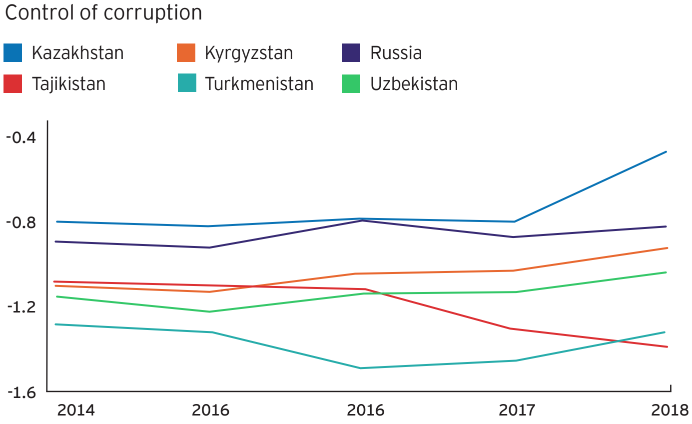
Globalization
Uncertain outlook
Slowing growth of key trading partners (China and the major EU economies) weighs on the Eurasian economic outlook. Nevertheless, Russia is building a strategic energy relationship with China, opening the Power of Siberia pipeline and consolidating its access to European energy markets by pursuing the Nord Stream 2 project. Within the region, the Eurasian Economic Union (EEU) continues to face challenges in deepening economic integration with member states.

Demographics
Seeking immigrants to stabilize populations
Demographic change looms large for Eurasia, as aging populations continue to decline. Once again, Russia is very much at the center of developments. As its population declines, the Kremlin has made it a priority to provide Russian citizenship to between 5 million to 10 million migrants from countries with a strong Russian-speaking population.

Technology
Prioritizing cyber power over broader connectivity
Military, nuclear and cyber technology are largely the focus of the region's, and in particular Russia's, technology prowess. To that end, Russia will remain one of the world's top cyber powers. In contrast, the region's role in the emerging technologies of the fourth industrial revolution will remain limited. Case in point, the EEU's digital agenda, which promises to develop an integrated digital infrastructure and expand Internet access, remains stalled.

Environment
Capitalizing on the Polar Silk Road
Receding ice in the Arctic Sea has opened the prospect that the Northern Sea Route, which circuits the Russian Arctic coast, could one day become a global shipping artery. Russian ice breakers are active on the route during the summer months,

Control of corruption is low but slowly improving for many countries in the region



Source: "Worldwide Governance Indicators," *World Bank website*, https://info.worldbank.org/governance/wgi, accessed 3 January 2020.
Note: Scores range from -2.5 (weak) to 2.5 (strong) governance performance.

Eurasian countries are becoming crucial transit corridors between East Asia and Europe

Source: "Belt and Road Europe," *OBOReurope website*, https://www.oboreurope.com/en, accessed 3 January 2020.

and a global shipping company conducted an exploratory voyage in 2018. The commercialization of this so-called Polar Silk Road would dramatically alter global shipping routes and shift the geopolitical dynamic around the Arctic region.

Business implications

Finance and tax
Russia continues to face US and EU sanctions for its role in the Ukraine crisis that began in 2014. While the EU's sanctions are set to expire at various points in 2020, they are likely to be extended once again. The US Congress is also considering additional sanctions on Russia in response to its alleged meddling in the 2016 presidential election. When assessing business prospects in the region, executives should evaluate the likely evolution of these sanctions to determine Eurasia's geopolitical risk-adjusted commercial attractiveness.

Operations and supply chains
China's BRI holds great promise to significantly upgrade the region's transport infrastructure network, making it an attractive route for trading goods between China and Europe. Companies should monitor the progress of these infrastructure projects and evaluate how the BRI affects the economics of their supply chain logistics.

Reputation and compliance
The lack of government transparency in many Eurasian countries can create significant challenges for corporate governance. Any breaches of anti-corruption laws would cause not only compliance issues, but also reputational damage in home markets. Executives need to exercise continued due diligence when conducting business in the region.

Issues to watch

- How will BRI projects evolve in 2020 and beyond?
- How sustainable is Russia's pivot to China, given the strategic rivalry the two countries have for influence in the Eurasia region?
- How will European companies balance the risk of US sanctions against opportunities across Eurasia?
- How will data localization policies evolve in Russia and other key countries?
- Will any political risks associated with brittle governments in the region be realized?

Europe

Shifting internal and external equilibriums

Europe is witnessing the most profound transformation of its internal politics and external relations since the end of the Cold War.

The rise of extreme populist and nationalist movements challenges the vision of a more integrated Europe. This has superseded, if not replaced, Europe's traditional political party landscape, historically dominated by social democratic and socialist parties on the left and centrist and conservative parties on the right. **The result has been a further fragmentation of the political spectrum across Europe, hindering coalition building and government formation.**

The most prominent example of this new political reality is Brexit. The exact contours of the Brexit arrangement, which will emerge throughout 2020 and beyond, will not only be crucial for future EU-UK relations, but also for intra-EU relations. **Brexit will accelerate a significant reorientation across the political alliances within the EU**, placing more focus on the Franco-German relationship as the gravitational center of European politics.

In its external relations, the EU's commitment to a rules-based global order will remain robust. But **Europe will increasingly be challenged to embrace a more realist perspective in its geopolitical relations** given that national interest-based politics are on the rise.

To that end, **EU policy debates will continue to proactively re-evaluate options toward Russia and China** in an effort to improve Europe's strategic sovereignty. Although EU relations with Russia have been in a stalemate for several years now, France is among the EU members that are beginning to question whether Europe needs to rethink this approach and reopen a strategic dialogue with its Eastern neighbor.

Moreover, although the European Commission has identified China as a "systemic rival,"[5] many EU Member States are engaging proactively with Beijing. Given the commercial attractiveness of China's economy and converging international interests (such as a commitment to the Iran nuclear deal, China's increasing engagement in Africa and climate change), the EU will continue to **develop a more nuanced, pragmatic perspective in its geopolitical relations with China.**

Primary forces

Globalization

Aligning economic and political interests

The more competitive geopolitical environment and Europe's growing concern about the increasingly state-centrist and nationalist economic policies of the world's other major economies have prompted a reconsideration of its economic strategies and overall commercial philosophy. Though the EU will continue to be fiercely protective of the established principles of competition within the single market, it will develop more proactive industrial policies to bolster European competitiveness abroad.

Demographics

Political realities of aging

With a median age of 43.8 years in 2020, Europe is by far the oldest region in the world (North America is the second oldest, at 39.4 years). Rapidly aging societies create vast political challenges, which include paying for pensions and maintaining economic growth with a smaller labor force. One option would be to increase immigration, but this creates political challenges in an age of identity politics and populism.

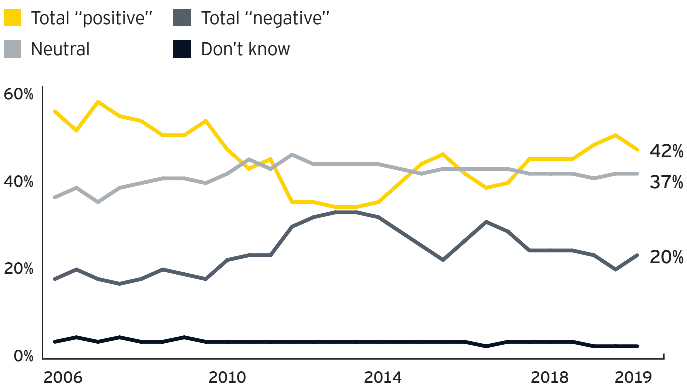
Technology

Seeking technological sovereignty

As the race for technological supremacy between the US and China heats up, Europe is increasingly focused on achieving technological sovereignty. Though Europe is behind in developing a number of critical technologies, it remains the leader in defining global standards for the new generation of technologies (e.g., data privacy and localization). Europe's choice of suppliers for 5G infrastructure will seek to balance the commercial attractiveness of engaging with China with the security concerns voiced by the United States.

42% of Europeans view the EU positively, down slightly from the last two surveys yet above post-European debt crisis low

Perception of the European Union



Source: "Public opinion in the European Union," Standard Eurobarometer 92, autumn 2019.

Changing of the guard in Europe

New EU leaders shift the bloc's policy agenda

Ursula von der Leyen
President of the European Commission
Mainstreaming a green agenda

Charles Michel
President of the European Council
Maintaining the EU's unity

Josep Borrell
High Representative of the Union for Foreign Affairs and Security Policy
Strengthening multilateralism and a rules-based global order

Christine Lagarde
President of the European Central Bank
Reforming the ECB

Source: EY analysis.

Environment
Blending sustainability with competitiveness
Climate change protests have received overwhelming public support, leading to the acceleration of legislation implementing national commitments under the Paris Agreement. While staking a strong leadership position on climate change regulations — the European Green Deal will make Europe the first climate-neutral continent — will likely position the EU economy well in the long run, it could also lead to short-term competitiveness challenges.

Business implications

Strategy
The ongoing realignment of Europe and EU Member States creates challenges for corporate strategy. Executives must account for the instability of transatlantic affairs and Europe's evolving relations with China, Russia and other emerging economies when designing their strategies for the region. Perhaps the most notable issue that companies should monitor in this regard is how the EU balances its relationship with the US and China on 5G infrastructure.

Finance and tax
Europe's climate policies are likely to create new opportunities and markets, but they will also impose new costs on companies operating within the bloc. Companies will need to monitor new climate change regulations and ensure that they are in compliance. Executives should engage with policymakers and other stakeholders (at the local and EU levels) to inform the policy debate on key areas that enable businesses to continue to grow and innovate in a sustainable and competitive way. In addition, executives should be aware of the growing attention their investors and consumers are paying to climate change.

Operations and supply chain
European economic growth remains dependent on a well-functioning global trade regime. This includes both maintaining access to traditional markets in the Americas and building new markets in emerging economies, particularly in Asia. With the WTO increasingly undermined as the custodian of global trade regulation, executives must be aware that Europe's regional trade relationships will become more prominent in securing market access.

Issues to watch

- Will populist political parties continue to grow in power, and what consequences will they have on policymaking? Have we seen "peak populism" in Europe?
- How will Brexit shift the EU's internal policy dynamic, and what consequences will it have for Franco-German relations? How will it shape the UK's approach and focus on Commonwealth economic partners and politics?
- How aggressively will the European Commission move forward with its industry, technology and climate policies?
- What effect will the US presidential elections have on the future shape of the transatlantic alliance?
- How will EU members' relationships with Russia and China evolve, and to what degree will this cause tensions among EU members?

Middle East and North Africa

Volatility and the risk of disruption

The politics of the Middle East and North Africa will remain fragmented and volatile in 2020 and beyond. The shifting dynamic of geopolitics requires governments in the region to seek a new balance, likely altering business environments in those markets.

Geopolitics within the region will likely be even more volatile in 2020. **As the aftermath from the recent US killing of an Iranian general continues to play out, there is an elevated risk of further attacks** — conventional, cyber or other asymmetric methods — either by or against Iran. The fate of the Joint Comprehensive Plan of Action (JCPOA) and its effect on global oil markets will create significant business uncertainties throughout 2020. In addition, while the blockade that Saudi Arabia, the United Arab Emirates, Bahrain and Egypt have imposed on Qatar since 2017 might be lessened in 2020, tensions are likely to remain high. And Israeli-Palestinian peace will remain as distant as it has ever been.

Importantly for future policy stances, **the involvement of international players in the region is shifting**. Even though the US is less dependent on energy from the Gulf, thanks to the development of its shale gas industry, the US still maintains a strong military presence in the region — and, in fact, is increasing its presence in an effort to contain Iran. In contrast, since 2015, China has become the biggest global importer of crude oil, with almost half of its supply coming from the Middle East. As a result, China is increasing its diplomatic engagement in the region, taking an extremely cautious approach to local political and security challenges.

Russia will also continue to present itself as a regional power broker, maintaining its presence in Syria and seeking to extend its influence in the Gulf region. The EU will remain active in promoting gradual economic and political reforms throughout North Africa to help reduce inward migration to Europe.

Fragile domestic politics will also continue to cloud the outlook throughout 2020. The Syrian civil war goes into its ninth year, the Libyan into its sixth and the Yemeni into its fourth year — all with no apparent end in sight. Popular unrest swept through Algeria, Lebanon, Iraq and Iran in 2019, and underlying sociopolitical dynamics suggest more protests are likely this year. And Israel is heading for an unprecedented third election within a year after party leaders once again failed to form a coalition government. This just adds to the growing uncertainty facing the region's business and investor communities.

Primary forces

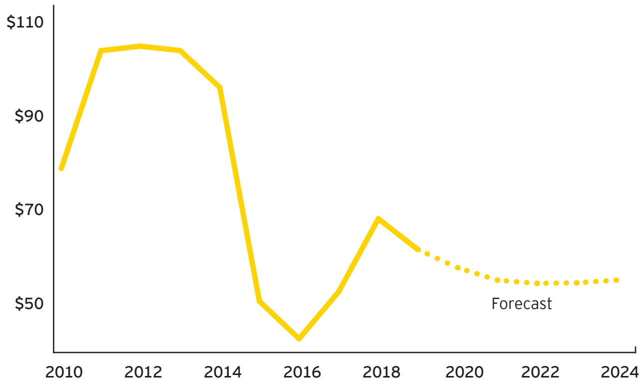
Globalization
Geopolitical tensions affect economic flows
The region's economic outlook will be clouded by its proximity to geopolitical risks. These include US-Iran tensions, the trade tension between the US and China, politically driven oil price volatility and international sanctions. Persistent regional tensions, such as the Saudi-led blockade of Qatar, further complicate cross-border economic flows.

Demographics
Dramatically shifting fertility rates
According to The World Bank, fertility rates have dropped dramatically across the Middle East from about seven births per woman in the 1960s to about three today. The average fertility rate in Iran dropped even more dramatically from above six births per woman in the early 1980s to about two today. While youth unemployment remains a pressing issue today, lower fertility rates will, over time, reduce some of the pressure on governments to create jobs as they seek to accommodate a growing labor force.

Technology
Opportunity and risk
Technology is a double-edged sword in the region. On the one hand, the attack on Saudi Arabian oil installations last summer was

Persistent low global oil prices will create fiscal pressures for oil exporters

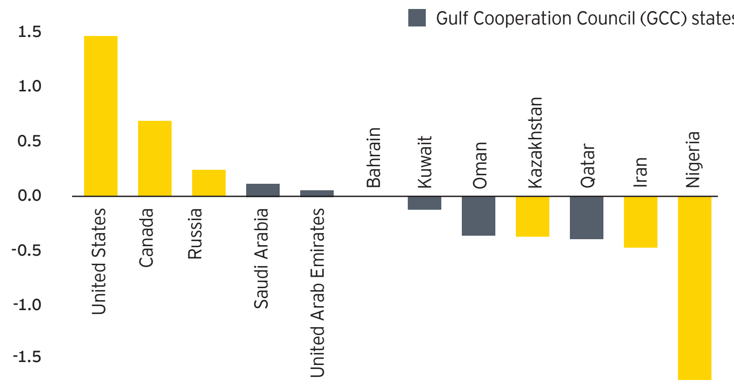
World oil prices, per barrel



Source: International Monetary Fund, World Economic Outlook Database, October 2019.
Note: Global oil prices are presented as the simple average of three spot prices in US dollars per barrel: Dated Brent, West Texas Intermediate and the Dubai Fateh.

GCC economic complexity is in the middle of the pack of the world's largest oil exporters

Economic complexity index rankings



Source: "The Atlas of Economic Complexity," *Center for International Development at Harvard University website*, http://atlas.cid.harvard.edu, accessed 3 January 2020.
Note: Index values are for latest available year (2017) and range from -2.13 (least complex) to 2.28 (most complex).

conducted with the launch of drones and missiles, which highlights the destabilizing consequences of the proliferation of military technology. On the other hand, the Middle East seeks to be a stakeholder in the unfolding fourth industrial revolution. To that end, Israel has developed a robust, home-grown tech ecosystem, and Gulf investors are vying to present themselves as powerful backers of the global tech industry.

Environment

Need for economic diversification

As a key producer of the world's oil, the Gulf region is exposed to the outcomes of global climate change and the geopolitics around it. Climate change not only affects demand for oil exports as a result of the energy transition to renewables, but also affects energy costs of Gulf countries. The International Energy Agency estimates that almost one-fifth of the growth in global energy use in 2018 was due to hotter summers driving up demand for cooling.

Business implications

Operations and supply chain

Business activities across the Middle East will remain exposed to disruptions caused by military conflicts and large-scale social unrest. The consequences will ripple through the global air travel, shipping and energy industries. Shipping disruptions in the Gulf of Aden and Persian Gulf have a particularly harmful impact on the oil and gas markets. Executives should closely monitor these situations throughout the year and develop contingency plans to ensure the continuity of operations.

Strategy

The Middle East continues to be a geopolitical hotspot, with various trade and investment sanctions significantly affecting whether and how multinational companies can do business there. The US maintains a strict sanctions policy on Iran, for instance, while the embargo against Qatar has forced Doha to adjust its external economic relations. Companies need to tailor their strategies to the current political realities in the region, while also designing strategies to be agile enough to adapt to future shifts in a volatile geopolitical environment.

Finance and tax

Economic and financial diplomacy that tie outside powers to the Middle East will remain a prominent element in the region's business environment. While this has been the case for decades when it comes to the politics of oil, financial assets are now also being used to build and support alliances with strong external players. Executives should keep in mind that capital allocation decisions will continue to be driven by such political calculations.

Issues to watch

- How will Iran's nuclear ambitions play out, and what consequences will they have for regional balance of power dynamics?
- Will Saudi Arabia make progress on its economic reform agenda?
- How will the shifting involvement of great powers in regional politics affect the viability of current supply chains and operations?
- Will Israel's politicians be able to form a stable government after elections in March?

Sub-Saharan Africa

Economics and elections create divergent trajectories

The political and economic fortunes of countries in Sub-Saharan Africa will increasingly diverge throughout 2020, **intensifying the need for a market-by-market approach to doing business in the region.** South Africa and Nigeria, the region's two largest economies, have the most troubled outlook, while elections elsewhere will create policy uncertainty.

In South Africa, social tensions will likely rise as the government attempts to implement much-needed structural reforms as the economy continues to stagnate. The ruling African National Congress party's popularity will likely slide further, opening it up to challenges from the Economic Freedom Fighters and other political movements. If the government's reform efforts fail, the risk of a more populist policy agenda will rise.

Political risk is also high in Nigeria. The IMF forecasts that economic growth will be only about 2.5% in 2020, despite — or perhaps because of — the government asserting more control over the economy. The land border trade ban imposed in August 2019 will likely continue, complicating supply chains and dampening economic potential. The government's task to deliver promised benefits to the public will be made more difficult by low global commodity prices and rapid population growth.

In contrast, **Rwanda, Ethiopia, Cote d'Ivoire, Uganda and Kenya are among the fastest-growing economies in the region** because they are less dependent on commodity exports, have better governance, or both. Several of these countries have elections in 2020, though. Ethiopia's election could highlight ongoing ethnic divisions in the country, despite the government's efforts to promote unity. In Cote d'Ivoire, the president may decide to run for a third term, which would postpone an expected generational handoff of power and could provoke unrest. Kenyans may also get the chance to vote in a referendum on proposed changes to the country's executive branch of government.

Geopolitical maneuvering also plays an important role in Sub-Saharan Africa's 2020 outlook, as China, Russia, Europe and the US vie for influence. Much of this new geopolitical competition in Africa comes in the form of foreign investment, particularly in infrastructure. While such investment provides a welcome economic boost, it also risks creating tensions between Sub-Saharan African countries that align themselves with rival external powers.

Primary forces

Globalization

Losing momentum on the AfCFTA

Although the African Continental Free Trade Agreement (AfCFTA) was signed to much fanfare in 2019, it is only a framework agreement. Rules of origin, tariff concessions and the like still need to be negotiated. As always, the devil is in the details. With so many regional powers facing elections and internal governance challenges, there is likely to be little to no progress on the AfCFTA in 2020.

Technology

Politicization of internet use

Even as internet penetration is rising rapidly, almost half of African governments have imposed network blackouts in recent years, primarily in attempts to quell social unrest. Unsurprisingly, the less democratic the government, the more likely it is to order telecommunications companies to disrupt internet access. Some governments are taking less dramatic measures to control internet content instead, including through imposing taxes on social media apps.

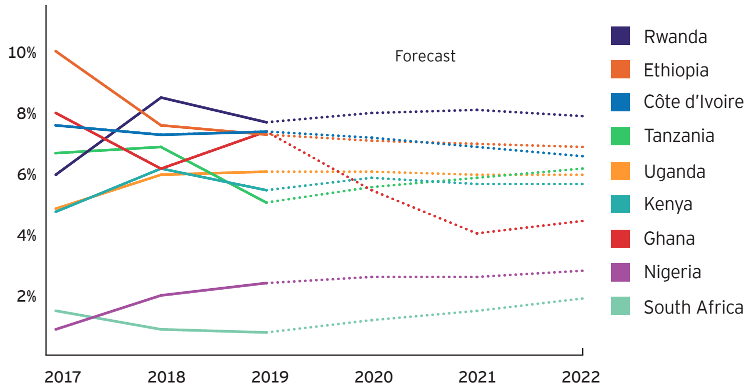
Demographics

Opportunities and challenges of a youth bulge

In 2020, fully 42% of the Sub-Saharan African population will be under the age of 15, compared with just 25% of the global population. Whether this youth

Divergent economic growth across the region

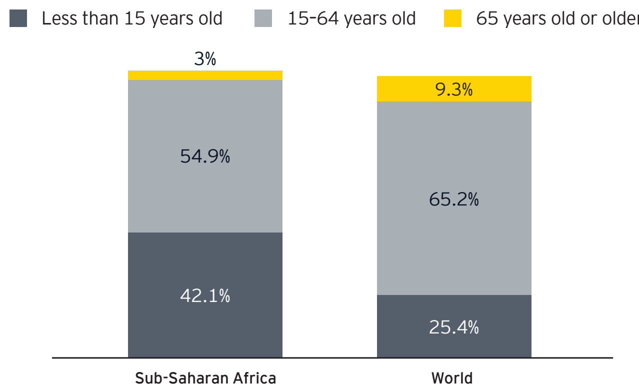
Annual GDP growth



Source: International Monetary Fund, World Economic Outlook Database, October 2019.

Sub-Saharan Africa's dramatic youth bulge provides both opportunities and challenges

Share of population by age group



Source: United Nations, Department of Economic and Social Affairs, Population Division (2019), World Population Prospects 2019.

bulge translates into greater economic growth will depend on whether government policies support education and training, promote entrepreneurship and enable private-sector job creation. The risk of future social unrest will rise if young Africans lack economic opportunities.

Environment

Growing climate change vulnerabilities

The majority of Sub-Saharan African countries are at extreme risk of climate change. Already, the increased frequency and severity of droughts, floods and extreme storms is worsening food and water insecurity, facilitating the spread of diseases, causing forced migration and increasing the appeal of militant groups such as Al-Shabaab. If national governments struggle to address climate change issues, the likelihood of additional climate change protests – led by the younger urban generations – will rise.

Business implications

Growth

Sub-Saharan African markets are diverse and their diverging political and economic trajectories will become even more apparent in 2020 and beyond. Companies cannot take a one-size-fits-all approach to market entry or expansion in the region. Rather, a market-by-market assessment of growth potential, including an analysis of the impact of political risk, is needed. Such political risk analysis is particularly important when commodity prices decrease because fiscal pressures increase, raising the risk of social unrest and dramatic shifts in policy.

Operations and supply chain

With so many elections occurring throughout the region in 2020, the risk of social unrest is high, particularly in countries with weak economic growth or in which electoral irregularities occur. Any significant social unrest is likely to disrupt business operations, particularly in major cities, creating the need for executives to prepare contingency plans. In addition, although the AfCFTA offers great promise to establish integrated supply chains across the continent, executives should keep in mind that this is a future vision, not a current reality.

Human capital

Labor is abundant in markets throughout Sub-Saharan Africa, but finding the right talent could prove challenging in some markets. To capitalize on excess labor, companies should consider partnering with local educational institutions to provide training in needed skills. This would not only improve the talent pipeline, but also help reduce sociopolitical tensions by providing greater economic opportunities to the local population.

Issues to watch

- Will South African President Cyril Ramaphosa succeed in pushing through his economic reform agenda?
- How will the populations view the transparency of the electoral process in Ethiopia, Cote d'Ivoire and other countries that are holding elections?
- Will negotiators make progress on crucial details of the AfCFTA? And how will Nigeria's role in the AfCFTA evolve?
- To what extent will the economic and geopolitical interests of external powers clash in Sub-Saharan Africa in 2020?
- How will the young, urban middle classes affect politics and policymaking in countries throughout the region?

Latin America

Protests and populists drive policymaking

Latin America was uncharacteristically late to join the populist wave that began in 2016, but the region is more than making up for its tardiness now. **Political and economic grievances are bringing populists to power and sending the masses to the streets.** These two forces will shape policymaking in key countries throughout the region in 2020, creating uncertainty for the business environment.

Street protests erupted in several countries in 2019, including Chile, Colombia, Ecuador and Bolivia. While the proximate causes differed, the underlying issues were similar — all of which will continue to be politically salient in 2020. These include enduring high levels of inequality, persistent low economic growth and political corruption scandals. **Further street protests are therefore likely, which will result in governments shifting policies to address popular demands.** Some of these policy shifts could prove consequential for businesses, such as Chilean President Sebastián Piñera's move to increase the country's minimum wage.

Policymaking is also likely to be somewhat volatile in Mexico, Brazil and Argentina, thanks to populist governments. In Mexico and Brazil, where the current governments have been in power for more than a year already, popular discontent is likely to rise if they fail to deliver on their electoral promises. Argentines may give the new Peronist government more leeway, as President Alberto Fernández only came to power in December 2019.

The highest level of political risk in the region will continue to be in Venezuela. The increasingly authoritarian government of President Nicolás Maduro has presided over an economy that has been shrinking since 2014. In 2020, the opposition President of the National Assembly, Juan Guaidó, will likely continue to be frustrated by his efforts to unseat Maduro. This will result in further deterioration in the economic and political environment, even as China and Russia continue to support the Maduro regime.

The role of these external actors points to a broader trend of geopolitical competition in Latin America. **While the US still views Latin America as its backyard, China has become an increasingly important investment partner for the region.** Chinese demand for Latin American commodity exports could fall, however, as Beijing seeks to manage a slowdown in its domestic economy.

Primary forces

Globalization

Pushing the Pacific Alliance and Mercosur

The regional trade liberalization agenda will continue to be led by the Pacific Alliance countries: Chile, Colombia, Mexico and Peru. In 2020, Ecuador may also join the bloc, which would mark the first expansion since it was established in 2012. Mercosur, a trade agreement among Argentina, Brazil, Paraguay and Uruguay, will also be in the spotlight as animosities between the presidents of its two largest members threaten the future of the bloc.

Technology

Strategic decisions on undersea cable

A planned undersea fiber optic cable that will connect Asia to South America via Chile raises strategic questions about how to finance this project, who will control the infrastructure and how secure it will be. This cable could get caught up in broader US-China technology tensions.

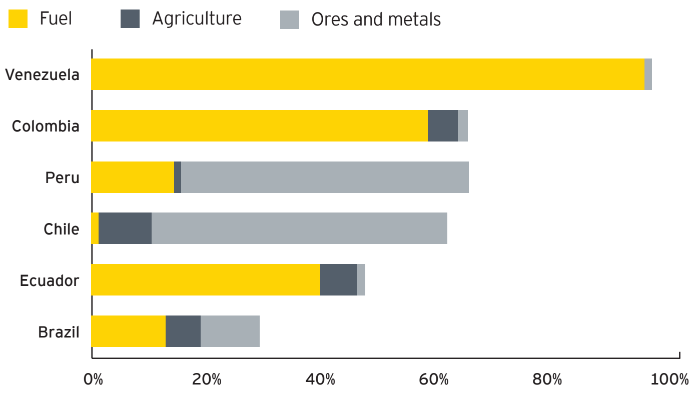
Demographics

A flood of Venezuelan refugees

As the economic crisis in Venezuela continues, more Venezuelans will join the almost 5 million of their countrymen who have already fled abroad. The biggest recipients of these refugees will continue to be neighboring countries, most notably Colombia, Peru and Chile. A lack of international aid for this refugee crisis will further exacerbate social and political tensions in these and other host nations throughout Latin America.

Most of Latin America's major economies remain dependent on commodity exports

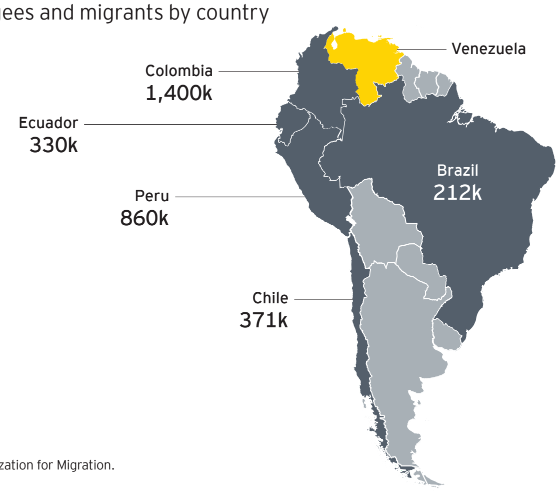
Commodities as a percentage of merchandise exports



Source: World Bank.
Note: Latest available data presented for each country.

Through October 2019, 4.5 million refugees and migrants have left Venezuela

Venezuelan refugees and migrants by country



Source: International Organization for Migration.

Environment

Commodity dependence conundrum

Latin America's major economies remain largely dependent on commodity exports, including hydrocarbons, metals and agricultural products. The extraction of these resources both contributes to environmental degradation and is at risk from future climate change effects and policies. Despite this interdependence, governments throughout the region have yet to prioritize climate change, focusing instead on more immediately salient issues, such as inequality.

Business implications

Operations and supply chain

Widespread protests would likely disrupt operations and supply chains in major urban areas throughout the region. In such situations, continuous communication with company employees will be crucial. As the Pacific Alliance countries continue their liberalization agenda, the falling costs of producing in or sourcing from these markets may present new business opportunities. Executives should monitor developments around Mercosur closely. The trading bloc presents both upside and downside risk.

Growth

After dramatic gains for the middle class during the previous global commodity boom, Latin America's economy has sputtered. This, in turn, has reduced business growth and expansion opportunities in the region, particularly for consumer-facing companies. Executives need to take lower growth trajectories for Latin American markets into account when setting growth targets for the region.

Finance and tax

Argentina's new government is likely to reorient economic policies, which will affect the country's international financial position and its cost of capital. More broadly, populist governments may impose higher taxes on companies or mandate new regulations granting greater domestic control of key industries. Executives should monitor any such policy proposals closely and conduct scenario analysis to determine how these changes would affect their companies' finances and operations.

Reputation and compliance

Companies in the extractive industries have long faced reputational risks in dealing with indigenous communities throughout Latin America. These risks are likely to intensify in 2020 as global attention to climate change continues to rise. The Venezuelan refugee crisis similarly poses reputational risks — on the upside as well as the downside — for companies that are involved in refugee relocation, service provision or employing displaced Venezuelans. Executives should engage with local stakeholders to proactively manage these risks.

Issues to watch

- Will the new government in Argentina reach agreement with international debtors or implement a more populist economic policy agenda?
- Will indigenous communities and other groups draw more attention to the climate change agenda in 2020?
- How will the political, economic and humanitarian crisis in Venezuela continue to unfold?
- Will the geopolitical alignment of Latin American countries shift further from the US to China?

North America

Uncertainty abounds ahead of US election

North America will remain a source of political and economic volatility in 2020, especially in the run-up to the November election in the US. Canada will be more stable, but will continue to be challenged to balance its foreign policies between its relationship with the US and its objectives elsewhere.

This will be a monumental year for the US, as an impeached president vies for re-election. A Democratic winner in the presidential election could herald a wave of socially minded, perhaps ultra-liberal, programs. A Trump victory, however, would provide a renewed mandate for the "America First" agenda. While these implications will not play out until 2021, the uncertain political future will affect the business environment in 2020.

Maintaining economic momentum will remain the top US domestic policy objective. The US outpaces the rest of the G7 economies in growth, and equity markets regularly reach record highs. **But business investment has cooled in the context of geopolitical tensions and mixed economic signals.** The administration is therefore likely to focus on incentivizing business investment in 2020. And it will continue to favor statecraft rooted in economic leverage as its primary form of foreign policy, at the expense of diplomacy. Sanctions, CFIUS reviews and tariffs are likely to continue making headlines. Relationships with the country's top three trade partners will evolve in 2020 as part of the USMCA and US-China "phase one" trade deals.

Canadian policy will similarly remain focused on the economy. Entering his second term, Prime Minister Justin Trudeau will work to strengthen trade relations, manage an economy at risk of entering recession and devise climate-oriented policies that do not alienate provinces that rely on natural resource exports. Renewed separatist movements, such as oil-rich Alberta's "Wexit," will continue to create political volatility.

Primary forces

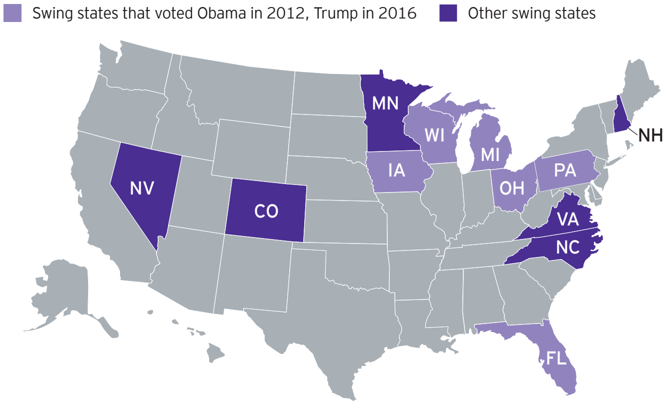
Globalization
Diverging global aims
The Trump administration will continue to focus on bolstering American producers and shielding low-skilled labor from competition, even if it results in disengagement from the global economy. In contrast, Canada will continue to pursue expanding trade relations, particularly in Asia (where it is a CPTPP member) and Europe (through the Canada-EU Comprehensive Economic and Trade Agreement).

Technology
A trust crisis
Data-reliant technologies are becoming ubiquitous, raising concerns about the use and misuse of consumer data and creating the need for revamped governance structures. Barring a crisis, the US Congress will not take legislative action in an election year, though, instead ramping up criticism of data-rich businesses on the campaign trail. Use of AI is only likely to intensify distrust.

Demographics
Shifting foreign talent base
Between 2016 and 2018, applications for two key US visa programs fell, seemingly in response to inordinate processing backlogs and an intimidating political environment. Meanwhile, Canada attracted more than 20,000 high-skilled immigrants in the first two years of a new work permit program. Ottawa will likely accelerate efforts to attract foreign students and workers in 2020, recognizing the economic potential.

Environment
Divides around climate change
While some US states have enacted measures to combat climate change, there remains skepticism at the federal level, even as the US faces pressure to do more as a key source of emissions. By contrast, the issue remains a top political concern in Canada, as the country has experienced double the global average of warming

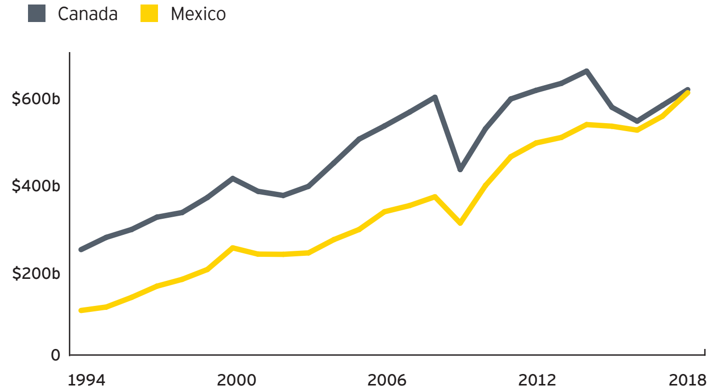
The 2020 US presidential election will be determined by voters in swing states



Source: FiveThirtyEight.

Canada and Mexico are the US's second and third largest goods trading partners, respectively

US two-way trade in goods



Source: U.S. Census Bureau.

according to the Council of Canadian Academies. There is also a generational divide in both countries, with youth increasingly demanding leaders put more resources toward climate action.

Business implications

Finance and tax
US corporate debt is at an all-time high, at around $10 trillion for large companies, and a growing portion is held in low-grade bonds. An economic slowdown could distress financially overextended businesses. Moreover, as US businesses paid taxes at one of the lowest rates on record in 2019, corporations are likely to continue to attract public ire from the political left – and perhaps more broadly in a future downturn.

Reputation and compliance
A Pew Research Center report finds that most Americans do not trust business leaders to act in the best interests of the public. Coupled with historically high income inequality and a populist surge, societal anger toward political and business elites is likely to rise. Boycotts of businesses viewed as harming the public good will likely increase in tandem. Executives should find ways to demonstrate their commitment to the communities they serve and the issues they care about.

Growth
Public pressure is growing to reform antitrust enforcement to address evolving business models and the importance of network effects in a digital economy. Any changes would likely rely less on consumer welfare as the sole determinant of antitrust violations. Technology companies are particularly vulnerable, as many grow revenues through collecting users' data rather than dollars. Companies should consider whether potential M&A deals could be construed as anticompetitive under likely future antitrust policies.

Data and intellectual property
Partisan gridlock and a Congress struggling to keep pace with the evolving technological age are pushing US states to take the lead on regulatory issues from privacy and clean energy policies to drug pricing and more. For instance, the California Consumer Privacy Act, which came into effect in January, will become the effective national standard on data privacy given its application to any business dealing with Californians. Companies will need to increasingly follow state-level legislative agendas.

Issues to watch

- Will the Federal Reserve continue making cuts to the federal funds rate? And how rapidly?
- Which foreign policy issues will receive focus from US presidential candidates?
- How will traditional and social media companies navigate potential foreign influence attempts on the 2020 US election?
- Will Canada join its Five Eyes partners in restricting Chinese telecoms from installing 5G technology?
- Will an increasing focus on climate change lead to investments in upgrading physical infrastructure?

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Unless otherwise noted, the source for all economic growth forecasts is the International Monetary Fund and the source for all demographics data is the United Nations Population Division.

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