Geostrategic Business Group

2020 Geostrategic Outlook

COVID-19 update: Global rebalancing amid a pandemic

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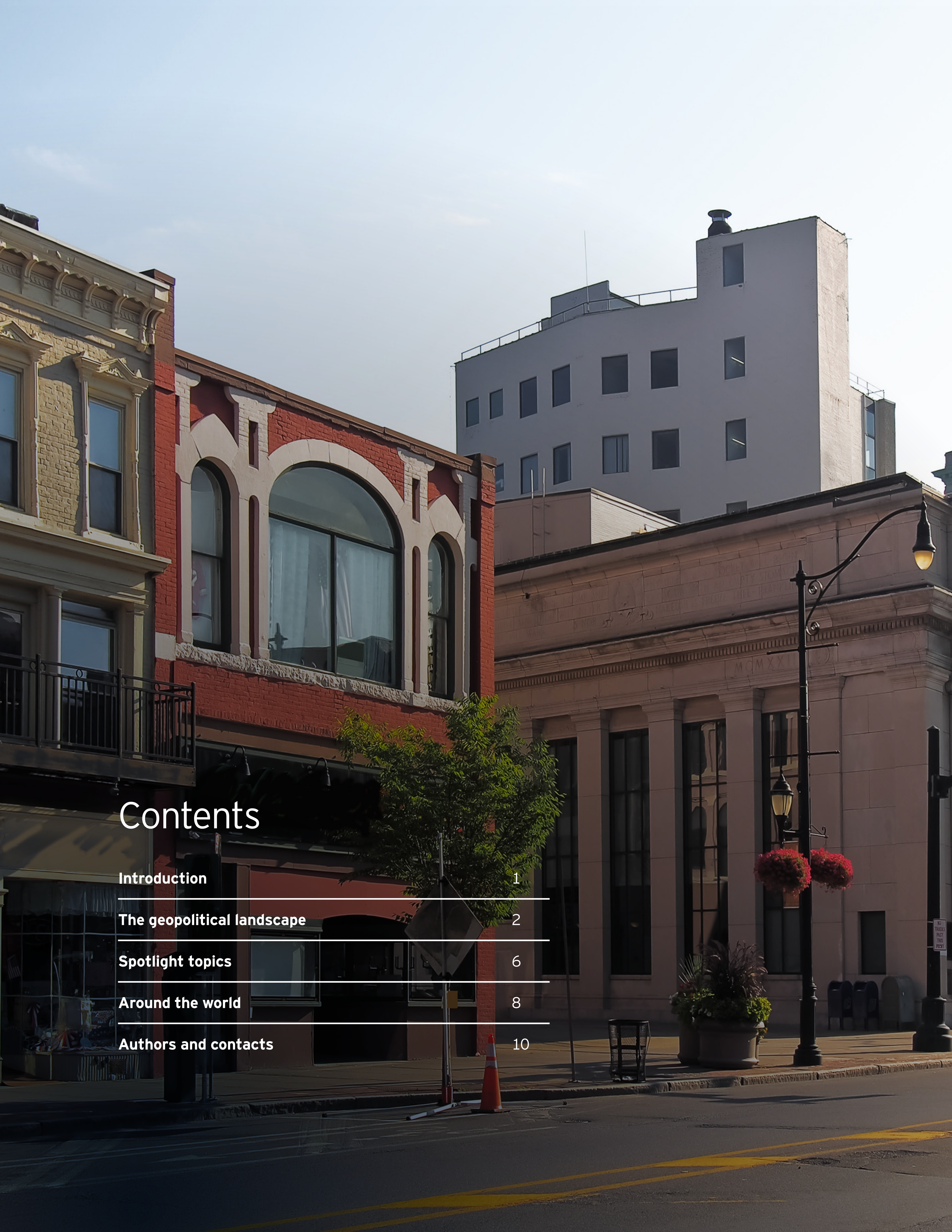

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Introduction

In our _2020 Geostrategic Outlook_, the Geostrategic Business Group outlined four primary forces that are transforming the geopolitical landscape — globalization, technology, demographics and environment — and assessed how these forces are shaping global and regional developments in the now and next timeframes.

When we published our *2020 Geostrategic Outlook*, the COVID-19 epidemic had begun to break out in China, but had not yet become a global pandemic. This event, while long envisioned by public health experts, has been unprecedented — indeed shocking — in the pace of the development and the scale of its impact. The pace and scale of the policy and business responses have also been unparalleled. Because developments are having a profound impact on the fundamental well-being of countries, they also have acquired a geopolitical tone, involving issues such as national security, global leadership, and international cooperation and competition. In this context, a dynamic understanding of the geopolitical landscape is essential.

In terms of geostrategy, companies around the world are focused on the "now" of ensuring business continuity and managing disruption during the COVID-19 pandemic. But it is also important for companies to be looking ahead to the "next" of resuming work or scaling back up during the initial recovery period and planning for the "beyond" of the new normal that will emerge when the pandemic is firmly behind us.

This brief examines how the global COVID-19 pandemic is impacting the salience and trajectory of the four primary forces we presented in our *2020 Geostrategic Outlook* and updates our regional assessments. Our key takeaway is that while COVID-19 dominates the headlines and has seemingly put all other geostrategic business and policy issues on hold, the pandemic does not fundamentally change our view of the four primary forces shaping the geopolitical landscape and global business environment. Indeed, we expect that the crisis will in many ways accelerate the trajectory of the trends we analyzed in our *2020 Geostrategic Outlook*.

In this environment, companies need to focus on how the geostrategic implications of COVID-19 affect a wide array of business activities, including supply chains, human resources, revenue, and reputation and compliance. Mapping these impacts is particularly important in the fast-changing political and policy environments that the COVID-19 pandemic presents.

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Primary forces

Globalization

Emergence of a new regionalism

The rise of populism has unleashed strong anti-globalization sentiments in countries around the world and this has resulted in a shift toward rising regionalization of economic and political systems that businesses must navigate. COVID-19 could escalate nationalist and populist sentiments, as the virus does not respect borders and people embrace "buy national" attitudes. At the same time, many national governments have shown that they are ill-prepared, despite warnings, to protect their people and economies. This has resulted in asset prices falling and increasing volatility in the financial markets.

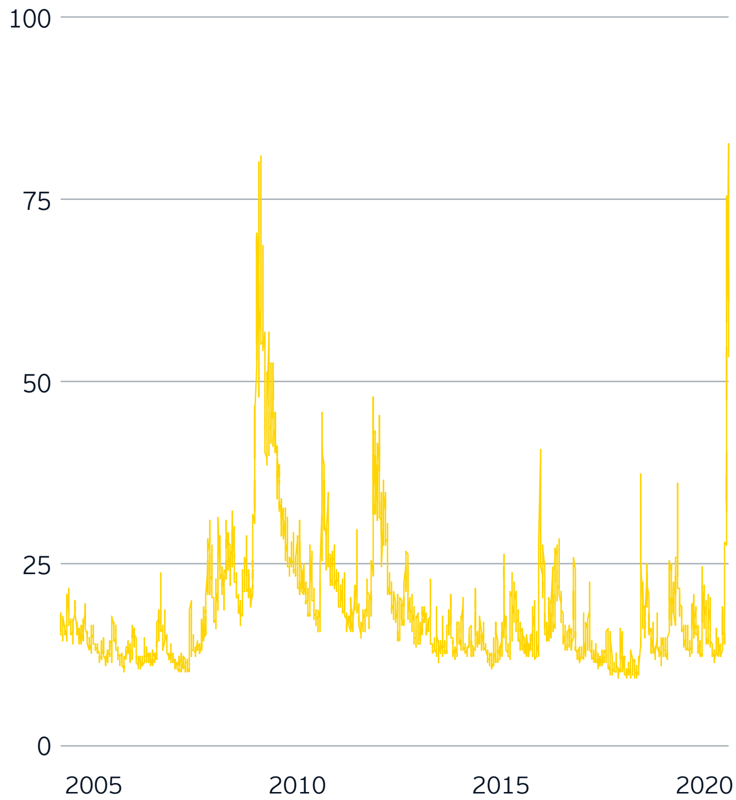
Globalization won't halt because of newfound pandemic fears, but it is highlighting supply chain risks — especially if a firm is dependent on a single supplier or country. Companies have been reassessing their China strategies for a number of years, due to rising costs, a challenging business environment and US-China trade tensions. This has motivated many companies to pursue "China-plus-one" strategies, and COVID-19 is likely to ramp up such supply chain diversification efforts.

The nearshoring of key operations — dubbed "in-market, for market" — will accelerate as biosecurity joins physical security and cybersecurity as a prominent global business risk. Governments have quickly closed borders in a rush to reinforce notions of national security. Post COVID-19, some governments may impose new restrictions on the movement of people, goods and technologies. They may also mandate onshore R&D, manufacturing and stockpiling of pharmaceuticals, medical gear such as ventilators and test systems, and personal protective equipment.

Finally, national, regional and local governments are pursuing a vast array of tactics to quell the pandemic. Authoritarian leaders are using the crisis to reinforce their control, while democracies are trying to balance public health directives with concerns about freedom, privacy and trust. And multilateral governance institutions have thus far failed to coordinate the pandemic response at a global level. In short, COVID-19 is accentuating the regionalism trend we identified in our *2020 Geostrategic Outlook*.

Volatility in the US stock market has surpassed the peak reached during the global financial crisis

Cboe Volatility Index (VIX)



Source: Chicago Board Options Exchange (Cboe)

Issues to consider

- How will rising nationalism and regionalism affect the viability of global **supply chains**?
- Will **human resources** strategies need to evolve if the workforce becomes less global?

Technology

Accelerating global competition

The health and economic challenges of combatting COVID-19 make technology and innovation more critical than ever to business survival and success — and, indeed, to the survival and success of countries as well. Social distancing and economic lockdowns have dramatically accelerated many long-term trends, such as digitalization, the shift to e-commerce, disintermediation, remote working and distance learning. Late adopters are being forced to catch up overnight.

While we all desire a "return to normalcy," many business practices will be altered not only in the short term, but also in the long term. Business attire, lengthy commutes and crowded offices will look less attractive than dressing casually, working from home and virtual meetings. Stay-at-home orders are also showing that working virtually can facilitate real-time collaboration and execution as the effort, cost and delay associated with in-person meetings are eliminated. The deployment of artificial intelligence (AI) and robotics will accelerate as companies seek to reduce their exposure to workforce outages.

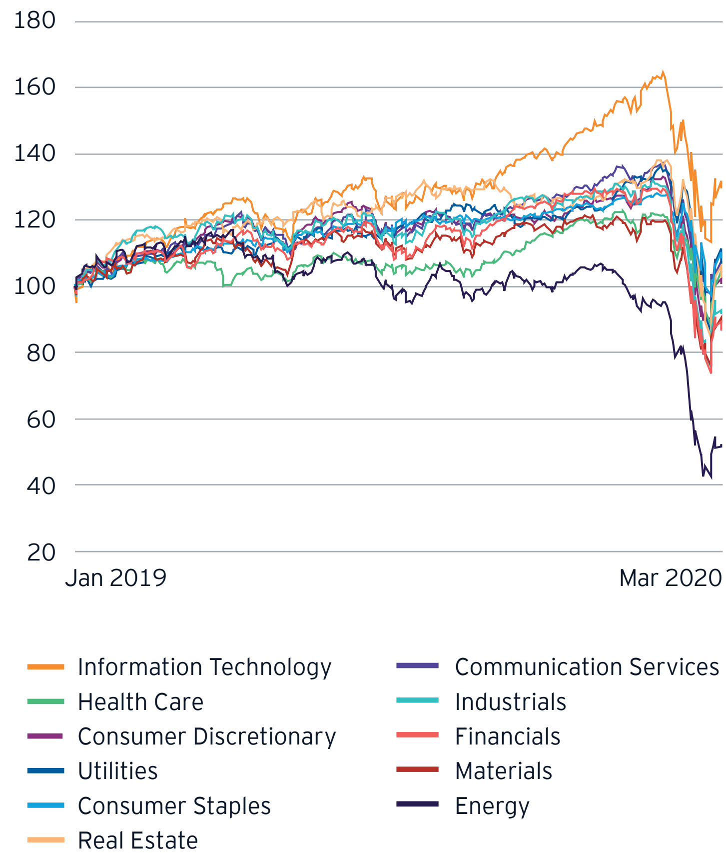
Technology is also playing a crucial role in managing the COVID-19 crisis, including contact tracing apps and robotic process automation (RPA) to deliver test results faster. And a long-term solution to the pandemic will also depend on technology and innovation, such as the creation of real-time health surveillance systems, rapid and inexpensive testing, effective treatment therapies, distributed production of protective gear and, ultimately, a vaccine.

Yet, the politicization of science and technology will not go away and seems likely instead to intensify. Efforts to promote health security will have to be balanced with privacy, ethics and trust concerns. This may accelerate the ongoing trend of data localization, creating new data management challenges for companies. Countries will strike this balance in divergent ways, forcing multinational companies to navigate conflicting political and social pressures across markets.

The rapid escalation of social and business activity online has also created an environment that is more vulnerable to disinformation campaigns and cyber attacks. Finally, COVID-19 will elevate biosecurity as a strategic defense and economic interest. It will, therefore, join the ranks of AI, 5G and other Fourth Industrial Revolution technologies in accelerating geopolitical technology competition.

Technology stocks have continued to outperform those in other sectors during the COVID-19 crisis

S&P 500 sector indices performance



Source: S&P Capital IQ
Note: Data are base-100 values for each sector index, with the base values set to January 2, 2019.

Issues to consider

- Will technology-driven crisis responses shift societal norms and government regulations on **data and intellectual property**?
- How will accelerating technology competition affect the **operations and supply chains** of companies across sectors?

Primary forces

Demographics

Aging catalyzes global rebalancing

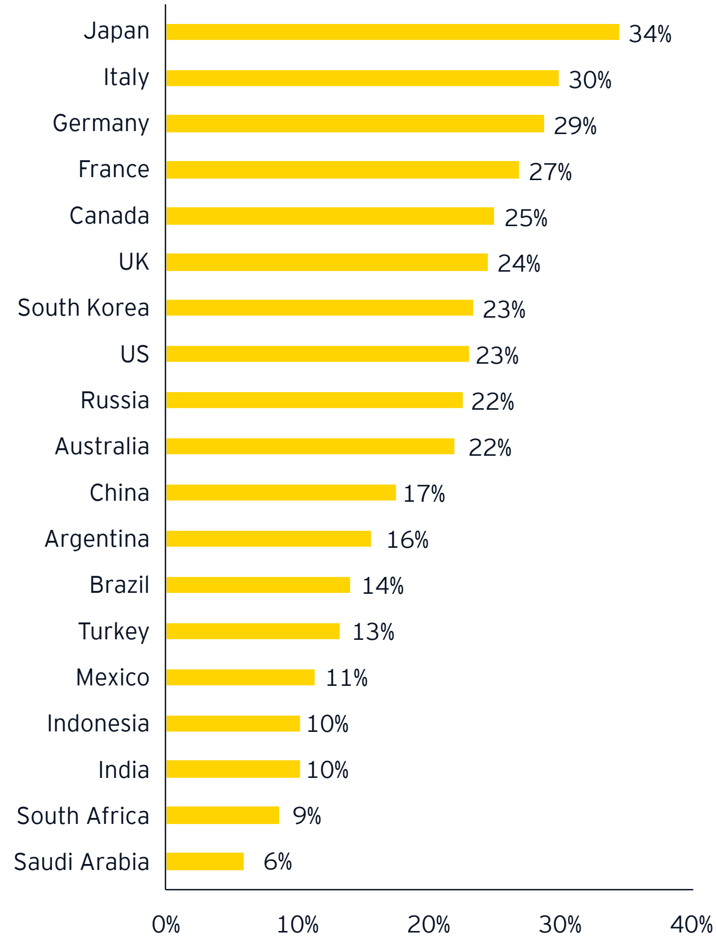
The aging of societies is a fundamental long-term trend that won't be altered by COVID-19. Rather, the pandemic accentuates the societal, economic and policy implications of aging. For reasons not yet understood, the elderly are especially at risk from the disease. The heavy human toll of the disease in Italy is attributed in part to the advanced age of its population. Thus, a country's demographic profile will shape the operational and cost burdens the pandemic imposes on health care systems. Public health officials have urged the elderly to be especially vigilant about social distancing. When the pandemic ebbs, they could remain risk-averse and limit their activities, thus dampening the recovery of the travel, leisure and cultural sectors.

COVID-19 could also accelerate the aging of societies by reducing fertility rates. Countries that have imposed stay-at-home mandates could see a spike in births at the end of the year, but demographic history suggests that the global recession will result in a significant and prolonged drop in fertility, especially in hard-hit economies. Labor force growth and economic dynamism consequently will suffer in the long term. These economic challenges could be exacerbated if the COVID-19 crisis causes a long-term reduction in international migration and outsourcing parts of a company's workforce to other counties.

Finally, the COVID-19 crisis could reignite the "year of protest" that we saw in 2019, when grievances about the high cost of living, limited economic opportunity and unresponsive political leadership sparked large-scale demonstrations from Lebanon and Iran to Chile, France and Hong Kong. Economies with large youth populations and high levels of inequality (real or perceived) could see even more social unrest in the near to medium term — especially if restrictions on mass gatherings are lifted and lingering fears about social contact are limited. To this point, United Nations Secretary-General António Guterres on 31 March warned of skyrocketing unemployment and heightened instability and conflict across poorer countries.

Countries with older populations are more vulnerable to severe illness and death from COVID-19

Percentage of population aged 60+ years



Source: United Nations Population Division
Note: Graph shows G20 member countries

Issues to consider

- How will more rapidly aging societies affect companies' **growth** prospects in markets around the world?
- Where are protest movements most likely to reemerge and how will that affect **operations** and **revenue** in those markets?

Environment

Racing against the clock

As the year opened, climate change was a dominant political issue around the world and businesses were feeling intense pressure from society to take more radical action. Since then, COVID-19 has wiped climate policy off the table, even as it has helped sharply reduce emissions. It is unclear when and how the policy issue will reemerge, but it will.

Common wisdom holds that economic uncertainty and hardship diminish the stature of environmental concerns, low fuel prices slow the transition to electric vehicles, and capital market volatility thwarts long-term deals and financing for renewables.

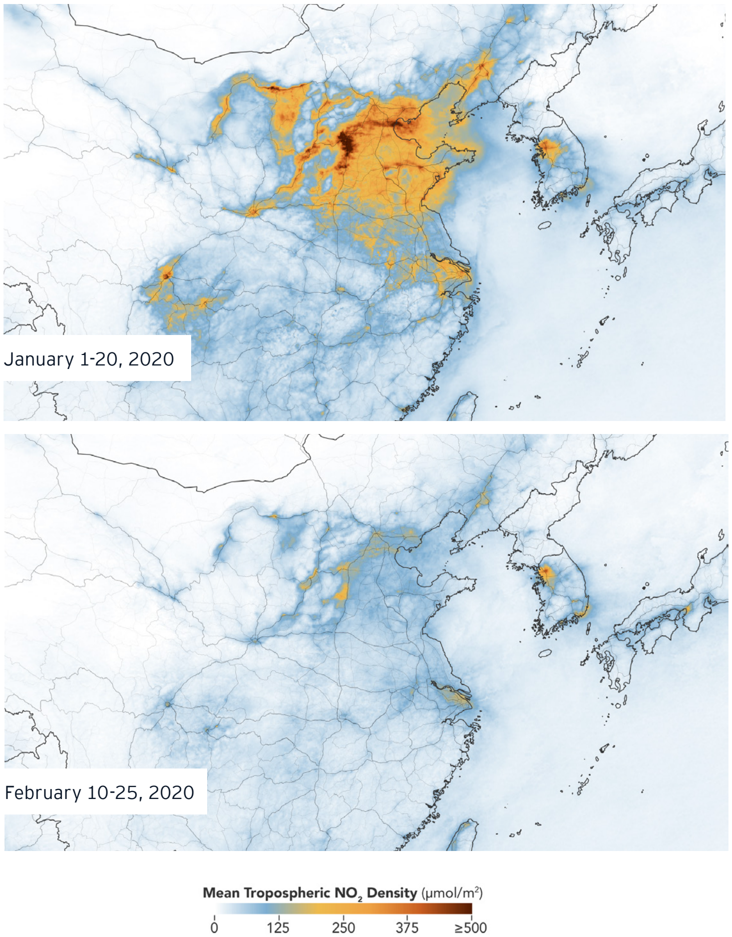
But there are also important countervailing forces. The 2008–09 global recession was seen by Democratic policymakers in the US as an opportunity to reset sustainability priorities as part of their stimulus strategy. Should they win the White House and Congress in November, they have pledged to quickly rekindle an ambitious climate agenda. And EU policymakers have called for acceleration of the European Green Deal — an investment plan announced in late 2019 to make the European economy carbon-neutral by 2050 — as part of a post-pandemic economic reboot.

The COVID-19 pandemic is also accelerating fundamental shifts in economic and social activity that may persist after the crisis recedes. It has forced enterprises of all kinds to adopt teleworking and virtual meetings. Scrutiny of long-distance air travel (dubbed "flight shame") has been on the rise, and as a result of the pandemic, businesses and individuals are learning how to work, build and sustain teamwork, serve clients and live without getting on an airplane.

While executives are focused on short-term crisis management now, those committed to long-term value creation will refresh their environmental plans as they look ahead to recovery, growth and gaining strategic advantage. This will also position them well with investors, many of whom are increasingly pressuring companies to address sustainability head on.

COVID-19 economic shutdown dramatically reduced air pollution levels

Airborne nitrogen dioxide in China



Source: US National Aeronautic and Space Administration (NASA) Earth Observatory

Issues to consider

- How could companies' actions on climate change during the crisis affect their **reputation** in the post-crisis period?
- Will governments' post-crisis stimulus plans affect companies' **operations** costs and **taxes** associated with climate change mitigation?

Spotlight topics

Global trade

Preparing for continued uncertainty

The new normal in global trade remains unchanged by COVID-19. For years, multinational companies operated under the belief that globalization would continue without interruption or a major challenge to the rules-based global trading system. The rise of populism and nationalism in key markets shattered that assumption, and COVID-19 is amplifying and deepening these trends.

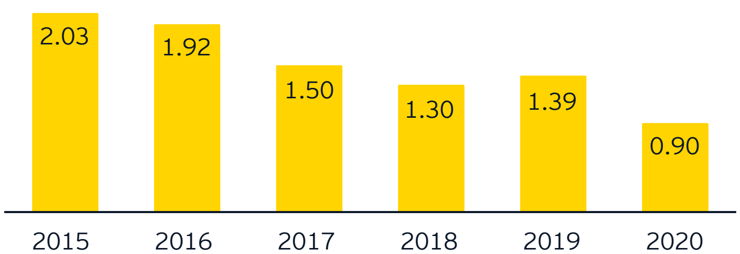
The COVID-19 crisis and associated global recession will cause global trade and investment volumes to fall dramatically. For illustration, on 26 March, the United Nations Conference on Trade and Development estimated that global foreign direct investment flows could fall by 30% to 40% percent during 2020–21. And the World Trade Organization (WTO) said in April that it foresees a 13-32% drop in global trade this year.

Other trade governance challenges will be exacerbated, including implementing the US-China "phase one" agreement and negotiation of a new EU-UK trade agreement. Prime Minister Boris Johnson has said the UK will exit the EU regulatory regime if no agreement is inked by the end of 2020. Negotiations have been on hold and an extension will likely be requested in the name of preserving stability. And while the WTO's dispute settlement mechanism remains offline, a grouping of countries, including the EU and China, has agreed to their own mechanism.

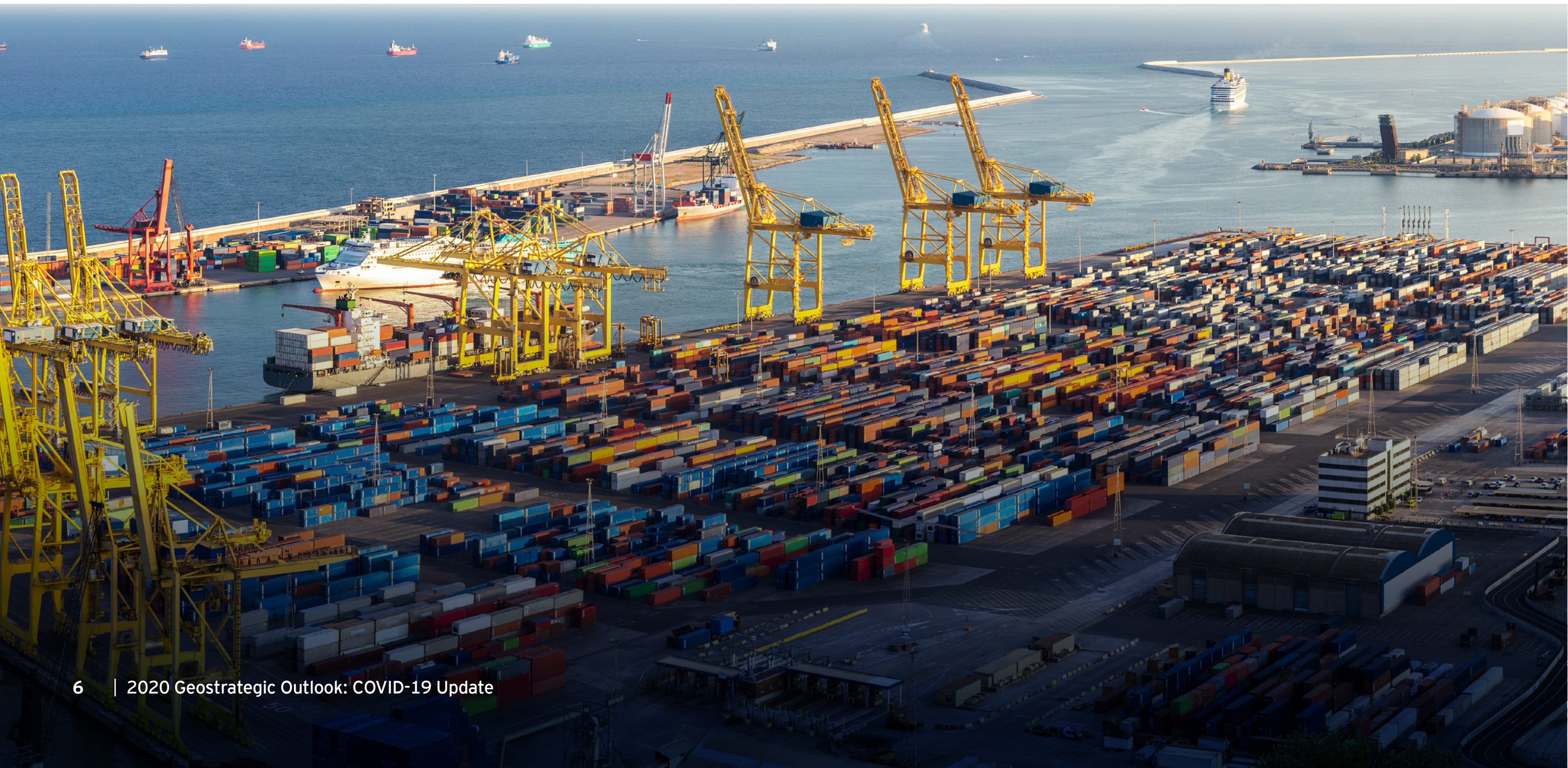
In this new landscape, global trade governance will become less cohesive. As a result, companies need to be even more agile as they manage cross-border activities. Supply bottlenecks, and in some cases export restrictions, have exacerbated supply chain pressures, which in turn will cause firms to reexamine long and vulnerable supply chains. Developing more resilient supply chains will be a business imperative, and in some instances, like pharmaceuticals, likely will be mandated by governments.

The COVID-19 crisis is expected to cause a dramatic decline in foreign direct investment (FDI) flows

Global FDI inflows, USD trillions



Source: United Nations Conference on Trade and Development (UNCTAD)
Note: 2020 forecast is based on preliminary UNCTAD estimate of 30-40% decrease in FDI In 2020-2021



US-China relations

Navigating strategic interdependence

Despite tight economic interdependence, the US-China relationship is increasingly strained. COVID-19 has eclipsed the positive messages and economic benefits from the "phase one" trade deal that was agreed to in January 2020. The US deciding not to relax tariffs on Chinese imports to ease the recessionary forces in the US indicates the depth of the growing geostrategic rivalry. In this context, a "phase two" deal is unlikely to materialize in the foreseeable future.

Since the eruption of COVID-19, American political critiques of China have focused on the timeframe of the initial response and on transparency at the beginning of the outbreak. Concerns about US dependence on China for pharmaceuticals and personal protective equipment have come to the fore.

Chinese leaders have argued that it took painful economic steps to slow the disease and buy the rest of the world time to respond and it is now recovering economically and resuming exports. Beijing has also deployed "mask diplomacy" to rush medical equipment to countries in need. In a diplomatic low point of the relationship in March, US and Chinese officials traded accusations that the other was to blame for the global pandemic.

COVID-19 won't change long-term fundamentals of the bilateral relationship — namely that both countries represent large and dynamic "must-have" markets. It has created an opening for China and the US to realize shared interests and cooperate in areas such as coronavirus research and pandemic response. But it also adds another thread to the expanding narrative of superpower rivalry and risk.

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Geopolitics in a world of regions

East Asia and Pacific

COVID-19 has intensified China's long-term growth slowdown, especially as the sharp decline in global demand has slowed its domestic economic recovery. But Beijing has used past crises to make geostrategic shifts for a long-term advantage. In Southeast Asia, a key signpost to watch is how supply chains are affected by COVID-19. The postponement of the Summer Olympics has been a blow to Japan, but government and business initiatives to go global won't abate.

Eurasia

Russia has become less globally integrated, but its economy will be hard hit by low oil prices, and this has pushed Vladimir Putin to defer his plans to extend his presidency. Yet, he continues to boost Russia's strategic significance by sending emergency medical supplies to Italy and the US. Diminished oil revenues could sharpen political grievances in Kazakhstan.

Europe

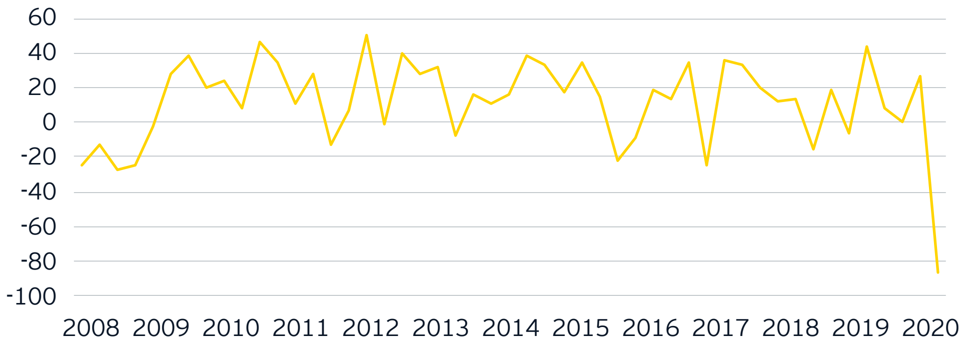
The EU's new leadership has promised a more unified and muscular policy agenda, but member states retain authority on health care and fiscal policy. The resulting uncoordinated national policy responses have highlighted fragmentation across the bloc. The heavy toll of pandemic response on Italy and Spain's debt burden could reignite questions about eurozone sustainability without fiscal integration and highlight north-south disagreements on economic policy.

South Asia

India has not met reform and growth expectations in recent years and Prime Minister Narendra Modi has increasingly used populist nationalism to boost his standing. COVID-19 will make India's political environment more volatile and could accentuate regional tensions. The region has a very youthful population, though, which could help to mitigate the pandemic's impact.

The magnitude of EM outflows during the COVID-19 crisis are unprecedented

Net non-resident purchases of EM stocks and bonds, USD billions



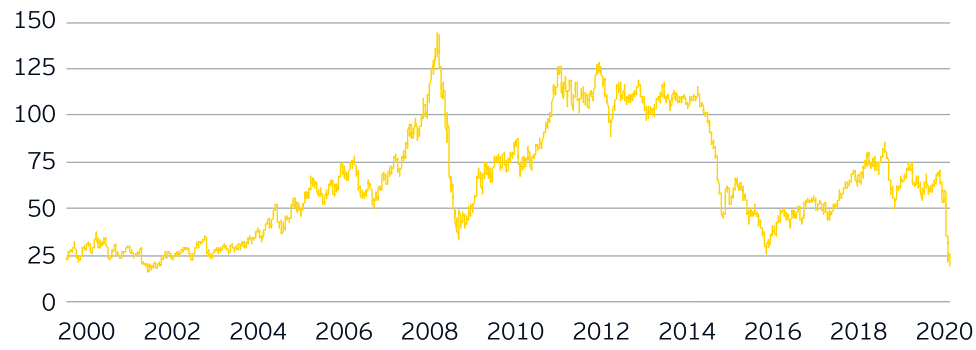
Source: The Institute of International Finance

Middle East and North Africa

Oil prices dropped by two-thirds in the first quarter of 2020 and the price collapse, if sustained, could significantly impact regional political stability later in the year. As one of the first countries to suffer heavily from the COVID-19 pandemic, Iran's public health resiliency will be particularly damaged by lower oil revenues. More broadly, countries considered most exposed economically to a global downturn include Turkey, Tunisia, Bahrain and Jordan, while Saudi Arabia's Vision 2030 restructuring plan may be deferred.

COVID-19 crisis and OPEC+ supply increase have sent oil prices to lows not seen since 2002

Brent spot price, USD per barrel



Source: U.S. Energy Information Administration
Note: Data on daily basis from 4 Jan 2000 to 31 March 2020

Sub-Saharan Africa

In the wake of COVID-19, Sub-Saharan markets are being hit hard by falling commodity exports, remittances and tourism; rising costs of managing the pandemic; and current account shocks. In March, Moody's rescinded South Africa's long-held investment-grade credit rating. Across the continent, anger is being directed at Western and Chinese companies and individuals for allegedly spreading COVID-19 and for not providing emergency assistance.

Latin America

Slow growth, combined with rising concerns about economic inequality, catalyzed political protests across the region in 2019, but COVID-19 has brought them to a halt. Falling commodity exports and remittances will add new shocks, putting pressure on fiscally strapped governments to support living standards, even as they fight the pandemic. Political risk hot spots Argentina and Venezuela are likely to again dominate the headlines.

North America

Just as the race for the White House peaked in early March with the rise of former Vice President Joe Biden as the Democratic front-runner, election politics suddenly dropped from view. For businesses, uncertainty about a potentially big swing in US policy – on regulation, tax, health care, climate and international engagement– still looms in November. Meanwhile, the imposing and global nature of COVID-19 has pushed tensions between the US and Canada and Mexico off the front burner.

Other issues to watch

COVID-19 has completely dominated the landscape in recent months, but a number of other geostrategic issues bear watching, including:

Oil prices

What will be the lasting impact of the Saudi-Russia oil price dispute on the geopolitics of energy? How long will low oil prices persist? And how will low prices affect energy companies and oil-exporting economies around the world?

Geopolitical opportunism

Perpetual geopolitical spoilers Iran and North Korea continue to operate in the background and threaten to undermine global stability. Will Pyongyang continue its ballistic missile tests? And how will the Iranian regime react to the double whammy of low global oil prices and a widespread domestic epidemic?

Belt and Road Initiative (BRI)

Emerging markets have gained valuable infrastructure, but also borrowed heavily from Bejing to finance some of these projects. How will BRI evolve in the COVID-19 era? Will the focus shift from transportation to health care infrastructure? And as emerging market governments face falling export revenues and acute liquidity and solvency challenges, will Beijing restructure BRI debts?

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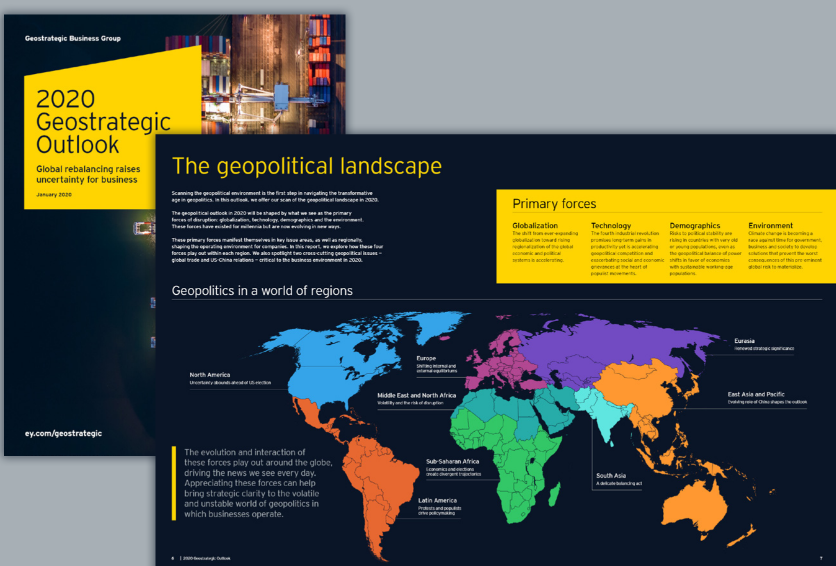
For more, read EY's original *2020 Geostrategic Outlook*



In EY's original *2020 Geostrategic Outlook*, we explore four primary forces that are transforming the geopolitical landscape – globalization, technology, demographics and environment – and assess how they will unfold within each region. We also spotlight two cross-cutting geopolitical issues – global trade and US-China relations – critical to the business environment in 2020.

The Outlook draws on the views of EY leaders around the world and is informed by our many client conversations.

To read the original report, visit ey.com/geostrategic

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About EY Geostrategic Business Group

The EY Geostrategic Business Group (GBG) helps organizations incorporate the risks and opportunities of the shifting global political landscape into their business strategy. By harnessing our global footprint and local knowledge, we help organizations translate global politics into business strategy.

EY member firms collaborate with third-party firms to bring an added independent political risk perspective. Together with the breadth of our strategic and operational expertise, our teams translate political trends into actionable plans that guide you through new ways of monitoring and mitigating risk.

In 2019, the GBG launched a collaboration with The Wharton School at the University of Pennsylvania to launch the Wharton Political Risk Lab. This collaboration forms a global innovation ecosystem exploring the relationship between political risk, corporate performance and political risk management.

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