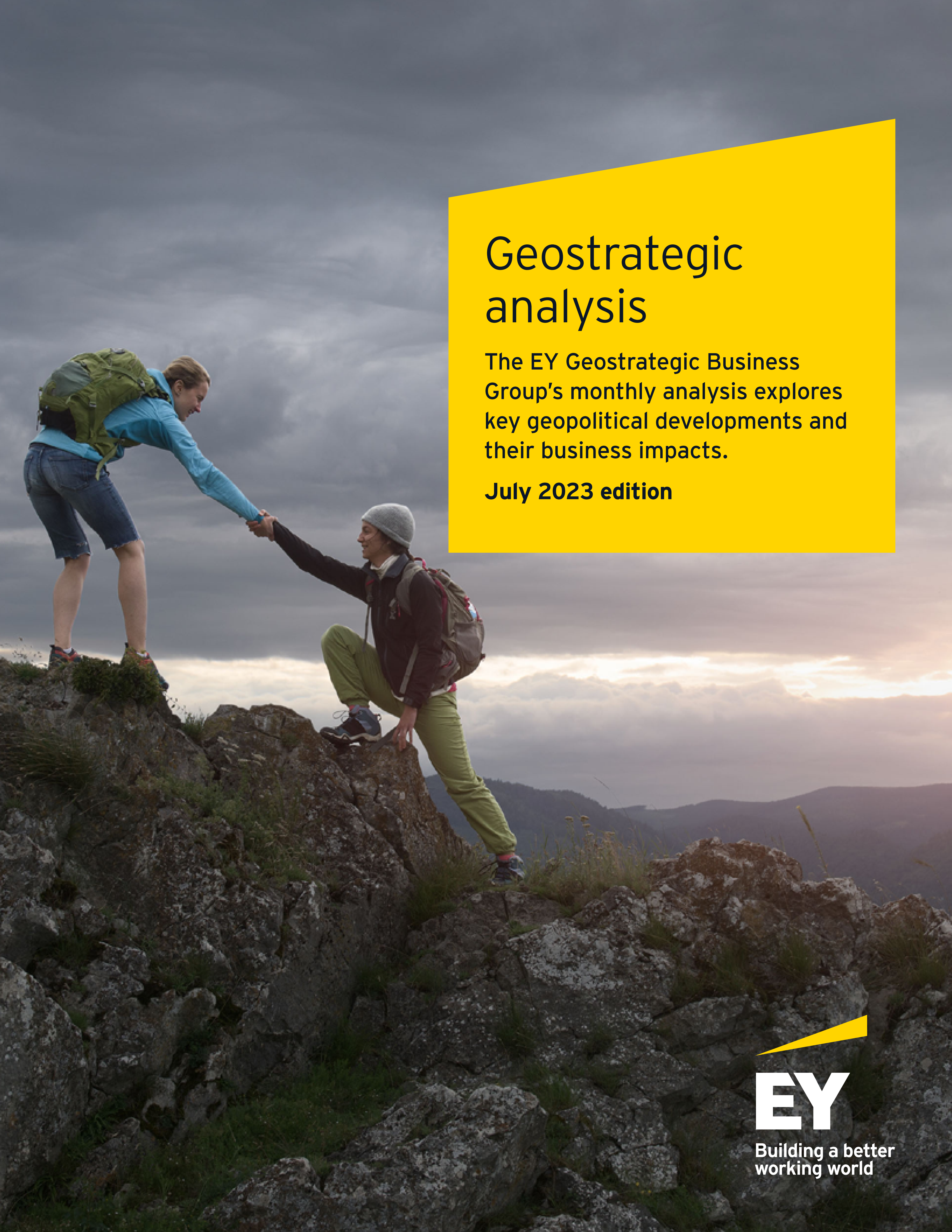

Geostrategic analysis

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

July 2023 edition

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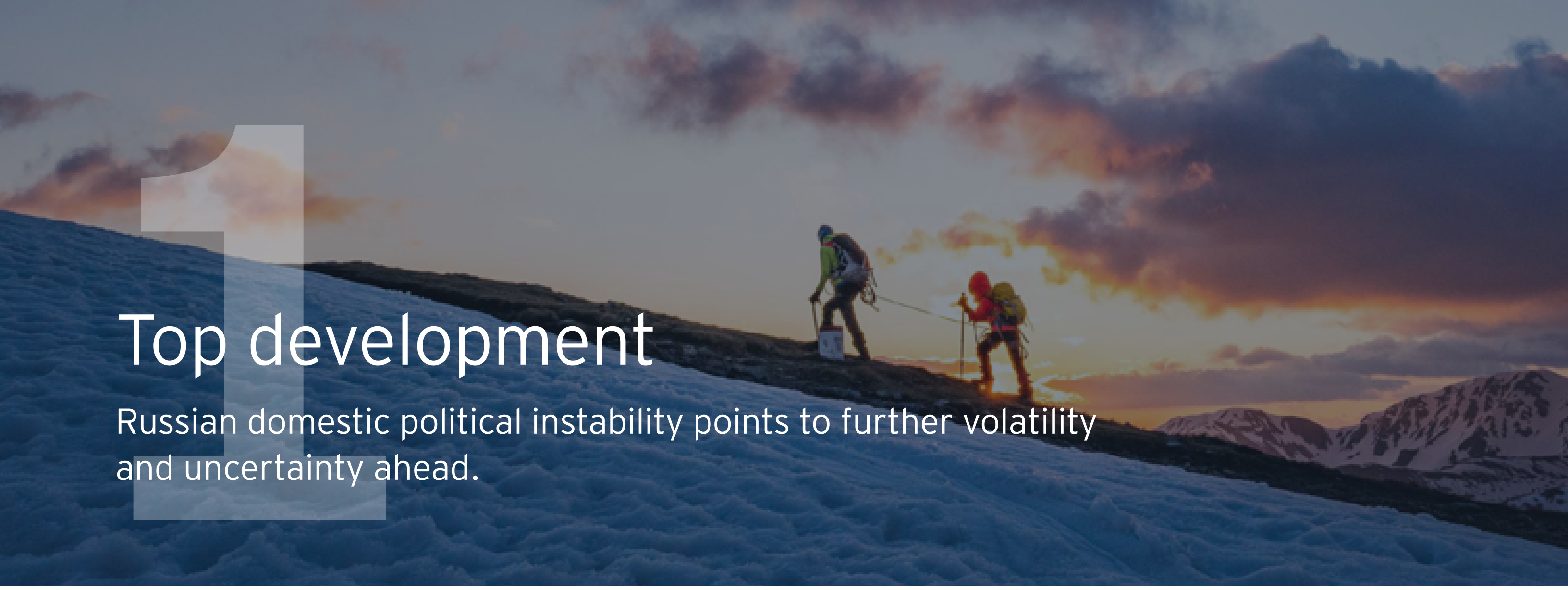


1 Top development

Russian domestic political instability points to further volatility and uncertainty ahead.

What happened

Following months of public criticism of Russia's military leaders for their command of the war in Ukraine, on 23 June, Yevgeny Prigozhin[1] — the ultra-nationalist leader of the private Wagner Group[2] mercenary organization — launched a so-called "march for justice," which authorities described as a mutiny, and took control of military facilities in two cities south of Moscow.

An armed convoy also moved toward Moscow, but Prigozhin turned the convoy around on 24 June following negotiations led by Belarussian President Alexander Lukashenko. Russian authorities have been inconsistent in their statements about whether Prigozhin would face charges.

Russian President Vladimir Putin has made public statements about these developments and signaled he remains in control. The military commanders against whom the "march for justice" was targeted — Defense Minister Sergei Shoigu and Chief of the General Staff Army General Valery Gerasimov — remain in their posts. But Russian army general Sergei Surovikin — who is known to be close to Prigozhin — appears to have been detained.

What's next

The domestic political environment in Russia remains the largest source of uncertainty about the trajectory of the war in Ukraine. As argued in the EY 2023 Geostrategic Outlook, "If the conflict drags on, Putin could come under pressure domestically. As he is unlikely to step down voluntarily, any sort of regime change would likely be disorderly, and could even increase the risk of escalation if hard-liners prevail."

Analysts have argued this episode has weakened Putin by apparently calling into question his ability to maintain control and stability — key anchors of his regime's legitimacy. Further developments related to the events of June 23–24 are likely to unfold in the coming weeks and months — and will be central in determining the future of the Putin regime.

The Kremlin is likely to maintain or further increase its heightened domestic security posture. Russians' access to information will be more tightly controlled, as well, with secure messaging service Telegram, and international news aggregators likely to remain restricted in the short term.

The future of the Wagner Group is uncertain. The Russian Ministry of Defense appears set on incorporating at least some of its fighters into the Russian military. Given the long-standing feud between the mercenaries and the regular Russian military, attempts to integrate Wagner personnel could reduce operational units' cohesion and damage troop morale for all involved.

Fighting in Ukraine continued throughout this episode, demonstrating the strong resolve of the Kremlin to blunt the current counteroffensive — which may include an escalation in missile strikes against Ukrainian targets. Ukrainian morale will likely get a boost from the perception of Russia's internal fragility. Nonetheless, the Ukrainian offensive will still likely face heavy going against in-depth Russian defenses designed to channel their advances and possibly permit counter attacks.

Business impact

Any foreign companies that are still in the process of exiting their positions in Russia are likely to face heightened pressure to sell their assets to Russian entities at low prices. The Kremlin may also explore expropriation and nationalization of strategic industries to more directly support the war effort.

With reports of a fire at an oil depot in Voronezh during the Wagner Group's advance toward Moscow, this episode highlights the risk of further Russian domestic instability to global energy markets. Russian oil and gas supply many countries around the world, including large economies such as China and India. Any reduction or disruption in Russian energy exports would raise global prices and could weaken global economic growth prospects.

Ukraine's grain exports remain below pre-war levels, continuing to create supply challenges and input price increases across the agribusiness and food value chain. Any persistence or escalation of unrest in Russia is likely to negatively impact global food supply chains, which would further raise prices for food and fuel in countries around the world, stoking already high inflation and raising the risk of social unrest in affected countries.

As Russia's military balances both the war in Ukraine and ensuring domestic order, Russian arms exports are likely to fall even further. This may provide opportunities for other defense industry exporters, including traditional American suppliers, those pursuing a more aggressive industrial growth strategy (China, Europe), and newer entrants (Turkey, South Korea, etc.).

Wagner Group has thousands of troops in Africa (including in Central African Republic, Mali, Libya, Burkina Faso and Sudan).[3] It is unclear how recent developments will impact Wagner Group's operations in Africa, but any changes could lead to heightened instability and operational disruptions for companies operating or sourcing from within affected markets.

For more information, contact Courtney Rickert McCaffrey and Famke Krumbmüller.

Additional reading: How can reimagined mobility help organizations see reward and not risk?

[1] Who is Yevgeny Prigozhin, the man behind the Wagner Group? | Economist https://www.economist.com/the-economist-explains/2022/09/29/who-is-yevgeny-prigozhin-the-man-behind-the-wagner-group
[2] What is Russia's Wagner group of mercenaries and why did it march on Moscow? | BBC https://www.bbc.com/news/world-60947877
[3] What Is Russia's Wagner Group Doing in Africa? | Council on Foreign Relations https://www.cfr.org/in-brief/what-russias-wagner-group-doing-africa

Sector in focus: advanced manufacturing and mobility

The automotive sector remains a key target for industrial policy amid global competition.

What happened

The world's largest vehicle-producing countries have introduced a range of policies to accelerate the electrification of the automotive sector while also supporting domestic industries. For example, Brazil recently launched incentives for domestic automotive manufacturing while also encouraging the purchase of more energy-efficient vehicles.[4]

The US Inflation Reduction Act (IRA) seeks to stimulate demand for electric vehicles (EVs) through consumer tax credits and loans for business investment, while also imposing stringent domestic content requirements. In part as a response to this, South Korea has expanded tax incentives for investment in EV production facilities and vehicle subsidies that favor domestic carmakers.[5]

What's next

While the electrification of passenger vehicles has been the primary focus of government efforts, such policies are likely to expand to incentivize the decarbonization of commercial and off-road vehicles.[6] Such efforts may reach beyond electrification to include support for alternative power sources such as biofuels and hydrogen fuel cells.

Government support for transportation infrastructure, such as electric charging stations, is also expected to rise. For instance, the government in Japan — where EV adoption remains low — has proposed adjusting regulations to reduce the cost of rapid charging stations.[7]

China phased out subsidies for EV purchases in 2022, having achieved large-scale production, but recently announced it will extend tax breaks to further stimulate demand. In Germany, policymakers have similarly announced EV subsidies will expire in 2025 — with uncertain effects on future demand.[8]

Business impact

A mix of more stringent sustainability regulations and industrial policy incentives for vehicles will create a new set of strategic choices for automakers. As a result, original equipment manufacturers (OEMs) and suppliers should seek to anticipate shifting customer demand and market dynamics.

Firms involved in transportation-related infrastructure (e.g., EV charging, battery recycling) should prepare for and seek to shape an anticipated rise of government interventions in their sector to capture future growth opportunities.

For more information, contact Joern Buss and Adam L Barbina.

Additional reading: Why consumers are charging toward electric vehicles

[4] Brazil announces funding, tax cuts in bid to boost industry | Reuters https://www.reuters.com/business/autos-transportation/brazil-provide-financing-auto-industry-lower-taxes-2023-05-25/
[5] Korea's new EV subsidy plan favors Hyundai over Tesla, other imports - KED Global https://www.kedglobal.com/business-politics/newsView/ked202302030011
[6] Executive summary – Global EV Outlook 2023 – Analysis - IEA https://www.iea.org/reports/global-ev-outlook-2023/executive-summary
[7] Japan to relax rules on fast EV chargers, jump-starting rollout - Nikkei Asia https://asia.nikkei.com/Business/Automobiles/Japan-to-relax-rules-on-fast-EV-chargers-jump-starting-rollout
[8] China unveils $72 billion tax break for EVs, other green cars to spur demand | Reuters https://www.reuters.com/business/autos-transportation/china-announces-extension-purchase-tax-break-nevs-until-2027-2023-06-21/

3 Other issues we are watching

Nigeria's new president is forging a new path

Following newly elected President Bola Ahmed Tinubu's inaugural speech[9] at the end of May, Tinubu's administration has announced the elimination of fuel subsidies.[10] The Central Bank of Nigeria has also signaled a move toward a free-floating currency, a significant shift in monetary policy. Further anticipated changes include the appointment of new cabinet ministers and reducing the government's share of ownership of state-owned enterprises.

Business impact: The removal of fuel subsidies will improve the government's fiscal situation. However, it will likely result in higher operating costs for businesses in the short term and could raise the likelihood of social unrest. A free-floating Naira will make it easier to conduct business internationally, although significant foreign exchange shortages will delay this positive effect. There could also be increased private sector investment opportunities.

For more information, contact Hulisani Muloiwa and Angelika Goliger.

Spanish elections likely won't shift the policy agenda significantly

After the poor performance of the left-wing Socialist party (PSOE) in local elections in May, Spanish Prime Minister Pedro Sánchez – and leader of the PSOE – called snap general elections for 23 July.[11] According to polls, the center-right People's Party (PP) – currently polling at 34% – could win the national elections without an absolute majority, perhaps entering coalition talks with far-right Vox. This potential shift in political leadership would occur just three weeks into Spain's six-month Presidency of the Council of the EU.[12]

Business impact: Although a PP-Vox coalition government may appear to portend a significant policy shift, the PP would likely hold key ministries and continue mainstream economic policies and reforms to maintain access to EU funds. The PP would also likely align with the PSOE's current priorities for the Council's Presidency and push forward key EU priorities around strategic autonomy, supporting Ukraine and sustainability – including new targets for renewables deployment, environmental rules, electricity market reform, and a trade agreement with MERCOSUR aimed at building resilient green supply chains.

For more information, contact Famke Krumbmüller.

Saudi-China economic ties are set to expand further

The recent Arab-China Business Conference in Riyadh produced 30 deals for Chinese investment in Saudi Arabia, valued at US$10 billion in total.[13] These included an electric vehicle (EV) manufacturing joint venture, investment in metals processing and chemical production facilities, and rail car assembly. This mix of deals is likely to support Riyadh's industrial diversification initiative and China's efforts to increase its economic presence in the Gulf. It may be accompanied by further Middle Eastern investment in China.[14]

Business impact: The China-Saudi economic relationship has historically focused on the energy sector, but is now expanding to include advanced manufacturing, transportation and logistics, IT telecommunications and health care. This diversification and deepening of economic ties is likely to generate growth and investment opportunities for companies in these sectors. Companies in these and related sectors may also identify supply chain diversification opportunities, since these deals are likely to contribute to an expansion in bilateral trade, which totaled US$106 billion in 2022.

For more information, contact Jay Young.

[9] First Inaugural Address by President Bola Ahmed Tinubu Delivered on May 29, 2023 at the Eagle Square, Abuja – The Statehouse, Abuja https://statehouse.gov.ng/news/first-inaugural-address-by-president-bola-ahmed-tinubu-delivered-on-may-29-2023-at-the-eagle-square-abuja/
[10] IMF Executive Board Concludes 2022 Article IV Consultation with Nigeria https://www.imf.org/en/News/Articles/2023/02/07/pr2334-nigeria-imf-executive-board-concludes-2022-article-iv-consultation
[11] La Moncloa. 29/05/2023. Institutional declaration by the President of the Government of Spain [President/Speeches] https://www.lamoncloa.gob.es/lang/en/presidente/intervenciones/Paginas/2023/20230529_institutional-declaration.aspx
[12] The president of the Government presents the priorities of the Spanish presidency of the Council of the EU (europa.eu) https://spanish-presidency.consilium.europa.eu/en/news/priorities-of-the-spanish-presidency-of-the-council-of-the-eu/
[13] 10th Arab China Business Conference https://www.arabchinaconference.com/
[14] China's local governments look to Middle Eastern funds for investment | Financial Times https://www.ft.com/content/f3d841cf-cc94-4d0c-bd88-69f0a8dde199sudan/

Geostrategic indicator of the month

Annual temperature anomalies and the El Niño-Southern Oscillation Precipitation Index

The indicator

Climate scientists at the US National Oceanic and Atmospheric Administration (NOAA) are warning that the current El Niño-Southern Oscillation (ENSO) cycle has a 56% probability of developing into a strong climatic event by Q4 2023.[15] While El Niño cycles typically occur every 2 to 7 years, the strength of such climatic events varies dramatically. Three exceptionally strong recent El Niño cycles generated significant shifts in weather patterns, which in turn affected policy priorities and business activity.

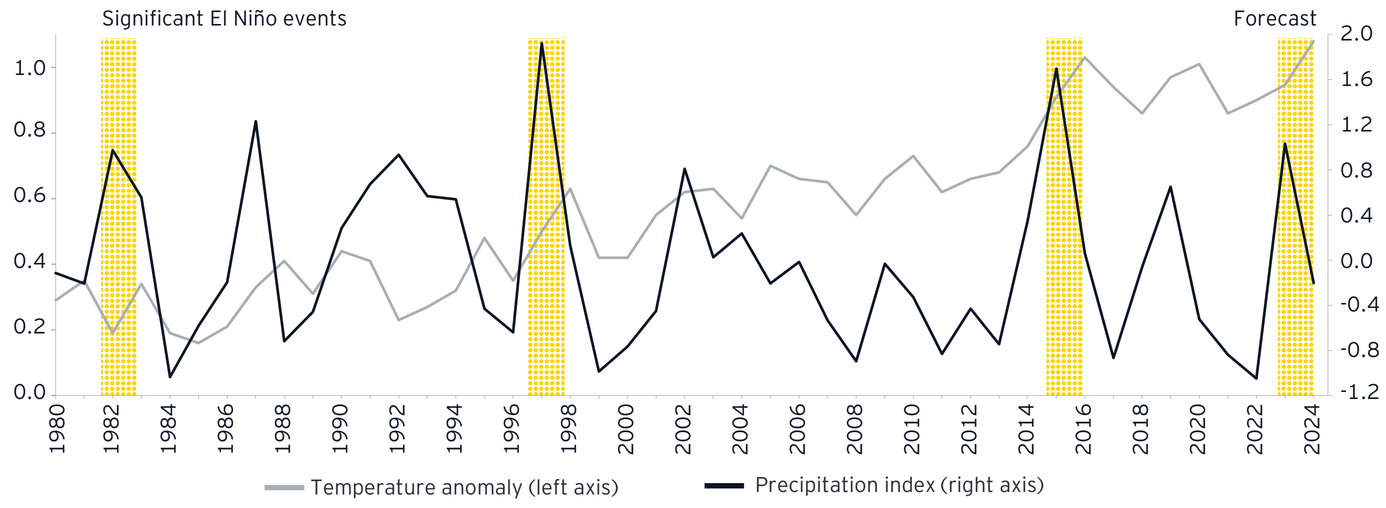
Business impact

A strong El Niño would generate significant droughts and floods, posing challenges for households and businesses. Other effects may include extreme weather, such as heatwaves, flooding and landslides. Such incidents can strain energy infrastructure and cause damage or destruction of physical capital and fixed assets, which could disrupt companies' operations and supply chains. A higher incidence of mosquito-borne disease[16] could affect public health systems and companies' talent. In addition, many communities are likely to suffer socioeconomic disruptions from extreme weather, which could be a source of social unrest in some markets. El Niño may also encourage some governments increase tax revenues to finance investments to make infrastructure more resilient to climate change.

Additional reading: When political disruption surrounds you, what's your next strategic move?

A significant El Niño cycle could disrupt economies and raise political risk levels

Annual temperature anomalies (degrees Celsius) and El Nino-Southern Oscillation Precipitation Index



Sources: University of Maryland College Park Earth System Science Interdisciplinary Center, Global Precipitation Climatology Project (GPCP)[17]; US National Oceanic and Atmospheric Administration (NOAA) National Centers for Environmental Information.[18]
Note: NOAA reports global land-ocean temperature anomalies with respect to the 1901–2000 average. The El Nino-Southern Oscillation Precipitation Index was created by Curtis and Adler (2000) and measures rainfall anomalies over the Maritime Continent and Pacific. The forecast estimates for 2023 and 2024 are an average of the data during the first and second years, respectively, of the past three significant El Nino cycles.

[15] June 2023 ENSO update: El Niño is here | NOAA Climate.gov https://www.climate.gov/news-features/blogs/june-2023-enso-update-el-ni%C3%B1o-here
[16] Global Disease Outbreaks Associated with the 2015–2016 El Niño Event | Scientific Reports (nature.com) https://www.nature.com/articles/s41598-018-38034-z
[17] University of Maryland College Park Earth System Science Interdisciplinary Center, Global Precipitation Climatology Project (GPCP) http://gpcp.umd.edu/espi.htm
[18] US National Oceanic and Atmospheric Administration (NOAA) National Centers for Environmental Information https://www.ncei.noaa.gov/access/monitoring/climate-at-a-glance/global/time-series/globe/land_ocean/ann/1/1980-2023

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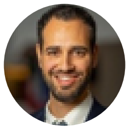

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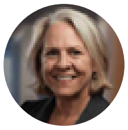

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