

Geostrategic analysis

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

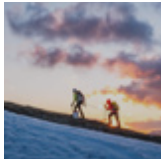
May 2026 edition



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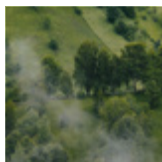
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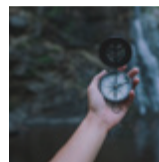
Defense alliances appear poised to transition to more regional initiatives.

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US maintains pressure on Cuba as reforms remain uncertain; India's state elections unlikely to alter reforms; Europe strengthens Japan and South Korea ties ahead of G7.

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The energy price and supply shock is expected to constrain household consumption over the medium term, particularly for durable goods.

EY-Parthenon Geostrategic Business Group (GBG)

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1 Top development

Defense alliances appear poised to transition to more regional initiatives.

What happened: The conflict in the Middle East is highlighting for policymakers the importance of maintaining strong defense capabilities and systems throughout the region – and around the world.

This is accelerating pre-existing trends of defense investment and modernization. For instance, Japan reached its 2% GDP defense target in 2025 – two years ahead of schedule – and is now deploying further missile defense infrastructure for counterstrike capabilities. The European Union (EU) defense expenditure reached €381 billion in 2025,¹ above the 2% of GDP target originally set by the North Atlantic Treaty Organization (NATO), while NATO increased its defense spending goal to 3.5% by 2035² at its 2025 summit.

The conflict is also leading governments to ease export control processes for defense equipment, as recently seen in Germany's defense export control relaxation to meet the needs of customers in the Gulf and Ukraine.

The conflict raises questions about the strength and stability of traditional defense alliances. In particular, how US security policy and actions across the Western Hemisphere and the Middle East could affect US security guarantees.

What's next: Gulf Cooperation Council (GCC) members are likely to expand purchases of US defense systems given their reportedly successful performance and to replenish supplies. Some GCC states may allow the US full use of local bases to raise the cost of hostilities for Iran. But a recalibration in security relationships is likely. Some Gulf states may seek to enter or expand other security relationships – such as with Europe, Russia or China. Importantly, the GCC will likely evolve internal dynamics as well, with an increased exploration of regional collective security links.

In Europe, increased national spending, with budgetary support from the EU,³ is expected to continue to gradually boost European capabilities in selected areas, notably air defense.⁴ Although some European countries, especially Germany, see boosting military spending as a means of reinvigorating industrial growth and accelerating advanced technology development, achieving "strategic autonomy" in defense could prove increasingly difficult given regional fiscal and economic challenges and continuing domestic concerns about cuts to social programs. However, if the US continues to prioritize non-European military commitments, European states will face tough choices between reallocating more money for defense at the expense of other government spending or accepting permanent capability gaps. In addition, leading European countries may seek to assume more control over NATO to transform it into a European-led regional defense organization, while expanding security and defense-industrial cooperation with other countries such as Japan, India, South Korea, and possibly the Gulf States.

In Asia, the 23rd Shangri-La Dialogue,⁵ to be held in Singapore on 29-31 May, will serve as a key venue for evaluating the impacts of the evolving

US security policy on Asia-Pacific countries. While US-led agreements like the Australia, UK and US trilateral security partnership (AUKUS) and the Quadrilateral Security Dialogue (Quad) are likely to remain strategically important, efforts to reduce reliance on US-led security guarantees and develop regional security alliances are also likely. For instance, the Philippines-Japan Reciprocal Access Agreement⁶ indicates a shift to further geopolitical complexity. India's strategic partnerships with Israel⁷ and Cyprus⁸ bolster its strategic autonomy while allowing it to remain aligned with the US security architecture. These ties focus on joint technological development with Israel and enhanced maritime information sharing with Cyprus. Across the region, Asia-Pacific governments are increasingly prioritizing industrial resilience; in South Korea, for instance, a record 76% of the public⁹ now supports the development of indigenous nuclear capabilities.

Business impact: Major sectors affected include government; aerospace and defense; mining and metals; oil, gas and chemicals; industrial products; and technology.

Defense procurement may transition from direct acquisitions to models that prioritize partners that support building domestic capabilities, such as offering high-level technology transfers and co-development or export rights. This could pose challenges where AI-enabled processes or intellectual property are concerned.

Shifting geopolitical and defense alliance systems may lead to new industrial policies. Companies in strategic sectors including **semiconductors** and **energy** will need to align with any such "security-first" industrial policies. Governments will likely prefer domestic supply chains and "friendshoring" to mitigate single-source vulnerabilities. Companies may consider positioning their operations and suppliers to align with regional alliances and consider joint ventures and partnerships with local companies as new alliances form.

Emerging defense build-up and shifts in security guarantees raise the risk of unintended regional military escalations. Executives may therefore consider engaging in **contingency planning** for new conflict disruptions, such as regional conflicts, naval blockades, critical infrastructure attacks and raw material shortages. Risk functions may consider carrying out geopolitically driven scenario stress tests to explore operational impacts and crisis response options.

As regional security architectures proliferate, the regulations and standards for military and dual-use technologies (including AI) are likely to fragment further. These divergences could extend to data management as well. Operations between non-aligned regions, such as certain manufacturing hubs in Asia and end markets in the US and Europe, could pose reputation and compliance risks for companies. Legal and compliance teams may consider a geopolitical compliance framework that proactively monitors shifting alliances and assesses the impacts on their business.

For more information, contact [Ben-Ari Boukai](#), [Jay Young](#) and [David Li](#).

Additional reading: [Top 10 geopolitical developments in 2026](#)

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2. The Hague Summit Declaration | NATO <https://www.nato.int/en/about-us/official-texts-and-resources/official-texts/2025/06/25/the-hague-summit-declaration>
3. EU Defence Industry Transformation Roadmap: Unleashing Disruptive Innovation for Defence Readiness (PDF) | European Commission https://defence-industry-space.ec.europa.eu/document/download/513de692-d08c-40cc-80c3-cb6611ace178_en?filename=EU-Defence-Industry-Transformation-Roadmap.pdf
4. Germany's Defense Initiatives: Building Europe's New Security Architecture | Defense.info <https://defense.info/re-shaping-defence-security/2025/07/germanys-defense-initiatives-building-europes-new-security-architecture/>
5. The IISS Shangri-La Dialogue 2026 | IISS <https://www.iiss.org/events/shangri-la-dialogue/shangri-la-dialogue-2026/>

6. Agreement between Japan and the Republic of the Philippines concerning Reciprocal Access and Cooperation (PDF) | Ministry of Foreign Affairs of Japan <https://www.mofa.go.jp/files/100694772.pdf>
7. India - Israel Joint Statement (February 26, 2026) | Ministry of External Affairs, Government of India https://www.mea.gov.in/bilateral-documents.htm?dtl/40828/India_Israel_Joint_Statement_February_26_2026
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Sector in focus: Power and utilities

How the conflict in the Middle East creates an energy security shock and the rise of the “electrostate.”

What happened

The conflict in the Middle East has evolved into a global energy-security repricing event, driven by disrupted shipping, sharply tighter LNG availability and higher risk premiums across oil, gas and power. The International Energy Agency (IEA)¹⁰ describes it as the largest supply disruption in the history of the global oil market and notes roughly one-fifth of global LNG supply has been effectively shut down.

For power and utilities (P&U), the main shock is gas and LNG. Asia is most exposed to physical LNG terms because almost 90% of Hormuz LNG volumes went there in 2025, while Europe is more exposed through price linkage and competition for flexible cargoes. For instance, the price for Dutch Title Transfer Facility (TTF), the European benchmark for natural gas, rose by over 60% in March 2026, pushing up power prices where gas sets the marginal cost.

Governments have already shifted into contingency mode. The IEA coordinated its largest-ever emergency oil stock release, while the EU,¹¹ UK, India, Japan and others have activated fuel security, storage, consumer protection and diversification measures to manage a sustained supply shock.

What's next

The outlook depends on whether shipping through the Strait of Hormuz normalizes quickly or gradually. The US Energy Information Administration's (EIA)¹² current base case assumes traffic resumes only slowly and does not return to pre-conflict levels until late 2026, implying a persistent risk premium in oil, LNG and freight even if military escalation eases.

The next phase is likely to accelerate a structural shift from fuel security toward electricity system security. If oil and LNG markets remain volatile through late 2026, governments and utilities will place more strategic value on domestic clean generation, storage, transmission, electric vehicle (EV) adoption and flexible demand – not only as decarbonization tools, but as energy security tools to protect against imported-fuel disruption.

Policy is likely to shift further toward resilience over efficiency,¹³ reinforcing investment in supply diversification, storage, grids and lower-fuel-intensity generation mixes. This shift also creates new concentrations of risk. As economies electrify, vulnerability shifts from tankers and pipelines toward grids, cyber systems, critical-mineral processing, aluminum, sulfur-linked chemicals and power-electronics supply chains.

Business impact

The supply shock is reinforcing a strategic divide between fuel-importing systems and more electrified systems. Countries that rely heavily on imported hydrocarbons remain most exposed,¹⁴ while countries building an “electrostate” model, based on domestic power grids, storage and electrified transport, are better positioned to absorb fuel-supply shocks. Strategy and capital allocation teams should treat electrification not just as a transition pathway but as an energy-security hedge.

Fuel procurement, trading and treasury teams can prepare for sustained volatility in gas, LNG and oil, with higher working capital requirements, stronger hedging governance demands and more pressure on liquidity where utilities retain spot exposure. This raises the value of [geostrategic risk analysis](#) and [risk transformation](#).

Operations, engineering and supply-chain functions can focus on the most direct transition-input risks: aluminum and sulfur-linked processing, alongside broader freight, insurance and lead-time disruption. Utilities and developers can aim to strengthen inventory, vendor and route diversification through [supply and operations transformation](#) and broader [supply chain resilience](#).

Strategy, regulation and customer teams should expect sharper trade-offs between affordability and security of supply, especially in gas-linked markets such as the UK and Italy, and in import-dependent systems, such as parts of Southeast Asia, where fuel price volatility can still feed through to power costs. This strengthens the case for [enterprise resilience](#), [energy transition strategy](#) (via EY.com US) and sector-specific capabilities in [power and utilities](#) to manage intervention risk and accelerate diversification.

For more information, contact [Stephanie Chesnick Cutter](#) and [Andrew Horstead](#).

Additional reading: [Six actions to turn soaring energy demand into lasting prosperity](#)

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14. How the War in the Middle East is Affecting Energy, Trade, and Finance | IMF <https://www.imf.org/en/blogs/articles/2026/03/30/how-the-war-in-the-middle-east-is-affecting-energy-trade-and-finance>

3 Other issues we are watching

US maintains pressure on Cuba as reforms remain uncertain; India's state electoral dynamics; Europe strengthens Japan and South Korea ties ahead of the G7.

US maintains pressure on Cuba as reforms remain uncertain

Officials from the US and Cuba held talks in late April 2026, following sustained US pressure for economic and political reform in the island nation – including, most notably, the US government's implementation of an energy embargo that has accelerated economic weaknesses and led to humanitarian concerns in Cuba. The US's ongoing economic and political pressure also builds on the January 2026 US National Defense Strategy,¹⁵ which highlighted the importance of Western Hemisphere security. Questions remain around the US government's ultimate objectives for Cuban political change and its engagement with Cuba's Revolutionary Armed Forces, which hold significant influence over the state and any outlook for meaningful regime or economic changes. Prolonged negotiations or any future US intervention efforts (for instance, similar to those of Venezuelan leader Nicolas Maduro) could lead to public unrest, the risk of a surge in emigration and longer-term political instability.

Business impact: In the short term, political risks are expected to remain heightened for companies with exposure to Cuba, as the US restricts the country's ability to attain crucial energy supplies and capital. Longer term, any future easing of existing US embargos on Cuba would make it easier for US and other foreign businesses to transact with the country and create new investment opportunities in areas such as energy, infrastructure and tourism. Investment conditions could remain complex, including due to unresolved issues tied to past expropriations, which could shape the pace and structure of market re-entry. Executives should continue to monitor the situation for evidence of economic reform in Cuba, which is likely to be required before US policymakers consider reducing existing restrictions on trade with the country.

For more information, contact [Adam Barbina](#) and [Jay Young](#).

India's state elections unlikely to alter reforms

The recent Indian state election outcomes highlight persistent regional political diversity within the country. In Kerala and Tamil Nadu, regional parties continue to shape state-level governance, while the Bharatiya Janata Party (BJP) – which leads the national government – won elections in West Bengal, Assam and Puducherry. These dynamics are unlikely to alter India's national policy trajectory. Prime Minister Narendra Modi remains popular and opposition parties seem unable to significantly challenge the BJP at the national level. Over the past year, policy momentum has centered on deeper integration with developed markets and reforms to enhance competitiveness, including progress on major free trade agreements (FTAs) and deregulation.

Business impact: The recent state election outcomes do not signal a shift away from India's broader reform agenda. Central initiatives on trade liberalization, deregulation and manufacturing expansion are expected to continue, supporting sectors including manufacturing, infrastructure and energy. Importantly, states – regardless of whether they are ruled by the BJP or opposition parties – are competing to attract private investment by leveraging central government incentive schemes and layering additional state-level support. This competition raises the importance of state-specific regulatory navigation, stakeholder management and investment planning.

For more information, contact [David Li](#) and [Lakshita Chadha](#).

Europe strengthens ties with Japan and South Korea ahead of G7

In his dual role as French president and G7 chair, Emmanuel Macron's recent visit to Japan¹⁶ and South Korea¹⁷ underscores Europe's deepening engagement with key Indo-Pacific partners ahead of the June G7 leaders' summit in France. Against the backdrop of wider geopolitical spillovers from the conflict in the Middle East, Macron framed closer cooperation with Japan and South Korea as part of Europe's accelerating economic and political pivot toward Asia. The outreach reflects a broader effort by European and Asian countries to diversify partnerships and limit exposure to both the US and China, while strengthening cooperation on trade, technology and economic resilience.

Business impact: Europe's expanding ties with Japan and South Korea carry implications for defense, semiconductors, automotive, digital platforms, energy and advanced manufacturing companies. The visit advanced cooperation initiatives on critical minerals, nuclear energy, semiconductors and clean power, alongside efforts to expand bilateral trade and investment. For European companies, this will likely create opportunities for market access, joint ventures and supply chain diversification, while increasing the need for robust geopolitical risk management and resilient supply chain strategies. Meanwhile, Asia-headquartered companies will likely see opportunities for R&D collaborations with European partners via cross-border investment initiatives. Deeper industrial and defense cooperation is also likely to influence standards-setting, procurement frameworks and competitive dynamics, prompting companies to reassess regional investment priorities, partner ecosystems and exposure to shifting geoeconomic alignments.

For more information, contact [David Li](#) and [Maxim Hofer](#).

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17. Joint statement between the President of the French Republic and the President of the Republic of Korea | Elysee <https://www.elysee.fr/en/emmanuel-macron/2026/04/03/joint-statement-between-the-president-of-the-french-republic-and-the-president-of-the-republic-of-korea>

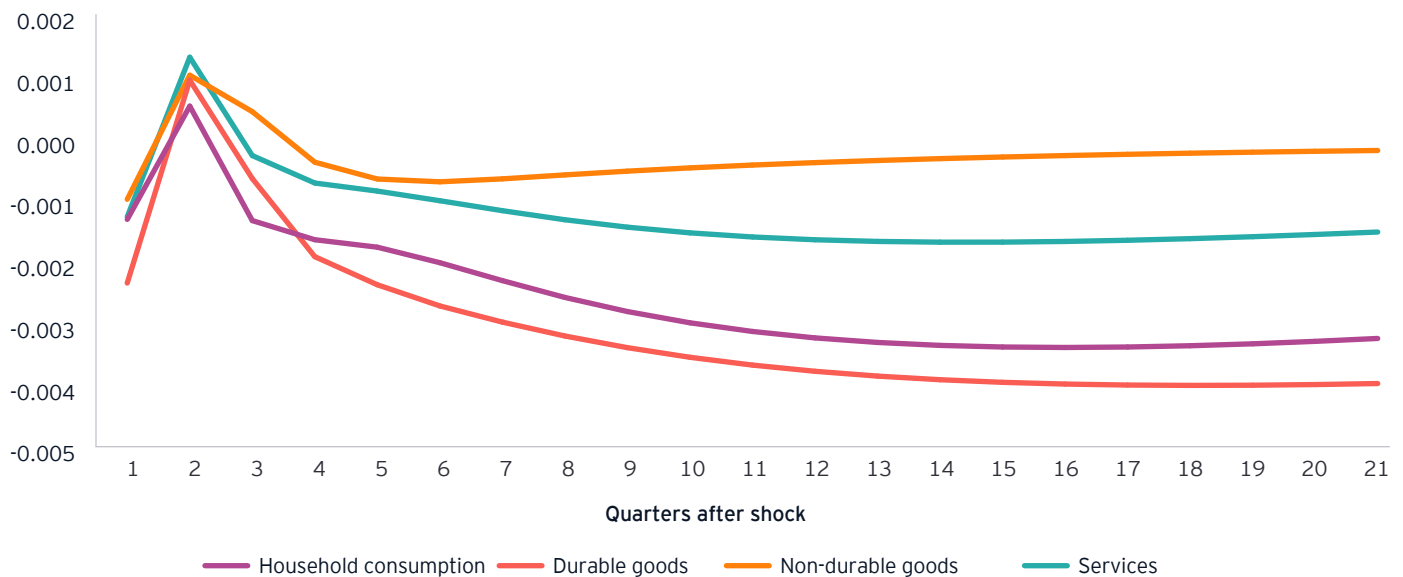
4 Geostrategic indicator of the month

The energy price and supply shock is expected to constrain household consumption over the medium term, particularly for durable goods.

The indicator

The energy price and supply shock driven by the conflict in the Middle East is likely to have dynamic effects on household consumption over the medium term. Higher energy costs tend to fuel inflationary pressures and erode real disposable income, a key driver of consumer spending. As shown in the chart, estimates by Oxford Economics show consumption initially ticks up before declining persistently – particularly for sectors tied to discretionary spending.

The conflict in the Middle East is expected to constrain household consumption over the medium term, particularly for durable goods
Percent deviation in consumption from a no shock baseline across G7 countries



1. Most recently available data points shown for all central banks.
2. Data starts in 2015.
Source: Respective country or jurisdiction central banks; EY-Parthenon

Business impact: The downturn is forecast to be most pronounced in discretionary services and durable goods, as high-value purchases are typically the first to be deferred by consumers when uncertainty rises. Non-durable goods and essential services (food, housing, healthcare) are likely to experience a more muted response, reflecting their necessity-driven demand. Companies are likely to face sustained pressure on volumes and margins across consumer durables, automotive, and services such as travel and leisure. Executives should prepare for a longer adjustment period by enhancing cost flexibility, strengthening demand analytics, and [re-orienting pricing and product strategies](#) toward value-oriented segments – emphasizing affordability and functional essentials over premium features – to better align with constrained consumer spending conditions.

Additional reading: [Executive Briefing: Macroeconomic and strategic business outlook](#)

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