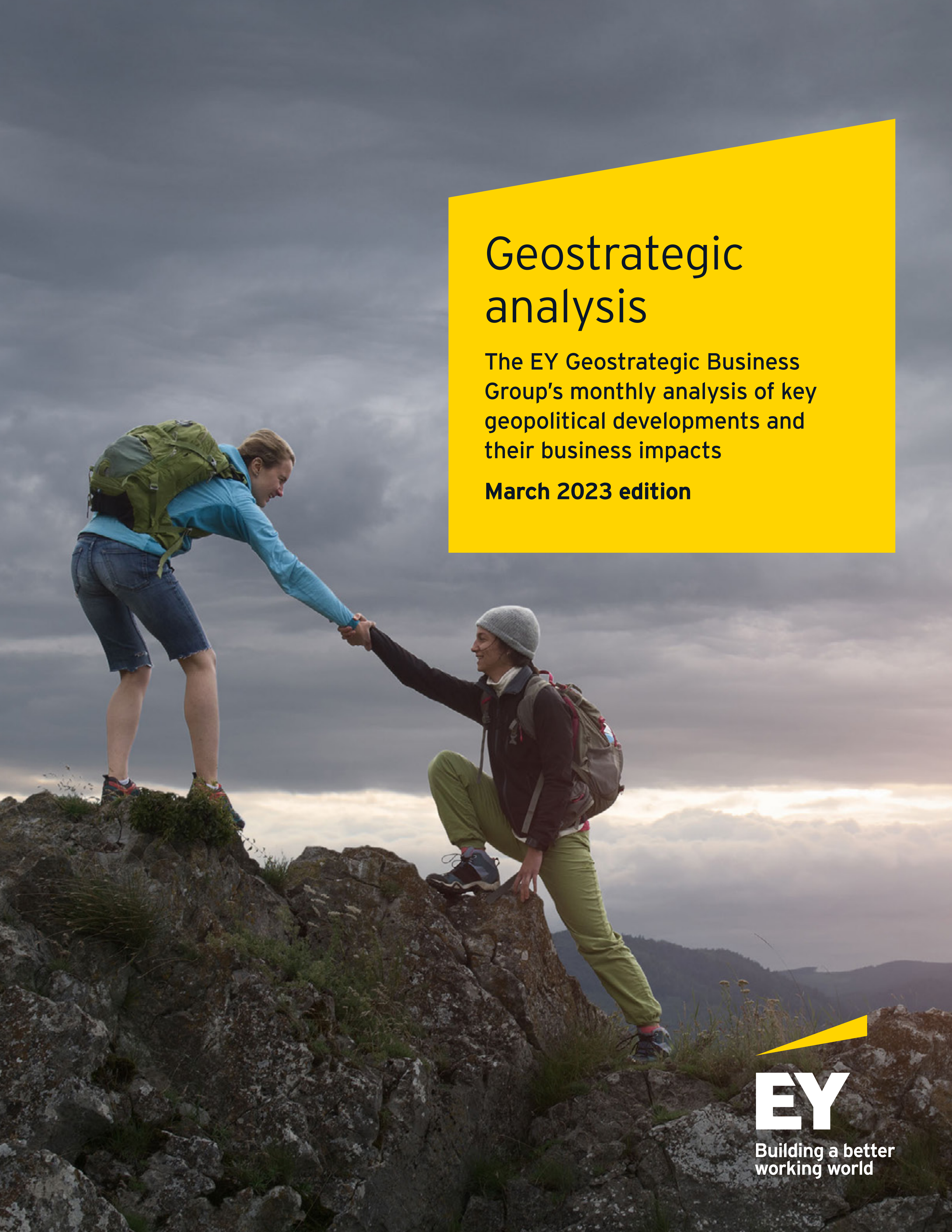

Geostrategic analysis

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

March 2023 edition

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Top development

China's evolving geopolitical and economic positioning will create business opportunities and challenges.

What happened

Following the nationwide loosening of COVID-19 restrictions in late 2022, the Chinese government signaled a willingness to mend strained relationships with Western countries.

After years of diplomatic tensions, Australia made a ministerial visit to China in December 2022, its first since 2019. In February, the first shipment of Australian coal since October 2020 entered China, signaling a potential improvement in trade relations.

Geopolitical tensions persist, however. The US military shot down an alleged Chinese spy balloon in early February, leading to a pause in efforts to reduce bilateral tensions. The exchanges between Chinese State Councilor Wang Yi and US Secretary of State Anthony Blinken, at the Munich Security Conference, highlighted the difficulty in establishing guardrails for the US-China relationship.

What's next

Despite a post-COVID economic bump, China's growth trajectory seems to have slowed – which is likely to be reinforced by continued declines in its working-age population. Going forward, Chinese policymakers will likely have to innovate in their economic growth policy.

The outcomes of the annual legislative sessions of the National People's Congress (NPC) and the National Committee of the Chinese People's Political Consultative Conference (CPPCC) in March will indicate the government's policy priorities relating to property market challenges, the slowdown in growth and the trajectory for the government's Common Prosperity agenda.

Beijing's strong reaction to the balloon incident indicates China is likely to pursue a mixed foreign policy. Elements are likely to include restoring trade with Australia as well as more military drills in the Pacific.

While the EU will continue to engage with China in certain areas, Beijing's relationship with Moscow is likely to be a point of contention. More broadly, the EU will seek to de-risk its supply chains.

The US is likely to impose transparency requirements and restrictions on outbound investment to China. In addition, the US Congress will likely consider new legislation to strengthen strategic competition with China.

Business impact

Major sectors affected include manufacturing, technology, energy and consumer.

The Chinese economy's reopening will have global business implications. Growth in Chinese consumer spending is expected to benefit luxury goods companies. Companies across sectors – including manufacturing and consumer goods – will likely have fewer supply chain disruptions. But executives should plan for global inflation to potentially persist for a longer period, driven by stronger demand for energy and other commodities.

Within China, higher-end manufacturing and innovative technology companies (excluding digital consumer platforms) will likely have strong growth opportunities, with state-backed financing and preferential regulations.

Digital technology companies – particularly those in the semiconductor value chain – are likely to continue to face limits on cross-border business activities as a result of US export controls. Companies operating in China that rely on advanced semiconductors may face supply constraints in the near to medium term.

If China continues to resume imports of Australian coal, then mining companies in countries such as Indonesia, Canada and elsewhere may experience shifts in demand for their products. Executives may need to adjust their production and growth targets.

Contact Courtney Rickert McCaffrey or Douglas Bell for additional information.

Sector in focus: Energy

Geopolitical dynamics will continue to pose energy supply and pricing risks in Europe.

What happened

Since the start of the war in Ukraine one year ago, Europe has reduced Russian gas imports and increased imports of liquefied natural gas (LNG) from the US, Qatar and Nigeria (25%) and gas from Norway (25%) and Algeria (12%).

European gas prices have recently dropped to pre-war rates thanks to historically high storage levels, alternative supplies, mild weather and lower consumption by businesses and households. This has boosted confidence that Europe will avert shortages this winter and in winter 2023–24.

What's next

Supply and price risks will underpin the market outlook throughout the year as the war in Ukraine is expected to continue, China's reopening will increase its energy demand and the limited fiscal space of European governments for further domestic support.

The simultaneous imperatives of energy security, affordability and sustainability will push EU countries to accelerate the deployment of renewables, reforming electricity markets and improving energy efficiency.

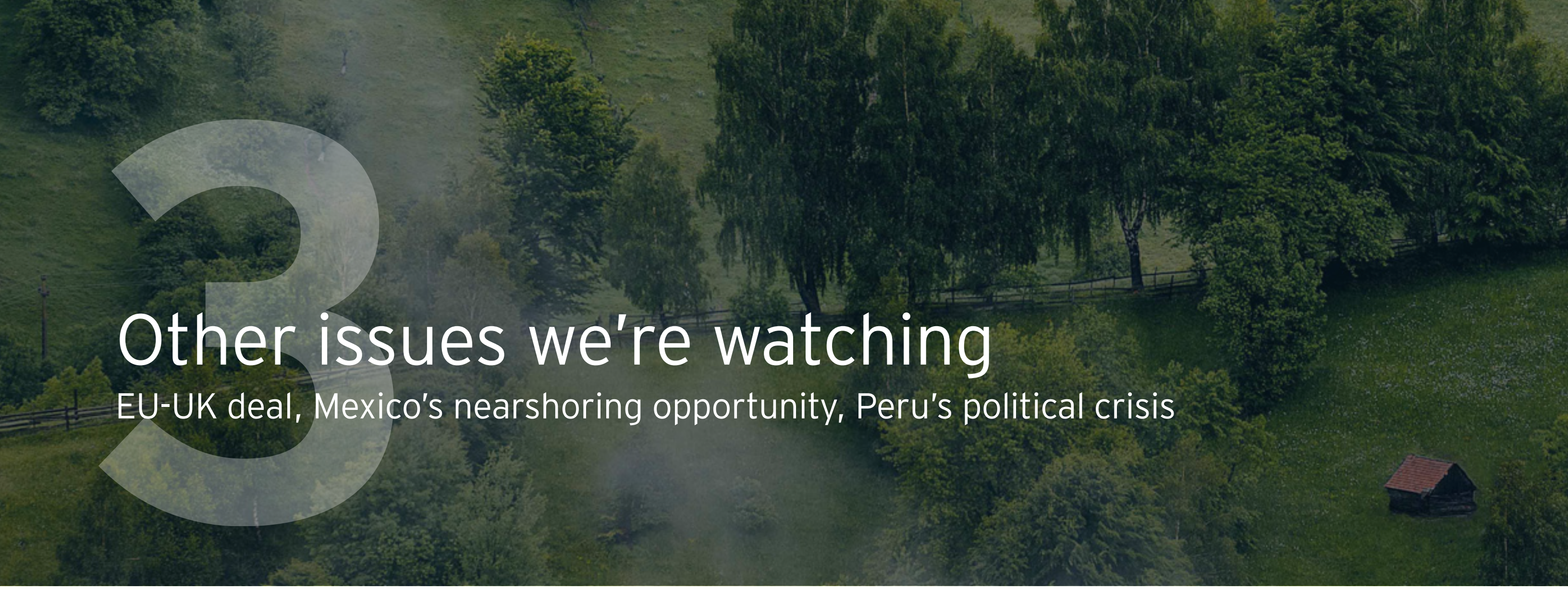
Business impact

While some European companies might face lower energy bills in the short term, future demand increases would put upward pressure on prices. The risk of operations disruptions will remain, especially for energy-intensive industries in countries with stretched government finances.

Companies operating in the energy sector – particularly power and utilities, renewables and mining – are likely to have growth and investment opportunities as European governments incentivize the deployment of renewables and associated industries within Europe.

Contact Famke Krumbmüller or Andrew Horstead for additional information.

Additional reading: Does the need for energy security challenge the quest for net zero?



3 Other issues we’re watching

EU-UK deal, Mexico’s nearshoring opportunity, Peru’s political crisis

Newly agreed Northern Ireland trade rules signal more EU-UK cooperation

In late February, the EU and UK agreed to remove most border checks for trade between Great Britain and Northern Ireland, and allow the latter to follow UK value-added tax (VAT) and state-aid rules. The so-called “Windsor Framework” will likely be approved by the British Parliament, despite hard-liners’ opposition. The agreement could pave the way for more EU-UK cooperation, for instance, on immigration, financial regulations, and joint research funding.

British companies trading with Northern Ireland will benefit from reduced border checks, regulatory harmonization with the UK and the removal of current restrictions on certain goods (e.g., meat, plants, medicines). The Windsor Framework enables the EU and UK to shift their attention to post-Brexit discussions on financial regulations and on allowing British organizations to access EU research funds, which would unlock R&D opportunities with EU-based institutions.

Contact Famke Krumbmüller or Oliver Jones for additional information.

Mexico’s open trade policy creates opportunities amid nearshoring push

A global shift in supply chains, driven in part by the US’s nearshoring and friendshoring efforts, is increasing investment in Mexico’s industrial hubs. The recent summit among United States-Mexico-Canada (USMCA) trade agreement members highlighted the trade policy advantages of the Mexican market, although trade tensions remain in several areas, including Mexico’s energy policy. The recent suspension of proposed changes to the natural gas market is positive for the business environment.

Mexico poses opportunities for companies seeking local value chains and networks near the US market, and nearshoring trends indicate a high potential for additional investments in logistics, transportation and manufacturing. But the high demand is likely to continue to create challenges, such as a lack of warehouses and inventories or an increase in utilities prices. And concerns may persist over government actions in certain areas of the Mexican economy.

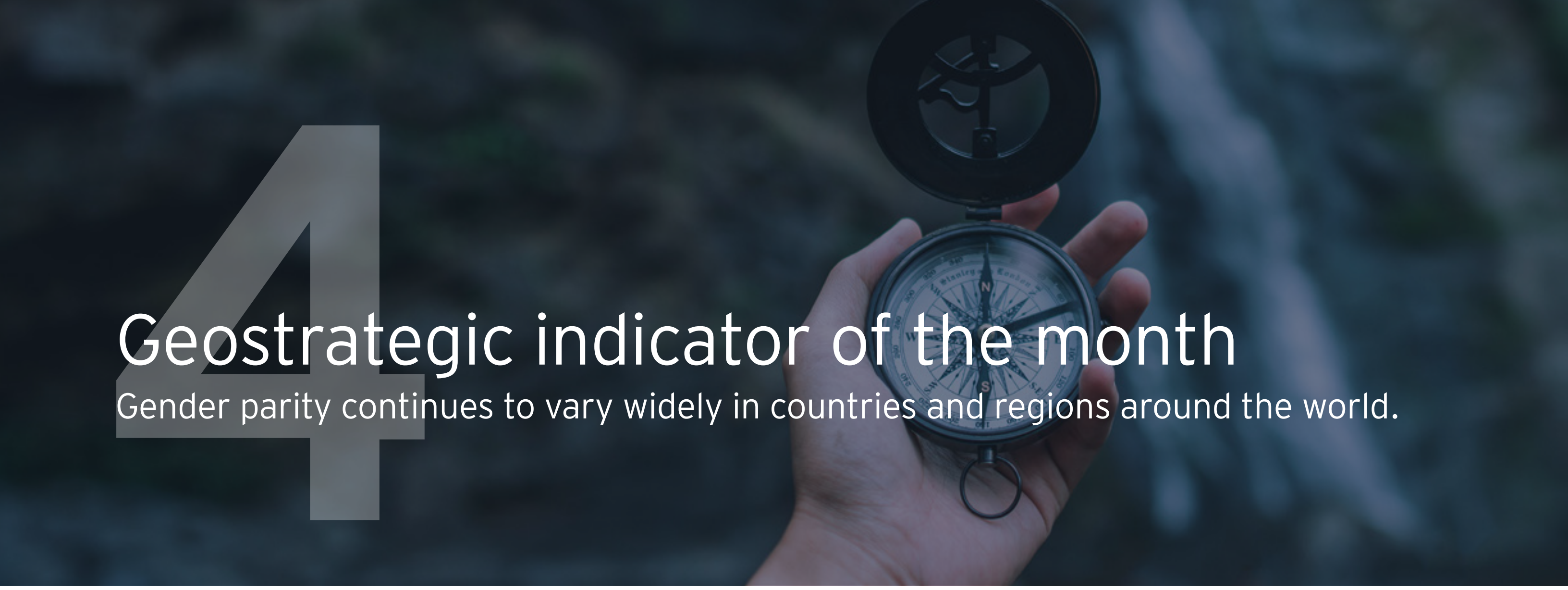
Contact Ari B. Saks for additional information.

Peruvian political crisis threatens copper production

Peru’s ongoing constitutional crisis has led to political gridlock and violent protests. Some supporters of ousted President Pedro Castillo are demanding new elections this year as well as a convention to rewrite Peru’s constitution. The current government appears to be considering early elections, but there is Congressional opposition to constitutional reform, and some citizens are angry about police tactics, suggesting Peru will face continued unrest in the coming weeks.

Persistent or growing unrest could disrupt business operations in Peru. Globally, such disruptions would most greatly impact copper output, as Peru is the second-largest global copper producer. Agriculture and tourism, two other key pillars of the economy, have been affected. The political stalemate and rising societal tensions indicate that businesses should prepare for continued challenges.

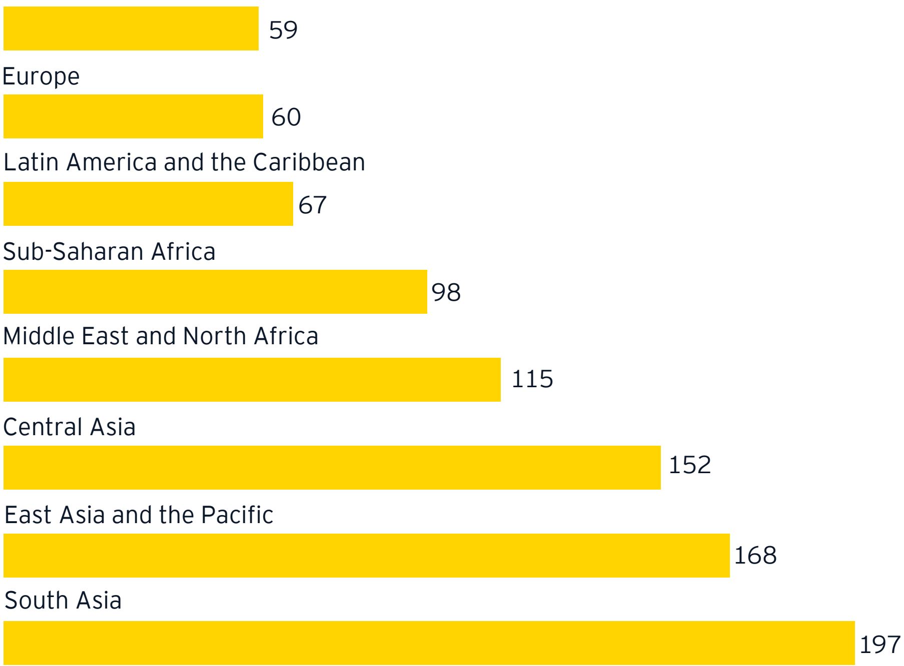
Contact Jay Young for additional information.



4 Geostrategic indicator of the month

Gender parity continues to vary widely in countries and regions around the world.

Estimated number of years for regions to close the gender gap



Source: World Economic Forum, Global gender gap Report 2022

The indicator. The World Economic Forum's 2022 Global gender gap Index ranks countries according to their current state and evolution of gender parity across four dimensions. Government policies, as well as the actions of private companies, have a crucial role in closing the gender gap. For instance, several countries now require companies to publicly disclose human capital data, which could reduce gender disparities in hiring, compensation, and seniority.

Business impact. Gender equality for economic rights and opportunities affects the availability, quality and cost of human capital. It also has implications for growth and revenue prospects, as economies with higher female labor force participation have more consumption power and enjoy stronger economic growth in the long term. Also, companies with a higher representation of female workers enjoy higher productivity gains. Operating in markets with low levels of gender equality could pose reputational risks to global companies.

Additional reading: How to inspire the next generation of women in STEM

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EYG no. 003727-23Gbl

2303-4207109
ED None

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