GEOPOLITICS

Geopolitics and Economics in 2015: a challenging interplay

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Words carry meaning, particularly when they are spoken by the President of the European Central Bank. At the annual summit of the world's top central bankers in Jackson Hole (Wyoming, 22 August 2014), Mario Draghi delivered his plea for a more active and coordinated budgetary policy, backed by a European political union to drag the continent out of stagnation; his criticism of overzealous austerity certainly made people sit up and take notice. In his previous speech (Frankfurt, 7 August) he had mentioned "heightened geopolitical risks" which "may have the potential to affect economic conditions negatively, including through effects on energy prices and global demand for euro-area products".

In both cases Mario Draghi continued his strategy of "forward guidance" for "investor expectations" by presenting criteria for monetary policy, expanding them for the very first time to include a factor that is neither economic nor financial.

In its report on Regional Economic Prospects, the EBRD also emphasised the threat to the peace dividend resulting from the end of the Soviet Union, should Russia's neighbouring states react to the "new geopolitical risks" with a significant increase in military spending. The OECD highlighted, in its interim report on 15 September, the short-term "geopolitical risks" that could negatively affect the economic upturn in the Euro zone: tension in Ukraine and the Middle East, and uncertainty in Scotland. And the recent Economic Forum in Davos pointed out the growing role of geopolitical uncertainties to be addressed within the framework of the long-term decisions to be made by investors.

Yet geopolitical change is underway, sparked by economic change. The pursuit of the Chinese dream so dear to President Xi Jinping is evident in its ambition to establish a new China-led regional order in East Asia. One manifestation of this is the maritime tension between China and Japan (between a revisionist power and a country fretting about a loss of status), which resulted in a 50% drop in direct investment in 2014 and a fall in exports by Japanese companies. Japan is now actively looking for new markets and investment opportunities in India, Africa and ... Europe. Russia, whose reputation is tarnished by its weak legal system, its tendency to resort to armed intervention and forecasts of declining foreign (Western) investment, is examining economic models based on greater self-sufficiency to make up for a lack of imports, hit by the Kremlin's counter-sanctions and retaliatory measures. To circumvent Western sanctions, Russia is turning to China, Turkey and Brazil.

Across a united Europe, the business environment will be affected by nine sets of elections in 2015. These include Greece, which will neither leave the Eurozone nor have its debt erased, but whose repayment schedule will probably be extended; and the still-United Kingdom, where close parliamentary results on 7 May will lead to the Conservatives and Labour forming a "national" coalition government. Although the economic climate will remain extremely clement, the government will have to decide whether to organise an "in/out" referendum on Europe, something David Cameron hopes will resolve, once and for all, the tensions within his own ranks over EU membership, an issue on which the Conservatives face fierce competition from the populist UK Independence Party to their right. The Bank of England will not raise interest rates between now and then.

The Eurozone could see a gentle upturn, riding on the common currency's exchange rate, which should favour exports, and on an oil price expected to stay low for several months due to increased production on the Arabian Peninsula and in North America and reduced demand from emerging economies. Despite the reluctance of six ECB board members, the Eurozone might also benefit from the introduction of quantitative easing sometime before March. Is there any alternative when inflation is stuck at 0.3%? The ECB's goal is to boost investment in conjunction with the Juncker plan, whose effectiveness will be judged by whether it proves a springboard for a genuinely European industrial policy.

Due to strong economic growth in the US, the Federal Reserve is planning the opposite; its Chair suggested in San Francisco that the Fed would raise base rates in June. Discussions between the two central banks can only lead to the realisation that they have no choice but to bolster economic recovery in Europe, and that the Fed must allow the dollar to appreciate.

The conflict between Russia and Ukraine has had a real impact on European countries, which have had to apply sanctions to enforce international law (German exports to Russia fell by 20% in 2014); yet the question of the borders of the autonomous Donbas region has proved a serious stumbling block in negotiations between the two presidents. Unless Ukraine forges closer ties with NATO (something both Berlin and Paris oppose), the tensions between the two states will ease in 2015, although local clashes will continue in a now largely static conflict. It will fall to the two capitals, along with the European External Action Service, to reboot the unfinished task of defining a framework for relations between the EU and Russia, which is in the obvious interest of both parties.

Among other geopolitical situations with an economic impact, it is worth mentioning a probable non-agreement / non-aggression settlement of indefinite length with Iran, allowing business to pick up again; dynastic succession in Saudi Arabia; continuing Western military assistance to Baghdad but no boots on the ground; and the extension of French military operations in the northern Sahel, without any fresh intervention in Libya. A rising China will face domestic development challenges and increasing demands from civil society. Modi's India will follow on its heels.

In 2015, the impact of geopolitical tensions on economic development, so evident in 2014, will be coupled with the increasing effects of domestic political change, in established and emerging powers alike, on public policy.

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