

Berlin, October 9th 2023

Geopolitics Update Q4 2023

In the second half of 2023, Germany is increasingly confronted with the economic costs of the *Zeitenwende* and the unexpectedly sharp slowdown of Chinese growth. The Ukrainian counteroffensive has so far been characterized on the ground as a war of attrition with limited progress but is showing significant success with attacks on Crimea and hybrid actions in Russia. Meanwhile, with the power struggles in Congress and the start of the primary campaign season in the USA, uncertainties about the long-term orientation of American foreign and security policy are coming to the fore again. Trump still dominates the field of Republican candidates, while legal proceedings based on the 14th Amendment of the US Constitution could prevent him from running again. Together with the European Parliament elections, 2024 will be a “super election year.” In the short time remaining, the US administration is advancing negotiations in the Middle East and its diplomatic initiatives at establishing guardrails to the relationship with China. At the same time, the European Commission is seeking to reach an agreement with the USA on key industrial and trade policy issues.

With BRICS-plus, China is continuing its strategy of forming its own alliances as a way of expanding global influence. The new member countries Iran, Saudi Arabia, UAE, Egypt, Ethiopia, and Argentina are driven by a strong interest in a counterweight to Western-dominated global institutions.

Europe's environment is being destabilized by conflicts in the Near and Middle East, North and Central Africa, the Balkans, and the Caucasus. The Europe-wide strengthening of right-wing parties and the upcoming massive EU-enlargement wave pose great challenges to the EU's ability to act. Poland's action against grain deliveries from Ukraine illustrates the pressures the EU - especially the European structural policy with the EU accession process for Ukraine – will be exposed to.

With the terrorist attacks launched by Hamas last Saturday morning, diplomatic initiatives by the US to broker an accord between Israel, Saudi Arabia and the Palestinians have been most effectively disrupted. Escalation risks are high given Hamas' backing by Iran, the huge pressure on the Israeli military to clear Gaza from Hamas terrorists and numerous hostages taken not only from Israel but also amongst US nationals. A large-scale ground offensive into the Gaza Strip would further increase risks of Hezbollah involvement and the possibility of a two-front war.

In addition, these circumstances will put an end to the recent limited understanding reached between the US and Iran. Israel ordering a shutdown of one of its offshore gas fields near Gaza has added to commodity price pressure, with in particular gas jumping double-digit.

Russia-Ukraine Invasion: From Blitzkrieg to War of Attrition

More than 500 days since Russia's invasion of Ukraine, the conflict has developed into a war of attrition. Ukraine has only a few weeks in its current counteroffensive left for significant territorial gains before the weather impedes troop movements. Attacks in Russia, unmanned sea drones decimating the Black Sea fleet, and successful attacks on Russian military and command structures in Crimea are putting increasing pressure on Russia. They also document Ukraine's strategic focus to make Crimea untenable for Russia - a crucial prerequisite for Ukraine's documented willingness, to negotiate a possible international status for Crimea following a ceasefire.

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A significant factor for the further course of the war is the continued equipping with military hardware and technological upgrade of Ukraine by the West, especially with artillery capacity. Russia's diplomatic calculus will be shaped by dynamics on the battlefield and the US presidential elections in the coming year. Since the start of the war, Putin increasingly has to manage his power balance at home, particularly after the failed mutiny by Prigozhin revealed cracks in the Russian power structure. More than ever, the Russian president is therefore relying on victory in Ukraine and a firm grip on power at home. The country's economic reorientation towards a war economy and Russia's financial problems are deepening, prompting Putin to try to create breathing space by deepening alliances (China, Iran, North Korea).

Embargoes and supply chain interruptions on sea routes in the Black Sea and the Strait of Kerch, through which a significant part of Russian and Ukrainian agricultural products is exported, could intensify inflationary pressure in the Eurozone once again. Tensions between Warsaw and Kyiv in the run-up to the elections in Poland show the increasing difficulties in a number of European countries to maintain public support for substantial aid for Ukraine. Further EU or US measures against non-Western states and companies in Turkey, the UAE, or Kazakhstan, through which Russia is circumventing sanctions, can be expected.

Sino-Western Relations: Diplomacy and De-risking

The Biden administration is seeking to stabilize relations between China and the West in a balancing act of de-risking, deterrence, and diplomacy. After the G7's agreement in May on de-risking economic relations with China, President Biden issued an executive order for an outbound investment screening mechanism which the European Commission is likely to follow with its own proposal by the end of the year. Contrary to widespread expectations, the American proposal, with a focus on relevant high-tech sectors such as AI or quantum computing, largely aligns with the "small yard, high fence" principle formulated by Biden's National Security Advisor Jake Sullivan.

Following the US diplomatic outreach of the past months, a meeting between Xi and Biden in San Francisco on the sidelines of the Asia-Pacific Economic Cooperation Conference in November is currently in the works.

However, Sino-American relations remain vulnerable to sudden disruptions with Taiwan as the most dangerous hotspot. A (probable) victory of the independence-friendly Democratic Progressive Party (DPP) in the presidential elections in Taiwan in January 2024 would further decrease the likelihood of a peaceful integration of Taiwan into the People's Republic and push the Communist Party to an even more confrontational course towards Taiwan. At the same time, China's military pressure remains high: September 17 marks a preliminary climax with 40 violations of the Taiwanese air defense identification zone by the Chinese air force. The annual publication of the so-called "Chinese Map," against which South Pacific states like Vietnam have protested, this year contains the "10 dash" - instead of the "9 dash" line used in previous years - which runs east of Taiwan, thus adjusting the border according to Beijing's view.

In response to the unexpectedly sluggish recovery of the Chinese economy after the end of the zero-Covid policy, the Chinese government has not yet reacted with a significant stimulus. The weakness of the real

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estate sector dampens domestic demand and increases the risk of a crisis-like development in China's financial system. Nevertheless, General Secretary Xi has effectively reiterated the priority of security over growth in his comments at the May meeting of the Chinese National Security Committee. Further restrictions, for example on access to financial information, justified based on the protection of Chinese companies from US sanctions, will hamper a trend reversal in FDI to China.

US Presidential Elections: He's Back...

The polarization in the US Congress, as well as the upcoming Republican primary campaign ahead of the presidential elections next year, impedes Washington's ability to act. At the time of writing, the House of Representatives is without a speaker, limiting its legislative abilities. Even though solid majorities in the House and Senate continue to support aid to Ukraine, Washington's current vacillations will strain the trust of US allies and strengthen Putin's resolve to pursue his war objectives in Ukraine.

Meanwhile, a renewed showdown between Biden and Trump in November 2024 is becoming increasingly likely. According to the data analysis organization *FiveThirtyEight*, Trump has a win probability of 78% in the Republican primaries. On the other hand, Biden as of yet doesn't have any serious opponent in the Democratic nomination. While polls from the relevant battleground states are still sparse at this point, national polls show Trump and Biden statistically tied. Simultaneously, alongside Trump's six ongoing court cases, lawsuits are currently being filed with the aim of disqualifying the former president under the 14th amendment of the US Constitution. This amendment denies citizens, who as military members or officeholders have sworn an oath to the Constitution, the right to run for an elective office if they have supported an insurrection against the US and its Constitution.

At the same time, President Biden and Commission President von der Leyen will try to resolve existing trade disputes before the end of their respective terms. Currently, a trade agreement in rare earths is in focus, which would allow companies based in the EU to benefit from IRA subsidies for EV batteries. On the other hand, a basic agreement to settle a US-EU tariff dispute on steel and aluminum exports is likely to be reached. In this context, the US and the EU are currently also trying to coordinate possible trade restrictions against Chinese steel and aluminum exports. Adding to the announced investigation of Chinese subsidies for EVs by the Commission, this would add further tensions to the Sino-European trade relationship.

Middle East: Hamas terror disrupts Abraham process

In the Middle East, the successful mediation by China between Iran and Saudi Arabia, Iran's admission to the BRICS group, and the continued coordination of crude oil supply cuts between Saudi Arabia and Russia had triggered new diplomatic initiatives by the US administration. Triangular negotiations between the USA, Saudi Arabia, Israel (and the Palestinian Authority) were geared towards a new security partnership between the USA and the kingdom and normalizing diplomatic relations between Jerusalem and Riyadh. This could have become the biggest game changer for the Middle East since the rapprochement between Israel and the UAE, and, together with the recent negotiations between the USA and Iran, could also have contributed to a relaxation in global oil markets.

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Geopolitics Update Q4 2023

With the terrorist attacks launched by Hamas last Saturday morning, those initiatives will have been most effectively disrupted. Escalation risks are high given Hamas backing by Iran, the huge pressure on the Israeli military to clear Gaza from Hamas terrorists and numerous hostages taken not only from Israel but also amongst US nationals. In addition, not only will these developments question the strategy of the Biden administration to seek a limited détente in its relationship with Iran, but also bring Iran's nuclear program back on the agenda as a significant geopolitical risk to the region and beyond.

Berlin Global Advisors specializes in government affairs and geopolitical risks. We advise clients on complex transactions and support them in implementing business strategies in foreign markets.

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