

Hidden Risks To The Global Economy

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Abstracts

Most of the main risks to global economic and geopolitical stability are well known. These are typically a double-dip recession in the United States; the collapse of the eurozone; a 'hard landing' in China; and a war involving the US and its allies against Iran. However, there are plenty of other risks that, while not necessarily 'global' in scope, have the ability to destabilise their regions. This in turn would have negative consequences for business and investment and add to the sense of a dangerous world. In this report, we outline 12 of these 'hidden risks'. When we say hidden risks, we do not mean 'black swan' or completely unpredictable events. Such risks could include a new mass-casualty Islamist terror attack against a major city; a large-scale natural disaster such as a flood or volcanic eruption affecting a key economic region; and the sudden emergence of a new pandemic that disrupts global travel and trade. These are all certainly plausible risks, but they are events whose probability or timing simply cannot be estimated with any degree of confidence. Our list of hidden risks also excludes events such as a geopolitical crisis on the Korean Peninsula or in the South China Sea, a large European state quitting the eurozone, or Western intervention in Syria, because these are all widely recognised in our view. Rather, the hidden risks we identify are all developments which, while not necessarily unknown, are sufficiently 'under the radar' to most business decision-makers or under-reported by the mainstream media that if they were to escalate, would make investors say 'I wish I'd known about this earlier'. Our selection of risks was also determined by our belief that each could play out over the next 12-15 months, rather than an indefinite timeframe spanning many years. As it happens, most of the risks are political, although most also have economic implications. However, there is a mismatch between geopolitical and economic risks. For example, a major crisis in Pakistan or a decisive break in US-Pakistani relations would have substantial geopolitical consequences, such as exacerbating the war in Afghanistan, and increasing the risk of Islamist militant attacks in Central and South Asia. Nonetheless, due to the somewhat peripheral status of Pakistan's economy, it would have a very limited impact on the global economy, aside

from increasing India's risk environment. For a geopolitical crisis to have a global economic impact, it would have to lead to a spike in oil prices (which would be felt worldwide) or result in moves towards armed hostilities by at least two major economies. For this reason, we regard a potential conflict between Armenia and Azerbaijan over the disputed territory of Nagorno-Karabakh as a potential global crisis. This is because Armenia is allied to Russia, while Azerbaijan has very close ties with Turkey (a member of NATO) and the US. Iran also has very strong interests in the South Caucasus. Thus, a new conflict between Armenia and Azerbaijan could quickly drag in Russia and NATO states on opposite sides, with Iran potentially thrown into the mix. Given the importance of Azerbaijan to the development of Caspian Sea oil and gas resources, and the fact that the Baku-Tbilisi-Ceyhan (BTC) pipeline passes through Azerbaijan, a conflict in the region could cause oil prices to surge. Even after a putative war had ended, we would expect relations between Russia and the West to be substantially cooler than before. A further Russia-centric risk we see stems from the likelihood of a more assertive Kremlin, when Vladimir Putin returns to the presidency in March 2012. We see scope for greater strains between Russia and the Baltic states over the status of ethnic Russians, and between Moscow and Western capitals over the United States' planned missile shield.

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Risks and Implications

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