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December 11, 2023

The 2024 Geopolitical Outlook

(Note: This is the final BWGR of 2023; the next report will be published on January 15, 2024.)

As is our custom, in mid-December, we publish our geopolitical outlook for the upcoming year. This report is less a series of predictions as it is a list of potential geopolitical issues that we believe will dominate the international landscape in the coming year. It should also be noted that some of these issues may be important only in 2024, while others could affect 2024 as well as later years. The report is not designed to be an exhaustive list but instead focuses on the big-picture conditions that we believe will affect policy and markets going forward. They are listed in order of importance.

Issue #1: The Jungle Grows Back

The title of this section refers to a book [published by Robert Kagan in 2018](#).¹ Kagan's point was that the U.S. was seemingly pulling back from its engagement with the world and creating global instability in the process of doing so, i.e., allowing "the jungle" to return to the world.

Here at Confluence, we subscribe to Hegemonic Stability Theory. This concept, first discussed by Charles Kindleberger, is that the world needs an engaged, dominant country—or hegemon—to provide two key global public goods. First, the hegemon must ensure global security. That generally

entails preventing small wars from becoming major ones and protecting the global sea lanes in order to support commerce. Second, the hegemon usually supports the global financial system by providing the reserve currency and reserve asset.

In the absence of a hegemon, global trade declines because trade becomes unsafe (shipping is at risk of interdiction), and there isn't a reliable currency to conduct trade or an asset to hold surpluses. Trade is reduced to partners close enough for the participants to provide security with bilateral financing relationships. In addition, wars not only become more frequent, but individual conflicts can expand due to the lack of hegemonic control.

One of our key concerns over the past 15 years is that American leadership has not been able to create a policy formula that would allow the U.S. to maintain hegemony while fostering domestic political stability. Unnecessary wars of choice, domestic de-industrialization, and widening income inequality have led to the rise of populism, which tends to support isolationism. Thus, as the U.S. retreats from its global responsibilities, the world becomes increasingly dangerous.

Surveying the global landscape today, we see an extraordinary number of conflicts and tensions that are evidence of a breakdown in global order:

1. War in Ukraine
2. War in Gaza
3. Potential conflict in Serbia

¹ Kagan, R. (2018). *The Jungle Grows Back: America and Our Imperiled World*. New York, NY: Knopf.

4. War in Azerbaijan/Armenia
5. Increased tensions in space
6. Russian and Chinese encroachment in the Arctic
7. Undersea issues, including undersea cables being cut in the North Atlantic
8. Chinese aggression in the South China Sea
9. Venezuela's threats to Guyana's oil producing region.

Essentially, the U.S. is faced with threats in multiple domains. Although America probably has the resources to address these issues, it can't do so given the current degree of attention. In other words, the response from policymakers to these threats has been slow. We believe the slow response is due, in part, to the desire to hold onto the post-Cold War peace dividend. If the focus shifts toward addressing these concerns, we would expect more fiscal spending and higher inflation.

In 2024, a key risk will be the ability of the political class to manage these various threats. Of particular concern are signs of fatigue in support of the war in Ukraine. Although congressional support for funding the Russia-Ukraine War has persisted, there is steadily growing opposition to continued expenditures. As the threat environment widens and grows, decisions about the level of support will become a persistent issue.

Another worry is that there appears to be limited bandwidth of attention. Venezuela's recent threats to Guyana over the latter's western border are related to unresolved issues that date back to the early 1800s. Until oil was discovered in Guyana, Venezuela had little interest in bringing up this issue. But now, with Guyana poised to become a major oil producer, Caracas is dredging up these old claims and threatening military action. Under normal

circumstances, the U.S. could keep the peace, but in a world of high oil prices, we have seen the Biden administration ease sanctions on Venezuela. It's possible that President Maduro senses an opportunity; the U.S. may not interfere due to worries about a disruption of oil supplies.

In sum, when "the jungle is growing back," problems that would usually be contained are instead left to fester. We see this as a growing risk that will continue in 2024.

— BOG

Figure 1



(Source: New York Times)

Issue #2: Elections Everywhere

Another extraordinary aspect about 2024 is that its global political calendar is jam-packed, with many important national elections scheduled. By national elections, we mean either legislative or national leader votes. Here is a list of the key contests we'll be monitoring:

Taiwan will be holding presidential and parliamentary elections on January 13. The presidential election is important as William Lai, the Democratic Progressive Party (DPP) candidate, is strongly opposed by Beijing. China believes the DPP's goal is to declare independence. Either Hou Yu-ih, the Kuomintang (KMT) candidate, or Ko Wen-je, the Taiwan People's Party (TPP)

candidate, would be preferred by China as these parties tend to support the “one China” concept. There was an attempt by the KMT and TPP candidates to agree on a unity ticket, which would have been a major threat to the DPP, but, so far, the opposition hasn’t been able to settle on a candidate. We expect that Beijing will try to interfere in this election. If the DPP prevails, increased tensions would likely result.

Finland will hold a presidential election on January 28. The country runs a multi-party election and, currently, there are nine confirmed candidates. The current polling leader is Alexander Stubb, the former prime minister from 2014-15, who is at 24%. He represents the National Coalition Party, which is center-right. If no candidate receives a majority, a second round between the two leading candidates will be held on February 11. Finland is a parliamentary democracy where the prime minister is the head of government, whereas the president is the head of state and commander in chief of Finland’s military forces. This election is important because Finland has joined NATO in response to Russia’s invasion of Ukraine. Russia has exercised some degree of influence over Finland since the early 1800s. During the Cold War, the Soviet Union’s relationship with the country was called “Finlandization,” which described a position where Finland was decidedly neutral. A Finland in NATO is a threat to Russia, and so, we expect some attempts by Moscow to influence this election.

El Salvador will hold presidential and parliamentary elections in February. [China has been attempting to expand its influence in El Salvador](#), with some success. Nayib Bukele, the current president, is running for a third term. The constitution doesn’t allow for third terms, but a recent court decision is

allowing him to run. We expect Bukele to win.

Russia will hold a presidential election on March 17. Vladimir Putin is almost certain to win. Nevertheless, we will be watching the level of turnout as an indication of support for the country’s war in Ukraine.

Ukraine is scheduled to hold presidential and parliamentary elections on March 31. However, due to the war, it is not certain that they will be held.

Mexico will hold presidential and legislative elections on June 2. The current president, Andrés Manuel López Obrador, also known by his initials AMLO, is barred by the constitution from running again. His party’s expected nominee, Claudia Sheinbaum, is leading in the polls. If elected, she would be the first woman and Jew to win Mexico’s presidency. Although Sheinbaum would be expected to maintain the current policies of Obrador’s presidency, one significant difference could be on environmental issues. AMLO has supported the fossil fuel industry, whereas Sheinbaum is much more supportive of alternative energy development. Two items are especially important to watch: First, will she hamper oil and gas supplies from Mexico? And second, will she buy the components for wind and solar from China?

The **United States** will hold presidential and legislative elections on November 5. We will cover the American elections in more detail below.

The **United Kingdom** must hold elections by January 28, 2025, but in the British system, the prime minister can call for elections before that date. Given the Conservative Party’s current weak polling, we doubt Prime Minister Sunak would call the

elections early. However, if something occurs to improve the Tories' popularity, an election is possible in 2024.

Venezuela must hold elections this year. Currently, the Maduro regime is in talks with the opposition to establish the ground rules for an election. The U.S. has eased sanctions on Caracas in part to boost global oil supplies and in part to encourage Maduro to hold "free and fair" elections. If oil prices remain elevated, we expect Washington to give President Maduro wide latitude in determining what is "free and fair." On the other hand, if oil prices fall, we could see the return of sanctions if Maduro doesn't assure the U.S. that elections will be legitimate. — *BOG*

Issue #3: The U.S. Elections

It is obvious the U.S. political system is becoming increasingly fractured. Anger over de-industrialization, long and inconclusive wars, income inequality, the Great Financial Crisis of 2008, and other trends have all conspired to undermine the electorate's faith in the country's political system. It's therefore not surprising that non-traditional presidential candidates won the elections of 2008, 2012, and 2016. We have viewed the Biden presidency as an attempt to return to the "old guard," but, swept up in the times, he has actually passed several groundbreaking legislative measures. Interestingly enough, these victories have done little to improve his approval numbers. There are increasing worries about Biden's advanced age.

On the GOP side, former President Trump is trying to do something that hasn't been done since President Cleveland won non-consecutive terms. Also unique is that Trump is facing a myriad of legal actions. And, like Biden, he is no youngster.

At this juncture, the [political betting sites](#) suggest a close race, with Trump leading 40% to 37%. However, the generic question of "which party wins the White House" favors Democrats 54% to 48%.

Our sense is that the political situation is fluid. In recent years, third-party candidates have mostly been spoilers. The last extra-party candidate to win electoral votes was George Wallace in 1968. This time around, though, it is conceivable that a third-party candidate might be viable. At the very least, a third-party candidate might lead a major party to select a different candidate.

From a geopolitical perspective, we see two key concerns. First, it is conceivable that foreign policy could be very candidate-dependent. Although both Biden and Trump have opposed China, their policies toward the country have been quite different. Foreign nations are watching closely to see how they will have to adjust to the next occupant of the White House. Second, given the stakes, there will be an incentive for foreign governments to try to sway the American electorate. We saw some of that in 2020, and given how technology has evolved, we expect both sophisticated and blatant attempts to affect the election.

Next year's election raises the fear of uncertainty. Investors should be wary of facile analysis based on historical precedent that will probably be less relevant in the current environment. We don't know the outcome, but one should be prepared for surprises. — *BOG*

Issue #4: U.S.-China Tensions

We continue to believe that the world's key geopolitical relationship is the one between the U.S., the current global hegemon, and China, the aspiring power. As noted above, U.S. policymakers and voters will continue

to tussle in 2024 over the costs and benefits of maintaining the country's leading role in the world. In authoritarian China, General Secretary Xi and the Communist Party will show no such hesitancy. They will surely keep working to bulk up all aspects of Chinese power in order to eventually displace the U.S. and achieve Xi's goal of "the great rejuvenation of the Chinese people."

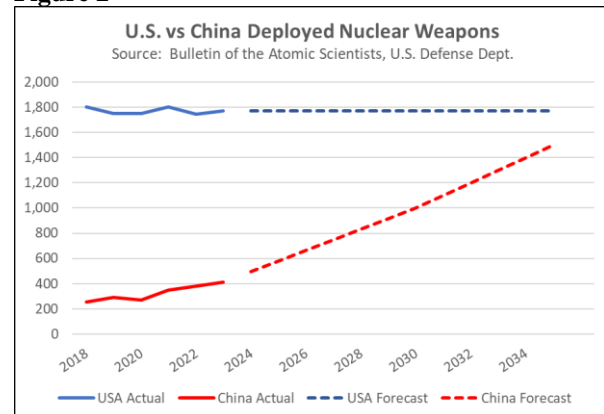
All the same, China in 2024 will continue to face economic headwinds from what we call the **Five Ds**: weak consumer **demand**, high corporate and local government **debt**, poor **demographics**, economic **disincentives** from the Communist Party's increasing intrusion into the economy, and **decoupling** as foreign countries shift their trade, investment, and technology flows away from China. These challenges have already prompted Xi to seek an easing of tensions with the West, and we think he'll remain focused on détente in 2024, at least in terms of diplomatic and economic relations.

In contrast, we've seen no sign that Xi is ready to ease up on China's defense buildup, its aggressive military operations, or its effort to create "positional advantage" where it has territorial disputes, especially around Taiwan and in the South China Sea. Even with China's slowing economic growth, we assess that it can keep pouring resources into its armed forces. [Importantly, the latest intelligence shows China continues to ramp up its arsenal of strategic nuclear weapons, putting it on track to match or exceed the U.S. arsenal of about 1,750 deployed warheads by 2035.](#) China's future nuclear arsenal, possibly coordinated with Russia's existing U.S.-sized arsenal, will be a formidable back-up to China's growing navy (now the world's largest, with about 370 combat ships versus 295 for the U.S.) and to its arsenal of conventional tactical

missiles that can already saturate the waters off China's coasts.

As U.S. officials and voters become more aware of China's military buildup and the U.S.'s lagging effort to rebuild its defenses, there is an increased chance of a sudden U.S. political crisis reminiscent of the "Missile Gap" controversy of the 1950s and 1960s. The result could be a crash effort to hike U.S. defense spending and expand the military, with any politicians who oppose the effort pilloried for being "soft on China."

Figure 2



That political dynamic would be especially likely if China further ramps up its highly provocative military operations in the Taiwan Strait, the East China Sea, and the South China Sea. [The Chinese navy's aggressive harassment of Philippine ships around disputed shoals in the South China Sea should be considered especially dangerous, given that the U.S. has a mutual defense treaty with Manila.](#) If the Chinese navy, coast guard, or maritime militia accidentally sinks a Philippine ship or injures Philippine sailors, the U.S. could be drawn into a risky crisis. — PFH

Issue #5: Shifting Geopolitical Blocs

Because of the U.S.-China rivalry, the world continues to fracture into relatively separate geopolitical and economic blocs. In 2024, the U.S. and China will likely keep trying to

solidify their own camps and peel countries away from their rival. For the U.S., an important effort in 2024 will be to keep drawing India—now the world’s most populous country—into a closer economic, military, and diplomatic relationship with Washington. However, Indian Prime Minister Modi is becoming increasingly authoritarian, even to the point where he has apparently ordered his intelligence services to assassinate Sikh separatists living in the [U.S.](#) and [Canada](#). Reflecting India’s past close relations with the Soviet Union and its modest level of trade with the U.S., our analysis currently places India in the “Leaning China” bloc. The U.S. is trying to pull India into the “Neutral” bloc or even the “Leaning U.S.” bloc, but Modi’s authoritarian ways could potentially slow or even scuttle that effort in 2024.

Another key test for the U.S. in 2024 will be Argentina, which our analysis currently places in the “Leaning China” bloc. [Newly elected President Javier Milei, a radical populist libertarian, has expressed a desire to reorient Argentine economic and diplomatic relations away from China and back to the U.S.](#) If Milei can successfully reverse the prior Peronist governments’ priority of exporting Argentine commodity riches to China, it could help reverse Beijing’s growing influence in Latin America. — *PFH*

Issue #6: Russia-Ukraine

Russia’s invasion of Ukraine, launched in February 2022, now appears to have evolved into a virtual stalemate. Russian forces now hold some 20% of Ukraine’s territory, and the front lines have largely devolved into World War I-style trenchworks. Russia’s superior manpower availability and defense industry capacity now stand in rough balance with Ukraine’s ability to source advanced equipment from the West. That dynamic is likely to continue in 2024,

especially if the U.S. and its allies maintain some level of support for Kyiv.

Over time, if the two sides reach something like exhaustion, the most likely outcome will be a negotiated peace that leaves Russia with some gains. The more gains Russia ends up with, the more it is likely to bolster Russia’s place as the key partner in China’s geopolitical bloc (which is why we often refer to the group as the “China/Russia bloc”). However, this mutual exhaustion may not occur even in 2024. It would not be surprising to see the fighting continue throughout the new year. — *PFH*

Figure 3



Issue #7: Israel-Hamas

While Israel’s military has already destroyed much of northern Gaza in retaliation for the Hamas group’s October 7 attacks, Prime Minister Netanyahu has signaled that his government will continue its military operations in the territory in the coming

weeks. The operations could well continue into 2024, especially given Netanyahu's professed goal of dismantling the militant group. Growing violence in the West Bank, and by Iran-backed militants elsewhere in the Middle East, will keep alive the risk of the conflict broadening.

If Israel continues its airstrikes and ground operations and civilian casualties keep mounting, Israel will come under increasing international pressure to ease up. We suspect Israel will ultimately be forced to cease its attacks before it can destroy Hamas outright. After all, the complete destruction of such a group is a tall order, since it would require destroying the very idea that Hamas stands for, i.e., eliminating Israel as a country and allowing the Palestinians to take control of Israeli territory. Still, even if Israel stops its attacks on Gaza early, it could successfully improve its security situation by severely weakening Hamas. That would especially be the case if Israel and the international community agree on a plan that would eliminate Hamas's political power in Gaza. — PFH

Ramifications

As noted earlier, we don't view these issues as exhaustive, but they do represent the concerns we will be most closely watching as the year progresses. We encourage readers to monitor our reports throughout the year for updates.

In terms of the global investment environment, all these issues are consistent with what we have been expecting as the post-Cold War period of relative peace and globalization gives way to the new era of Great Power competition and U.S.-China rivalry. The increased risk of conflict and potentially sharp political shifts will probably push companies to keep reorienting their supply chains and focus on resilience rather than efficiency. This "friend-shoring" and focus on resilience will likely lead to a period of re-industrialization in the U.S. and the rest of the West, with higher and more volatile consumer price inflation and interest rates over time. Looking at 2024 alone, however, the most important implication may simply be that greater international tensions and political uncertainty are likely to boost risk premiums and act as headwinds for risk assets. Falling inflation and an end to the major central banks' interest rate hikes could spark a rally in risk asset prices in 2024, but the issues we describe in this report could also produce bouts of volatility.

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