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Geopolitical conflict

Charting a course through geopolitical conflict

Food, electronics, critical medical supplies, cars, fuel - nearly all the world's essential imports and exports are at sea at any given time. The security of these goods and a robust supply chain are vital for the functioning of modern society. A geopolitical conflict that threatens supply chain stability could threaten economic resilience around the world.

Picture the scene: Global economy capsizes

Tensions rising – Following a regime change, tensions between a superpower, a neighbouring territory that controls access to critical shipping routes, and the wider political community begin to escalate.

Hostile attack – The superpower launches an invasion on a neighbouring economy, marked by an internet blackout, cyber-attacks on critical infrastructure, and a physical blockade. Disruption to global trade begins.

Alliances escalate conflict – Response from another superpower, supporting the besieged territory, leads to a coalition of allied states forming on both sides. Trade routes around the territory are avoided, and both superpowers impose sanctions on each other disrupting the global flow of goods.

In response, threats to close the shipping lanes create an unofficial war zone. Opposing coalition forces amass in the region, ready to counter any efforts to seal access and the superpower's lawmakers seek to pass a bill preventing other states from using the shipping lane without express permission.

Stalemate and skirmish – The diplomatic standoff continues, tensions on the ground boil over and violence breaks out between rival factions. Critical infrastructure such as ports, power plants and other utilities are affected leading to shortages in essential resources. The need to divert military resources to the area puts governments on a war footing, shocking global financial markets and potentially impacting taxes and public spending. An extended closure and the involvement of multiple nations magnifies the economic fallout. Civil unrest across the world in reaction to the events grows.

Diplomacy – Governments engage in diplomatic negotiations with the superpower in an effort to open the shipping lane. Continued presence of forces close to its borders is taken as an act of bad faith and the country's leadership proceeds with closing the shipping lane.

Paralysis – A military response has a knock-on effect; closing alternative routes and causing a wide variety of supply chains to slow down or effectively pause global production. The reduced supply of goods leads to significant price rises, adding inflationary pressure to already stretched economies.

How severe could the situation get?

To help understand the need to build societal resilience and preparedness against potential geopolitical conflicts, we have calculated the impact this scenario could have across our three severity levels on businesses and the wider economy. In all three levels the fighting takes place in the besieged territory and at no point are there territorial attacks on the superpowers or on any major powers.

Level	Scenario severity descriptions
Major	**Regional conflict:** The invasion to the besieged territory disrupts shipping lines and supply chains. Conflict remains between the invader and invaded territory. Other superpowers limit support to the supply of military equipment. Other major and minor powers do not get involved. Conflict impact lasts for one year.
Severe	**Involvement of major powers:** The conflict intensifies as major powers intervene, deploying their own forces to counter the invasion. Conventional military engagements extend to surrounding areas, exacerbating the situation. Conflict impact lasts for more than a year
Extreme	**Involvement of minor powers:** The conflict expands as minor powers also become involved, leading to hostilities that extend beyond the initial region. Escalation results in prolonged disruptions to supply chains and global trade. Conflict impact lasts for more than three years.

$14.5trn

5- year global economic loss from a geopolitical conflict

How vulnerable is the economy?

If this scenario were to take place, the global economic impact could reach $14.5 trillion over a five-year period (this represents the probability weighted average across the three severities we have modelled), with an expected economic loss of $1.4 trillion (the economic loss multiplied by the probability of the event occurring).

Which sectors might be most at risk?

Manufacturing – With a shortage of raw materials, producer countries may not receive payment for goods and importing countries will not be able to use the materials to create new products.

Semiconductors – No single country has end-to-end dominance over the production and supply segments that result in finished semiconductor chips. Interruptions to the semiconductor supply chain can cause supply shortages and price inflation of the end product.

Healthcare – Supply chain interruptions could hinder access to critical medical equipment reliant on global supply chains. Increased costs and reduced confidence could stall investment in large projects and new equipment.

Transportation – Conflicts can impact the movement of goods as ships and airfreight are prevented from travelling through the conflict zone. No-fly zones and sanctions may prevent the movement of goods and people, and cause transport companies to lose revenue or close.

What can businesses do?

Data collection: Understanding the flow of goods in individual supply chains, how customers react, and how third parties impact your own supply chain is a good way to understand where potential weaknesses – or opportunities – lie.

Contingency planning: Approaches such as broadening the range of suppliers, finding alternative locations for manufacturing and operations, and developing a system of redundancy can help maintain business continuity in a crisis.

Act responsibly: Global companies with teams in local hubs have a responsibility to support their staff, and to an extent the wider community. Protocols should be in place to evacuate or cease operations in the event of geopolitical conflict.

Digital network resilience: A regular regiment of offline or external backup processes can keep most information secure and up to date. Contingency and business recovery plans allow companies to find ways to carry out their operations while still offline.

Next steps

Work proactively to build resilience in your risk management against these threats and connect with your broker to discuss risk transfer for geopolitical conflict.

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