TOP RISKS 2023

Ian Bremmer
President

Cliff Kupchan
Chairman

1 Rogue Russia
2 Maximum Xi
3 Weapons of mass disruption
4 Inflation shockwaves
5 Iran in a corner
6 Energy crunch
7 Arrested global development
8 Divided States of America
9 Tik Tok boom
10 Water stress
* *Red herrings*

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We're (mostly) through the pandemic. Russia has no way to win in Ukraine. The European Union is stronger than ever. NATO rediscovered its reason for being. The G7 is strengthening. Renewables are becoming dirt cheap. American hard power remains unrivaled. Midterms in the United States were decidedly normal ... and many of the candidates posing the biggest threat to democracy (especially those who would have had authority over elections) lost their races. Meanwhile, Donald Trump is the weakest he has been since he became president, with a large number of Republicans preparing to take him on for the GOP nomination.

There's got to be a catch.

The big one: A small group of individuals has amassed an extraordinary amount of power, making decisions of profound geopolitical consequence with limited information in opaque environments. On a spectrum of geopolitics with integrated globalization at one extreme, these developments are at the other extreme, and they're driving a disproportionate amount of the uncertainty in the world today.

Our top risks this year are skewed toward these actors and their impact: Rogue Russia, Maximum Xi, Weapons of mass disruption, and Iran in a corner all come from international actors facing severe structural challenges and strong opposition (internal and/or external) in achieving their desired goals, with neither oversight, adequate expert inputs, nor checks and balances constraining their actions.

Dictatorships are stumbling at the same time that they're becoming more consolidated. Vladimir Putin's Russia is too isolated for its leader to attend the G20 summit, facing serious economic and military decline ... while NATO has never looked stronger. Iran, Russia's most important military ally, faces a deeply hostile geopolitical environment alongside the greatest domestic unrest since the 1979 revolution that brought the Islamic Republic to power. China was thoroughly unprepared for its troubles with zero Covid (our #1 risk last year), leading to unprecedented demonstrations ... and a sudden turnaround of President Xi Jinping's policy, ending restrictions two years after the Americans and Europeans. Their trajectories are, to varying degrees, increasingly unsustainable.

More broadly, progress in human development has been thrown into reverse by a global pandemic, a land war in Europe, a massive inflationary shock, and mounting climate catastrophe. After decades of globalization pushing unprecedented global growth and the emergence of a robust global middle class, we are now seeing a majority of the world's 8 billion people fare worse, not better, in education levels, life expectancy, economic well-being, and safety and security. The headwinds for human development will grow in 2023.

American leadership is a double-edged sword. One year into Russia's failed war, the United States has only gained as the world's sole global military leader. Core allies clearly recognize their reliance on the United States for national security, broadly defined. America's comparative economic power is stronger coming out of the pandemic

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and through the Russia war than after the global financial crisis in 2008. Whispering in Europe has gotten louder that the global position of the United States is benefiting from the war, while the Europeans and Japan face deindustrialization and a permanent end to the peace dividend. China, too, faces massive economic challenges, much greater than other major countries. Its economy is still expected to surpass that of the United States in GDP by 2030, but there is a growing chance it never does. And if it does, this does not herald a Chinese century as China's population halves by 2100. If any major middle-income country is truly outperforming in the coming decades, it's the world's soon-to-be third largest economy (and its largest democracy), India.

But in terms of leading by example, it's a radically different story for the United States. In 1989, the US was the world's leading exporter of democracy. Today, it is the leading exporter of tools that undermine democracy—the result of algorithms and social media platforms that rip at the fabric of civil society while maximizing profit, creating unprecedented political division, disruption, and dysfunction. That trend is accelerating fast—not driven by governments but by a small collection of individuals with little understanding of the social and political impact of their actions.

Is the tech centibillionaire a bigger threat to global instability than Putin or Xi? It's unclear but the right question to ask and a critical challenge for the world's democracies, highlighting the vulnerability of representative political institutions and the growing allure of state control and surveillance. As we showed with the J Curve back in 2006, open societies were the most stable, in part because technology strengthened them and weakened authoritarian regimes. In 2023, less than two decades later, the opposite is true.

It's not the end of democracy (nor of NATO or the West). But we remain in the depths of a geopolitical recession, with the risks this year the most dangerous we've encountered in the 25 years since we started Eurasia Group.

And now, our top risks.

1 Rogue Russia

A humiliated Russia will turn from global player into the world's most dangerous rogue state, posing a serious security threat to Europe, the United States, and beyond.

In 2022, despite much bluster directed at the West, the Kremlin was careful to keep its war on Ukraine contained within the country, avoiding direct confrontation with NATO and hoping to divide the united Western front in support of Kyiv. In 2023, Putin can't afford to be that cautious.

Nearly one year since it invaded Ukraine and promised quick victory, Russia has no good remaining military options to win the war. Moscow will continue shelling Ukrainian cities and critical infrastructure, but that won't affect the military balance on the ground. Russia can also launch an offensive with newly mobilized troops this spring, but a lack of training and strong Ukrainian defenses will limit their effectiveness.

Russia also has little leverage left over either the United States or Europe. While it will cut off most remaining gas flows to Europe, increasing European public support for negotiations, this won't prompt a rollback of sanctions (with nine rounds now unanimously approved by all 27 EU member states) or undermine military support for Ukraine (most of which comes from the United States, the United Kingdom, and the most steadfastly anti-Russian EU states).

Russia won't back down. Having raised the war's stakes by mobilizing hundreds of thousands of Russian troops and annexing four Ukrainian regions (much of which they didn't—and don't—actually occupy), Putin remains under intense pressure to, at a minimum, control most of Donetsk, Luhansk, Kherson, and Zaporizhzhia. But Ukrainians will accept only a full Russian withdrawal from all Ukrainian territory, likely including Crimea. Adding to the pressure, Ukraine's now formidable military capabilities might threaten Russia's ability to defend Crimea—a Kremlin red line.

The war has only escalated since it started

Event categories Escalation by Russia | Retaliation by the West | Retaliation by Ukraine

Feb

- **21st** Russia recognizes the independence of Donetsk and Luhansk separatist regions and orders troops to prepare to deploy
- **22nd** Germany cancels certification of Nord Stream 2 pipeline
- **24th** Russian invasion begins
- **23rd to 28th** The EU, the US, and allies impose sweeping sanctions on Russian financial institutions, the export of dual-use goods and technology, and Russian officials and close associates; Russia's central bank is sanctioned and foreign reserves frozen

Mar

- **2nd** Seven Russian banks are banned from accessing the SWIFT international financial messaging system
- **15th** Russia says it takes complete control of Kherson region

Apr

- **12th** Putin says talks hosted by Turkey are at a dead end
- **14th** Ukraine sinks the Moskva, the flagship of Russia's Black Sea Fleet

Jun

- **23rd** US Department of Defense announces Ukraine will receive high-mobility artillery rocket systems (HIMARS)

Aug

- **29th** Ukraine launches counter-offensive and recaptures territory in the east

Sep

- **21st** Putin declares partial mobilization of military age men
- **26th** Nord Stream pipeline attack *(evidence for responsibility inconclusive)*

Oct

- **8th** Explosion on Kerch bridge connecting Crimea to Russia
- **10th** Russia begins bombing Ukrainian infrastructure, civilians, and cities, including Kyiv

Nov

- **11th** Ukraine recaptures Kherson

Dec

- **7th** Putin makes veiled threats to use nuclear weapons
- **21st** Putin declares no limits to war financing ahead of Zelensky visit to Washington
- **21st** US announces Ukraine will receive Patriot missile systems

Source: Eurasia Group

Putin has little left to lose from further escalation against the West and Ukraine, short of actions that risk direct war with NATO. Russia is nearly completely cut off from advanced industrial democracies—economically, diplomatically, culturally, and technologically. And the United States and Europe are already giving Ukraine some of their most advanced military systems; the Patriot missile system headed its way makes this point abundantly clear to the Kremlin. The only deterrent remaining for the West is direct war against the world's largest nuclear power—something Putin knows the West won't gamble on.

Defeated on the battlefield in Ukraine, increasingly staggered by sanctions, left without leverage over the EU or the United States, with little to lose from further isolation and Western retaliation, and facing intense domestic pressure to show strength, Russia will turn to asymmetric warfare against the West to inflict damage and weaken NATO unity, rather than employ overt aggression that depends on military and/or economic power that Russia no longer has.

Rogue Russia will increasingly act like a global version of its now-closest remaining ally of consequence, Iran. Before Russia's fall from grace, Iran had been the world's most powerful rogue state, itself effectively "decoupled" from the international community. Accordingly, Tehran has long pursued a revisionist foreign policy in the Middle East via asymmetric means, including espionage, drone and missile strikes, support for terrorism, proxy wars, and the like. Russia will likewise intensify its efforts to destabilize the United States and Europe—but with greater asymmetric security capabilities than Iran, and with the world's biggest nuclear arsenal as the ultimate cover to deter Western retaliation.

Nuclear saber-rattling by Moscow will intensify. Putin's threats will become more explicit; he's likely to move tactical nuclear weapons closer to Ukraine—and publicize it—and we could see an increase in the alert status of Russia's nuclear arsenal. Russia will calibrate its nuclear threats, and direct nuclear use remains unlikely; Putin is as Armageddon-averse as Iran's supreme leader. But the risk is clear: Nuclear signaling is easier said than done, and the potential for mutually assured destruction because of accidents and miscalculation will be higher in 2023 than at any time since the Cuban missile crisis in 1962. And unlike the height of the Cold War, Putin has no way to climb down or return to a pre-war status quo.

Kremlin-affiliated hackers will ramp up cyberattacks on Western firms and governments. Pipelines, as well as LNG terminals, will be attractive targets for Russian sabotage. Russian officials have credibly threatened retaliation against American and European satellites that play a role in the war. Fiber is vulnerable too: Cables in Europe and under the Atlantic will be targets, probably in a fingerprint-free way as with the Nord Stream pipeline attack in September (where there's still no evidence of responsibility).

Russia will also intensify its offensive against Western elections by supporting and funding disinformation and extremism. The US presidential campaign will quickly ramp up this year, and Trump is all-in with an anti-war plank that's music to Putin's ears. Disruptive disinformation against Republican challengers to Trump and potential Democratic nominees, including President Joe Biden, will begin early. Moscow will also stir trouble in the Balkans, as a ploy to distract NATO from Ukraine.

Ukraine will also face new risks. Russia can't retake much Ukrainian territory, but it can inflict much more suffering on the Ukrainian people. It will continue to pound Ukrainian critical infrastructure, including with newly obtained Iranian ballistic missiles (please see risk #5). It may try harder to decapitate the Ukrainian government, possibly with assassination attempts against Ukrainian President Volodymyr Zelensky and other senior officials. Finally, Moscow will try to make a rump Ukraine economically unviable at a time when Kyiv faces an uphill struggle to fund the country's reconstruction. That will likely include new stoppages of grain exports, with efforts to blame Ukraine and the West for global food insecurity that exacerbates frictions between the West and developing countries. These moves will in turn lead to growing European calls to seize frozen Russian assets and use them for Ukrainian reconstruction.

Rogue Russia will increasingly act like a global version of its now-closest remaining ally of consequence, Iran

Several actions remain off-limits, even for a rogue Russia. Major attacks on Western critical infrastructure that can be quickly and clearly traced to the Russian government remain unlikely, at least unless the Ukrainian military achieves another major breakthrough on the ground. So are targeted assassinations of Western leaders and missile or drone strikes on NATO territory. Moscow has so far avoided waging a major cyber conflict with the United States for fear it might lose that war too. That will probably remain the case in 2023.

There is a silver lining: Just like Iran's rogue behavior has created a new alignment among Gulf nations, the United States, and Israel (most dramatically, but not limited to the Abraham Accords), Russia's rogue behavior will create ongoing opportunities for the G7 to strengthen cooperation among advanced industrial democracies and rebuild institutions for a stronger global security order. That said, a rogue Russia represents a geopolitical crisis of the highest order. It's a threat to global security, Western political systems, the cybersphere, space, and food security … not to mention every Ukrainian civilian.

2 Maximum Xi

Xi emerged from China's 20th Party Congress in October 2022 with a grip on power unrivaled since Mao Zedong.

Having stacked the Communist Party's Politburo Standing Committee with his closest allies, Xi is virtually unfettered in his ability to pursue his statist and nationalist policy agenda. But with few checks and balances left to constrain him and no dissenting voices to challenge his views, Xi's ability to make big mistakes is also unrivaled. Arbitrary decisions, policy volatility, and elevated uncertainty will be endemic in Xi's China. That's a massive and underappreciated global challenge, given the unprecedented reality of a state capitalist dictatorship having such an outsized role in the global economy.

Xi has committed a series of missteps in the recent past.

Last year we warned that China had walked itself into a zero-Covid trap; unfortunately, we were right. Xi's refusal to offer high-quality, foreign-made mRNA vaccines, combined with underwhelming vaccination drives even with locally made doses, left the Chinese population more vulnerable to severe disease than it should be, and have made Xi's sudden and surprise exit from zero Covid much deadlier.

An opaque crackdown on private technology companies undercut global investor sentiment, put some of the country's most promising firms into a deep freeze, and wiped out an estimated one trillion dollars in market value.

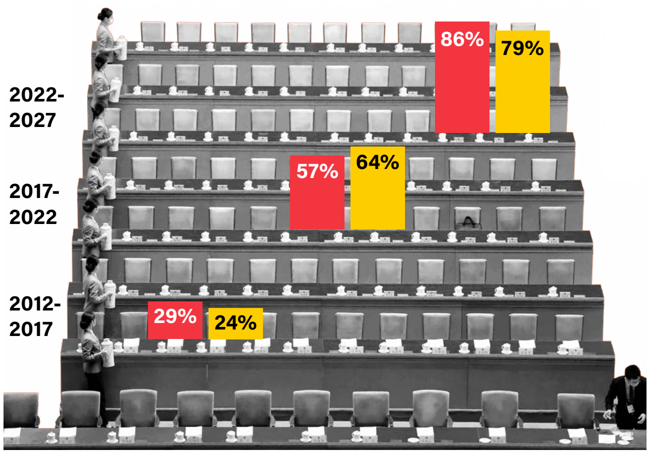
And Xi's announcement of a "no limits friendship" with Russia on 4 February 2022 lent credibility to Putin's war in Ukraine and darkened perceptions of China's influence on the global system.

In each instance, Xi's authoritarian personality and policy preferences—political control, economic statism, and assertive diplomacy—overrode the advice of pragmatic voices within the bureaucracy. And that was before Xi cemented

Xi loyalists now dominate top Communist Party bodies

% of members who have personal ties to Xi, worked under Xi, or worked under a top Xi lieutenant

Politburo Standing Committee Politburo



Note: Data do not include Wang Huning, an adviser to previous leaders who is now a Xi ally; counting Wang, 100% of PSC members are Xi allies
Source: Eurasia Group

his position as modern-day emperor. Now that all Chinese policy flows directly from a single all-powerful leader, there's even less transparency on the decision-making process, less information flowing to the top, and less room to admit error, course correct, or compromise.

We see risks in three areas this year, all stemming from Maximum Xi.

First, the ill effects of centralized decision-making on public health are now on display. Just weeks ago, Xi ended the zero-Covid policy in the same arbitrary manner that he implemented it more than two years ago. His snap decision to lift all restrictions and let the virus spread unchecked despite low elderly vaccination rates, without warning citizens and local governments, and absent sufficient preparations to cope with the resulting outbreaks will all but ensure that more than one million Chinese people will die, many unnecessarily (though most will not be reported). Only a leader with unchallenged power could execute such an extraordinary—and extraordinarily costly—reversal.

Moreover, if a severe new strain of Covid were to emerge, Maximum Xi makes it more likely that it would spread widely in China and beyond. China would be unlikely to identify the new variant because of reduced testing and sequencing, to recognize more severe disease due to an overwhelmed health system, and to let news of a more severe variant get out given Xi's track record on transparency. The world would have little or no time to prepare for a deadlier virus.

A second area of concern is the economy, where Xi's drive for state control will produce arbitrary decisions and policy volatility. China's economy is in a fragile state after two years of harsh Covid-19 controls. Forced deleveraging efforts and plummeting homebuyer and market sentiment have ground growth in the critical real estate sector to a halt, depleting local government revenue. Debt defaults threaten to spread to the broader financial sector. It has long been the case that more global GDP growth was coming from a politically riskier market as China's economic footprint expanded. But in 2023, China's outlook is even more important, given the rising risks of recession elsewhere (please see risk #4).

This backdrop—of weakening global growth and deepening domestic challenges—demands competent economic management from Beijing. But the Chinese leadership is delivering opacity and unpredictability. China's sudden decision to delay the release of long-scheduled economic data during the 20th Party Congress was an ominous sign of things to come for global markets. At a minimum, heightened market and company sensitivity to the singular voice of Xi will invite volatility in response to any signals he conveys, resulting in a repricing of credit risks that in turn drives debt defaults and bankruptcies. Beijing will struggle to manage these pressures in an environment of centralized power and stifled debate.

A final risk area is foreign policy, where Xi's nationalist views and assertive style will drive Beijing's relations with the world. Xi isn't looking for a near-term crisis, given the scale and immediacy of economic challenges at home. But "wolf warrior" diplomacy will nonetheless intensify as diplomats channel Xi's bold rhetoric, often at the expense of effective engagement. Xi's personal affinity for Putin will limit how closely China is willing to align with the developed world—and even, in the worst-case scenarios, with developing countries—in response to increasingly rogue behavior by Russia (please see risk #1) that threatens global peace and stability. An indifferent response to Russian aggression could invite a global backlash, undermining China's international standing and adding to economic risks. China's foreign policymaking would be less marked by overzealousness and miscues if it was informed by effective debate and feedback on likely global responses. In this, as in other critical policy areas, Xi will be listening to no one more than himself.

The last time a Chinese leader had this much power to pursue such a misguided policy agenda, the result was widespread famine, economic ruin, and death. While another Cultural Revolution or Great Leap Forward is unlikely given the size of China's educated urban middle class, Xi's consolidation of power will take China at least a few steps backward this year.

Xi ended the zero-Covid policy in the same arbitrary manner that he implemented it more than two years ago

3 Weapons of mass disruption

When the Berlin Wall came down, the United States was the world's principal exporter of democracy. Not always consistently and not always with positive results, but no other country came close. For most of the time since, technological innovation (much of which took place in America) has been a liberalizing force. But today, the US has become the principal exporter of tools that undermine democracy—not intentionally, but nonetheless as a direct consequence of the business models driving growth. Resulting technological advances in artificial intelligence (AI) will erode social trust, empower demagogues and authoritarians, and disrupt businesses and markets.

This year will be a tipping point for disruptive technology's role in society. A new form of AI, known as generative AI, will allow users to create realistic images, videos, and text with just a few sentences of guidance. Large language models like GPT-3 and the soon-to-be-released GPT-4 will be able to reliably pass the Turing test—a Rubicon for machines' ability to imitate human intelligence. And advances in deepfakes, facial recognition, and voice synthesis software will render control over one's likeness a relic of the past. User-friendly applications such as ChatGPT and Stable Diffusion will allow anyone minimally tech-savvy to harness the power of AI (indeed, the title of this risk was generated by the former in under five seconds).

These advances represent a step-change in AI's potential to manipulate people and sow political chaos. When barriers to entry for creating content no longer exist, the volume of content rises exponentially, making it impossible for most citizens to reliably distinguish fact from fiction. Disinformation will flourish, and trust—the already-tenuous basis of social cohesion, commerce, and democracy—will erode further. This will remain the core currency of social media, which—by virtue of their private ownership, lack of regulation, and engagement-maximizing business model—are the ideal breeding ground for AI's disruptive effects to go viral.

New technologies will be a gift to autocrats bent on undermining democracy abroad and stifling dissent at home

These breakthroughs will have far-reaching political and economic effects.

Demagogues and populists will weaponize AI for narrow political gain at the expense of democracy and civil society. We've already seen the likes of Trump, Brazil's Jair Bolsonaro, and Hungary's Viktor Orbán leverage the power of social media and disinformation to manipulate electorates and win elections, but technological advances will create structural advantages for every political leader to deploy these tools—no matter where they sit on the political spectrum. Political actors will use AI breakthroughs to create low-cost armies of human-like bots tasked with elevating fringe candidates, peddling conspiracy theories and "fake news," stoking polarization, and exacerbating extremism and even violence—all of it amplified by social media's echo chambers. We will no doubt see this trend play out this year in the early stages of the US primary season (please see risk #8) as well as in general elections in Spain and Pakistan.

These tools will also be a gift to autocrats bent on undermining democracy abroad and stifling dissent at home. Here, Russia and China lead the way. Building on its subversion of the 2016 US election, as well as disinformation campaigns in Ukraine and Eastern Europe, Moscow will step up its rogue behavior (please see risk #1) with newly empowered influence operations targeting NATO countries. The 2023 Polish parliamentary elections are the most obvious target, but others will be vulnerable, too. Meanwhile, Beijing—which already uses sensors, mobile tech, and facial recognition to track its citizens' movements, activities, and communications—will deploy new technologies not only to tighten surveillance and control of its own society, but also to spread propaganda on social media and intimidate Chinese language communities overseas, including in Western democracies.

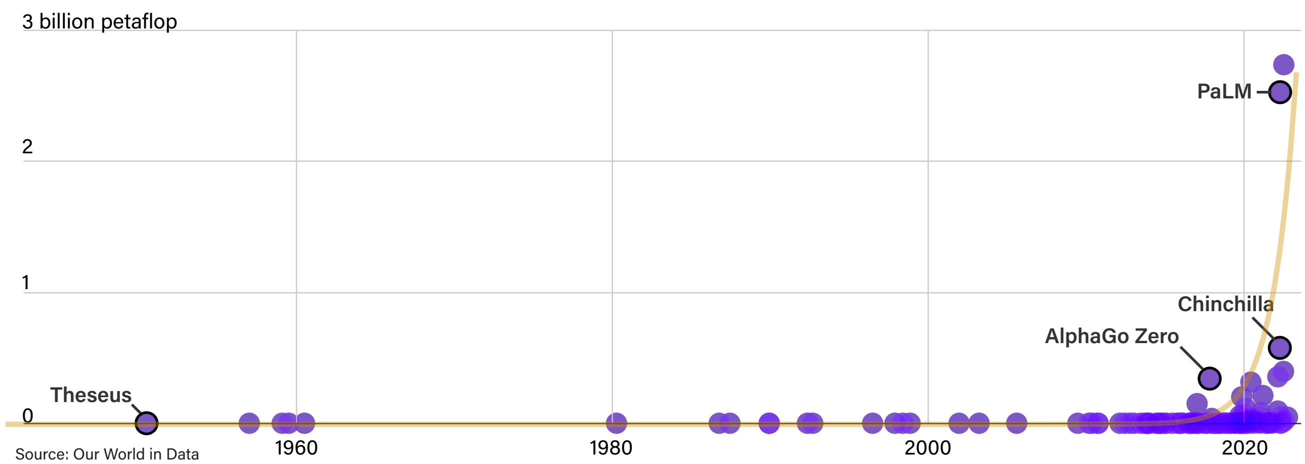
The proliferation of AI will have profound implications beyond politics, too. Companies in every sector will contend with new reputational risks when key executives or accounts are impersonated with malicious intent, triggering public relations scandals and even stock selloffs. Generative AI will make it difficult for businesses and investors to distinguish between genuine engagement and sentiment on the one hand, and sabotage attempts by hackers, activist investors, or corporate rivals on the other, with material implications for their bottom lines. Citizen activists, trolls, and anyone in-between will be able to cause corporate crises by generating large enough volumes of high-quality tweets, product reviews, online comments, and letters to executives to simulate mass movements in public opinion. AI-generated content amplified by social media will overwhelm high-frequency trading and sentiment-driven investment strategies, with market-moving effects.

Of course, AI also offers incredible productivity gains that we've only just begun to appreciate (if this wasn't our Top Risks report, we'd be writing more about them). But that's the thing with revolutionary technologies, from the printing press to nuclear fission and the internet—their power to drive human progress is matched by their ability to amplify humanity's most destructive tendencies. The former is embraced and promoted; the latter downplayed and usually ignored … until there's a crisis.

The irony is that America's fertile ground for innovation—nurtured by its representative democracy, free markets, and open society—has allowed these technologies to develop and spread without guardrails, to the point that they now threaten the very political systems that made them possible.

AI's power is growing exponentially

Computation used to train AI systems, measured in total petaflops (10^{15} floating-point operations per second)



Source: Our World in Data

4 Inflation shockwaves

The global inflation shock that began in the United States in 2021 and took hold worldwide in 2022 will have powerful economic and political ripple effects in 2023. It will be the principal driver of global recession, add to financial stress, and stoke social discontent and political instability everywhere.

Today's historically high inflation comes from multiple sources. First was the Covid-19 pandemic, which prompted governments to cushion the fall in incomes with extraordinary fiscal and monetary stimulus at the same time that it disrupted global supply. Then, just as the United States and Europe were coming out of the pandemic thanks to vaccines, China doubled down on its zero-Covid policy, locking down the global economy's most important manufacturing and shipping hubs. Finally, Russia's invasion of Ukraine and the West's sanctions in response put a strain on the global supply of energy, food, and fertilizer.

This unprecedented confluence of overlapping shocks pushed inflation to levels most countries hadn't seen in nearly 50 years. At first, central bankers believed the mounting price pressures would be "transitory" and kept policy too loose for too long. Once they realized their mistake, they were forced to respond to prevent inflation expectations from becoming unmoored. The US Federal Reserve took the lead with aggressive interest rate hikes and balance-sheet reduction in 2022, prompting others to follow suit.

Though the end of the tightening cycle is now in sight, central banks will maintain a restrictive policy stance through much of 2023, undermining global demand. And global credit and financial conditions will continue to tighten beyond this year as past rate hikes work their way through the financial system with a lag.

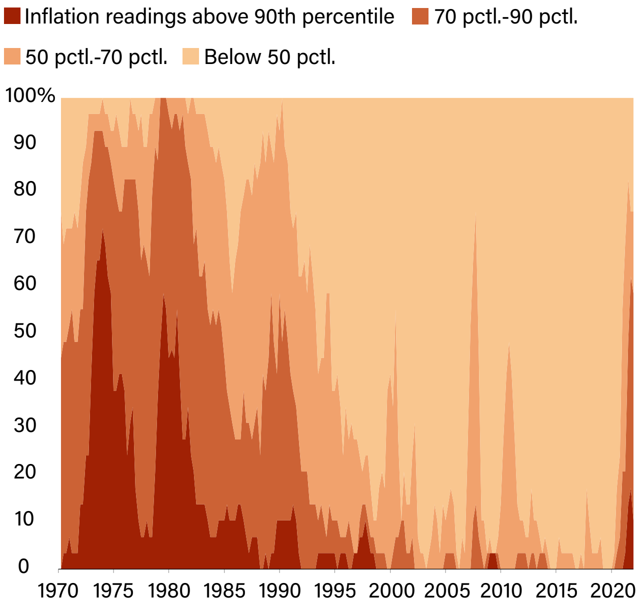
But inflation will prove sticky despite rapidly rising interest rates, driven by continued supply chain constraints and lingering pandemic-era "excess savings"—but also, critically, by persistently high energy prices caused by the war in Ukraine (please see risk #6) that can't be countered by monetary policy.

With tightening credit and financial conditions at a time of still-high inflation, households and companies will feel the pinch. Wary of adding fuel to the inflation fire and facing rising interest costs, policymakers in credit-worthy advanced economies will try to absorb the income risk for households and relieve cost pressures on businesses through costly energy market interventions and subsidies financed by public debt. But in some advanced economies such as the United Kingdom and Italy, and in most developing markets, comprehensive and long-lasting fiscal support measures will be too expensive. As a result, households and companies will see their real incomes erode.

The combination of high inflation, rising interest rates, and insufficient fiscal support will push the global economy into recession. The global downturn will be compounded by uncertainty in China's economic rebound post-zero Covid (please see risk #2) and Europe's painful transition to living without Russian energy. With consumer and business confidence weakening, global growth will slow from 6% in 2021 to about 3% in 2022 to less than 2% in 2023, with much of the world experiencing negative growth. While the absence of financial imbalances of the scale witnessed in 2008 or 2020 will limit the depth of the downturn, without a boost from expansionary monetary and fiscal policy, the recession will prove protracted.

Inflation at levels not seen in a generation

Percentage of OECD countries experiencing higher-than-average inflation



Inflation shocks* and government change**

Any change in government

Since 1970	Since 1996	Total
54%	**67%**	**58%**

Change in government through elections

Since 1970	Since 1996	Total
72%	**81%**	**76%**

*Five or more consecutive quarters of inflation above 90th percentile; 57 shocks analyzed.
** Change in government during the inflationary shock or 24 months after its peak.
Source: IMF, Eurasia Group

[redacted]

Rising interest rates and global recession will raise the risk of emerging-market crises

One immediate effect of these economic troubles will be pressure on incumbents in countries with elections this year: Turkey, Spain, Argentina, Nigeria, and Poland. But even countries where elections are not scheduled will see greater risk of government turnover. And where governments muddle through, popular pressure for fiscally unsustainable policies in a tight financial environment will exacerbate debt problems and could trigger market instability—for example, in the UK, Italy, Brazil, Colombia, and Hungary.

Rising interest rates and global recession will also raise the risk of emerging-market crises. The nightmare scenario is a sudden stop in capital flows to emerging markets as we saw in the early 1980s, 1997, and 2008, prompted by a collapse in risk appetite that causes capital flight to the United States. These sorts of crises take much longer to happen than expected ... and then happen very suddenly. The resulting currency depreciation would make it hard for countries to service their dollar-denominated debts and to afford imports of food, energy, and other necessities. Lower income commodity importers with high levels of foreign-currency debt and fixed exchange rates or low foreign exchange reserves such as Pakistan and Egypt are especially vulnerable to balance-of-payments, debt, and banking crises. But even rich countries that borrow in their own currencies, such as the UK and Japan, are in danger from rapid depreciations that leave them unable to afford imports and vulnerable to financial stress.

In the unlikely-but-plausible event of a systemic financial crisis, global policy coordination will be lacking. Neither geopolitics nor domestic politics are in the same place they were in 2008, when the world's largest economies came together at the G20 to avert disaster. Consumed by domestic challenges, creditor nations have little appetite for multilateral debt restructuring and relief, and international financial institutions such as the IMF could fill only part of the resulting financing gaps. Several countries would be forced to make the difficult decision to default on their debts, further weakening global growth, fueling social unrest, and disrupting politics.

5 Iran in a corner

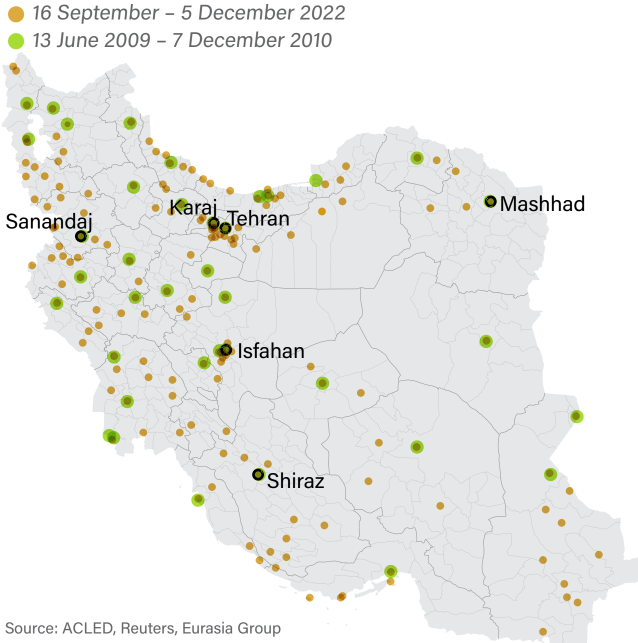
More than three months after a young woman named Mahsa Amini was killed by Iran's so-called Morality Police, nationwide anti-government protests continue. At the same time, Tehran has escalated its nuclear program in dramatic ways, all but ending any chance of reviving the nuclear deal. And now Iran has wedded itself to Putin's imperial ambitions in Ukraine. Facing convulsions at home while lashing out abroad, this year will feature new confrontations between the Islamic Republic and the West.

Led by young people and women, protests have spread across the country—creating the most serious popular threat to the state since the revolution that brought the Islamic Republic to power in 1979. The demonstrations are explicitly anti-government, with protesters calling for the fall of the clerical regime. In response, the authorities have killed more than 500 people, according to human rights groups. Tehran has ceded no ground on demands for meaningful reforms. Faced with popular unrest, the state has shown that it lacks any capacity to respond except with repression.

The protests are leaderless, dispersed, and attract relatively small numbers—all factors that make them unlikely to overthrow the Iranian regime. But they've also been remarkably persistent, with security services so far unable to crush the protesters as they did in previous rounds of unrest. The demonstrations will accordingly erode what's left of the regime's legitimacy and lead Iran to lash out against countries that support the protesters.

Then there's the nuclear program. The effort to revive the 2015 Joint Comprehensive Plan of Action and impose time-limited constraints on Iran's nuclear development has failed. The mood in Tehran has shifted decisively against compromise, given the protests and the government's perception that the deal won't deliver enough sure benefits.

Protests across Iran: 2022 vs 2009



Source: ACLED, Reuters, Eurasia Group

Meanwhile, since Biden took office, Iran's nuclear program has become both more advanced and less monitored. Iran announced in November that it would begin producing near-weapons grade enriched uranium using some of its most advanced centrifuges at a facility buried deep inside a mountain, a site impenetrable to all but the biggest munitions. Iran today can produce enough fissile material for a nuclear weapon in a matter of weeks—the closest it has ever been. That poses threats to both the region and the West.

Iran's material support for Russia's war in Ukraine had added another dimension to its failed relations with the West. Tehran has sold Moscow hundreds of drones used to attack civilians in Ukrainian cities, and it is poised to build a drone production factory in Russia and ship short-range ballistic missiles. Combined with repression at home (supported by Russia), Iran's involvement in a European war has swung public and elite opinion on the continent sharply against the Islamic Republic; it will also lead the United States to impose additional economic sanctions and otherwise disrupt Iran's supply chains, with Europe likely to step up its own measures over human rights concerns and Tehran's military cooperation with Moscow.

These three factors—domestic repression, nuclear advances, and involvement in the Ukraine war—all combine to increase the risk of confrontation with Iran this year.

With a nuclear deal out of reach, the gloves will again come off between Iran and Israel. Israel's new prime minister, Binyamin Netanyahu, has been committed for decades to setting back Iran's nuclear advances. Israel will likely ramp up covert efforts through cyberattacks and sabotage of key nuclear sites and critical infrastructure. For its part, Iran will likely retaliate against Israel with strikes from Syria, Lebanon, Iraq, Yemen, Gaza—and at sea.

Israel, and to a lesser extent the United States, will once again make noisy preparations for an aerial assault on Iran's nuclear sites. The chance of an attack in 2023 remains low, given the risks of a devastating regional conflict, the likelihood that Iran will not take steps that provoke an attack, and the fact that Iran is not actively working on technology that is key to the final stages of a weapon. But in October, when the UN missile ban is set to expire, Western countries will be poised to trigger the snapback of prior UN sanctions, if they haven't done so already by then. Iran would respond in provocative ways, by expelling inspectors or resuming efforts to weaponize, for example. All this significantly elevates the risk of military attack.

Risks to Gulf states will increase as well. Tehran accuses Riyadh of fueling the demonstrations inside Iran, and it could retaliate militarily to both punish Saudi Arabia and distract the domestic population. Even if the 2019 attacks on Saudi oil facilities are not repeated, the risks of missile attacks from Yemen and Iraq are significant. The United Arab Emirates would be vulnerable as well but less so, given its careful efforts to maintain ties with Tehran. But the deployment of Israeli missile defense systems in the UAE in 2022 demonstrated Abu Dhabi's concerns.

Lastly, there will be more questions this year about the stability and longevity of the Islamic Republic. The chance of regime collapse is low, but it's higher than at any point in the past four decades. For most Iranians, the state has lost legitimacy and shows little capacity to reform. The uncertainty rises if Supreme Leader Ali Khamenei, 83, dies or is incapacitated. The leader has no chosen successor, and the succession process has only happened once in the state's history. These problems could create unexpected infighting during the transition and open the door for the Islamic Revolutionary Guard Corps to further expand its influence—shifting Iran closer to a military dictatorship with a more aggressive policy toward the region.

The chance of regime collapse is low, but it's higher than at any point in the past four decades

6 Energy crunch

Energy consumers are breathing a sigh of relief now that the oil-supply shock expected after the Russian invasion of Ukraine failed to materialize and gas prices, especially in Europe, have fallen back from their 2022 highs. But despite mostly sanguine forecasts for this year, a combination of geopolitics, economics, and production factors will create much tighter market conditions, especially in the second half of 2023. That will raise costs for households and businesses, increase the fiscal burden on consumer economies, widen the rift between OPEC+ and major consumers, and create yet another source of increased tensions between the West and the developing world.

On oil, a faster-than-expected economic recovery in China driven by the country's sudden exit from zero-Covid policies, combined with only a shallow recession in the United States that will not cause demand destruction, will increase crude-oil demand growth and expose an acute lack of new supply. Contributing to the problem are Russian production declines amid continued sanctions, low levels of OPEC+ spare capacity, reduced capital investment in non-OPEC production, and the absence of an Iran nuclear deal (please see risk #5). The supply shocks anticipated in 2022 will drive crude prices above $100 per barrel before the end of the year.

On gas, the European Union's need to rebuild gas storage from the second quarter of 2023 in the absence of cheap Russian supplies will create new competition for LNG and more demand for pipeline gas from Norway and North Africa. That will drive up prices, especially for Europe but also indirectly in North America, Asia, and other regional markets. Markets in Europe already price in almost $50 per million British thermal units (MMBTU) next summer; the price is likely to spike higher as China's growth recovers and global demand for LNG increases. US natural gas prices will also feel the strain,

Higher oil prices will also increase frictions between OPEC+ and the United States

heading above the $5 per MMBTU currently priced in and closer to the $8 or more we saw when European demand for gas drove up US prices in 2022.

High oil prices will place a heavy burden on poorer developing countries, which have limited cash for expensive energy imports and face surging borrowing costs to fill the hole, resulting in energy shortages and social discontent. Angry over having to shoulder costs for sanctions on Russia they didn't agree to, emerging markets will chip away at the Western sanctions regime by continuing to trade with Russia. Two of the world's three biggest energy consumers, China and India, will continue to buy large quantities of Russian crude at a steep discount. The United States will respond by hitting some emerging markets (albeit not China or India) with secondary sanctions, further inflaming tensions between industrialized economies and emerging markets already rocked by high inflation (please see risk #4), the war in Ukraine, the Covid-19 pandemic, and climate change.

Higher oil prices will also increase frictions between OPEC+, led by Saudi Arabia, and global consumers, led by the United States, as both sides pursue conflicting fiscal objectives. OPEC+ wants to protect a price floor of about $90 per barrel for Brent (some in the West think $100), much higher than before the Ukraine war and at odds with consumer preferences. This divergence will increase conflict between the US and its Gulf allies with rising grievances already driven by Washington's pivot to Asia, its transition to non-hydrocarbon energy, its focus on domestic production, and the Gulf's growing energy and security ties with China. Not to mention the Biden administration's focus on human rights and "democracy vs. autocracy," as well as its move to build an oil consumer cartel of sorts. Higher prices will prompt the US to intervene directly in markets and punish moves by oil-producing states it sees as (at least partially) politically motivated.

Regarding gas, high prices and supply limits will require more financial support from already stretched European governments, fueling calls for more EU-wide borrowing to help member states shoulder the burden. This comes on top of energy costs for households and businesses in Europe doubling between 2021 and 2022, despite government efforts to cushion the impact of extreme wholesale price spikes. The EU's industrial sector will remain at risk of government-mandated curbs on gas supply, threatening energy-intensive sectors such as steel, aluminum, and fertilizers, and creating an overall drag on economic growth. While extended gas shortages in Europe will be avoided thanks to reduced consumption and close cooperation with allied suppliers such as the United States and Norway, the risk of temporary power outages will remain high.

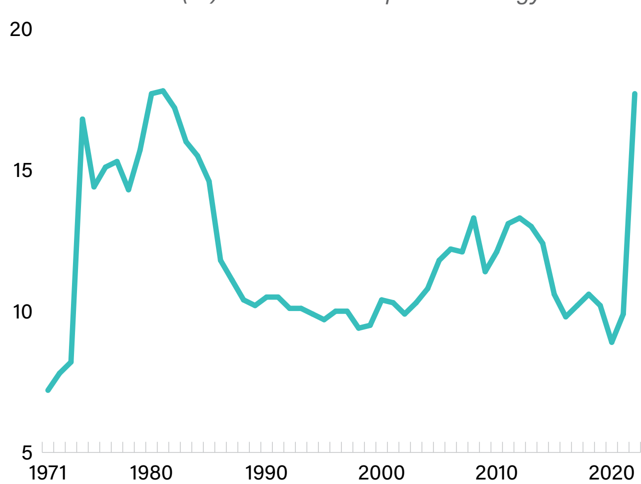
High gas prices as Europe seeks to secure adequate supplies for the 2023-2024 winter will leave energy-hungry states in South and Southeast Asia priced out of the LNG market for long stretches of 2023. The impact will be felt most acutely in the agricultural sectors of emerging markets, where fertilizer costs and food prices will increase again following the war-induced spike of 2022. As with oil, the result will be widespread energy shortfalls, food insecurity, and social unrest.

West-South tensions inflamed by the global energy crunch will also undermine climate policy. In developed nations, high prices will lead governments to prioritize energy security over emissions reductions. In developing nations, especially in Asia and Latin America, the high price of gas will disrupt energy transition plans. As climate-related extreme weather events increase in frequency and severity, emerging market calls for financial support from advanced economies for climate adaptation and loss and damage compensation will grow louder but largely go unheeded, and international climate cooperation will continue to falter.

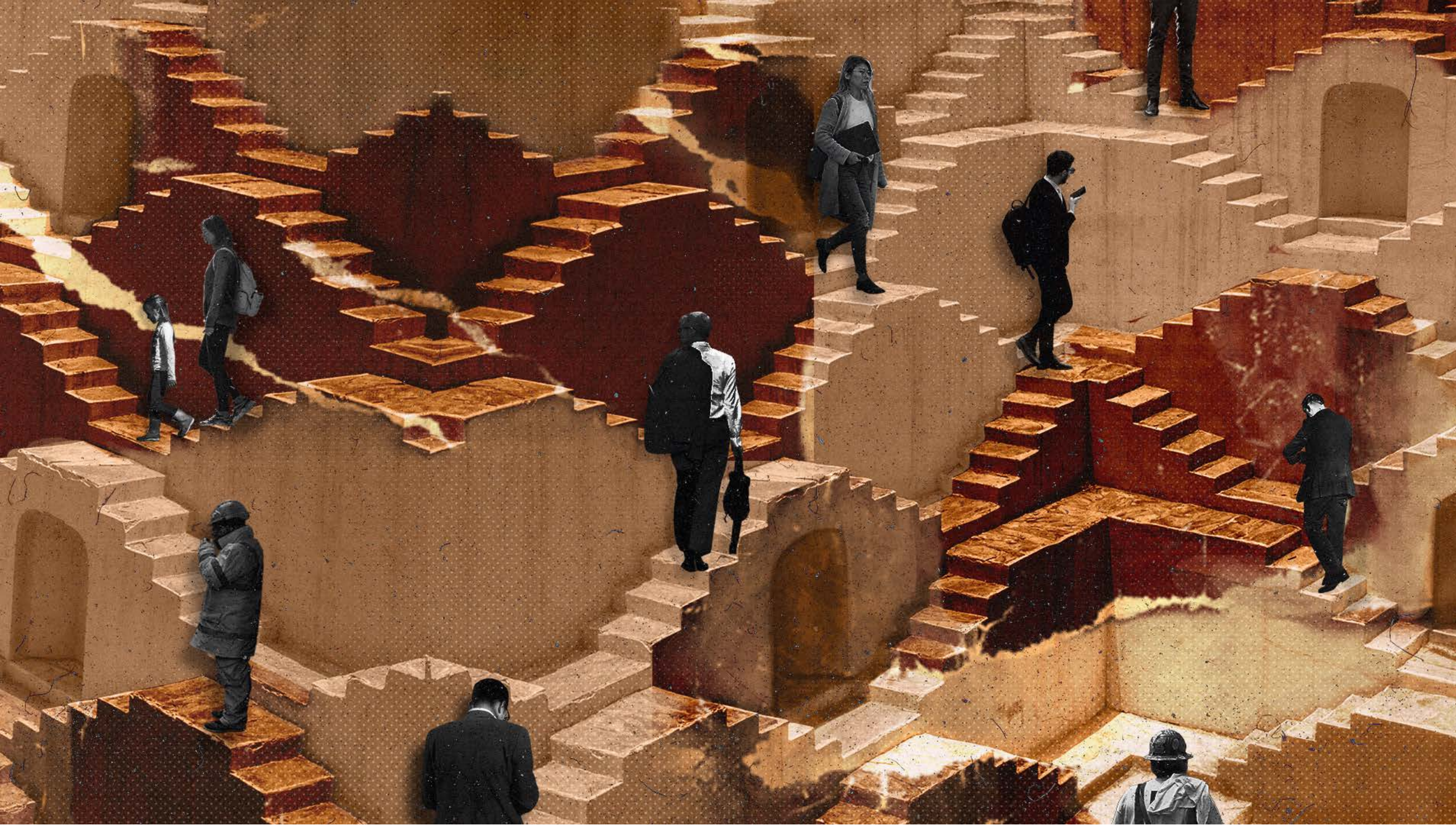
In short, the respite in energy markets this winter will be temporary—the eye of the hurricane before a renewed energy crunch adds to pressure on consumers, puts fiscal strain on governments, and deepens divides between developed and developing nations and the United States and Gulf countries.

Expensive energy

Estimated share (%) of OECD GDP spent on energy end-use



Source: OECD, FT



7 Arrested global development

The last two generations of humanity have experienced an unprecedented period of fast-expanding and broad-based prosperity. The world economy tripled in size, almost every country grew significantly richer, and more than one billion people escaped extreme poverty to join the ranks of history's first global middle class, narrowing the opportunity gap between developing and advanced industrialized nations. Human development indicators ranging from infant mortality and life expectancy to education and women's rights tell a story of nearly uninterrupted improvement in living standards and quality of life around the world.

That progress has been thrown into reverse by three years of mutually reinforcing shocks, including the Covid-19 pandemic, the Russia-Ukraine war, and the global inflation surge. The United Nations estimates that five years of human development progress have been lost since Covid-19 hit, and the impact has been global: More than 90% of countries experienced a decline in human development in 2020 or 2021. In 2023, billions of people will become more vulnerable as more economic, security, and political gains are lost.

Inflation's global shockwaves (please see risk #4) will take an especially heavy toll on vulnerable populations in developing countries as rising prices, tighter financial conditions, and slowing global growth stoke public (and therefore political) anxiety.

Food insecurity will intensify as food supplies are further disrupted by the Russia-Ukraine war and inflation eats away at purchasing power. Uncertainty will encourage more governments to impose protectionist trade restrictions. High gas prices will threaten fertilizer production and raise costs for farmers across the board, driving up food prices (please see risk #6). Higher costs of farming will also increase the demand for cheap labor in the agricultural sector, which accounts for 70% of global child labor and mainly employs children of early school age.

Women and girls will suffer the most, losing hard-earned rights, opportunities, and security

There will be longer-term impacts on educational attainment and inequality as more children—especially girls—are forced out of school to work. This issue is affecting emerging markets and advanced industrial economies alike: In the United States, the average elementary-school student lost over half a school year's-worth of learning in math and roughly a quarter of a school year in reading during the pandemic—the biggest educational disruption in American history. The Horn of Africa, heavily dependent on Ukraine's grain and struck by four consecutive failed rainy seasons, will be worst hit. In Ethiopia, Kenya, and Somalia, for example, the number of children at risk of dropping out of school tripled in the first three months of war.

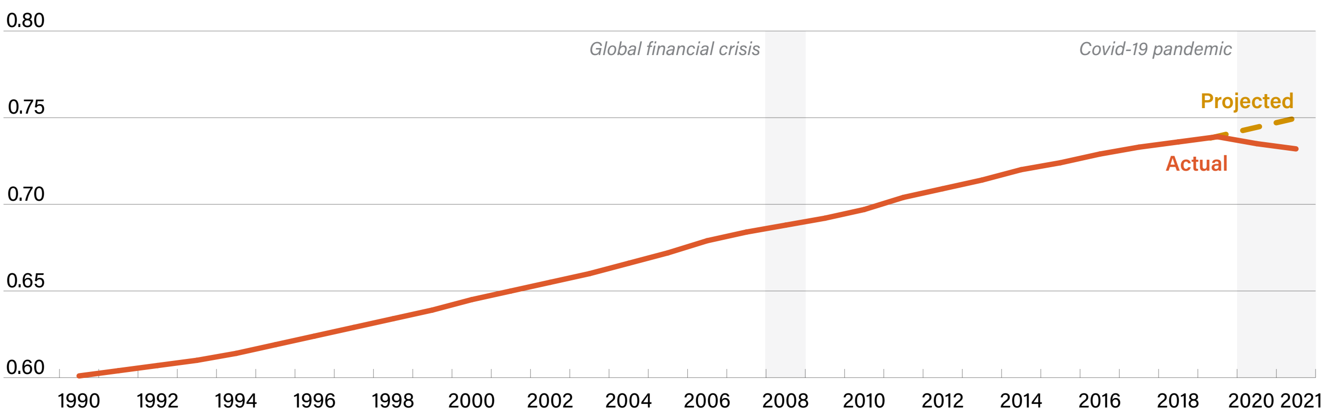
Women and girls will suffer the most, losing rights, opportunities, and security as advances in gender equality are rolled back. Stagnating growth, food insecurity, and cuts in social and health spending will push more women out of the labor market or into the informal economy, leaving them at higher risk of poverty, hunger, domestic violence, and sexual exploitation. More girls will be at risk of child and forced marriages, especially in West and Central Africa. The pandemic alone is projected to force an additional 10 million girls into early marriage by 2030 and lead to the first increase in the practice after more than 20 years of declining rates.

Climate change will multiply these threats as extreme weather events disrupt supply chains and trade patterns, adding stress to food and energy markets. These conditions will force larger numbers of people from their homes and across borders, with regional political, economic, and security spillovers.

Most developing country governments have limited fiscal space to address these humanitarian crises. Further, tighter financial conditions will prompt rich nations to cut back on official development assistance, and aid to Ukraine (itself inadequate for reconstruction) will crowd out relief for the world's poorest, especially in sub-Saharan Africa and South Asia. The result: The global middle class will contract, and further down the development chain, tens of millions of people will find themselves on the verge of disaster without a safety net.

Human development in reverse

Human Development Index



Note: The period of the global financial crisis is indicative
Source: Human Development Report Office calcualtions based on data from Barro and Lee (2018), IMF (2021c, 2022), UNDESA (2022a, 2022b), UNESCO Institute for Statistics (2022), UNSD (2022) and World Bank (2022c)

8 Divided States of America

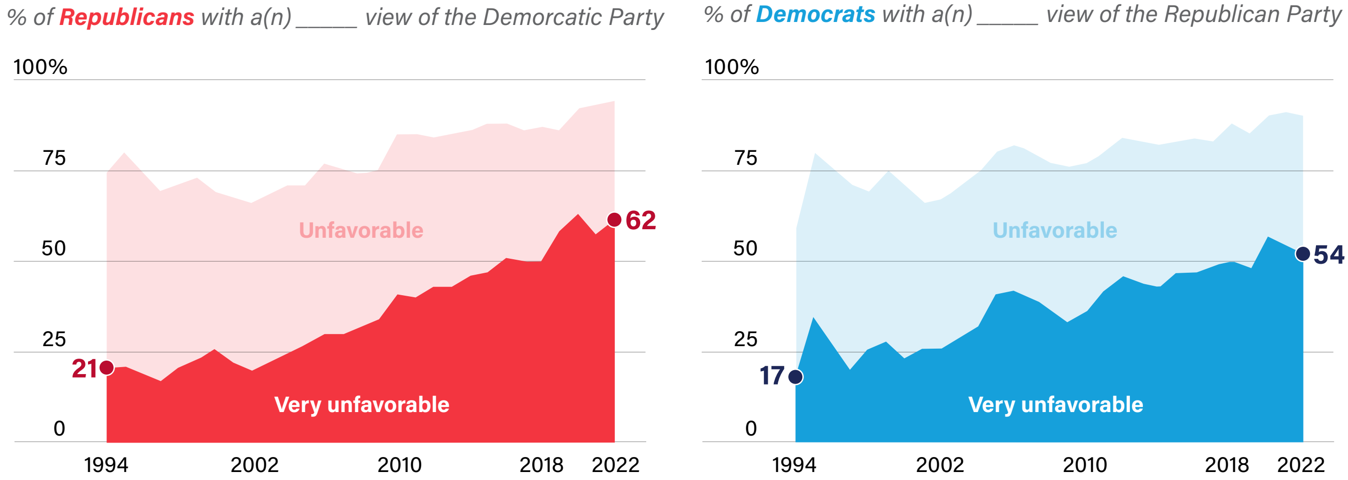
First, the good news. The 2022 midterm elections halted the slide toward a constitutional crisis in the next US presidential election. Not because the Republicans won control of the House of Representatives, nor because the Democrats held the Senate. Most importantly, voters across the United States rejected virtually all candidates running for governor or secretary of state who denied the legitimacy of Biden's victory over Trump in the 2020 vote. And it's governors and secretaries of state who will administer future elections at the state level. That's why US politics doesn't appear higher on this year's list of top risks.

But it still made the cut.

The United States remains one of the most politically polarized and dysfunctional of the world's advanced industrial democracies. The growing partisan polarization of the American electorate is continuing to erode the legitimacy of core federal institutions: the three branches of government and the peaceful transfer of power through free and fair elections. Consequently, political power is devolving to the states, increasingly led by partisans stepping into the void left by Washington to pursue agendas that cannot be implemented by a fractious and sclerotic federal government. Accordingly, the contrast in policy direction between Texas and California, for example, is far starker than it was even five years ago.

This polarization has less impact on America's global position than you might expect. US advanced industrial allies and partners around the world still rely heavily on the United States in national security relations—both in terms of direct military coordination as well as, more broadly, in asymmetric threats (counterterrorism, cyberdefense) and national

Partisan animosity is on the rise



Note: Based on partisans and does not include those who lean to each party.
Source: Yearly averages of survey data from Pew Research Center American Trends Panel (2020-2022) and Pew Research Center phone surveys (1994-2019).

security-related components of the global economy (semiconductors, financial transactions). That's become less true among developing countries from Latin America, Southeast Asia, and sub-Saharan Africa—and particularly among oil producers in the Middle East. But the shift has more to do with China's and other countries' rise than US political dysfunction.

Nonetheless, this environment will become increasingly challenging for companies used to thinking of the United States as a coherent market with a predictable regulatory regime. States traditionally have competed for corporate investment through incentive packages. But now, conservative politicians are differentiating themselves by picking fights with major employers over issues such as environmental, social, and governance (ESG) regulations, while left-leaning politicians are pursuing more pro-worker, consumer, and environmental policies that increase the cost of doing business in their states. This divergence will make long-term investment planning more difficult for both American and foreign firms because a mastery of state-level politics will become central to a successful business strategy.

There is also the continuing risk of political violence in the United States, even as some who participated in the Capitol riots two years ago on 6 January are now being sent to prison. The polarization that drives public anger has become a structural feature of American life, fueled in part by social media (please see risk #3).

Of course, red-blue animosity has been trending higher for decades. But today, roughly two-thirds of Americans view members of the opposing party not just as wrong but as dishonest, immoral, and a threat to the country itself. And the belief that threats and violence are politically justified has risen among members of both parties—though the increase has been sharper among Republicans. American's growing propensity toward settling political debates through non-democratic means will increase the risk of large-scale protests and one-off acts of political violence.

For all these reasons, America's bitter political polarization remains a risk we expect will grow through 2023.

There is a continuing risk of political violence in the US, even as some who participated in the Capitol riots go to prison

Oh, Canada

Canada has long seemed impervious to the political divisions and dysfunction apparent across the border in the United States. But the trucker convoy that occupied the capital of Ottawa last year—ostensibly protesting Covid-19 vaccination mandates—was a big indication that something had changed. In 2023, deepening polarization and regional antagonism in Canada will add to growing political instability on the continent.

Governments worldwide will face challenging economic conditions this year, and Canada is vulnerable. Persistent inflation will squeeze Canadians as rising interest rates and slowing growth prompt a sharp housing market correction, increase unemployment, and put fiscal pressures on indebted households, businesses, and governments.

These are manageable economic shocks. But two political factors are likely to make things worse. First, Canada's hyper-polarized political parties, divided along regional lines, will amplify rural-urban and eastern-western tensions for political gain.

Second, declining trust in traditional media outlets, combined with Canada's deep and unique exposure to the US political and media ecosystem—which manifests in cross-border political links, transnational special interest groups, Canadian consumption of US cable news and talk radio, and connections between US and Canadian far-right and far-left fringe groups (especially on social media)—will facilitate contagion from the divided republic to the south.

This means that Canada's combative partisan and regional politics are poised to take a turn for the worse. In Ottawa, inflammatory attacks on Prime Minister Justin Trudeau of the Liberal Party will be met by attempts to paint the Conservative opposition as a Canadian version of Trumpism. Both are overegged … but will gain traction. More serious would be hyper-partisan tactics by provincial premiers (taking a page from US governors) that reflect the increasing factionalization of Canadian politics. Flashpoints include negotiations over healthcare funding as well as federal immigration, energy, and climate change policies.

Canada and the US are growing closer, but it's less about alignment between Ottawa and Washington than cross-border alliances between sub-national governments and politicians of the same political stripe. Politics in Alberta and Texas (or New York and Ontario) are increasingly alike. This will add new uncertainties to US-Canada relations and the world's largest trading partnership. As the political temperature rises, we will see closer coordination between American and Canadian far-right and far-left fringe groups—with an increasing risk of disruptions, protests, civil disobedience, and even violence.

When the US sneezes, Canada catches a cold. Watch out for sniffles north of the border in 2023.

9 Tik Tok boom

Born between the mid-1990s and the early 2010s, Generation Z is the first with no experience of life without the internet. Digital devices and social media have connected its members across borders to create the first truly global generation. And that makes them a new political and geopolitical force, especially in the United States and Europe. Gen Z has both the ability and the motivation to organize online to reshape corporate and public policy, making life harder for multinationals everywhere and disrupting politics with the click of a button.

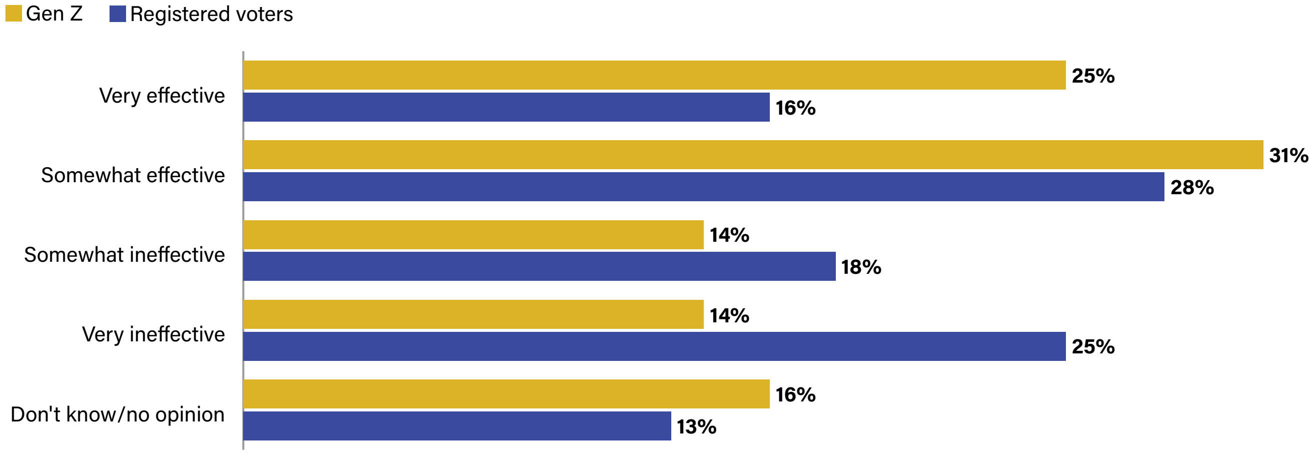
Gen Z grew up as America's post-Cold War dominance waned, revealing leadership failures at home and abroad through a series of formative historical events: the 2008 financial crisis, the Arab Spring and the Syrian civil war, Brexit, Trump's election, the Black Lives Matter movement, the #MeToo reckoning, mass school shootings in the US, the Covid-19 pandemic, and now the Russia-Ukraine war.

The result is a generation radicalized by the turbulent nature of its times and the failure of leaders and existing institutions to respond. Gen Z has broader expectations, demands, and policy impulses than its predecessors, including a marked distrust of institutions and traditional channels of political change and economic achievement.

Not only is this generation the most racially and ethnically diverse in Western history, but its members are also more aware of systemic racism, gender issues, and economic inequality—and they accordingly lean heavily progressive. Many are

The activist generation

How effective Gen Z think protesting is as a way to impact politics and public affairs, compared to registered voters



Source: POLITICO/Morning Consult survey of 1,000 eligible Gen Z voters and 1,987 registered voters of all ages in September 2020

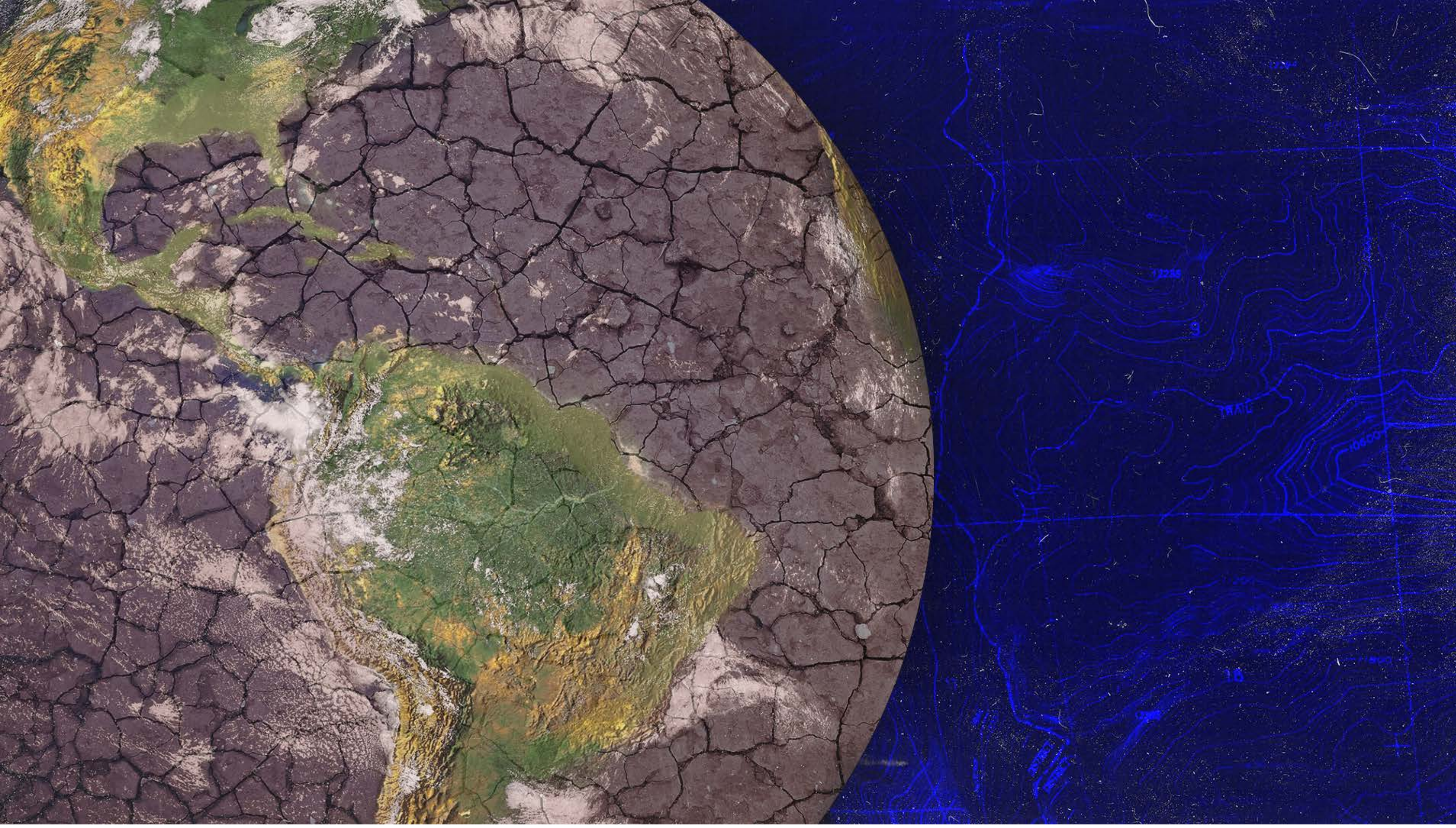
natural activists willing to skip school or work to protest government policies on climate change, gun control, and social justice while demanding that educational and business institutions conform to their worldview.

This generation is now coming of age, entering the workforce and political life. Gen Z currently makes up 30% of the world's population and is expected to comprise 27% of the global workforce by 2025. In the United States, Gen Z turned out in record numbers for the 2022 midterm elections, helping to hold off a Republican "red wave" by breaking in favor of Democratic candidates in swing states such as Pennsylvania and Michigan. And while its power at the ballot box will only grow, Gen Z's political influence already extends further owing to its outsized role in campaigns organized on social media.

Generational transitions often require corporations and governments to make significant institutional, strategic, and policy changes. When women entered the workforce during World War II, businesses were required to develop new workplace conditions better suited to childcare and family obligations. In the 1960s, baby boomers ushered in a period of radical social and political change. And more recently, millennials encouraged companies to think differently about issues such as mental health, leading to the adoption of new corporate services, benefits, and support systems.

Gen Z is redefining the workplace by pushing companies to incorporate fundamental changes in how they recruit, organize, retain, and develop talent; embrace new career paths and opportunities; foster genuine diversity and inclusion; and reevaluate their social, political, and environmental impact. As a result, corporations will feel unprecedented pressure to take sides in political and geopolitical debates, whether they like it or not.

Gen Z turned out in record numbers for the US midterm elections, helping to hold off a Republican "red wave"



10 Water stress

This year, water stress will become a global and systemic challenge … while governments will still treat it as a temporary crisis.

In 2022, receding water levels exacerbated the food crisis in Africa, halted shipping and nuclear output in Europe, and led to factory shutdowns in China. Water scarcity also forced the United States to limit water releases in western states and triggered social unrest in Latin America, heightening tensions between corporations and communities. Forecasts for 2023 are worse. Water stress will become the new normal: River levels will fall to new lows, and two-thirds of companies globally will face substantial water risks to their operations or supply chains.

Within countries, the number of water-related conflicts, already up sharply since the 1980s, will reach new heights in 2023. The impact will be greatest in the Middle East and Africa, where water will act as a “trigger” in places where militias fight over the scarce resource, and as a “casualty” in places where militants destroy water pumps, tanks, and pipes. Water scarcity will also trigger refugee flows in the Middle East (Syria, Iraq, and Yemen), threaten economic prospects in North Africa (Algeria, Morocco, and Tunisia), and heighten food insecurity in the horn of Africa (Ethiopia, Kenya, Somalia) by driving food prices higher and forcing farmers to migrate. The spillover effects on domestic inequality will increase social unrest in those places where they combine with other economic and social crises, including high inflation, unemployment, disease outbreaks, and energy shortages.

While the consequences of water stress will worsen, governments’ ability to handle them will not improve. Having failed to adequately prepare for a permanent decrease in water availability, policymakers will rely on short-term emergency measures that abruptly restrict and redistribute resources.

While the consequences of water stress will worsen, governments' ability to handle them will not improve

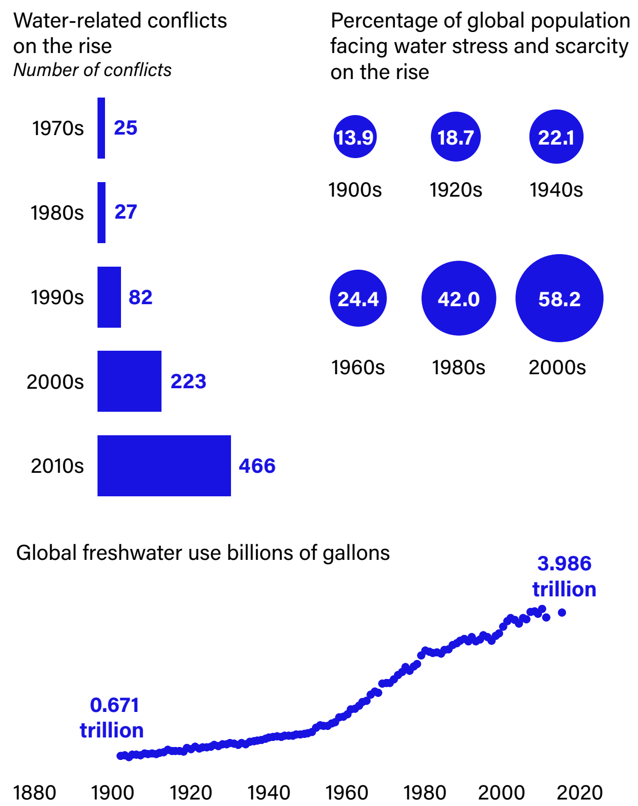
US policymakers will have to choose between electricity generation, water releases, industrial production, and food production on the one hand, and water conservation on the other. More US farmers, who will suffer the most from water restrictions taking effect in 2023 (an up to 21% reduction in Colorado River water supplies for some states), will be asked to forgo harvesting to help tackle water scarcity.

Europe will face different challenges. Norway may have to limit electricity exports to preserve hydropower for domestic use, exposing itself to legal challenges from the Netherlands and Germany. And sinking water levels in the Rhine and Po rivers will disrupt inland shipping and hamper broader economic activity in western Europe.

In Latin America, political decisions will push water-intensive industries such as beverage companies to move facilities from dry to water-rich regions. Local policymakers will follow Santiago de Chile's lead by rotating water cuts among customers, affecting the retail and hospitality industries.

There are no quick fixes in sight. For decades, rich nations treated water scarcity as a problem affecting poor countries that could be mitigated through bilateral aid. This led to chronic underinvestment in technological solutions such as desalination plants, which remain prohibitively expensive for use in agriculture—a sector accounting for 70% of freshwater withdrawals. International cooperation won't come to the rescue, either. While climate and biodiversity international negotiations—known as conferences of the parties, or COPs—are gaining traction, the COP focused on desertification remains overlooked (have you even heard of it?). The last one in May 2022 made no significant progress. And other global initiatives such as the upcoming UN Water Conference won't make a dent in water stress this year.

Water stress on the rise



Sources: Council on Strategic Risks, Population Connection, Nature, Kummu et al., Global International Geosphere-Biosphere Programme, Our World in Data

Water policy requires a transition from crisis to risk management. That shift will not materialize in 2023, leaving investors, insurers, and private companies to figure out how to handle this challenge on their own.

RED HERRINGS

Cracks in support for Ukraine

The United States and Europe will remain aligned in staunch support of Ukraine despite growing skepticism of involvement in the US and internal disagreement in the EU over whether to press Ukraine to negotiate.

Regardless of fluctuations in political support in the United States in the coming months, Ukraine's main benefactor has already frontloaded its 2023 material assistance. The Biden administration ensured military and financial aid for the year when it passed a $45 billion appropriation in December. In addition, lend-lease authority remains in place until the end of the year, granting the administration wide authority to provide Ukraine with more military hardware.

There is also strong bipartisan support for Ukraine in Washington, despite growing populist-right and progressive-left wariness of a "blank check" in US aid. Even with a majority in one chamber of Congress, Republicans will not block all new aid this year, and Congress will approve potential requests for smaller, military-focused packages. Such support will be tied to specific needs and conditioned on greater oversight of aid deployment, clarity on the US endgame, and increased EU contributions. Bipartisan consensus in the US on backing Kyiv will underpin continued transatlantic commitment to seek peace on Ukraine's terms.

For their part, most EU members see Russia's attack on Ukraine as a fundamental challenge to Europe's future. Washington's strong support for both Kyiv and NATO allies will be a constant reminder of the US security umbrella shielding Europe from hostilities, thereby dampening appetite for more EU strategic autonomy. Though European views diverge on how the war should end, EU members will not break ranks with Washington in deferring to Kyiv on peace talks.

Despite bearing the brunt of the war's economic fallout, European allies will also increase defense spending, in line with US demands. Sanctions pressure will remain high, with no political room for a climbdown on either side of the Atlantic. The EU will continue its economic decoupling from Russia, particularly in energy with the help of gas imports from the United States.

US-EU alignment on NATO's revitalization, including the addition of Finland and Sweden as members, will anchor stable transatlantic relations. Tensions will resurface when the time comes to fund Ukraine's reconstruction—made much more expensive by Russia's continued attacks on Ukrainian critical infrastructure—but that won't happen until the war ends, and the war isn't ending anytime soon. While 2023 may see the peak of Western aid to Ukraine, the Atlantic alliance will remain unified in its support for Kyiv this year.

Western support for Ukraine remains strong

The **United States** should continue to support Ukraine despite Russia threatening to use nuclear weapons

4-5 October 2022, % of US respondents

Overall, do you approve or disapprove of the **European Union's** support for Ukraine following Russia's invasion of Ukraine?

October/November 2022, % of EU respondents

Source: Reuters/Ipsos, Eurobarometer

EU political dysfunction

As much of the EU enters recession this quarter, the bloc is beginning to feel serious strain from the Ukraine war. This year's economic downturn and energy crunch (please see risks #4 and #6) will add to this pressure, exacerbating the outlook for the EU at a time it is grappling with leadership challenges. With a new government in Berlin struggling at home and abroad, French President Emmanuel Macron hobbled by his lack of a parliamentary majority, and Mario Draghi's exit as Italy's prime minister, there is no one capable of leading the bloc through this year's travails.

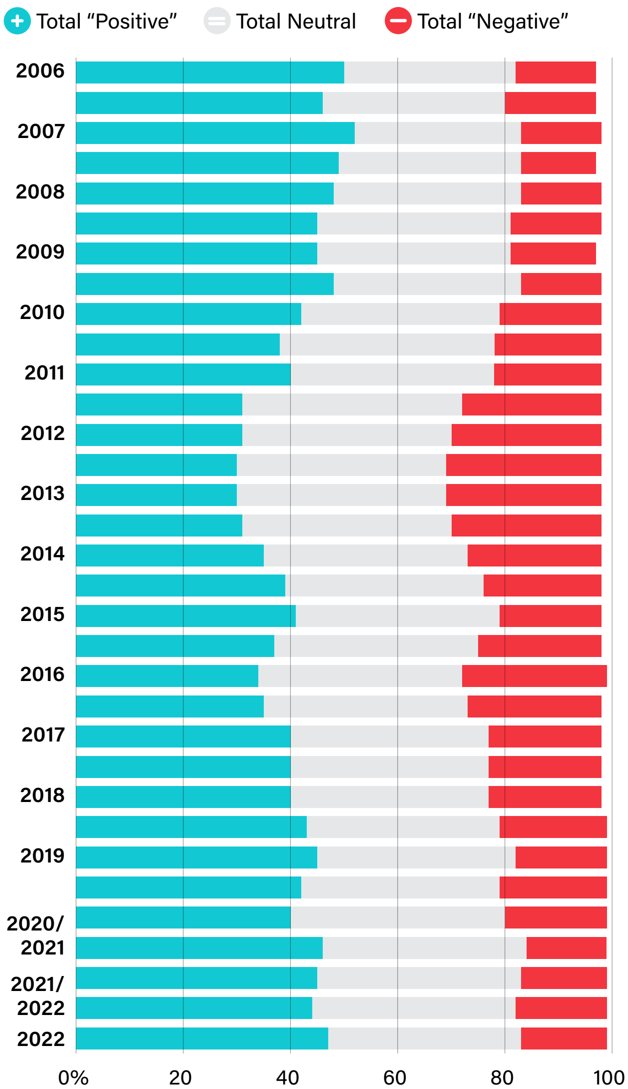
And yet, we expect the EU to remain cohesive in 2023. Yes, Germany will oppose more European fiscal solidarity and national budgets will continue to bear the brunt of the energy and inflation fallout in 2023. But more EU common borrowing remains possible. Discussions in Brussels on actions such as sanctions against Russia will also get more challenging (especially in terms of the economic fallout), but the EU is unlikely to waver in its commitment to Ukraine or reverse its decoupling from Russia.

In fact, the crises of the last several years—the Eurozone debt crisis, Brexit, the Covid-19 pandemic, and the Russia-Ukraine war—have all strengthened the European Union as a political actor. It now has stronger common fiscal policies, energy policies, health policies, and defense policies than ever before. This cohesion provides more direct economic leverage over potential outliers like Hungary. While it's true that no individual European leader has the ballast that Germany's former chancellor Angela Merkel had, the EU possesses the strongest supranational governance on the planet, so that doesn't matter nearly as much as it used to.

An existential threat from a surge in populism as a result of cost-of-living challenges is also unlikely. Italy's post-fascist ruling party, the Brothers of Italy, has tacked to the center. In France, Macron has assembled a fragile ad-hoc majority with the center right, and even if he calls an early election, the populists will remain divided and far from a majority. While Spanish elections at the end of next year may see the far-right Vox enter government for the first time, the center-right opposition Popular Party will

Support for the EU remains strong

In general, does the EU conjure up for you a very postive, fairly postive, neutral, fairly negative, or very negative image?



Source: Eurobarometer

remain firmly in the lead. The center-right government in Greece should narrowly hold onto power next summer, while Poland's euroskeptic government is likely to be replaced by a liberal, more pro-EU coalition in the fall.

Taiwan crisis

There is growing concern in Washington that the United States and China are headed for confrontation over Taiwan … and that it's increasingly likely China proactively changes the status quo, possibly even leading to direct military conflict in the near term. US Secretary of State Antony Blinken has asserted that China's Xi is "determined to pursue reunification on a much faster timeline" than previously thought. Senior defense officials have suggested Chinese use of force to retake Taiwan could happen by 2027, and possibly as soon as this year. But Taiwan isn't set to become a crisis in 2023.

Taiwan's ruling Democratic Progressive Party could escalate tensions with Beijing by advocating more overtly pro-autonomy policies ahead of the 2024 presidential election—especially now that President Tsai Ing-wen, a relative moderate on cross-strait issues, has stepped down as party chair. But last year's local elections made the engagement-minded Kuomintang opposition party more, not less, powerful.

Biden has repeatedly said the United States would defend Taiwan against a Chinese attack, casting doubt on Washington's longstanding commitment to "strategic ambiguity." But while the US will seek to improve political and economic ties with Taiwan, as well as military deterrence against any potential Chinese attack, the White House isn't considering a formalized security guarantee—let alone crossing Beijing's redline of recognizing Taiwan as a sovereign state.

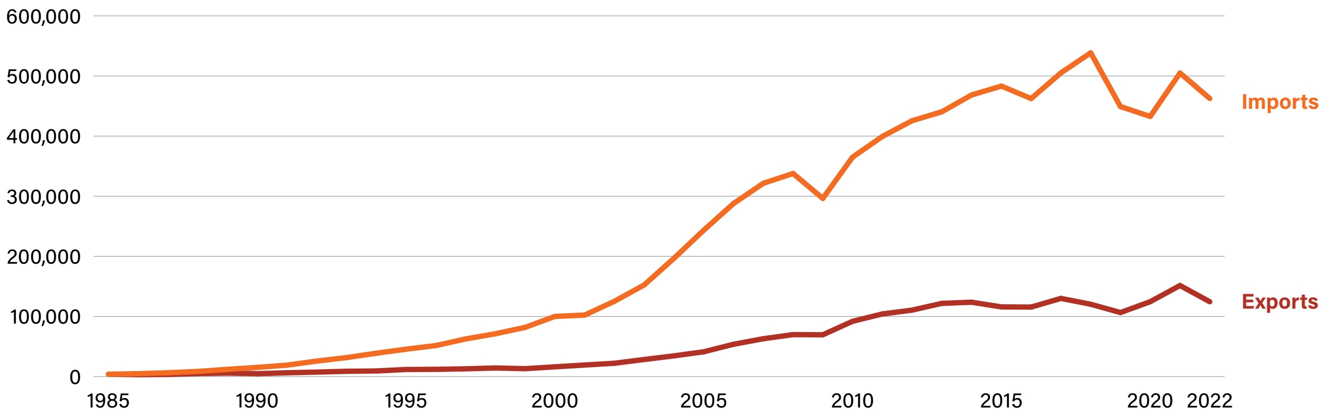
A more hawkish, Republican-controlled House will advance proposals to weaken or even abandon the United States's One China policy, but the real momentum is behind symbolic shows of support such as congressional visits to Taiwan and diplomatic engagements like the 21st Century Trade Initiative. Importantly, neither US private sector nor US allies want to risk a crisis.

For its part, China will match Taiwanese and American "provocations" with strong rhetoric and posturing of its own, and there may be more frequent military exercises and activities around Taiwan that prove disruptive to shipping and global supply chains. But Xi has recently reaffirmed Beijing's longstanding policy of prioritizing "peaceful unification" over the long term.

In short, neither China nor the United States is willing to test the other's redlines in 2023. In fact, Biden and Xi have told each other clearly and repeatedly that they're not looking for a crisis. And there are good reasons why a confrontation over Taiwan would pose intolerable risks for both countries. First, the US and China both remain consumed with domestic challenges—inflation in the US, slowing growth in China, and a possible global recession—challenges that would grow exponentially in the event of a military conflict. Second, China can't invade Taiwan without incurring significant US-led sanctions and losing access to the critical semiconductors that Taiwan Semiconductor Manufacturing Company (TSMC) produces. Third, despite sustained tension and efforts by both China and the US to reduce their interdependence, the two economies are deeply entangled and will remain so for the foreseeable future. A near-term military conflict would guarantee mutually assured economic destruction.

US and China remain economically interdependent

US trade in goods with China, $ Millions



Note: All figures are in millions of U.S. dollars on a nominal basis, not seasonally adjusted unless otherwise specified.
Source: United States Census Bureau

Especially after witnessing Russia's abrupt isolation by the West, China will defer moves that could possibly provoke military conflict until the balance of power is decisively in its favor, or until the US is ruled by a president who is clearly unwilling to defend Taiwan. None of this is remotely possible in 2023.

Tech tit-for-tat

When the US imposed sweeping restrictions on China's semiconductor industry last year, the move had the hallmarks of a containment policy, with Biden locking the two countries on course for a permanent tech competition. In effect, Washington was cutting Beijing off from the most critical technologies on earth. Retaliatory moves were sure to follow.

But there are several reasons why China is interested in keeping tensions contained in 2023.

First, between the exit from zero Covid, domestic unrest, and a challenging economic outlook, Xi has bigger fish to fry at home (please see risk #2) and is eager to avoid new crises.

Second, Xi's main retaliatory options—export controls on rare earth minerals, restrictions on semiconductor packaging for Western firms, unlinked economic measures—would damage China's own economy at a time of historically weak growth.

Third, China is hundreds of billions of dollars and a minimum of three to five years away from being able to produce the chips it needs domestically. Its dependence on older-generation semiconductors from TSMC, which are excluded from US export restrictions, will only increase in the meantime.

And fourth, Xi doesn't see the US moves as a step-change escalation. After all, China has been intent on achieving technological leadership and self-reliance for years. Export controls are considered fair game given Beijing's longstanding policies—for example, Made in China 2025 and "dual circulation".

None of this is to say that Xi is happy with Washington's new tech policy—he isn't. Nor does it mean that Washington won't keep pushing hardline policies in this area (including more targeted regulations and export controls) under the banner of national security—it will. But the White House knows it needs to draw a line under deteriorating relations with Beijing. This means refraining from embarrassing or provoking China unnecessarily, focusing instead on stabilizing the relationship overall and working more constructively in areas of mutual interest.

We try not to think too hard about writing a report on where the world is going (put it that way, and it feels like a daunting task). But it's not about prediction. You start with where the world is, really is, and to the extent that you get that assessment right, it constrains more outcomes than any crystal ball ever could. In many ways, Top Risks is about the art of what's not possible.

We learn as much about ourselves as the world in the process. What biases are we holding on to that need to be challenged? What are the things we think we know that aren't really so? And what would make us wrong?

We hope we've addressed these issues—we've certainly tried! As always, we'll be keeping the Top Risks on our homepage all year, so we can keep ourselves honest ... and then come back in December and see how we've done.

In the meantime, a heartfelt thanks for your support for the 25 years since we started Eurasia Group. It's a milestone that makes us stop for a moment. Yes, we're older, if not wiser (though it helps that we were children when we founded this thing). We're definitely more grateful.

Our very best wishes for our year ahead.

Ian and Cliff

Brasília London New York San Francisco São Paulo Singapore Tokyo Washington D.C.

25 years eurasia group