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Risk outlook 2024

Ten critical risk scenarios facing the global economy

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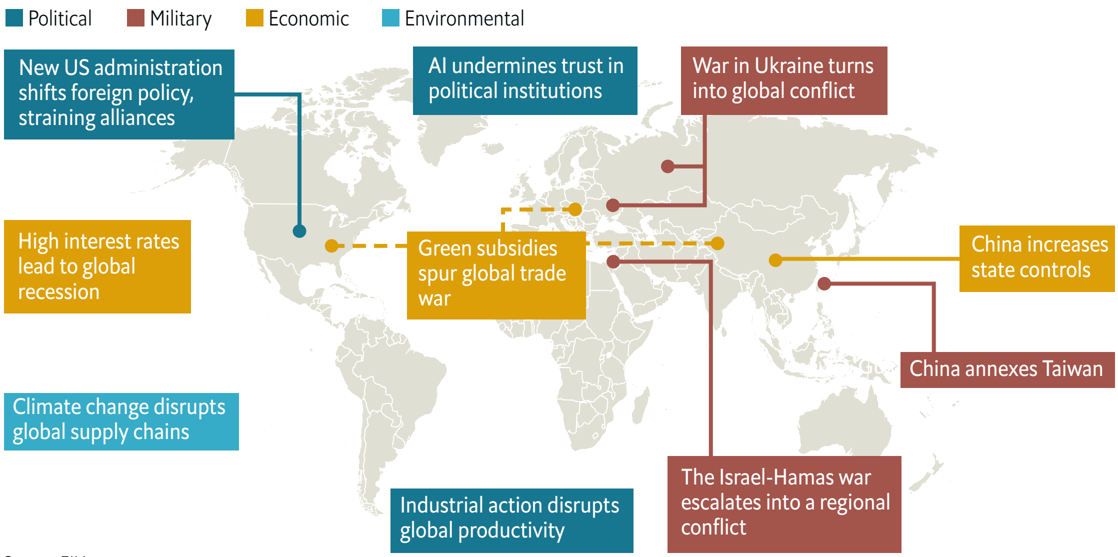
Ten critical risk scenarios facing the global economy

EIU's operational risk scenarios evaluate the events that could have a severe impact on its core economic and geopolitical forecasts, challenging the operations of businesses worldwide. In 2023 resilience among consumers and a gradual fall in inflation reassured uneasy investors and supported modest global growth. We expect stable, but unspectacular, global growth to continue into 2024 as economic uncertainty recedes and major central banks begin to lower policy rates in the second half of the year. This white paper explores how geopolitical tensions, the advent of new technologies and persistent environmental threats could upset the outlook for 2024.

Global risk scenarios



Source: EIU.

Scenario one: monetary policy tightening extends deep into 2024, leading to a global recession and financial volatility

Moderate probability; High impact

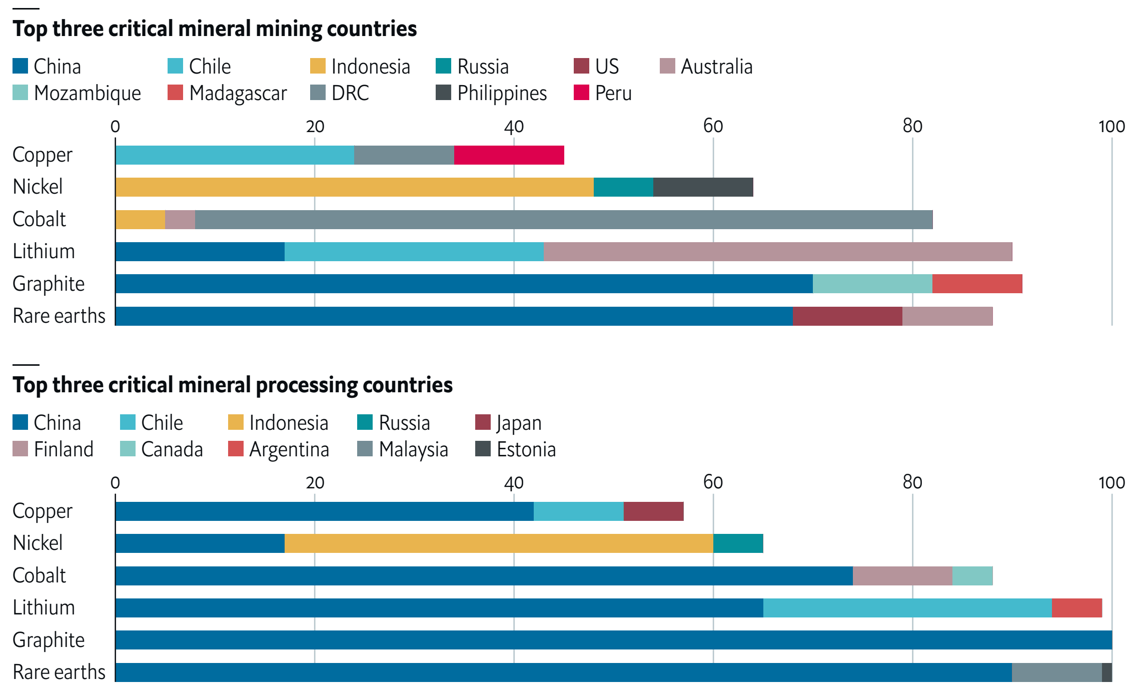
Since early 2022 major central banks have responded to high inflation by raising interest rates and starting to reduce the size of their balance sheets. As a disinflation trend has been established, our baseline forecasts assume that monetary policy tightening has now ended. However, there is a moderate risk that inflation will re-accelerate in 2024, driven by firm global demand (as labour markets remain tight and workers retain bargaining power) and an upswing in key commodity prices due to supply shortages. That could push central banks to keep tightening well into next year, raising interest rates to levels that would be likely to lead to a much more significant slump in consumer and investment demand. In emerging markets, higher than expected interest rates could also cause extreme currency depreciations, further increasing inflation and weighing on growth. Meanwhile, in major developed countries, the reduction of central banks' balance sheets could result in a sharp sell-off in the sovereign bond market and increase risk premiums in 2024, especially in highly indebted European economies. This could lead to a widespread asset-price crash, prompting a global recession.

Scenario two: a green technology subsidy race becomes a global trade war

Moderate probability; High impact

Western economies are rolling out generous incentives for businesses to invest in clean energy technologies by boosting domestic industrial capacity and enabling greater competition with China, which is the leader in the production of many green technologies. These initiatives also aim to accelerate countries' transition towards achieving net-zero greenhouse gas emissions, but most incentives include strict sourcing requirements for components (notably in the US). These requirements have already spurred tensions between the EU and the US, and will probably raise the cost of inputs and subsequently the green technologies themselves. If relations with China experience a severe downturn (including in relation to strengthening China-Russia ties or deepening concerns over China's state-driven industrial policy), Western economies could increase existing tariffs on Chinese imports or accelerate decisions on pending investigations into anti-dumping and state subsidy charges, further fuelling price growth. China would retaliate, possibly by blocking exports of raw materials that are critical to the green transition agenda such as rare earths, making decarbonisation efforts more expensive for developed markets. These costs would force economies to consider returning to carbon-based technologies, limit support from Western countries to fund emerging markets' energy transition and delay timelines for achieving net-zero emissions.

Made (but not always mined) in China
(% of global output, 2022)



Sources: International Energy Agency; US Geological Survey; EIU.

Scenario three: extreme weather events caused by climate change disrupt global supply chains

High probability; Moderate impact

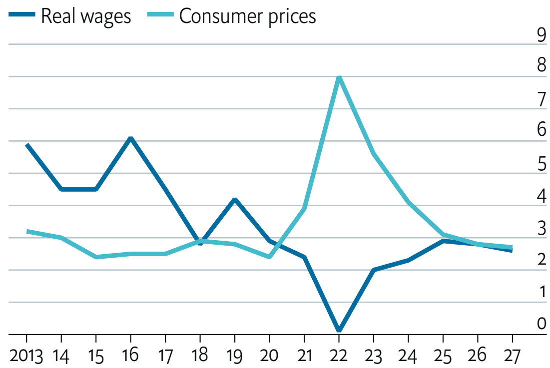
Climate change models point to increased frequency of extreme weather events. So far these have been sporadic and in different parts of the world, but they could start to happen in a more synchronised manner. Severe droughts and heatwaves have already weighed on crop yields, and the return of El Niño could exacerbate weather events and lead to record-high global temperatures in 2024. These disruptions, combined with geopolitical factors such as the collapse of a grain export deal between Russia and Ukraine, could put higher than expected operational stress on commodity-dependent industries, including agriculture, mining and manufacturing. If extreme weather events have a significant impact on production, this could lead to shortages, straining global supply chains and once again adding to upward inflationary pressures. These costs would probably spill over to households, exacerbating concerns about the cost of living and food security. Food shortages in some parts of the world could lead to mass migration, or even war, triggering severe political impacts in those countries that could ripple through to others.

Scenario four: industrial action spreads, disrupting global productivity

High probability; Moderate impact

High global commodity prices, continued supply-chain disruptions, high food prices and continued currency weakness against the US dollar for some countries will continue to fuel discontent in 2024-25. Wages have not risen as quickly as inflation in most countries, making it harder for poorer households to purchase basic staples. This could spark social unrest, expanding the small-scale protests and industrial action already seen in Europe, the US, South Korea and Argentina. In an extreme scenario, protests could push workers in major economies and who are employed by large manufacturers to co-ordinate large-scale strikes demanding salary increases that match inflation. Such movements, like those that have affected the automotive industry in the US and key services in the UK (healthcare, ports and railways), could paralyse entire industries or public services for an extended period and spill over to other sectors or countries, weighing on global growth.

Real wage growth in G20 economies has fallen behind inflation
(% change, year on year)



Source: EIU. *Data for 2023-27 are EIU estimates and forecasts.

Scenario five: China moves to annex Taiwan, forcing a sudden global decoupling

Low probability; Very high impact

A direct conflict between China and Taiwan is unlikely in 2024, owing to the risks to all those directly involved. Nonetheless, tensions are high, and Taiwan's elections in January may serve as a point of contention. Chinese military drills near Taiwan—including Chinese incursions into Taiwan's air defence identification zone—raise the risk of a miscalculation that could spiral into a wider incident. A formal Taiwanese declaration of independence (not our core forecast) would also precipitate a Chinese attack. Regardless of its trigger, a large-scale conflict would weigh heavily on Taiwan's economy, and its semiconductor industry would be temporarily cut off from the global supply chain. A cross-Strait war would also have global consequences, which would probably draw in military participation by the US, Australia, South Korea and Japan and prompt the EU and other US-aligned governments to impose trade and investment restrictions on China. Nuclear escalation would be a risk. Third markets (and companies) elsewhere would be forced to "choose" between China and Western economies. In retaliation, China could block exports of raw materials and goods that are crucial to Western economies, like rare earths.

The geographies most exposed to a conflict over Taiwan

Source: EIU.

Scenario six: a change in the US administration leads to abrupt foreign policy shifts, straining alliances

Moderate probability; Moderate impact

The administration of the US president, Joe Biden, a Democrat, has been supportive of the US presence in multilateral institutions, engaged strongly with key security and economic partners, and positioned the US as a serious actor in addressing climate change. A Republican-led administration following the 2024 elections would probably lead to some abrupt foreign policy shifts against these positions. A new administration could hold up global efforts to curb greenhouse gas emissions, step back from support for long-standing alliances, and abruptly withdraw US financial and military support for Ukraine, boosting Russia's position in the war. This would probably upset some US allies, such as the EU, the UK, Australia and Japan, and a general rise in volatility in US international policymaking could erode confidence in the country's ability to set long-term policies. In parallel, China would probably try to benefit from tensions by seeking to dissuade US partners from following US policies towards China.

Scenario seven: stimulus policy failures in China lead to increased state controls and diminished growth prospects

Low probability; High impact

China's sluggish response to covid-19 shocks and the subsequent post-pandemic slowdown has shaken confidence in the government's ability to communicate and guide markets. The breakdown in signalling increases the risk that the government, should it be faced with an economic recession, will have to opt for big-bang stimulus rather than rely on more subtle mechanisms to stabilise the economy and markets. Expansive measures could involve experimental helicopter money, monetary easing, property developer bail-outs, or easing housing purchase restrictions in first-tier cities that run the risk of reinflating asset bubbles and encouraging speculation or precipitating capital flight. The public criticism that would probably ensue from this approach, such as from wage earners that do not see the benefits of stimulus, might push the ruling Chinese Communist Party to reduce its support for the market economy and assert more direct state controls. This could involve reintroducing strict price controls on essential goods or nationalising the housing sector after a renewed deleveraging effort. The damage to private-sector confidence would be significant, economic productivity would be diminished and China's growth potential would be lowered, curbing global prospects.

Scenario eight: the Israel-Hamas war escalates into a regional conflict

Very low probability; High impact

If the military conflict between Israel and Hamas evolves into a long drawn-out war involving a lengthy Israeli occupation of Gaza, other state and non-state actors may become involved in sympathy with the Palestinian cause. We assess the likelihood of Iran getting directly involved in the war as slim, but it could use its influence on proxies such as Hezbollah in Lebanon to prolong and expand the scale of the conflict. Evidence of Iranian involvement would lead to counter-measures from Israel, turning the conflict into a regional one and widening its economic and geopolitical impact. In an already tight oil market, disruption to oil production and shipping from the Middle East would have significant upward impact on international oil prices, further prolonging cost of living pressure, particularly for oil-importing emerging economies. A regional conflict in the Middle East would also draw in external powers, potentially exacerbating tensions between, on one hand, the US and its allies, and China and Russia on the other. It would also decisively end efforts at Israeli-Arab rapprochement.

Scenario nine: artificial intelligence disrupts elections and undermines trust in political institutions

Moderate probability; Low impact

Global firms and governments have rapidly begun to test and integrate generative artificial intelligence (AI) into existing platforms and processes. We believe that AI will augment (rather than replace) human capabilities, presenting an opportunity for firms to improve productivity. However, the widespread adoption of AI and its use in social media will raise the risk of a spread in disinformation campaigns via text, imagery, audio and video in the coming years. Regulation across different geographies is coming, but malicious actors will still look to implement wide-ranging programmes aimed at fuelling existing scepticism of some citizens towards governments. This could potentially shift the result of major elections scheduled for 2024—including for the EU parliament, and in the US, the UK, India and Taiwan—and more broadly erode voters' trust in political systems.

Scenario ten: the Ukraine-Russia war spirals into a global conflict

Very low probability; Very high impact

Russia's invasion of Ukraine has fuelled underlying geopolitical tensions and accelerated global fragmentation. Ruptured relations between Western countries and Russia have raised numerous military risks, including a cyber-attack on critical infrastructure, a serious miscalculation at the NATO border with Russia, and an inadvertent incident among one of a growing number of nuclear arm-capable states. A state-led cyber-attack on another country is the greatest risk, as the perceived anonymity of these attacks make them more palatable to governments. In the event of a highly public or visible incident, the attacked country would probably retaliate. Western allies would present a united front, as Russia would try to convince other nations (notably China and Iran) to join the conflict. Such a conflict would be devastating; the global economy would fall into a deep recession, with severe human consequences and large-scale fatalities. It could assume a nuclear form, which would have catastrophic consequences.

EIU Viewpoint: Operational Risk
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