

## **Long term geopolitical scenario for a China-Taiwan war**

### **How likely is it?**

**The risk of a military conflict between China and Taiwan remains low in the short to medium term but rises over time.** Eurasia Group's basecase estimates that the probability of military conflict in the Taiwan Strait to be 10% through 2024, 20% through 2028, and 35% through 2035. Although the cross-strait military balance tilts toward China, its military has not fought a war since 1979, and Beijing would have to contend with a significant economic and even military response from the United States, its allies, and the Western world. President Xi Jinping faces numerous economic and other domestic policy challenges, which would suffer if he decided to initiate a conflict that would decimate regional security and likely cut China off from much of the Western international economy. Taiwan's critical position in global supply chains for high-end semiconductors is another disincentive, as China would cut off not just the rest of the world but also itself from a key technological input. Moreover, the Chinese leadership remains confident in China's future development—that "time and momentum are on their side"—and prefers to continue accumulating advantage to realize its preference of "peaceful unification" than risk war. But China is desperate to preserve this possibility and would likely respond militarily if its brightest red lines are crossed: if Taiwan declares independence or if the US recognizes Taiwan as a sovereign country.

### **How would it play out?**

**A China-Taiwan war is unlikely to begin with Chinese soldiers landing on the beaches of Taiwan,** but rather by a military crisis whereby Beijing uses limited force against the island to present an ultimatum for Taipei to enter negotiations for "peaceful unification" under a Hong Kong-like "one country, two systems" arrangement or prepare for a full-scale military attack. Such a crisis would be far more serious than Beijing's reaction to US House Speaker Pelosi's visit to Taiwan, likely involving the seizure of Taiwan's outlying islands, cyberattacks that disable critical infrastructure on Taiwan, a naval quarantine of Taiwan, and/or missile strikes that disable Taiwanese military facilities. Still, unification is extremely unpopular in Taiwan, and Taipei is unlikely to yield. Rising support for Taiwan in Washington and other Western capitals means it is becoming increasingly likely that the United States would then stage its own show of military force near Taiwan to try deterring Beijing from escalating further. If Beijing persisted, the likely consequence would be a regional war between China and the US and its allies (especially Japan), with both sides likely to sustain significant damage and neither having a decisive advantage.

### **What are the economic effects?**

**A China-Taiwan war would cause large-scale and enduring shocks on multiple fronts of the US and world economy.** The Taiwan Strait is one of the world's busiest waterways and would experience critical shipping disruptions in a China-Taiwan war, adding significant costs and delays to numerous supply chains, with shipping rates and insurance premiums also increasing significantly to accommodate heightened risk. East Asia is also a key node in the global semiconductor supply chain, containing 75% of the world's wafer fabrication capacity, with Taiwan holding 92% of the world's manufacturing capacity in advanced semiconductor chips below 10 nanometers. War would cause operations to grind to a halt, either due to conflict or Taiwan destroying foundries to prevent their capture by China, creating severe chip shortages, causing huge price hikes in consumer goods, and costing hundreds of billions of dollars of corporate revenue.

In 2021, China and Taiwan were the first and ninth largest US trade partners, respectively. In the event of a conflict, US exporters and importers would lose partial or complete access to Chinese and Taiwanese markets, as well as in-country suppliers, creating significant inflationary pressures. There would also be a sharp drop in bilateral investment and risks of seizure for US interests in China and vice versa. Markets would plummet and the risk of a geopolitical recession worldwide would be high. US sanctions and export controls against China would exacerbate such impacts and make significant strides toward economic decoupling between China and the West. RAND estimated in 2016 that the aggregate impact from losses in a US-China war over Taiwan in overall trade, consumption, and investment income would reduce US GDP by 5-10% and Chinese GDP by 25-35%.

## Long-term likelihood of a world depression or prolonged stagflation

### *How likely is it?*

**Low likelihood.** The global economy has been rocked by a series of unusual and extraordinary shocks, which have caused a material economic slowdown and a surge in inflationary pressures. Central banks around the world are responding to this global inflationary shock by tightening financial conditions, contributing to the stagflationary risks. Furthermore, the persistence of inflation and inflationary expectations means that central banks may have to keep interest rates restrictive for a longer period than currently anticipated by market participants. We now expect with a 75% probability that the US economy will enter a recession sometime before the end of 2023, and certain parts of the world (Europe, and perhaps even China) may already be in recession. A global recession now is possible. **Still, we are optimistic that a recession/stagflation will be moderate and temporary and the global economy will rebound by 2024.** Financial imbalances are limited compared to deep recessions in the past, and specifically the balance sheets of households and banks are stronger than in 2008. The post-pandemic, post war economy will be different in material ways from what preceded it, but it will also be dynamic and innovative.

### *How would it play out?*

A global depression—or more likely an extended period of high inflation and low growth—likely would require major geopolitical conflict or some other disruptive new event, and would need to be compounded by a series of policy mistakes. A scorched-earth strategy by Russia in Ukraine could cause a significant rise in geopolitical tensions, or a substantial increase in US-China tensions could trigger a new downturn. A new pandemic might see a weakened and less well coordinated international response, leading to new and extensive national restrictions on commerce. **The common element that could link these scenarios would be a retreat from globalization**—trade would contract, countries would enact additional barriers to goods and capital flows, combined with weak monetary and fiscal responses. Investment would decline. After more than two years of a pandemic, many governments have exhausted their financial and policy buffers—fiscal space is exhausted, institutional capacity has been eroded, and disillusioned populations have lost confidence in their leaders. On the economic front, **stop-start central bank policies could lead to inflation becoming entrenched, requiring a Volcker-style shock treatment to restore price stability.** All this makes for a toxic mix in which populism can thrive and economic growth would suffer.

### *What are the economic effects?*

**The stagflation scenario would be reflected in a significant downturn in global economic activity, combined with a sluggish recovery, resulting in a slower pace of trend global growth in the recovery in the medium term.** Even a ½-1% lower pace of trend global growth, compounded over 10 years, would be a material loss of output and a major increase in poverty. Global growth would average between 1-2% over the decade (compared to 3 ½% prior to the pandemic), which would be associated with near zero growth in much of the industrial world. Inflation would be higher and more volatile. Income distribution would become more inequitable, exacerbating political tensions.

## Energy transition long-term outlook (1/2)

### *How likely is it?*

While the direction of decarbonization is generally set, with national and private-sector pledges to reduce GHG emissions becoming more ambitious, **the timetable to reach net-zero is still very uncertain, and policies proposed so far are insufficient to reach the 1.5 degrees above pre-industrial levels target in the Paris Agreement.** Current pledges would only reduce the increase by 2100 to 2.4 degrees Celsius, and they are in most cases high-level and aspirational, especially on a government level, lacking both policy substance and mechanisms for implementation.

The next decade will be critical if mid-century emissions and temperature goals are to be met, as the global carbon budget is finite. Failure to meet the 2030 global emission-reductions target of 45% compared to 2010 levels mean that:

- Temperature increases in the interim will be accelerated, leading to more climate-related challenges, some of which will be irreversible.
- The scale of the emissions-mitigation challenge will be greater, with less time to address it.
- The severity of measures required post-2030 to achieve net-zero emissions by 2050 will increase exponentially, with a concomitant rise in economic and political disruptions. Failure to reach 2030 targets will put the net-zero-emissions target at severe risk, absent an as-yet-unanticipated technological breakthrough.

### *How would it play out?*

Current policy measures will not be enough to hit 2030 targets. Moreover, the Russian invasion of Ukraine has had a structural impact on the geopolitics of energy and energy transitions that will further complicate achieving end-of-decade goals, ensuring that the path over the next decade will not be smooth. **The renewed emphasis on energy security due to oil and gas price and supply shocks has delayed – at least temporarily – decarbonization and emissions-reduction initiatives by major emitters in Europe and Asia.** This shift will extend the use of coal in both geographies, potentially for a number of years, thereby making the task of reaching 2030 targets, and net-zero by 2050, increasingly difficult. Meanwhile, the invasion will accentuate differences in financial wherewithal, the availability of technology and natural resources, and political intent globally, leading to a wider divergence in the pace of and commitment to energy transitions and decarbonization among key emitters (the US, the EU, China, India, and Russia). The prospects for multilateral consensus and policy will diminish as domestic security of supply and price issues shape government policy and lead to more extreme climate events that heighten tension between industrialized countries and emerging markets over responsibility for the cost of climate adaptation and mitigation.

**There is a 70% risk that these factors will combine to delay or retard the climate action needed to hit peak emissions globally by 2025,** leading to temperature increases above the 1.5 degrees Celsius level within the next decade. Temperatures are already 1.2 degrees Celsius above pre-industrial levels.

### *What are the economic effects?*

A rise of this level would create widespread environmental and economic damage, such as:

- The globe's ice caps will continue to melt, and crucial ice sheets like the one in Greenland might start down an irreversible path toward complete disappearance. That will lead to more sea-level rise — about 0.3 to 0.6 feet on average globally by 2030.
- By 2030, 92 percent of countries will experience 'extreme hot' temperatures, or temperatures that would have been observed just once per century in pre-industrial times, every other year. The impact will be particularly acute in Southern Africa and parts of the Northern Hemisphere.
- Agricultural yields are expected to drop by 10%-25% for each degree of global warming
- Overall, climate change will kill an additional 241,000 people per year by 2030.
- Climate crisis will push an additional 100 million people into extreme poverty by 2030.

## Energy transition long-term outlook (2/2)

As the impact of climate change is incremental, the impact of rising temperatures and higher atmospheric concentration of GHGs will be felt increasingly over time, and they will be increasingly more difficult to reverse. As a result, an unabated rise in GHG levels and global temperatures between now and 2030 will have even more devastating impacts in the longer term:

- At the current rate, temperature increases will reduce global GDP by 11-14 percent by 2050. G7 economies could see an average loss of 8.5 percent per year by 2050 (\$4.8 trillion).
- Sea level will likely rise to up to 20 inches by 2050, displacing 2.5 percent of the global population.
- Climate change will likely cause 250 000 additional deaths per year between 2030 and 2050, through heat stress, malaria, malnutrition, and diarrhea incidence.
- Climate change will likely displace up to 1.2 billion people globally by 2050.
- If 2030 targets are not met and sufficient adaptation measures are not taken, global crop yields could decline by up to 30 percent by 2050. Wheat, corn, and rice yields will drop an additional 10 to 25% for each degree above the current 1.1 degrees.
- The share of cropland affected by drought is expected to more than triple globally by 2050, reaching close to 32%. Shares will reach close to 50% in the US and 70% in West Africa, for example.
- Land degradation will likely reduce global food productivity by 12%, increasing food prices by 30% by 2050.
- By 2050, 51% of the global population—as many as 4.9 billion people—will live in areas facing higher water risk, exposing 46% of global GDP and threatening 40% of global grain production.
- Each degree of global warming is projected to decrease water resources by at least 20% for an additional 7% of the global population.