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GEOPOLITICAL OUTLOOK INTELLIGENCE SEVRVICES

Monthly Intelligence Report

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GPF GEOPOLITICAL FUTURES

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THIS MONTH IN GEOPOLITICS

All Eyes on Ukraine

THE WAR IN UKRAINE continues to be one of the most geopolitically significant events in the world, mostly because the stakes haven't changed: If Russia wins, its forces are on the border of NATO, and if Ukraine and the United States win, we can expect regime change in Russia. This makes a negotiated agreement all the more likely, even if it isn't particularly imminent.

Meanwhile, the world is heading toward recession, the first in 14 years. Normal business cycles tend to generate recessions to rectify inefficiencies and irrationalities in the economy, and though there's a degree of cyclicality to the coming one, the U.S.-led economic war on Russia played a huge part as well, disrupting the flow of hydrocarbons just as the world was recovering from the economic fallout of the COVID-19 pandemic. This, in turn, could affect everything from interest rates and inflation to employment. The coming months will lock dysfunction into place.

> How bad things get will depend largely on the United States, which, for better or worse, dominates global geopolitics.

Put simply, what happens here matters everywhere. And what's happening here betrays an anger the likes of which hasn't been seen since the 1960s and 1970s. I'm not interested in litigating whether the anger is justified — some of it is timeless, some of it is newfound in light of recent Supreme Court decisions — because ultimately what matters is that there is anger, and that that anger is manifesting itself violently. Expect that to continue in the next month.

More important from a geopolitical perspective is how U.S. unrest affects U.S. foreign policy. The decision to establish permanent bases in Poland, for example, and to transfer substantial amounts of weapons there is largely divorced from domestic rage. But the economic hardship that has resulted from the economic war on Russia has certainly been felt at home. I believe there will be increased opposition to the war in Europe on these grounds, and thus more pressure to seek a negotiated end. Even so, economic anger will not be focused solely on Ukraine, and most U.S. residents seem to understand that their economic problems do not begin and end with the conflict there.

That conflict, as it happens, has entered a new phase. Russia has captured Luhansk and is positioned to take control over more of Donetsk. From a purely military point of view, this is neither a major breakthrough for Russia nor a major defeat for Ukraine. From a morale point of view, it is more significant. The capture of Luhansk marked a change in Russian operations. Moscow had initially fought with large armored divisions it could neither control nor supply. Its new strategy is more methodical, focusing on narrower objectives with a distinctly attritive flair.

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There will be a lot of talk of a cease-fire in the next month. Russia and Ukraine will both be tempted, but ultimately neither will sign on — Ukraine is being too heavily armed by the West for Russia to consider, and I can't believe Ukraine believes Russia would respect it. Instead, much of the next month will be about rest and deployment ahead of an assault on Odessa. Russia's recent gains open the door to success, but Ukraine has had a lot of time to train and reorganize. It's hard to imagine anything decisive will happen right now.

The same could be said for Joe Biden's visit to Saudi Arabia. Washington wants Riyadh to hike oil production, something Riyadh can absolutely do if it wants to. Bilateral ties are fraught — more on that in a separate article — but the fact is that Saudi Arabia can't completely spurn the U.S. any more than the U.S. can completely spurn Saudi Arabia. We expect a shift in supply of oil next month. The only question is how much.

Hovering in the background is China, which over the long term outweighs the short-term machinations of Ukraine. We are still seeing the consequences of China's default on real estate debt. We are still seeing the vast pandemic-induced closures in China's financial hub in Shanghai. And we are still seeing uncertainty surrounding its relationship with its biggest customer, the United States. Pressure on China's exports, led by declining economies around the world, has unbalanced its economy, and there is apparently real political pressure on President Xi Jinping as a result. Russia's performance in Ukraine, meanwhile, has forced Beijing to rethink its relationship with Moscow. It still needs Russian energy but would be happy to find other sources. More than anything, though, Beijing doesn't want to be drawn into Russia's war; next month, we will see more and more evidence that it isn't going to sabotage its relations with the U.S. just to please Russia.

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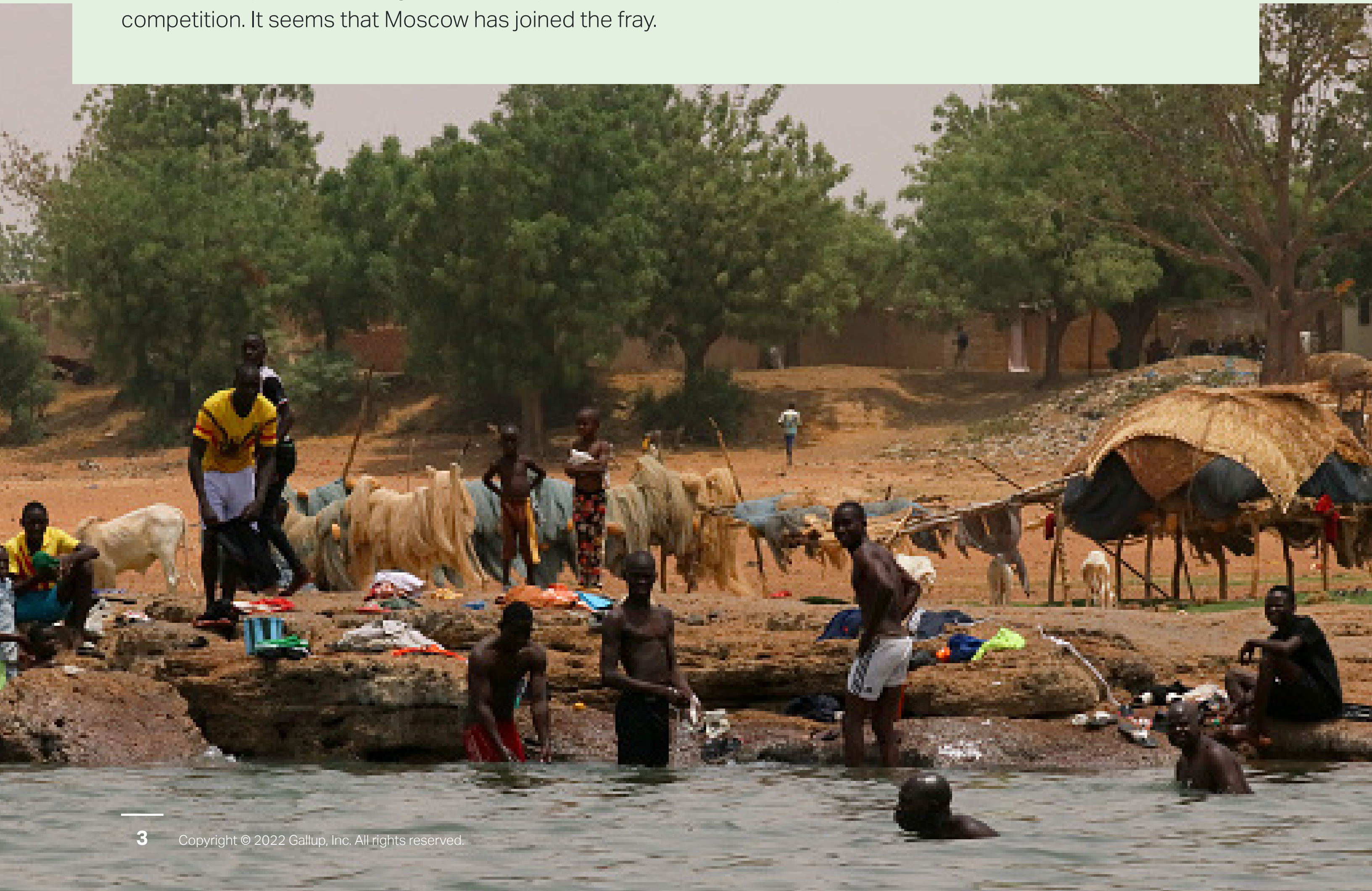
MATTERS OF OPINION

A Three-Way Race for Influence in Africa?

THE GERMAN GOVERNMENT RECENTLY ANNOUNCED that it would no longer participate in the U.N. military mission in Mali, the Sahelian country that has been at war with itself since 2012. France, a former colonial power with substantial influence in Africa, formally withdrew its troops from Mali on Aug. 17. Its foreign security allies growing thin, and with a still-pressing need to combat insurgents, the Malian government has since turned to the Wagner Group, the Russian mercenary outfit that on paper is private but in practice acts as an arm of the government in Moscow.

Mali is only the latest African nation to employ Russian private military contractors, or PMCs. Wagner-affiliated PMCs are also known to have operated recently in the Central African Republic, Mozambique and Libya.

Their deployment represents a sort of return by Russia to Africa. During the Soviet era, Moscow maintained a substantial presence throughout the continent, competing with the U.S. for influence and doling out military and development aid. But when the Soviet Union collapsed, Soviet funding dried up, and Russia ceased to be seen as a player in the region. Over the past few decades, it has been primarily an arena for U.S.-China competition. It seems that Moscow has joined the fray.



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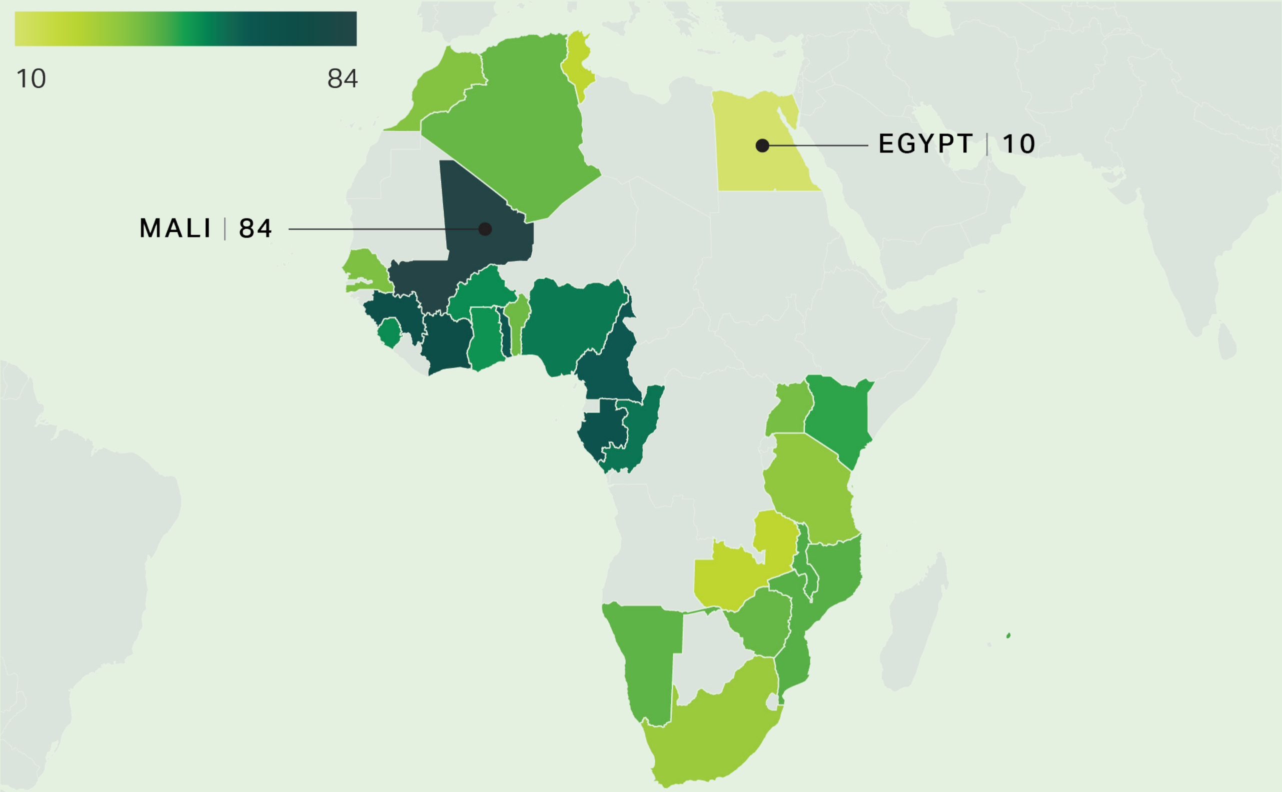
Gallup routinely collects data on how certain African populations view the leadership of these three powers. The level of approval for U.S., Chinese and Russian leadership is often a gauge of overall views of the countries in question. In general, Africans in these countries tend to be fairly positive on all three, with substantial percentages of the populations mostly approving.

Approval of Russian Leadership in Key African Countries

Do you approve or disapprove of the job performance of the leadership of Russia?

% Approve



Gallup, 2021

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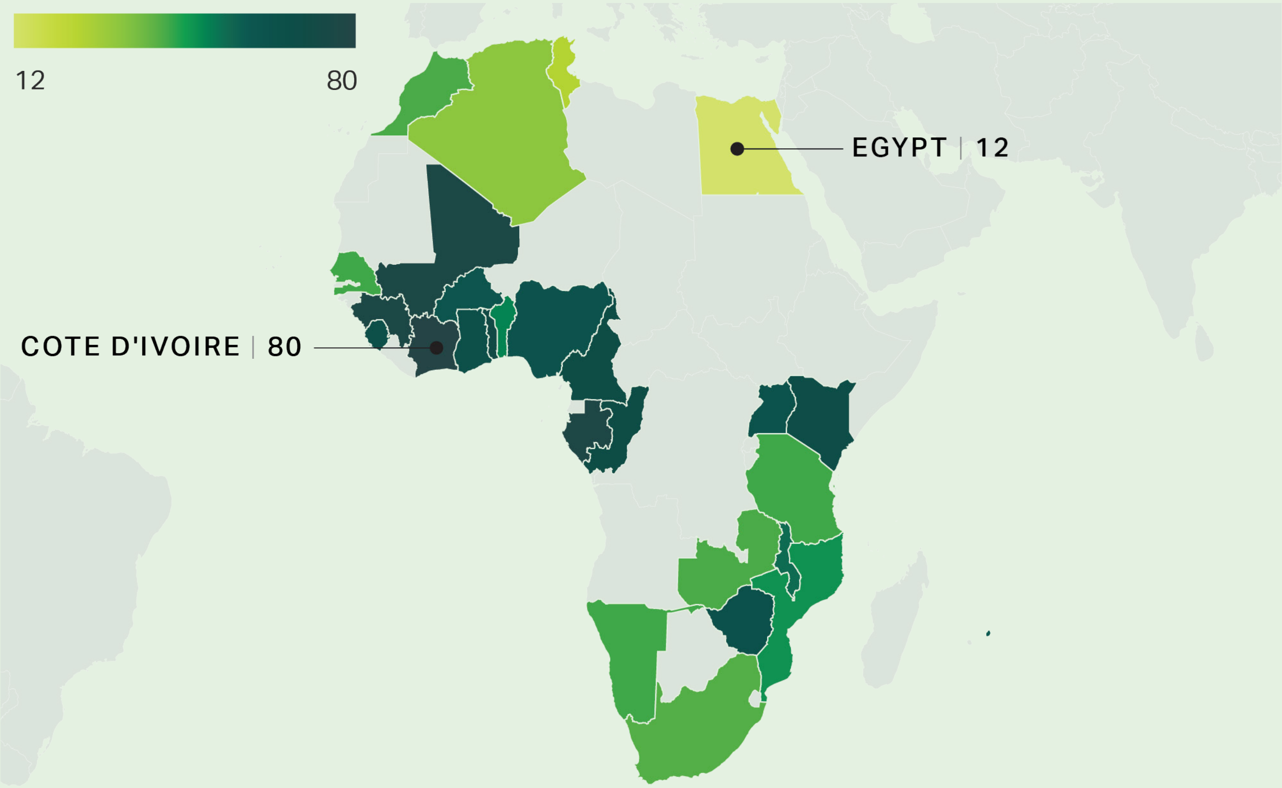
But even then, opinions differ markedly. In 2021, for example, approval of U.S. leadership ranged from a high of 80% in Cote d'Ivoire to a low of 12% in Egypt. In general, levels of approval for U.S. leadership are close to but slightly higher than that of Chinese leadership — approval of U.S. leadership tends to be particularly high in Sub-Saharan Africa — and are dramatically higher than that of Russian leadership.

Approval of U.S. Leadership in Key African Countries

Do you approve or disapprove of the job performance of the leadership of the United States?

% Approve



Gallup, 2021

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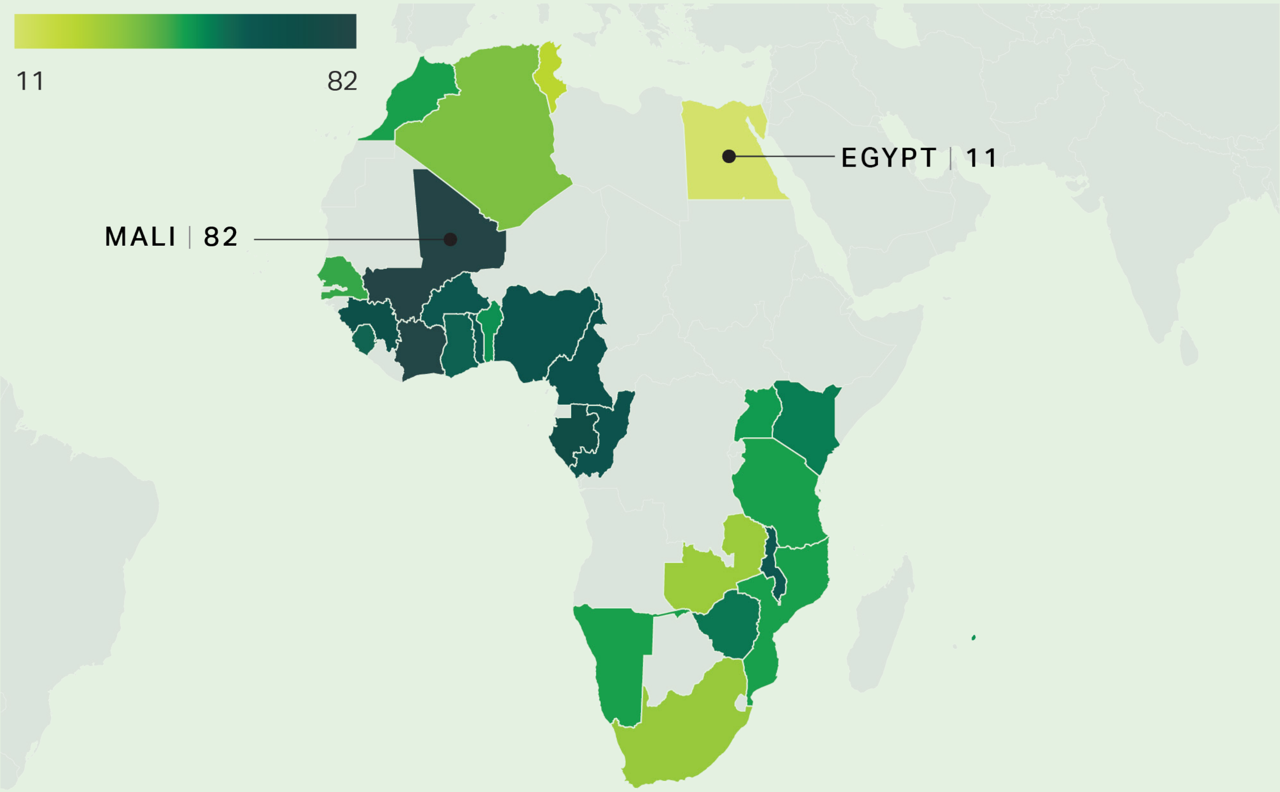
Approval of Chinese leadership in 2021 ranged from 82% in Mali to 11% in Egypt. Elsewhere, approval of Chinese leadership exceeded that of the U.S. and Russia in Cote d'Ivoire, Malawi, Morocco, Namibia, Nigeria, Senegal and Tanzania. (Interestingly, none of these countries were in the top 10 of African recipients of foreign direct investment [FDI] from China in 2020.) Approval of Russian leadership tends to be lower than that of either U.S. or Chinese leadership.

Approval of Chinese Leadership in Key African Countries

Do you approve or disapprove of the job performance of the leadership of China?

% Approve



Gallup, 2021

Each power has its own strategy for courting Africa. The U.S. has offered investment, development aid and military aid, which generally comes with strings attached — commitment to transparency, general adherence to global norms of human rights, etc. This approach has been criticized as having colonial overtones and creating a debt dependency for recipient countries. Though China's investment and development comes with much less oversight, Beijing is often criticized for exercising debt-trap diplomacy, offering African governments massive loans for projects that can never be paid back to increase its political leverage. Russia tends to offer military equipment and direct intervention through the Wagner Group, much of which has gone to illiberal African countries.

The data suggest that the approaches taken by the U.S. and China seem to be the most appealing. Gallup data on Africans' views of two key aspects of infrastructure — satisfaction with roads and highways and internet access — may provide insight into African countries that would be particularly open to trading influence for development in these areas, with those countries with the lowest levels of each potentially being the most open.

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Views on Infrastructure in Key African Countries

In the city or area where you live, are you satisfied or dissatisfied with the roads and highways?
Do you have access to the internet in any way, whether on a mobile phone, a computer or some other device?

	% Satisfied with roads and highways	% Yes, access to the internet
Algeria	43	81
Benin	40	31
Burkina Faso	36	26
Cameroon	34	41
Congo	44	34
Cote d'Ivoire	39	39
Egypt	59	42
Gabon	30	79
Ghana	41	41
Guinea	25	33
Kenya	49	52
Malawi	33	28
Mali	27	27
Mauritius	65	79
Morocco	60	71
Mozambique	51	26
Namibia	43	55
Nigeria	45	36
Senegal	54	51
Sierra Leone	26	26
South Africa	55	66
Tanzania	47	18
Togo	24	28
Tunisia	30	64
Uganda	42	44
Zambia	27	23
Zimbabwe	25	32

Gallup, 2021

Africans' low levels of satisfaction with roads and highways and internet access — perhaps the two most important aspects of African infrastructure — suggest a predisposition toward China and the U.S., which unlike Russia can actually help develop them. For now, Moscow is largely relegated to offering weapons and manpower through organizations like the Wagner Group. But for illiberal regimes fighting extremists, other countries or their own citizens, that may be enough.

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ON GEOECONOMICS

Economics and War

FOR BETTER OR WORSE, economics and war are the pillars on which our political history rests. Economics provides for the essentials of life; war withholds them. Both are enormously complex undertakings, with a dizzying number of functional layers and mechanisms. They are fundamentally different in intent yet profoundly symbiotic. Economics causes wars, and wars drive economies. Wars can be fought only by way of economic production. Economies can exist only if they are not captured or destroyed by war.

The United States has been engaged in large-scale war — that is, war involving multiple divisions — roughly 21% of the time since 1945: in Korea (1950-1953), in Vietnam (1965-1973), during Desert Storm (1991) and in Iraq (2003-2008). This is a staggering number, particularly because it excludes lesser engagements such as Grenada and Lebanon.

The reasons for this have less to do with policy than with power. It's a paradox that the more powerful a nation is, the greater its global interests are. The greater its global interests, the more likely it will engage in war as its interests increasingly conflict with those of its enemies.

War, in other words, isn't a black swan. It's a common event for major powers such as the U.S. and therefore for the U.S. economy. Given the expense and regularity of war, the American economy cannot be understood without building the high likelihood of war into that understanding.

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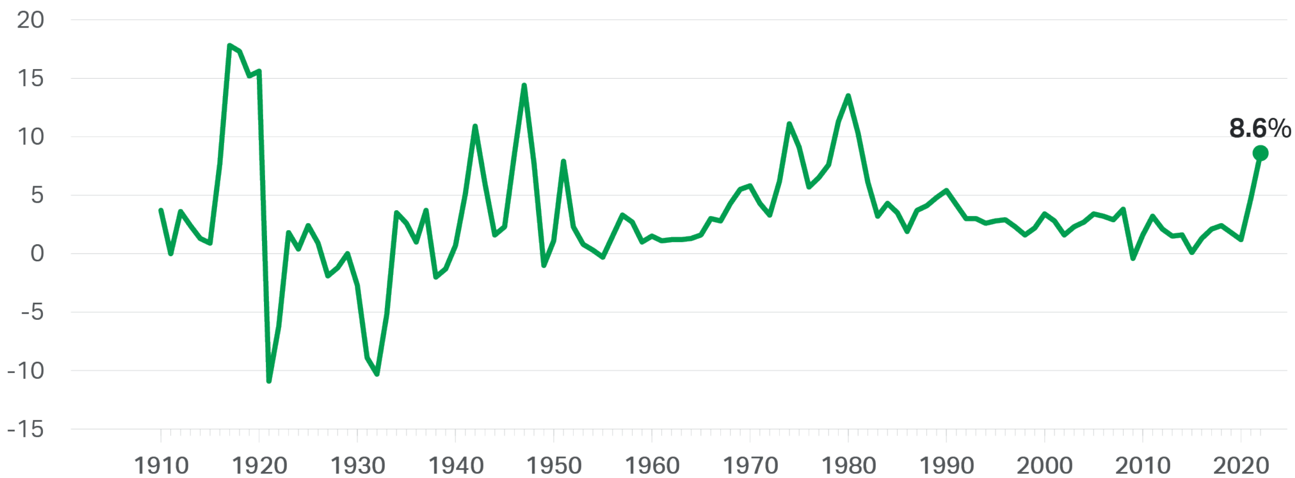
American war-time economies have a relatively stable pattern. GDP rises while inflation holds stable. As the end of war approaches, GDP falls. Inflation, meanwhile, will rise, even if it stabilizes to different degrees from year to year. The major variable is time. The longer the war lasts, the more extreme the shifts. And the more extreme the shifts, the greater the impact on other variables. Take World War II. GDP rose dramatically during the conflict, only for inflation to cut in after it ended.

Both were significant, but GDP's movement was more dramatic, and its sustained rise finally controlled inflation. This pattern held during the Vietnam War too. GDP rose, and inflation followed. The key difference was that GDP growth could not keep up with inflation.

U.S. Annual Inflation Rate, 1910-2022 (%)



Note: An estimate for 2022 is based on the change in CPI from Q1 2021 to Q1 2022

Source: U.S. Federal Reserve, Minneapolis

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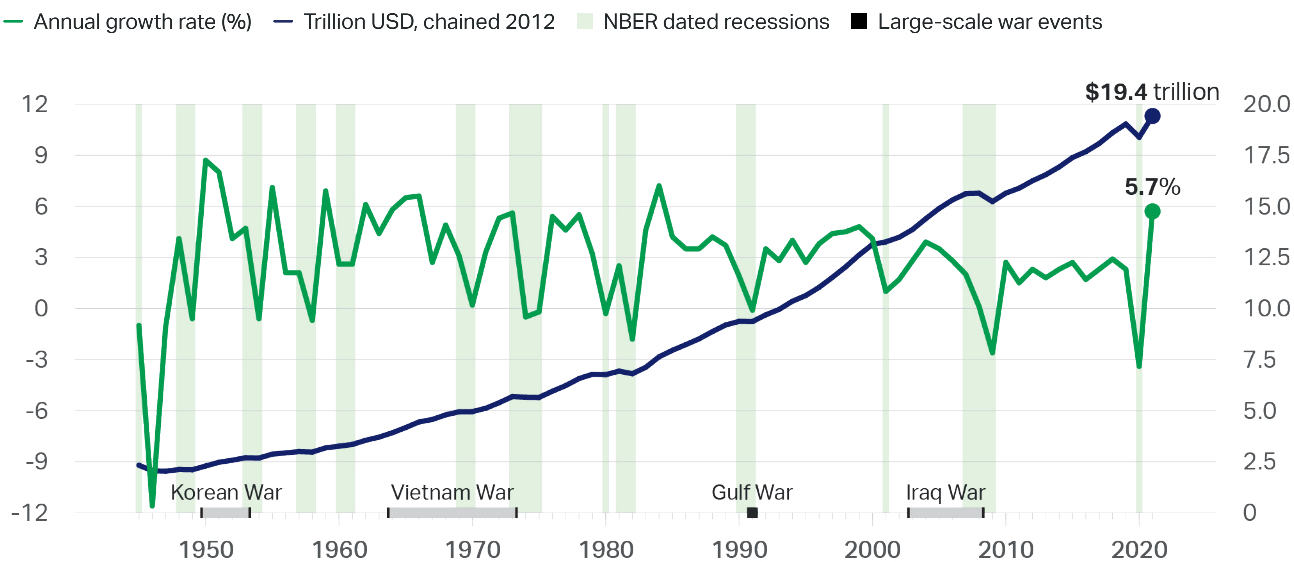
For the United States, war may create relatively short-term economic instability, built around crises of confidence that generally tend to resolve themselves. The reason they do is rooted in geography. In no war since the 19th century has the U.S. homeland been in danger of occupation, nor have its cities or industrial plants come under major attack. The Atlantic and Pacific oceans buffer the United States, while Canada and Mexico present no threat. The costs of war, then, are relatively little, and U.S. industry will maintain its value while consumption of goods continues, at times at higher prices.

U.S. Real GDP, 1945-2021



Source: U.S. Bureau of Economic Analysis, National Bureau of Economic Research

This is not the case for most other nations. China was devastated by Japan in World War II and took more than a generation to rebuild its economy. Russia essentially paid the same price in World War II as Germany and Japan did.

> **Even the victorious pay a price: Britain in World War II and the North Vietnamese during the Vietnam War both incurred huge costs despite winning. The American model involves a secure homeland, while most other nations face the possibility, even the likelihood, of war at home. The two have very different economic outcomes.**

Also important is the economic nature of warfare outside of military action. In the current war in Ukraine, the U.S. has withheld direct intervention but has nonetheless waged a multifront economic war against Russia. One tactic was to weaponize the dollar, specifically by denying Moscow access to the dollar as a trade currency, thus making it difficult for Russia to trade even with countries not involved in the conflict. Blocking an enemy's trade is routine in war, of course, but Washington demonstrated that it had the strength to demand other countries participate in the dollar war and that the war was not so much a physical war but a conceptual one in which the abstract force of currencies was used to endanger the Russian economy.

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The Russians have a more conventional option to use against the NATO alliance opposing them — cutting off the supply of natural gas to Europe — and they have used this option early and often. For Russia, the economic cost of losing European customers was worth the risk if spiraling prices on the Continent compelled members of the alliance to break faith with the rest of the West.

It's an old but effective move; the U.S. severed oil supplies to Japan before World War II, and Arab oil producers imposed an embargo during their war with Israel. But it's not without its dangers. Japan responded by striking Pearl Harbor. The West responded to the oil embargo by slowly but surely reducing dependence on Arab oil. Economic attacks, then, are vulnerable to military and economic countermeasures and thus require contingencies. The sanctions imposed on Iran over the past few years, for example, have indeed hurt its economy, but they haven't forced Tehran into submission. If anything, they have led to more Iranian proxy attacks throughout the Middle East. In short, economic attacks are never guaranteed to work and are never without consequence.

Kinetic warfare is therefore conducted with economic measures and physical contact. Here, too, geography gives the United States a huge advantage. The North American continent can sustain American economic needs — reliably if not quite painlessly. It's difficult for an enemy force to interdict supplies from outside the continent because the U.S. dominates the world's oceans. The strength of the American economy powers the American dollar, which can open another front. Most nations lack this critical advantage of economic geography.

There is another vital dimension that allows war, or war preparations, to power an economy. Consider the effect the development of long-range bombers in World War II had on the development of civilian aircraft and the subsequent economic consequences. Consider the Roman road system developed for military purposes but serving to unite Italy and, in time, overawe Europe. The development of military projects powers the civilian world and even civilization itself.

This is just as true in our time. Consider the components of the iPhone. The microchip was used in minuteman missiles. The GPS system was designed for the U.S. Navy to use in guiding cruise missiles and navigating nuclear submarines. The digital camera was first developed for use by the National Reconnaissance Office in the 1960s. There is a huge expenditure in most major countries on their militaries. There is a counterflow of value in the spinoffs from the development of weapons of war.

A nation survives by being able to protect its citizens and to deliver the necessities and pleasures of life to them. Militaries and economies are essential in that regard, their relationship immeasurably complex. And though that relationship is different for every country, for the U.S. it is central: The economy helps create national power and the military helps create the economy.

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THE WORLD AT LARGE

Big Trouble in Little Chinese Banks

CHINA HAS A LONG LIST of economic and financial problems. Its economy has yet to fully recover from the COVID-19 pandemic and its attendant supply chain disruptions. It has a staggering amount of debt, with a growing number of important companies in default. And it has, as always, profound wealth disparity between the rural interior and the wealthy coasts. Small banks in China's rural provinces, which are failing at an alarming rate, appear to be the latest potential flashpoint in a looming crisis. The fact that provincial leaders can't solve the banking problems on their own calls into question Beijing's strategy of empowering local governments to tend to their own affairs — which means the banking problem will soon be a political problem, if it isn't already.

Managed Fragility

Commercial banks in China's rural areas play a critical role in the government's strategy to support interior, poorer communities. Some 1,600 such institutions are scattered across China's interior. Though they account for just 12% of the banking system's total assets, they are the ones responsible for supporting the small businesses and farmers that constitute the lifeblood of rural communities. Consequently, domestic food production and rural stability depend on the healthy operations of small rural banks.

Beijing thus has a vested political interest in keeping these banks afloat and their depositors satisfied. When they fail, disgruntled residents have little recourse but to protest. Beijing, of course, has little tolerance for public dissent generally but especially in rural interior areas, which have been the breeding grounds for larger movements of national unrest and political discontent when wealth disparities grow too wide to stomach. After years of export-driven growth, this is exactly the situation in which China finds itself.

China's rural banking market consists of four types of financial institutions: a large commercial bank (Agricultural Bank of China), a policy bank (Agricultural Development Bank of China), the Postal Savings Bank of China, and a number of small- and medium-sized rural financial institutions. The latter are directly responsible for credit, lending, and financing local businesses and farmers, so they are highly exposed to small businesses whose loans are collateralized with land or property that is now rapidly depreciating. It used to be that national institutions such as the Agricultural Bank of China would underwrite the small ones, but now they are either unwilling or unable to as they contend with their own spike in overdue property loans.

The fragility of China's banking system is well documented, but until recently it has been effectively managed. But new pressures on the Chinese economy have created competing priorities for the central government. Beijing's economic strategy depended on export-driven growth. COVID-19 lockdowns and trade distortions have killed this strategy, while the war in Ukraine buried it. The government has thus been forced to pivot from aggressive exporting to industrial infrastructure investment to spur economic growth. Problems in small rural banks simply took a backseat to these bigger economic priorities.

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The most recent high-profile victim of this policy is in Henan province. In April, four rural banks there — Shangcai Huimin County Bank, Yuzhou Xinminsheng Village Bank, New Oriental Country Bank of Kaifeng and Zhecheng Huanghuai Community Bank — and one in the neighboring province of Anhui — Guzhen Xinhuaihe Village Bank — notified depositors that their accounts had been frozen and that they would not be able to withdraw their money. The banks repeatedly promised to unfreeze the accounts, but after a few months without satisfaction depositors staged a protest at a bank in Zhengzhou, the provincial capital, to demand that their savings be returned.

Trouble in Henan Province

In April, four rural banks in Henan province and one in Anhui froze customer accounts, leading to protests in Henan's provincial capital, Zhengzhou.

Source: GPF research

The Henan incident has called into question the central government's traditionally hands-off approach for dealing with small rural banks. Years of soaring debt, unproductive investment and rising property prices severely distorted the Chinese financial system. From this emerged risky, self-reinforcing borrowing structures such as shadow banking, a pattern that is especially pronounced in small rural banks. Rather than recognize these systemic vulnerabilities, the central government often downplays their existence and instead attributes any observed problems in rural banks to isolated incidents. Investigations into the Henan incident, for example, revealed that a private firm called the Henan Xincaifu Group had stakes in all of the banks listed and had embezzled funds through the use of fabricated loans and internal and external collusion.

Despite its best efforts, Beijing is unable to offload the work of fixing the problem to provincial governments. Small rural banks used to have a lifeline in local government funding vehicles and in selling deposits through third-party online platforms. But in recent years, most local government funding vehicles have accumulated a substantial amount of debt, and many are on the verge of defaulting. Changing bank management is a half-measure since there's no guarantee new management would be any less corrupt. The inability of local governments to address local banking problems, combined with Beijing's political sensitivity to unrest, has forced the central government to action, even if it would prefer to sit this one out.

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Beijing's Options

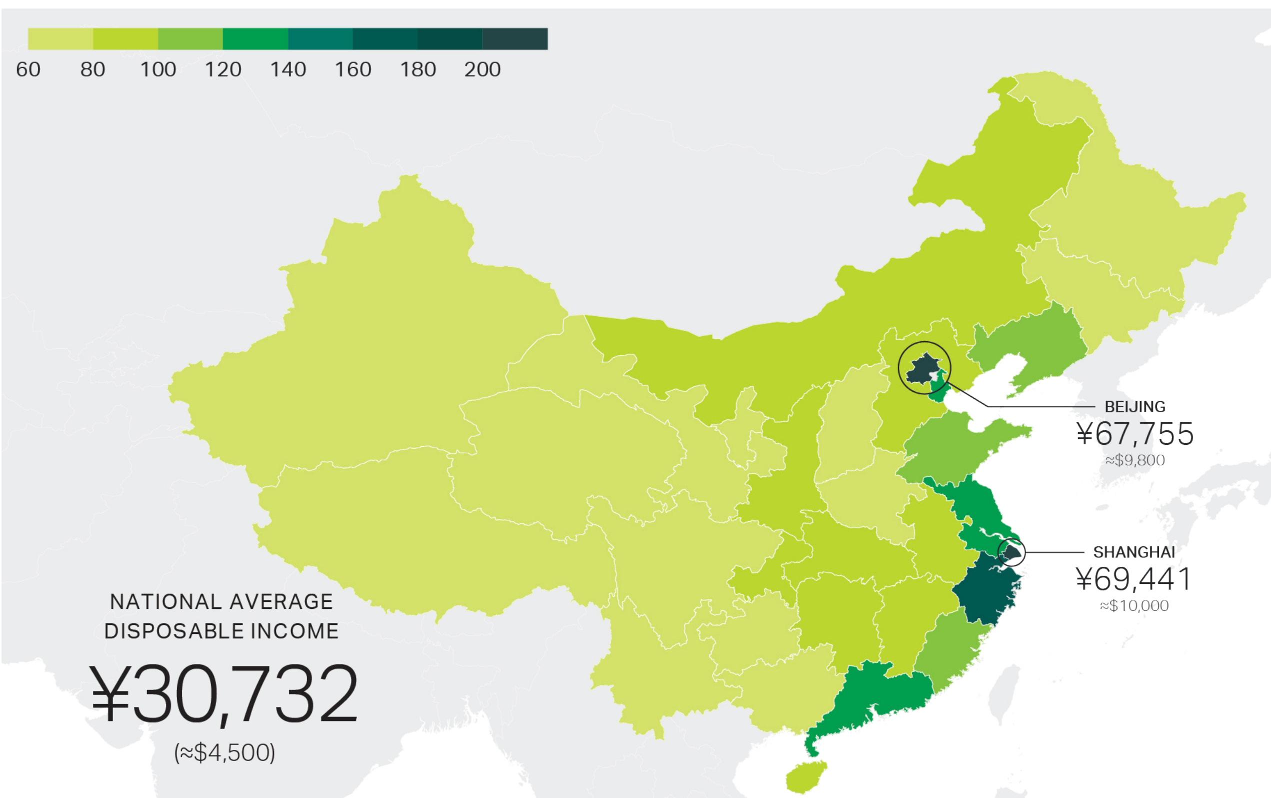
After the Henan protests, the Chinese central bank held an emergency meeting with other major banks and financial regulators. From the meeting came a measure for local officials to create task forces to mitigate the systemic risks posed by defaulters. To be sure, this is mostly symbolic; rampant corruption and insufficient enforcement mechanisms will completely defang it.

Interestingly, the central government did not implement banking reforms that it has introduced in other rural areas like Zhejiang and Guangdong provinces.

One such reform was to modify rural credit unions — cooperatives sanctioned by the central bank to provide credit in rural areas — to tighten the qualification requirements for executive management teams of rural credit unions, to regulate the corporate governance structures of RCUs and to strictly scrutinize shareholder behavior. The reforms worked well enough, but the government stopped short of executing a second round meant to fix problems such as insufficient assets, inadequate technology, poor corporate governance, weak risk management and the fragile credit quality of individual institutions.

China's Wealth Disparity

Per capita disposable income by administrative division, 2019 (Annual, national average = 100)



Note: Approximate USD figures based on average 2019 USD-CNY exchange rate of 6.91

Source: China Statistical Yearbook 2020

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China's broader economic problems and the systemic problems facing its financial sector constrain Beijing's ability to directly address the banking crisis. Larger banks facing mortgage boycotts and mounting debt problems in the real-estate sector threaten to collapse a major sector of the economy. Huge amounts of government funding are still being diverted to mass COVID-19 testing and related lockdown measures. This is, of course, in addition to government funding used to prop up local industrial production, secure expensive energy imports and support agriculture projects to make sure the country can feed its people. Compounding all of this is the contentious trade and investment with the U.S., both a key consumer of Chinese goods and an important source of investment. Beijing is simply unable to offer financial measures on a large enough scale to effectively aid rural banks since doing so would divert funds from other projects and provoke backlash from stronger business and political entities.

In theory, the government could enact financial reforms, but this too is easier said than done. The reforms needed to address the structural problems facing small rural banks require political capital that is currently in short supply. The problems afflicting small rural banks have a common source: rising debt and property prices, illegal activities, corruption, and the growing distrust of depositors and investors.

By improving regulatory and governance mechanisms in small rural banks, the latter will be able to improve their business strength, capital strength and risk management capacity. But this requires uprooting influential business and political leaders across affected provinces and shaking the pillars of rural economies. It's a recipe for destabilization.

Unsurprisingly, Beijing has decided to focus on containing the political fallout from bank failures rather than to address the financial problems head on. The government first showed signs of this strategy back in 2020. At the time, local banks successfully regulated their systemic issues and increased their money by selling deposit products through third-party online platforms. By partnering with these platforms, smaller banks were able to offer better rates and rewards for customers as well as easier channel access. The practice has since been officially banned by national regulators who feared that expanding the mostly unregulated and uncontrolled fintech sector could increase risks in the wider financial and social system.

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From the outside looking in, the decision may seem unreasonable. But policymakers in Beijing are hypersensitive to even the smallest amount of social unrest, especially in interior regions. To them, depriving local banks of the opportunity to replenish their capital was an acceptable risk. And history shows that the discontent that starts in the interior regions can spread like fire. Already there are forces within the Chinese Communist Party that oppose President Xi Jinping's recovery plans and are actively working against them. Xi can't afford to give them any more political ammunition.

Nor can China risk the foreign investment that political unrest could endanger. Unprecedented FDI outflow caused by the country's recent economic downturn has plagued Beijing for months. Beijing will have a difficult time solving its banking crisis — not to mention stabilizing its economy and boosting GDP growth — without foreign and especially dollar-denominated investment.

China's Foreign Direct Investment

Net flows, quarterly, billion USD

Source: China's State Administration of Foreign Exchange

There's a lot at stake in China's small, rural banks — much more than their size would suggest. Expect Beijing to do everything it can to keep the problem in check with modest reforms and, should that not suffice, police suppression and censorship. Just don't expect the government to tackle it head on.

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If the Lights Go Out in Europe

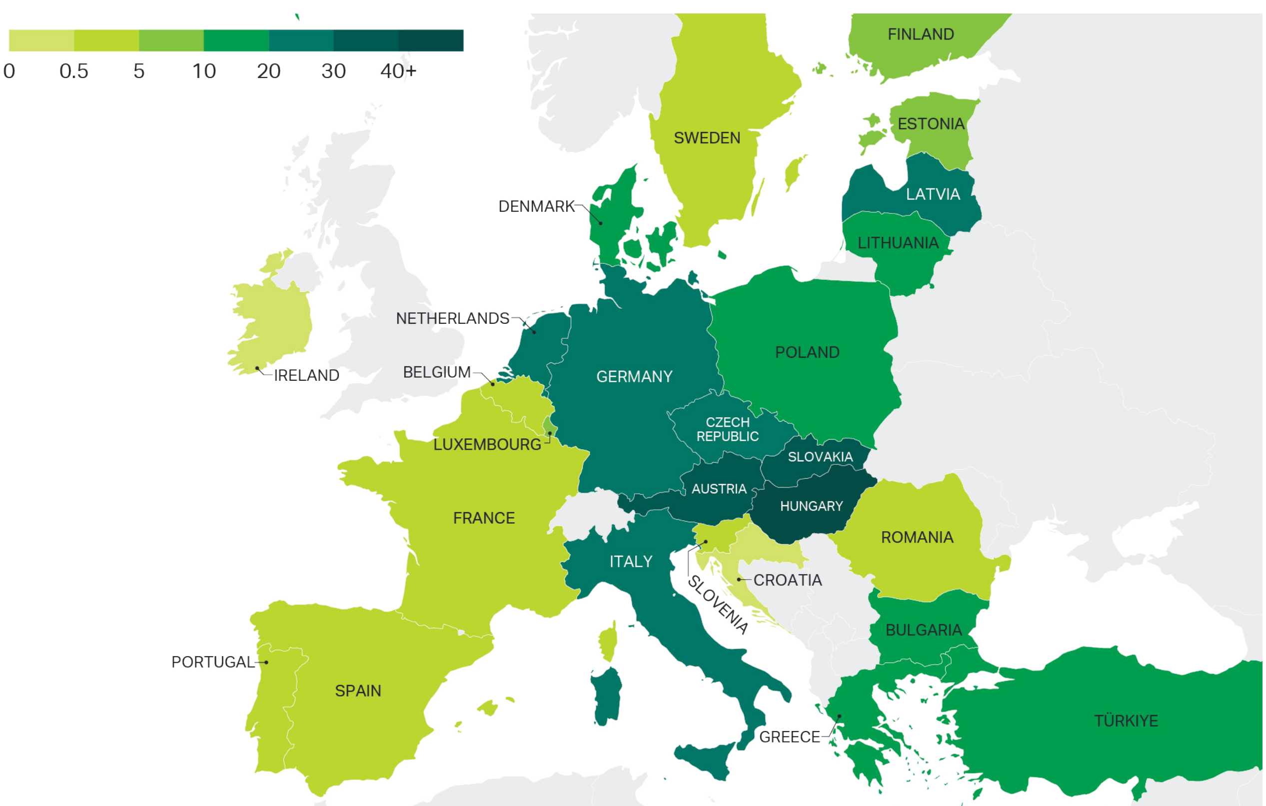
SINCE THE SHUTTERING OF THE NORD STREAM PIPELINE, the European Commission, in conjunction with European energy ministers, has since submitted a plan to see Europe through the rest of the year, but even their best efforts won't change the fact that energy markets will be mercurial for months to come. What is now an energy crisis could easily become a political crisis as leaders are forced to make the best of a more cash-strapped and energy-poor environment than they're used to.

In Europe, dependence on Russian energy varies from country to country, but in broad terms, it would lose anywhere from 10% to 30% of its energy needs if Russia cut off supplies.

That means Europe would need to come up with as much as a third of its energy from otherwise marginal suppliers to offset the losses — suppliers who are now setting the price of energy on the Continent. (And the market has restructured itself around that reality. Why wouldn't it? When gas prices in a market as big as Europe are $70/MMBtu, compared with $5-8/MMBtu in North America and $2-3/MMBtu in the Middle East, virtually every producer and marketer is trying to get in on the action.)

Europe's Dependence on Russian Gas

Russian gas as a percentage of total energy consumption, 2020



Source: IMF

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Germany — the economic engine of the Continent, the de facto leader of the EU and a huge buyer of Russian gas — began planning for this contingency months ago, meeting its natural gas inventory target of 85% of storage capacity, increasing coal-based energy generation and agreeing to keep some nuclear power plants up as a failsafe for consumers. Berlin has also supported the rapid expansion and improvement of the national and European liquefied natural gas (LNG) infrastructure.

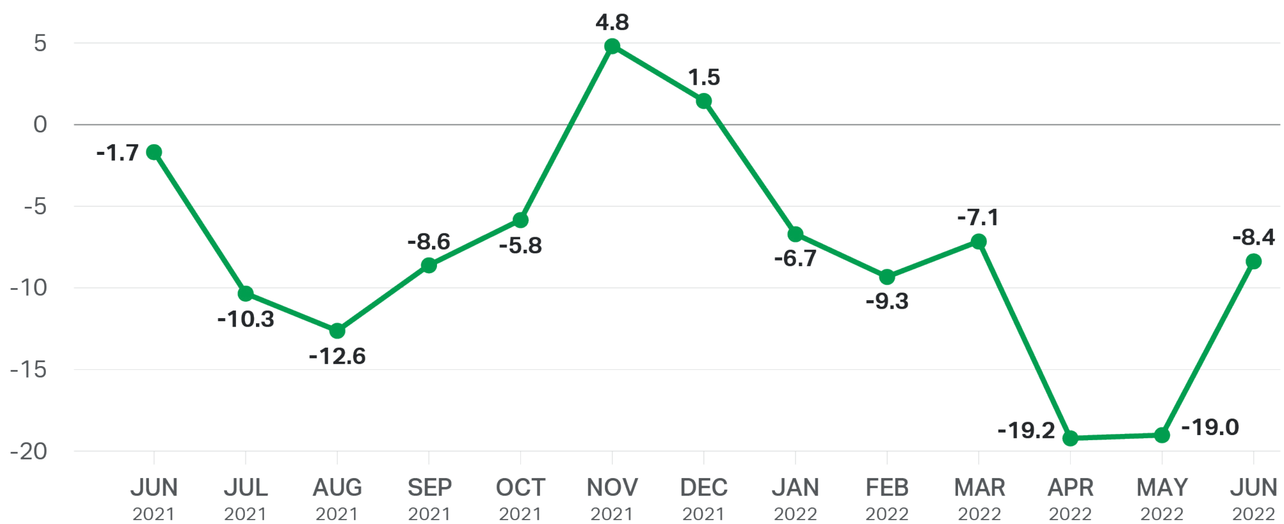
Other European states have taken similar measures. Most reduced their overall energy consumption by 10% to 15%, giving them time to fill their reserves and, just as important, to negotiate with new suppliers. France, Poland, Germany and others have thus been courting the likes of Algeria, Nigeria and Azerbaijan, even as they coordinate policy with the United States.

(Though LNG exports from the latter have plateaued lately, many are optimistic that they will rebound. The Texas Freeport LNG terminal will be back online as early as November, and Qatar appears to have agreed to supply Europe with LNG from Texas' Golden Pass plant.)

This is good news for a global LNG market that has proved quite flexible when sellers share pricing incentives with contract buyers. It means there will be enough supply for Europe in the coming months. It also means it will be more expensive: The newer, smaller suppliers entering the European market are located farther away than Russia, and the other alternative — LNG — is appreciably more expensive than natural gas.

EU Natural Gas Consumption

Monthly, year-over-year % change



Source: Eurostat

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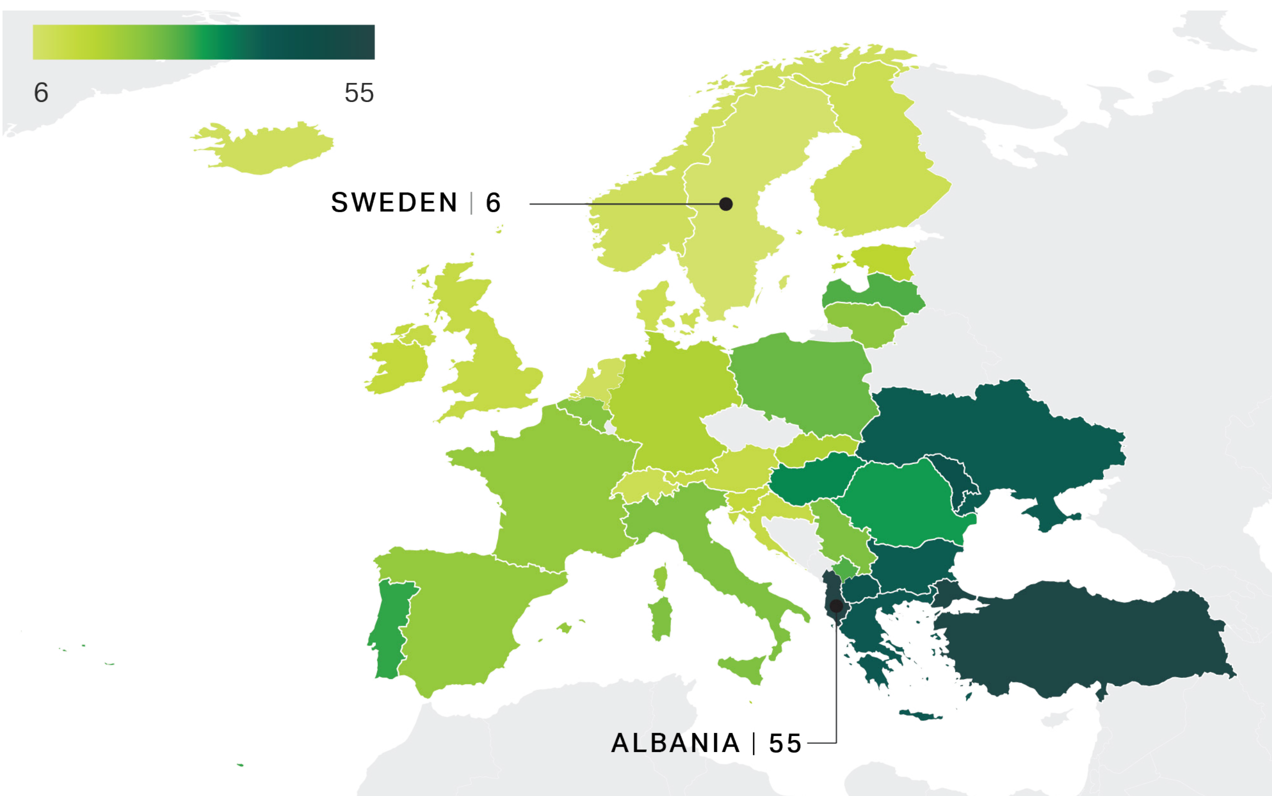
If the lights go out in Europe this winter, it'll be because Europeans will have a hard time affording it, not a hard time finding it. European governments can't afford to let their people die, but neither can they foot the bill for endless subsidy regimes, so expect them to set more energy reduction targets for consumers and to enact measures prohibiting major companies from exploiting them. It's unclear what the targets will be exactly, but many observers believe consumption needs to drop by about 20% to 30% in the next few months. Any more than that will almost certainly require a reduction in industrial output, which no one is eager to do.

Naturally, the countries most vulnerable to the crisis are the ones with a higher percentage of their respective populations having trouble making ends meet. Last year, at least 25% of the populations of at least 12 countries said they found it difficult or very difficult to get by on their current incomes. Though data isn't available for every country this year, the percentage of the population finding it difficult to get by has risen to 16% in the United Kingdom and 11% in Denmark. If those figures have risen in traditionally more affluent countries, it is reasonable to expect them to have risen in others.

Europeans' Feelings About Their Current Household Incomes

Which one of these phrases comes closest to your own feelings about your household income these days?

% Finding it difficult/very difficult to get by



Gallup, 2021

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Germany is in arguably the most difficult position come winter. Like all European countries, it will struggle to keep consumption down in the coldest months of the year and so will have to walk a tightrope between reducing household demand and industrial demand. Leaving its people to freeze is such a self-evidently bad idea that it will be all but forced to curb industrial output. Businesses already expect as much. The latest surveys published by Ifo — a Munich institute measuring the German business climate index — indicate the German business community is expecting a drop in production and its expectations are "extremely pessimistic" for the months to come.

The problem, of course, is that industry, especially manufacturing, is the heart of the German economy and, by extension, the European economy. An industrial recession in Germany will very likely lead to a recession in every country in the German production chain — the Netherlands, Belgium, Austria, Poland, Slovakia, Hungary, the Czech Republic, Romania, Bulgaria and most of the Western Balkans — even as unemployment rises.

At best, this is a recipe for political protest. As Germany opts for cutting industrial demand, keeping direct negotiations with Russia off the table will get more difficult as the winter gets colder.

There is, however, a potential lifeline. The United States is the most important destination for German goods and has a vested interest in the outcome of the Ukraine war. To some degree or another, it will be for Washington to decide whether or not it wants to save the heart of German manufacturing and thus the European economy.

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Iran's Nuclear Negotiations: Tactics and True Position

THE WAR IN UKRAINE has resurrected Cold War corpses long thought dead. NATO matters once more, Germany is rearming and the prospect of nuclear war, however remote, is a frequent subject of conversation again.

With so much new-old stuff to worry about, you'd be forgiven for forgetting about Iran's pursuit of its own nuclear program and the Western-led efforts to stop it. In fact, the world has tried to negotiate with the Islamic Republic for more than four decades, but despite the short-lived "success" of the Iran nuclear deal, it has little to show for it. Tehran's intransigent negotiating posture gives the impression that the covenants it signs and the international organizations it joins are merely platforms used to preach its ideology or legitimize its government.

Even so, U.S. President Joe Biden expressed a desire to resume nuclear talks after his predecessor, Donald Trump, essentially nullified the original deal shortly after taking office. And this time around, Iran has every intention of dragging out the negotiations. The government in Tehran knows how eager the West in general and the U.S. in particular is to score a political victory, and it understands the war in Ukraine has given it leverage as it presents itself as an alternative energy provider to Russia — that is, if sanctions are lifted.

Nuclear Facilities in Iran

● Research ● Enrichment/energy ■ Military complex ▲ Uranium mine

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For Iran, a nuclear program is more than just a new weapon; it is a means to reshape the power structure of the Middle East. Building a regional system with Iran on top is an old dream that refuses to die, even if the tools to reach and achieve it differ. Tehran failed to do so after both world wars, but after the revolution in 1979, it began a campaign of expansionism throughout the region.

But Iran knew its expansion had to be measured. The Iran-Iraq War taught it as much. The conflict killed as many as a million Iranians and cost more than $700 billion while revealing Iran's military weakness and inefficiency in conventional warfare, the obsolescence of its weapons and the absence of significant international allies. The war convinced Tehran to craft a new security doctrine based on the premise that it would never fight a direct war again, and if it had to, it would not do so on its own soil.

And so it decided to infiltrate the fragmented societies of the neighboring Arab countries to woo the marginalized Shiites, most notably and most successfully through Hezbollah in Lebanon. It adopted the use of proxy wars to achieve its regional objectives at the lowest possible costs. It commandeered the Palestinian issue when the Arabs abandoned it, giving arms to Hamas and the Palestinian Islamic Jihad to win over Arabs who were still sympathetic to the plight of Palestinian refugees. The strategy has mostly paid off. It has reduced the risk of direct involvement in armed conflict, deterred Iran's enemies from attacking it, and offset its conventional weaknesses and vulnerabilities. Unsurprisingly, the strategy has also become a major sticking point in the ongoing nuclear talks.

Iran's approach to those talks is to hard-bargain on a host of peripheral issues in the hopes of wearing down U.S. negotiators before bringing the real issue to the table. But Tehran also knows the limits of the possible. It understands that President Biden cannot issue a formal treaty because it would never be ratified by the Senate. It has abandoned its demands to have the Islamic Revolutionary Guard Corps removed from the U.S. terrorist list (thanks to the efforts of Qatar, which persuaded Washington to allow the group's financial companies to transact business with foreign banks). And it has given up on seeking guarantees that a future U.S. president will not withdraw unilaterally from the deal.

Still, Iran refuses to make meaningful concessions about its missile program as a sovereign right and a deterrent force, and it rejects internationalizing the issue of regional dialogue, insisting that the region's countries can resolve the matter themselves. This is both tactic and true position: Keeping the discussions going, even with lengthy suspensions, ensures that the U.S. will not authorize a military solution while diplomatic solutions exist. And the longer the talks drag on, the longer Tehran has to gain concessions on regional issues that it considers more important than its nuclear program qua nuclear program, and it will not compromise on any of them. Iran's fixation on regional dominance makes reaching a nuclear deal in Vienna more unlikely than likely.

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METHODOLOGY

Global Stability Index

AS ITS NAME IMPLIES, the Global Stability Index (GSTAB) is a measure of global stability. The higher its value, the more unstable the world is.

The GSTAB is holistic, measuring the political, economic and military profiles of much of the world, but it is fundamentally tied to the fate of the most important geopolitical actors — the United States, the European Union, Russia, China, the United Kingdom, India, Japan, Brazil and Türkiye — and its calculation is derived from Geopolitical Futures' unique methodology in conjunction with a modified version of the quantified judgement method (QJM). (The QJM is essential to studying military conflict, and military conflict is essential to determining stability.)

Geopolitical Futures' model tracks the functions and features that compose the stability profile of nation-states and regions. These include government characteristics, economic performance, the potential to encounter strategic disruptions, risk of domestic unrest and military capabilities. All of these features are tracked, quantitatively analyzed and weighted. Each month, a number is produced, and when compared to the previous months' data, that number gives a sense of how the world is faring.

The war in Ukraine has been the defining feature of the GSTAB since April.

	GSTAB
April 2022	**781.88**
May 2022	**657.68**
June 2022	**509.10**
July 2022	**615.92**
August 2022	**658.44**
September 2022 est.	**739.84**

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