BlackRock geopolitical risk dashboard

BlackRock

April 6, 2020

The coronavirus outbreak represents a major shock to the macro outlook. Public health measures deployed to stop the virus's spread are bringing economic activity to a near standstill and are set to cause a sharp contraction in second quarter growth. An overwhelming policy response in the developed world should limit permanent economic damage, but the implications of the pandemic for globalization and international cooperation may be long-lasting.

Key points of our latest update

- Market attention to geopolitics remains elevated as the pandemic strains the fabric of globalization and international cooperation. One of our key geopolitical themes for 2020 was fragmentation. The pandemic exacerbates this trend as countries increasingly show nationalist tendencies, unprecedented border and export restrictions take effect, and social distancing rules are implemented. We see the virus affecting every dimension of the geopolitical landscape as it spreads around the world.
- The economic fallout from the pandemic, alongside collapsing oil prices, looks set to have a profound effect on emerging markets (EMs), especially those reliant on commodity exports. We highlight the vulnerability of EMs and assess their outlook in this edition's *Focus risk*.
- This month, we increase the likelihood of three of our risks: *U.S.-China competition; Major cyber attacks;* and *LatAm policy*. A war of words between the U.S. and China—including recriminations over the origins of the virus—has hindered coordination between the two countries. Meanwhile, the risk of cyber attacks has risen as governments and organizations move to remote working. In Latin America, we worry about countries' limited institutional capacity to deal with the health crisis.
- Market attention to our *Gulf tensions* risk has declined, but we keep our likelihood score at a high level. The sharp fall in oil prices puts pressure on exporters in the region; Iran is especially hard hit. Amid increased frictions, we worry about a potential confrontation between the U.S. and Iran in Iraq.
- We note two risks where market attention and our views diverge: *European fragmentation* and *Russia-NATO tensions*. Market attention to both risks has spiked in recent weeks, but we rate the likelihood of each risk as low.

Our dashboard features both data-driven market attention barometers and judgment-based assessments of our top-10 risks. We show market attention to each risk, assess the likelihood of it occurring over a six-month horizon, and analyze its potential market impact. We adjust the market impact reading for how much each risk may be priced into markets. The greater the market's attention to the risk, the lower our estimate of the potential market impact.

The impact of geopolitical shocks has historically tended to be more acute when the economic backdrop is weak. See Gauging geopolitics of June 2019 for details. This makes analysis of geopolitical risk especially pertinent in the current economic shock, which is set to push many economies into recession. Tracking geopolitical risks and their market impact is as much an art as a science. We are continuously updating our risk scenarios and fine-tuning our methodologies. Our scenarios are hypothetical. Market impact analyses are not recommendations to invest in any specific investment strategy or product.

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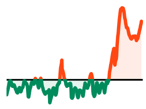
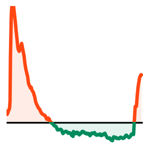
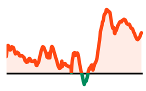
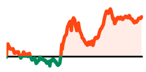
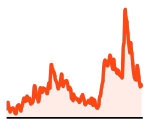
BlackRock Investment Institute

Global overview

We take a bird's eye look at our top-10 geopolitical risks, describing the hypothetical scenarios that power our market impact and likelihood analysis as well as summarizing our views. We show our focus risk first, then list the other nine risks by level of market attention as measured by the Blackrock Geopolitical Risk Indicators (BGRIs). We next show the latest reading of our global geopolitical risk barometer, and plot the risks in a graphic that shows each risk's relative likelihood and potential market impact.

Snapshot of top-10 geopolitical risks, April 2020

Risk	Scenario description	Our view	Risk index since 2014
European fragmentation	Tensions between Italy's government and Brussels rise over spending rules and other policies, and Italy threatens to leave the bloc. This scenario focuses specifically on Italy, but we see Brexit uncertainty and trade frictions posing additional challenges to Europe.	After initial wobbles, a united front has emerged in Europe in the response to the pandemic. It is characterized by a common approach to border controls and export restrictions, as well as a pledge of unconditional support by the ECB to help fund pandemic-related spending. We see a populist surge as unlikely for now, with moderate leaders polling well for their response to the crisis. We see an extension of the Brexit transition as marginally more likely. Frictions may re-emerge once the acute phase of the outbreak has passed.	
Russia - NATO conflict	Simmering tensions between Russia and the West boil over. This leads to mutual recriminations, military preparations and the potential for direct conflict.	Tensions are increasing between Russia and the West in the aftermath of Turkey's incursion into northeast Syria and expanding U.S. sanctions on Russia. Russia's refusal to agree with OPEC on production cuts was likely an effort to target U.S. shale producers. Low oil prices could prove economically and politically painful for Russia, however, potentially giving way to social unrest.	
U.S. - China competition	In the competition for dominance in advanced technology, the US bans all exports of semi-conductors to China, citing national security concerns.	Competition between the two countries has intensified along economic, financial, military and ideological dimensions. We see this competition as structural and long-lasting, and exacerbated by the current crisis. The virus outbreak has led to mutual recriminations, bringing relations to their lowest point in decades. We see tech rivalry as likely to continue, with the U.S. implementing new restrictions on semiconductor exports.	
South Asia tensions	Another terror attack by Pakistan-based militants leads India to retaliate more forcefully, using air strikes and ground troops. Pakistan responds, and limited war ensues along the Line of Control in Kashmir.	We see an escalation in hostilities between India and Pakistan as unlikely while both countries focus on pandemic response. Relatively weak health infrastructure and economic deterioration, however, could give way to broader instability and social unrest.	
Gulf tensions	The war in Yemen escalates and internal strife in Saudi Arabia increases. U.S. sanctions roil the Iranian economy and threaten a full unraveling of the nuclear deal.	We see the current oil price crash—resulting from a pandemic-induced demand shock and a dispute between OPEC and Russia over production cuts—causing fiscal strain across the Gulf. Iran is under severe pressure amid a large virus outbreak and U.S. sanctions. Tensions will persist between the U.S. and Iran, and we worry about a possible confrontation between the two countries in Iraq.	

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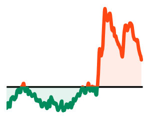
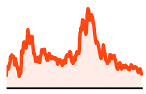
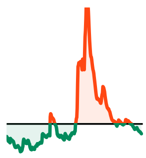
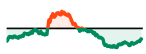
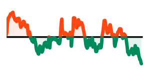
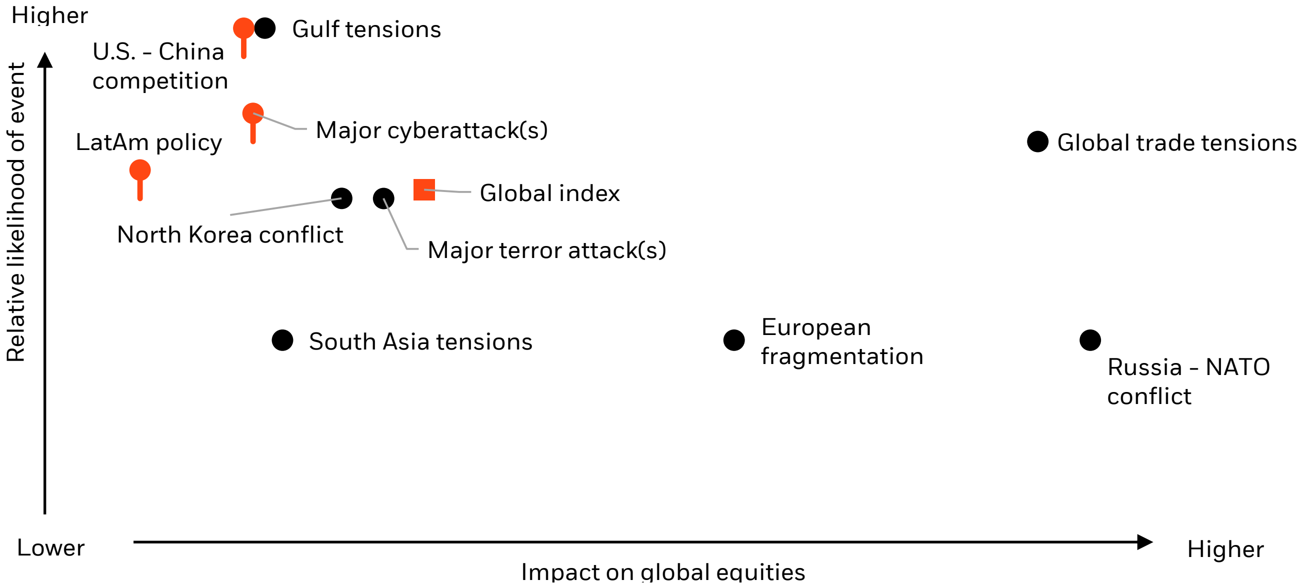
Risk	Scenario description	Our view	Risk index since 2014
Global trade tensions	The U.S. escalates trade disputes, and trading partners impose retaliatory tariffs. The erstwhile champion of free trade plans to overhaul key multilateral trade agreements in response, further undermining the global trade web. Market sentiment deteriorates amid fears of a global trade war.	The pandemic puts pressure on the international trade system and trade policy globally, as countries take protectionist steps to secure medical supplies. The "phase 1" trade deal between the U.S. and China looks likely to remain intact, and some tariffs and other trade actions have been suspended. We worry, however, about a broader deterioration in U.S.-China relations, including tech decoupling. We could see a delay in the implementation of the U.S.-Mexico-Canada Agreement on trade, and see trade tensions building between the U.S. and Europe. We worry about the broader disruption to global supply chains from the outbreak.	
Major cyberattack(s)	Cyberattacks increase in intensity and reach. Possibilities include attacks on the U.S. power grid, a breaching of the defenses of the global financial system, or hackers taking over key technology infrastructure and disrupting the operations of dependent industries.	Cyberattacks have increased in sophistication and quantity. We see a persistent risk of attacks on business-critical infrastructure and major elections. There is heightened risk of nation-state attacks on the U.S. in the wake of increasing tensions with Iran, China, North Korea, and Russia. We are focused on cyber and disinformation risks around the 2020 U.S. elections at a time of high domestic stress—and are worried about cyber risks to business infrastructure as companies globally transition to remote work.	
North Korea conflict	The U.S. pursues limited military action against North Korea in response to continued nuclear buildup and missile testing. Retaliation by North Korea draws a South Korean response, but North Korea backs down in the absence of Beijing's support and tensions de-escalate.	Significant gaps between the U.S and North Korea remain on core issues—highlighting a long road to any resolution. The U.S. is committed to staying on a diplomatic track despite increased North Korean provocations, including missile tests and a rejection of talks. Reduced trade and strained relations with China add pressure on North Korea. We see the risk of military conflict on the Korean peninsula as low for now.	
Major terror attack(s)	A coordinated terror attack in a major U.S. or European city leads to significant loss of life and commercial disruption, prompting a targeted response by the U.S. and its NATO allies against Middle East militants.	Despite the loss of ISIS's territory in Iraq and Syria, we see an ongoing risk of ISIS-inspired local assaults and see the group reconstituting key capabilities. The Turkish incursion into Syria, alongside the withdrawal of international forces from Iraq, could lead to an ISIS resurgence in the region.	
LatAm policy	Populist policies in Brazil and Mexico erode investor confidence. U.S.-Mexico relations deteriorate across social, political and economic issues. This scenario focuses on Mexico and Brazil, but we take into account risks around economic weakness in Argentina and crisis in Venezuela.	The outbreak and economic fallout cloud the outlook for Latin America. Relatively weak health infrastructure, significant governance challenges, and limited policy room could exacerbate the health emergency and economic shock in the region. Commodity exporters look particularly vulnerable. We worry that a prolonged downturn could give way to a fresh wave of social unrest.	

Source: BlackRock Investment Institute, April 2020. Notes: The table shows the top-10 geopolitical risks identified by the BlackRock Geopolitical Risk Steering Group. Risks are organized by level of market attention as indicated by the BlackRock Geopolitical Risk Indicator for each, our focus risk is highlighted in yellow. See the "How it works" section on page 5 for details.

Relative likelihood and market impact of risks



Forward-looking estimates may not come to pass. Source: BlackRock Investment Institute. April 2020. Notes: The graphic depicts BlackRock's estimates of the relative likelihood (vertical axis) of the risks over the next six months and their potential market impact on the MSCI ACWI Index (horizontal axis). The market impact estimates are based on analysis from BlackRock's Risk and Quantitative Analysis group. See the How it works section on our Geopolitical risk dashboard and the 2018 paper Market Driven Scenarios: An Approach for Plausible Scenario Construction for details. The chart shows our original estimate of market impact at the time the scenario was conceived. The Global dot represents our overall assessment of geopolitical risk. Its likelihood score is based on a simple average of our top 10 risks; the market impact is a weighted average by likelihood score of 10 risks. Some of the scenarios we envision do not have precedents – or only imperfect ones. The scenarios are for illustrative purposes only and do not reflect all possible outcomes as geopolitical risks are ever-evolving. Colored lines and dots show whether BlackRock's Geopolitical Risk Steering Committee has increased (orange), decreased (green) or left unchanged (black) the relative likelihood of any of the risks from our previous update. The chart is meant for illustrative purposes only.

The chart above shows our assessment of the relative likelihood of our top 10 risks and the potential severity of their market impact. Our geopolitical experts identify potential escalation triggers for each risk and assess the most likely manifestation of the risk over the next six months. The relative likelihood of each event (vertical axis) is then measured relative to the remaining risks. The severity of market impact (horizontal axis) is based on Market Driven Scenarios (MDS) analysis from our Risk and Quantitative Analysis group and estimates the one-month impact of each risk on global equities (as measured by the MSCI ACWI) if it were to come to pass. Colored lines and dots show whether BlackRock's Geopolitical Risk Steering Committee has increased (orange) or decreased (green) the relative likelihood of any of the risks from our previous update. We also show our overall measure. Its likelihood score is based on a simple average of our top 10 risks; the market impact is a weighted average by likelihood score.

Our Geopolitical Risk Steering Committee increased the relative likelihood of three of our risks.

U.S.-China competition

- Market attention to *U.S.-China competition* is ticking up; we increase our likelihood score from its already-high level.
- Rhetoric between the U.S. and China has escalated, and relations have hit their lowest point in decades. We see China extending its influence by aiding European and emerging markets in their pandemic response.
- We see U.S.-China tech competition intensifying with the introduction of restrictions on U.S. semiconductor exports.

Gulf tensions

- Market attention to *Gulf tensions* has declined from its peak. We maintain its likelihood at a high level.
- Weak global demand and a Russia-Saudi Arabia oil price dispute have sent oil prices plummeting, straining exporters in the region. Iran is particularly vulnerable amid a large number of COVID-19 cases and continued U.S. sanctions.
- Tensions are high between the U.S. and Iran. We worry about possible confrontation between the two countries in Iraq.

Major cyber attack(s)

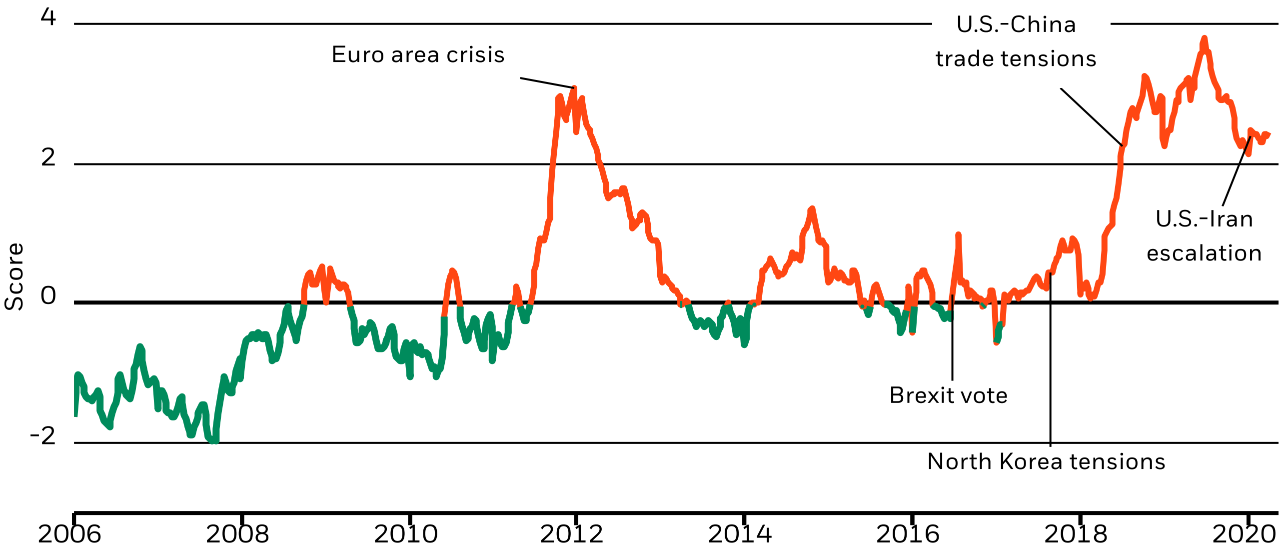
- Market attention to *Major cyber attacks* has declined, but we increase our relative likelihood assessment.
- Measures to slow the coronavirus spread are pushing business and government operations into virtual environments, making them more vulnerable. We are focused on disinformation and cyber risks around the 2020 U.S. elections.

LatAm policy

- Market attention to *LatAm policy* is the lowest among our top-10 risks. We increase our relative likelihood score.
- Relatively weak health infrastructure and limited institutional capacity will exacerbate the COVID-19 crisis in the region and could give way to a fresh wave of social unrest. See our *Focus risk* (p. 7) for more detail.

How it works

BlackRock Geopolitical Risk Indicator (Global)



Source: BlackRock Investment Institute, with data from Refinitiv. Data as of April 2020. Notes: We identify specific words related to geopolitical risk in general and to our top 10 risks. We then use text analysis to calculate the frequency of their appearance in the Refinitiv Broker Report and Dow Jones Global Newswire databases as well as on Twitter. We then adjust for whether the language reflects positive or negative sentiment, and assign a score. A zero score represents the average BGRI level over its history. A score of one means the BGRI level is one standard deviation above the five-year average. We weigh recent readings more heavily in calculating the average.

The BlackRock Geopolitical Risk Indicator (BGRI) tracks the relative frequency of analyst reports, financial news stories and tweets associated with geopolitical risks. We calculate the frequency of words that relate to geopolitical risk, adjust for positive and negative sentiment in the text of articles or tweets, and then assign a score. This score reflects the level of market attention to each risk versus a five-year history. We assign a much heavier weight to brokerage reports than to the other data sources because we want to measure the market's attention to any particular risk, not the public's.

Our global BlackRock Geopolitical Risk Indicator remains close to peak levels, driven by heightened market attention to our *European fragmentation, Russia-NATO conflict* and *U.S. -China competition* risks. See the Global overview chart.

The BGRI is primarily a market attention indicator, gauging to what extent market-related content is focused on geopolitical risk. The higher the index, the more financial analysts and media are referring to geopolitics relative to a five-year historical baseline period. We also take into account whether the market focus is couched in relative positive or negative sentiment. This can help mitigate spikes in the BGRI at times when market attention is high but positive sentiment indicates that risk may actually be receding. Conversely, the sentiment component can accentuate gains in the index when sentiment takes a turn for the worse. Example: The rise in our U.S.-China competition BGRI in 2019 has been exacerbated by worsening sentiment as both countries escalated rhetoric around trade and strategic tensions.

Here's the step-by-step process for calculating and interpreting our BGRIs:

- BGRI attention: This is the market attention score. The global BGRI uses words selected to denote broad geopolitical risks. Local BGRIs identify an anchor phrase specific to the risk (e.g., North Korea) and related words (e.g., missile, test). A cross-functional group of portfolio managers, geopolitical experts and risk managers agrees on key words for each risk and validates the resulting historical moves in the relevant BGRI. The group reviews the key words regularly.
- BGRI sentiment: This is the sentiment score. We use a proprietary dictionary of about 150 "positive sentiment" words and 150 "negative sentiment" words. A weighted moving average puts more emphasis on recent documents.
- BGRI total score: This is BGRI attention — (0.2 * BGRI sentiment). We want the indicator to fundamentally measure market attention, so we put a much greater weight on the attention score. A 20% weight of the sentiment score can mitigate spikes at times when risk may actually be receding.
- Meaning of the score: A zero score represents the average BGRI level over its history. A score of one means the BGRI level is one standard deviation above the average. We weigh recent readings more heavily in calculating the average. The level of the BGRIs changes slowly over time even if market attention remains constant. This is to reflect the concept that a consistently high level of market attention eventually becomes "normal." A recent tweak to our BGRIs has moderated the speed of this decay. See Gauging geopolitics of June 2019 for details.

Market impact

Our market driven scenarios (MDS) framework forms the basis for our scenarios and estimates of the one-month impact on global equities. The first step is a precise definition of our scenarios – and well -defined catalysts (or escalation triggers) for their occurrence. We then use an econometric framework to translate the various scenario outcomes into plausible shocks to a global set of market indexes and risk factors.

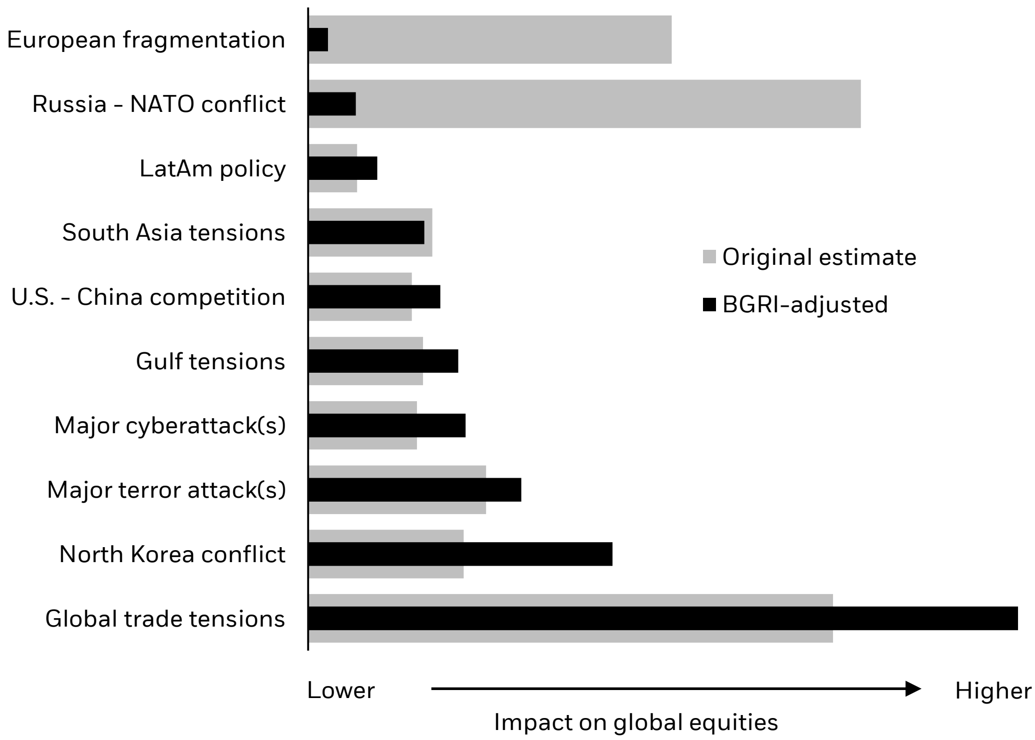
The size of the shocks is calibrated by various techniques, including analysis of historical periods that resemble the risk scenario. Recent historical parallels are assigned greater weight. Some of the scenarios we envision do not have precedents – and many have only imperfect ones. This is why we integrate the views of BlackRock's experts in geopolitical risk, portfolio management, and Risk and Quantitative Analysis into our framework. See the 2018 paper Market Driven Scenarios: An Approach for Plausible Scenario Construction for details. The BGRI's risk scenarios are for illustrative purposes only and do not reflect all possible outcomes as geopolitical risks are ever-evolving.

BGRI-adjusted market impact

We enhance our market impact analysis by adjusting the market impact scores to reflect shifting market attention over time. When scenarios are first defined, market shocks are calibrated to reflect what is not already priced in to the market by investors. We call this the original estimate.

As market attention fluctuates, the BGRI-adjusted market impact either increases or decreases in severity based on how market attention evolves. For example, an elevated BGRI level relative to the point at which a scenario is first defined would suggest an increase in investor attention. This would result in a less severe BGRI-adjusted market impact relative to our original estimate. The converse result — in the case of a depressed BGRI level — would also hold. We determine a factor that scales the size of the BGRI move since the date of our original market impact estimate to calculate the BGRI-adjusted market impact. We use a sigmoid function to do so, or a statistical technique that is characterized by an S-shaped curve. We then multiply our original estimate of the market impact by (1 – scaling factor) to reach the BGRI-adjusted market impact score.

Market impact of risks



Source: BlackRock Investment Institute, with data from Refinitiv, April 2020. Notes: The chart shows our estimates of the potential market impact on the MSCI ACWI Index, the grey bar shows our original estimate, the black bars show the adjusted impact based on the level of the BGRI. For example, an elevated BGRI level for a risk would suggest increased investor attention and therefore a lower BGRI- adjusted market impact. Estimates are based on analysis from BlackRock's Risk and Quantitative Analysis group. See the How it works section and the 2018 paper Market Driven Scenarios: An Approach for Plausible Scenario Construction for details. Some of the scenarios we envision do not have precedents – or only imperfect ones. The scenarios are for illustrative purposes only and do not reflect all possible outcomes as geopolitical risks are ever- evolving.

Original estimates are based on the analysis run on the following dates:
South Asia tensions (new): May 17, 2019
U.S. - China competition: April 19, 2019
LatAm policy: March 21, 2018
European fragmentation: July 3, 2018
Major cyberattack(s): December 18, 2018
Gulf tensions: February 12, 2019
Major terror attack(s): November 3, 2017
North Korea conflict: June 2, 2017
Russia - NATO conflict: April 23, 2018
Global trade tensions: June 11, 2018

Focus risk

Emerging markets amid global pandemic

The pandemic presents both a public health and economic crisis for many emerging markets (EMs). A cratering oil price adds additional strain for those economies reliant on oil and gas exports. This follows a year of mass protests in many EMs around the globe. Protests generated economic uncertainty, market selloffs and widening credit spreads in some EM economies. We worry about some emerging markets' ability to weather the current storm and see the potential for spillover risks to the global economy. In this focus risk, we highlight the vulnerability of EMs and assess their outlook. We see a wave of sovereign and corporate defaults across the EM universe, but note a key point: not all EMs are the same. Those with ample assets and low debt may be strong enough to manage the shock. Emerging Asia is a case in point. We see China, specifically, as in the early stages of restarting its economy and having more policy space to revive activity. More broadly, the spread of the virus appears to be slowing in the region.

Domestic impact

The outbreak is having a profound impact on the global economy and financial markets—and emerging markets have been hit particularly hard. International travel restrictions threaten mass unemployment in tourist destinations such as South Africa and Turkey, while the global industrial slowdown has hit commodity producers such as Brazil, Chile and Peru. Oil and gas exporters across Latin America, the Middle East and Africa are suffering amid the crash in oil prices—a consequence of reduced global demand and a dispute between Russia and Saudi Arabia over production cuts.

Emerging markets across the world are facing a severe loss of income, as well as significant capital flight with international investors redirecting toward perceived safe haven assets. Cumulative capital outflows from developing countries since January 2020 are double the level experienced during the 2008-2009 financial crisis, according to data from the Institute for International Finance. This is putting additional pressure on EM currencies.

The relatively weak health infrastructure of emerging markets makes them particularly vulnerable to the pandemic—as does more limited institutional capacity and, in some cases, poor governance. The health crisis could be made harder to fight by export restrictions on medical equipment by many advanced countries. Poorer EM economies may face humanitarian disasters. The crisis comes at a time when many EM governments are economically constrained in their ability to provide both stimulus and a public health response. Total public and private debt in EMs has soared to 165% of annual output from roughly 70% in 2007, according to Oxford Economics. Even if EM governments were to roll out significant fiscal stimulus, it will be difficult for relief to reach the households that need it most. The large size of the informal economy means many workers lack access to public services and social insurance.

Monetary space is also limited in some EMs amid historically low interest rates. Any meaningful stimulus package could spark substantial capital outflows, increasing the risk of capital controls and potentially leading to currency depreciation, inflation and rising cost of capital. EMs were facing a growth slowdown even prior to the virus outbreak. Earlier this year, we highlighted the risk that governments looking to make fiscal adjustments could suffer social and political backlash; the newly-created middle class was promised prosperity, and governments were failing to deliver it. Pressure on governments to provide economic relief and a meaningful public health response to the pandemic will likely grow. Inability to meet popular demands during this period could lead to a fresh wave of unrest or electoral challenges.

Global impact

Countries such as Argentina, Turkey and South Africa may find it increasingly difficult to service their foreign currency debt. We worry about insolvency and defaults as prolonged shutdowns around the world bring economic activity to a halt. Some of the largest EM oil exporters also happen to be the ones that are most leveraged, creating additional risk. Over recent years, EMs have become increasingly integrated into global capital markets. This creates the potential for crises to spill over globally and drive greater risk for financial intermediaries in developed markets. EM corporates are also vulnerable; weak entities could run into trouble. These risks could be partially offset by relief from the International Monetary Fund (IMF). The IMF has said it is willing to support vulnerable countries with lending facilities, including through rapid-disbursing of emergency financing. Such loans would not help lower-income countries that are already on the brink of insolvency. The IMF and the World Bank have also called on creditors to provide debt relief to the poorest EM economies, and the upcoming G-20 meeting likely will discuss a $500 billion IMF SDR (Special Drawing Rights) allocation to shore up reserves of the weakest EM economies. This, as well as the Federal Reserve's new repo facility for foreign central banks, is a sign that international cooperation is still alive.

Market views

We have reduced our EM equities position to neutral on a six-to-12 month horizon. Valuations have cheapened, but the global slowdown and cheaper oil challenge many EM economies. We have downgraded hard-currency EM debt to neutral, as we prefer to take risk in local-currency EM debt. Default risks may be underpriced. We are relatively positive in general on Asia ex-Japan assets as China slowly restarts its economy. See our Global Outlook asset views for details.

BlackRock Investment Institute

The BlackRock Investment Institute (BII) provides connectivity between BlackRock's portfolio managers; originates economic, markets and portfolio construction research; and publishes investment insights. Our goals are to help our portfolio managers become even better investors and to produce thought-provoking investment content for clients and policymakers.

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