

Geopolitical radar

Political status quo in Taiwan, truce hopes rise in Gaza

- Taiwan's independence-leaning party DPP won the Presidency again but with a weaker mandate. We look for continued tensions but not new escalation in the Taiwan Strait. EU Commission proposes economic security initiative aimed at China.
- After more than three months of intense fighting in Gaza, hopes for a ceasefire have risen after Israel offered a two month pause in war in exchange of Hamas releasing hostages. Meanwhile, US and its allies' attacks against the Houthis in the Red Sea continue, and the risk of regional escalation remains.
- War extends to the Baltic Sea as Ukraine's drones hit a major Russian gas exports terminal near the city of St. Petersburg. Ukraine has also managed to down two Russian command aircrafts recently.

China: Taiwan election does not point to escalation

In the Taiwan election on 13 January the independence-leaning DPP secured the presidency again as expected as their candidate Lai Ching-te (also known as William Lai) won with a 6.7 percentage points margin to KMT's Hou Yu-ih. However, Lai's victory with 40.1% of the votes was smaller than his predecessor Tsai Ing-wen who got 57.1% in 2020 and DPP lost the majority in the Taiwanese parliament. Hence Lai is ruling with a weaker mandate having support from less than half of the population. Lai's victory was also secured by keeping a more moderate tone on independence than before he became presidential candidate suggesting that he is unlikely to increase confrontations with China. It reflects a mood among the Taiwanese where polls show a clear majority in favour of the status quo - and more so over the past year, which suggests they do not like to see the boat rocked too much towards China.

While tensions in the Taiwan Strait are likely to remain, the election result does not point to a further escalation in our view, see *Research China – Taiwan election points to status quo, but not further escalation*, 15 January 2024. So far China's response has been muted contrary to some commentators' expectations of a sharp reaction if Lai won. It does not mean China has changed its' fundamental stance and they did criticize governments that congratulated Lai's victory. But we have not yet seen large scale military drills as some expected. The US president Joe Biden was quick to state that the US did not support Taiwanese independence. The domestic situations in both the US and China suggest that no one wants to stir up tensions too much this year. Biden probably does not want China to be an important theme in the Presidential campaign as Republicans could have the upper hand from being more hawkish than Biden. And on China's side they would probably also like to see tensions dial down as they aim to revive weak economic confidence both domestically as well as among foreign companies and investors.

On other fronts, US-China relations also seem to be on a more stable footing, despite continued underlying frictions and rivalry. In early January, Chinese military officials visited Pentagon for the first time in four years showing that the defence dialogue has been

Key events in 2024

- **January:** Seaborne trade disrupted in the Red Sea due to Houthi attacks
- **January:** DPP wins Taiwan election but weaker mandate points to status quo in China relations

Taiwan election results

	2012	2016	2020	2024
DPP Presidency	45.6	56.1	57.1	40.1
DPP Parliament seats	40	68	61	51
KMT Presidency	51.6	31	38.6	33.5
KMT Parliament seats	64	35	38	52
TPP Presidency	-	-	-	26.5
TPP Parliamentary seats	-	-	5	8

Source: Central Election Commission

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reestablished. A US *trade team visited China* last week continuing dialogues on trade and financial issues. In summary, so far, the calming of US-China tensions following the Xi-Biden meeting in November last year has continued into 2024.

On South China Sea issues, a conflict between China and the Philippines saw *some de-escalation* after a meeting last week with an agreement to improve maritime communication. However, the territorial dispute is still very much in place and Philippines' defence secretary Gilberto Teodoro *on Tuesday said* the Philippines will “increase the tempo” of activities with allies and major partners in the West Philippines Sea. The country also plans military *upgrades* to the disputed outposts, which China strongly opposes and has *warned* of “firm countermeasures”. Hence, the conflict continues to be a potential hotspot that could escalate at some point.

On EU-China issues a couple of things have happened over the past month. The EU's ongoing investigation on Chinese EV subsidies is currently under way and will be done by November. Last week China's vice-minister of industry and information technology indicated China would address EU concerns over overcapacity *saying that Beijing would take forceful measures* to address “blind” construction of new EV projects and stressed there were some disorderly competition behaviours. However, at the same time China has *started its own anti-dumping investigation* into EU brandy following price discounts on the Chinese market. It looks very much like a symbolic warning shot to EU of not taking to strong action against China on the EV issue.

The EU Commission on Wednesday presented a *proposal of an economic security strategy* with “*five initiatives to strengthen the EU's economic security at a time of growing geopolitical tensions and profound technological shifts*”. The proposal is clearly aimed at China and includes improved screening of inbound foreign investment, coordination of export controls, identifying risks from outbound investments in technologies and research cooperation with other countries. It looks very similar to the policies that have come out of Washington in recent years and the EU Commission has in general leaned in a more hawkish stance on China than some of the member states such as Germany, which has a high economic exposure to China. Hence the final adoption will likely have less teeth than US policies.

Speaking of Germany, a *business confidence report* from the German Chamber of Commerce in China this week stated that “*a vast majority of companies remain committed to the Chinese market*” with only 2% saying they expected to leave China partly. 54% of companies said they plan to increase investments led by the auto sector and electronics. It is slightly up from 51% in 2022 but lower than pre-pandemic levels around 66%.

Middle East: ceasefire hopes but also escalation risks

While the war in Gaza drags on, hopes for a ceasefire have raised their head. Israel's latest offer entailed a two-month pause in fighting and an exchange of Israeli hostages for Palestinian prisoners kept in Israel. *According to media reports*, however, Hamas who has previously demanded a complete withdrawal of Israeli troops from Gaza in exchange for the release of hostages, has already rejected the offer.

It is still not easy to see the way out of this conflict, and it is also very unclear what an end to this conflict would look like. For now, it seems unlikely that Israel would withdraw all of its troops from Gaza, also because Israel has said it wants a buffer zone on the Palestinian side of Gaza's border to prevent future attacks – *a plan that the US opposes*. In December, high-ranking Israeli officials said the war could still last for months. Israeli leadership has said they want to abolish Hamas completely, but *US intelligence agencies*

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estimate Israeli forces have only killed 20-30% of Hamas fighters. Clearly, Israel would have more ground to cover, but both international and domestic pressure is building up.

A temporary ceasefire, such as the one recently offered by Israel, could pave the way for diplomacy and more lasting truce. Yet, a protracted stalemate looks possible. Support for Hamas that initially rose after Israel launched its ground operation in Gaza, has started to decline. At the same time, Israel's Prime Minister Netanyahu's support is also falling. In a way, both are fighting for survival, and desperation could mean they are ready to take this further still. Israel's military power is clearly superior, but the probability of bringing the hostages back alive declines the longer the war drags on, which is a key issue domestically. For the same reasons, for Hamas, it makes no sense to accept an offer that would entail the release of all hostages.

For as long as the war drags on, the risk of escalation remains. As we wrote in our *Research Global: Tensions rise in the Red Sea – should we worry?* 12 January, we do not see the current situation in the Red Sea constituting a major risk for the global economy. The detour for commercial vessels around Africa implies longer delivery times for some goods and additional costs as freight rates have increased significantly. However, transport costs account for a small share of the end price of a good, and in the short term, freight demand is price inelastic. Furthermore, the world economy is now in a very different state compared to the pandemic when goods demand was excessive and companies' pricing power was strong. Also, energy markets remain calm, and gas prices have even declined.

With no immediate resolution to the war in Gaza in sight, tensions continue to build up between Iran and its neighbours. In mid-January, Iran launched missile strikes on three different countries – Iraq, Syria and Pakistan. The attack on Syria targeted IS militants while the strike on Pakistan was to target strongholds of an anti-Iran insurgent group (Jaish al-Adl). The concurrent attacks on Iraq were said to target Israeli spy sites. Meanwhile, Iran-backed militant groups continue their attacks against US bases in Iraq.

Particularly Iran's attack on Pakistan raised alarm since relations between the two countries have generally been *peaceful and functional*. Iran's motivations for taking such a risk with a neighbour whose army is more powerful than their own, remains unclear. At the same time, the attack also put the Pakistani leadership in a difficult position. Considering Pakistan's tense relations with its other neighbours – its arch-rival India, and the Taliban regime in Afghanistan – it was definitely not in their interest to stoke further instability, and they ended up responding with an attack on separatist militants inside Iran. This seems like a successful balancing act, since on January 22nd, *Iran and Pakistan announced* that they would resume diplomatic relations and return recalled ambassadors on Jan 26th.

Russia-Ukraine: stepping up attacks on Russian soil

Although Russia's war in Ukraine is not making as much headlines as it was in 2022, fighting remains intense. In December, Russia conducted a series of air strikes on Ukrainian cities, its largest attack since the war started. In January, Ukraine has also managed some wins. Around mid-month, Ukraine's military said it had shot down a Russian military spy plane (A.50), and an Il-22 control centre plane. According to UK MOD, Russia likely had six operational A-50s in service, meaning that Ukraine's successful attack would mark a significant blow to Moscow's air power.

Ukraine's attacks are increasingly targeting Russian soil. On Jan 22nd, an explosion was reported at a major gas export terminal in Russia, near the city of St. Petersburg, by the Baltic Sea. Kyiv officials said it was a 'special operation' conducted with drones that worked 'on target'. Same day, 25 people were killed by shelling at a market in the Russian

controlled city of Donetsk. Two days later, Russian Foreign Minister Sergei Lavrov called an emergency UN Security Council session to discuss the crash of a Russian plane that was carrying Ukrainian prisoners of war to a prisoners exchange due to take place in the Belgorod region. Russia has accused Ukraine for deliberately shooting down the plane while Ukraine insists it is Russia's responsibility to ensure safe transport of Ukrainian PoWs and that Kyiv should have been notified if they were on board.

Other developments on the radar

Sweden is finally close to become a NATO member after the Turkish parliament approved their membership bid. Hungary's Prime Minister Viktor Orbán was quick to announce that his government would also support the ratification of Sweden's accession. However, Hungary's parliament is in a winter break until February the 26th.

Our baseline scenarios on key geopolitical risks

War in Ukraine:	<p>Our main scenario remains a frozen conflict that could last for years. Russia with its increasingly demotivated army is not able to make significant advances, particularly as Western military support for Ukraine remains. Ukraine has managed to make some advance through its main offensive but pushing Russia back behind the 2014 defence lines seems like a massive challenge.</p>
	<p>Risks to our main scenario remain broadly balanced but downside risks are rising. The main downside risks are related to war fatigue among Ukraine's Western allies, leading to a significant reduction in particularly military support. The US 2024 presidential election poses a significant event risk if Trump is re-elected. Main upside risks are related to the scope and success of Ukraine's counteroffensives.</p>
Risk of war on Taiwan	<p>While tensions have increased and likely to remain high we see the risk of a war in the next couple of years as quite low (20%). The potential costs of a war for all sides (US, China, and Taiwan) will be substantial, hence we don't expect China to initiate a war unprovoked and we don't expect the US or Taiwan to cross the 'red line' of declaring sovereignty for Taiwan. In the medium to longer term the risk is high, though, see also Research China: The risk of a Taiwan war and what it implies - part 1, 11 August 2022.</p> <p>Risks to our scenario is that a war comes in the coming years if mishaps happen that trigger a tit-for-tat spiral or new governments in either the US or Taiwan crosses China's 'red line'. We see it as unlikely China would invade unprovoked in the coming years as they are still too vulnerable economically and not ready militarily.</p>

See Appendix next page for time line of historical events.

Appendix 1. Historical timeline



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Monthly

Date of first publication

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Report completed: 25/01/2024, 15:02 CET

Report first disseminated: 25/01/2024, 15:15 CET