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Key Developments in Global Affairs

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CHAPTER 1

Power shifts: Emerging markets emerged, geopolitics fractured

Matthew Hulbert

Emerging markets have recovered from the economic crisis far better than the West. As geoeconomic power is shifting East, it is questionable whether China should still be coined as 'emerging'. Yet it is not just on the geoeconomic level that emerging markets matter, but in the geopolitical realm. A debt-ridden US will stagger on, Europe will falter, new powers will rise on Beijing's commodity back. No common rule book will be found, and no cohesive blocs formed either way. Entropy will become the defining feature of a fractured international system.

Russia's President Medvedev, Brazil's (former) President Lula da Silva, China's President Hu and India's Prime Minister Singh in Brasilia, 16 April 2010

The world has become used to lazy assumptions when it comes to thinking about emerging markets: that is ironic, given that they have been the main 'headline' act of 2010/11. Faraway lands displaying rapid economic growth, favourable demographics, productivity growth, and burgeoning human capital are more or less the common criteria employed. That is before we get onto the acronyms used to 'group' emerging markets according to market potential and size. BRIC is the one that has really stuck (Brazil, Russia, India, China) after the 'Asia Tigers' lost their collective roar in the late 1990s. Others have been floated since, 'CIVET', 'N11', 'MIKT' and 'VISTA' are amongst some of those en vogue right now; more will no doubt follow.

Taken on their own, such acronyms mean absolutely nothing. They invariably do not even make compelling economic sense. But *collectively*, they underline a profound shift in the global economic balance of power, a shift that has been dramatically accelerated by the events of 2010. Geoeconomic power has gravitated so far East that whether we should still term China as 'emerging' is highly debatable. Yet the real catch for 2010/11 is not so much that these markets have economically 'emerged', but that they are now cutting their geopolitical teeth as a result. This is where the fresh thinking on emerging states must come into play: They are no longer just engines of economic growth, but catalysts of geopolitical movement. This trend will become glaringly apparent when capital accounts are made to 'pay'. As the US has long known, and the EU is viscously finding out, debtors always needed financiers, and it is ultimately Asian creditors that will start calling the geoeconomic and geopolitical shots. The clock simply cannot be turned back. The financial crisis has accelerated the long-term trend of Europe's relative decline; America is hanging on for all its worth, the 'rest' will continue to rise, with China at the helm. The 'rules of engagement' are however far from fully set.

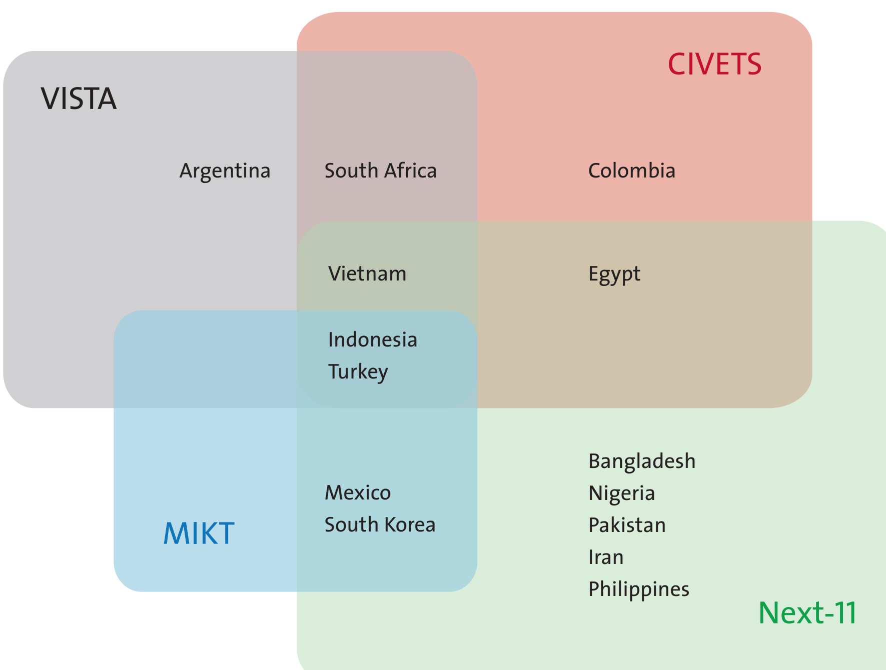
Such tectonic shifts are already playing out at the highest level of international relations: the G2 of the US and China. What makes the G2 particularly interesting is not just that it constitutes the pinnacle of global affairs, but that other emerging markets are starting to wield more regional political clout thanks to relative US decline and a rising Middle Kingdom. Smarter states are even starting to position themselves between the US and China to optimise political gains – a dynamic that will likely persist given the need for 'third party' counselling in any dysfunctional marriage.

Beijing and Washington are certainly no exception to this rule. G2 matrimony is real, but it is not working out well, and that is despite having the veiled polygamy of the G20 to 'work through'.

Africa, Central Asia, the Middle East, and even Latin America are playing this 'Chimerica' game. They know US power is on the wane; they also know that their economic 'demand security' (hydrocarbon or otherwise) will increasingly emanate from Asian shores. Gulf states are more acutely aware of this than anyone; political arbitrage with Sino-US energy interests is the order of the day for those structurally dependent on hydrocarbons. Commodities are 'geopolitical kings', for now at least. Meanwhile, the likes of Turkey and Iran are forging increasingly independent political roles from US, European, or Chinese interests.

India and Brazil also have their own foreign-policy preferences and goals. They sided with China on global climate talks, but continue to hedge their bets on currency questions. And even on critical security issues such as Iranian sanctions, the US has found

Emerging markets: Beyond BRICs



European support a little shaky at the UN and outright obstructive from Ankara and Brasilia. Russia is claiming regional leadership once more, a boast that few Europeans can refute in the Caucasus or Eastern Europe, while Venezuela, South Africa, and Nigeria have been carving out distinctive regional niches. This might not all sound like much yet, but it is a clear indication of what we can expect in a fractured geopolitical global configuration: divergence and entropy. The West can no longer carry the weight, and emerging markets have some way to go before they fill the geopolitical vacuum. Geopolitics will be an increasingly messy business as a result.

Bracing all emerging markets in the same political bracket does not really work at this stage. Stark differentiation is still needed, not only between China and the rest of the BRICs, but the BRICs and other emerging players all riding the Chinese dragon. It is also by no means 'guaranteed' that emerging markets will be able to overcome deep-seated capacity constraints any time soon – China included. MENA turmoil has been a very loud wake-up call for anyone assuming that emerging markets are already politically home and dry. But what it also starkly illustrates is that the West, and most notably the US, can no longer singularly keep pulling all the geoeconomic and geopolitical strings. The world has changed, and it is changed for good.

Economics, stupid: The West weakened

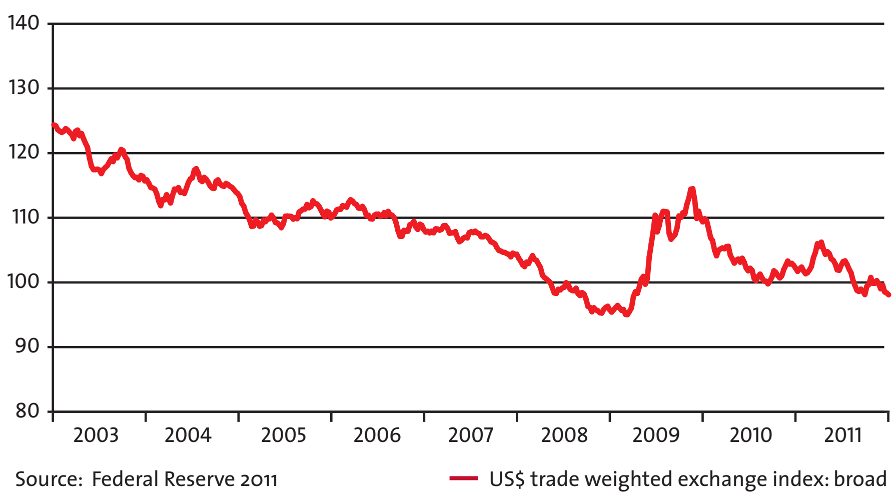
If we start with Western downside risks, it is clear that the roots of the problem are economic. Or more precisely, debt. Over the pond, the IMF thinks that US federal debt could well be equal to total GDP by as early as 2015, which marks a rapid expansion of federal balance sheets from a decade ago; debt was a far more slender 35 per cent of GDP. Macroeconomic mismanagement undoubtedly played a major role throughout the Bush Jnr years, but it is the financial crisis of 2008/9 that really inflicted the pain. Massive demand-side intervention helped to stave off the worst of the depression through unprecedented liquidity support and lax monetary policies. But the gap between spending and revenue is now huge; the US debt-to-revenue ratio is 358 per cent, according to Morgan Stanley, while the deficit hit a mammoth US$ 1.6 tr in 2009, and is set to rise to US$ 1.645 tr this year.

US$ 600 bn worth of 'Quantitative Easing II' obviously has not helped, but it is the trajectory of US debt that is most scary. In the coming decade, it is entirely feasible that US federal debt will increase by nearly 250 per cent from US$ 7.500 bn to US$ 20.000 bn – a scenario that would see the Treasury borrowing around US$ 5.000 bn per year to refinance maturing debt and raise new money. Interest payments on that kind of borrowing would exceed all domestic discretionary spending; forget QE2, it is more like the Titanic. Once you bring in private-sector debt and municipal balance sheets into the equation guaranteed by the US tax payer, things look even worse – extrapolate that towards 2035 and you get a figure closer to 200 per cent of GDP.

US Titanic

Cutting the budget deficit by US$ 1.100 bn over the next decade is therefore hardly going to tackle America's long-term debt problem. The Obama administration will be lucky to even make these reductions stick into 2012. Congress is divided, counter-cyclical measures will still be needed to prop up the recovery – and despite endless analysis that the US intends to cut defence spending, America remains remarkably bullish on military expenditure. Washington spent 50 per cent more on defence last year than at any point of the Cold War, and the Department of Defense has still tabled a US$ 553 bn invoice for this year – a US$ 4 bn uptick from 2010. The 'security risk' for Washington is therefore not military, but fiscal. Geoeconomic power is what matters now.

A weakening dollar



Source: Federal Reserve 2011

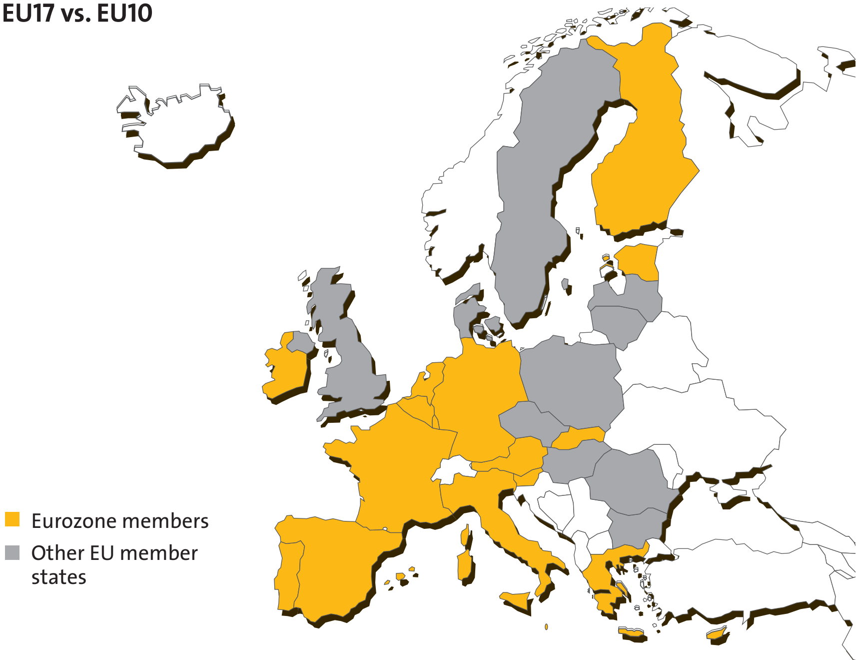
While it is by no means impossible that the US will manage to combine growth with economic prudence, the signs look ominous, not least because appetite for US treasuries remains ironically strong. Dollar interest rates are pretty low, ten-year yields are healthy, and the greenback remains relatively steady as the world's reserve currency. But the chances that this state of affairs will persist are at best hopeful. Underlying conditions are unsound, and pricing is out of sync with fundamentals. When capital markets eventually call time on US debt (and they will, given the leverage we are talking about), the adjustment will be rapid and the pain severe. Whether this is born out of currency markets spilling into bond markets or vice versa does not really matter; the same question will one day be put on the table: US default?

Eurozone crisis

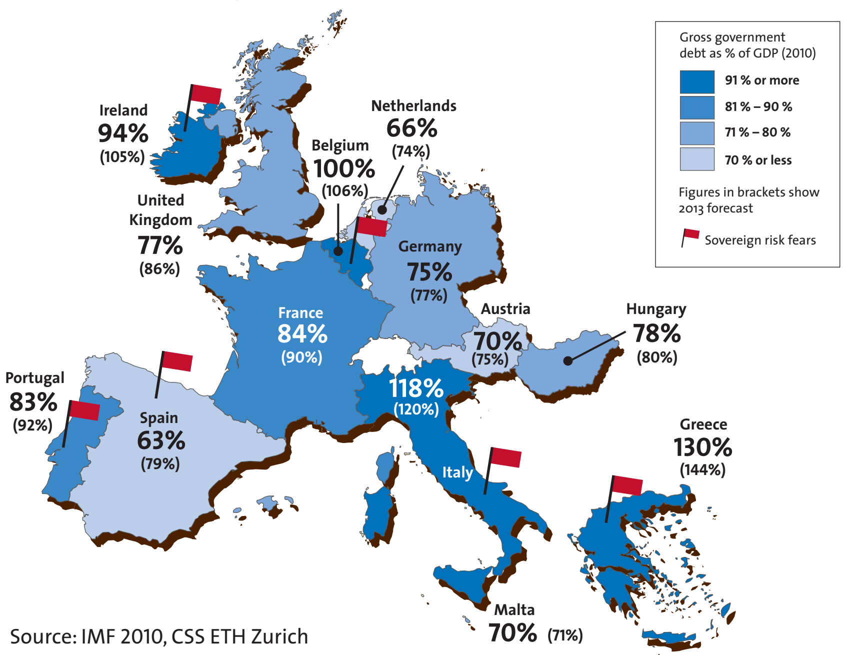
One of the main factors adding to US bond market hallucinations right now is not just trade-driven support for the dollar from abroad or low levels of investment demand, but capital flows driven by eurozone instability. If the US debt position is shaky, then the euro has been positively disastrous. Contagion from the Greek and Irish crises has spread to Portugal, Spain, Belgium, and Italy, and for many now poses serious threats to the very existence of European Monetary Union. The numbers are bad, but it has been a fundamental lack of political resolve that has turned a crisis in the periphery into a vital assault on the core.

European leaders have consistently failed to quell the market by providing a political firewall to protect weakened economies against market predations. The focus is on playing local politics rather than properly recapitalising European banks or providing for a much-needed single euro bond, and indeed, fiscal union. Put simply, tax revenues from the core will be needed to backstop bad debts of the periphery – a move that will cause enormous political heartburn across European capitals, but remains a crucial antacid. This is not just a question of liquidity for a growing number of eurozone economies, but fundamental solvency. The current policy of 'lend (a little) and hope that things will turn out OK' is not only futile, it is potentially very dangerous for a destructive run on the euro. If official resources are insufficient to cover liabilities, markets know exactly which way to bet. Likewise, any restructuring inevitably required in Greece and Ireland should be done sooner rather than later. Waiting until 2013 (as currently agreed) for a

EU17 vs. EU10



EU countries with largest debt to GDP ratios



Source: IMF 2010, CSS ETH Zurich

long-term mechanism for distressed sovereigns will merely lead to disorderly defaults and massive losses for private creditors; more likely than not, such losses would end up with the tax payer anyway.

The fact that Berlin (and Paris) have now shifted ground towards 'competitiveness' rather than getting to grips with the real problems to hand, risks making matters worse. No one doubts that rekindling growth and fiscal discipline are crucial components towards a sustainable eurozone; boosting German consumption would of course be a good start down the growth track. But the prospect of an 'EU17' forging ahead on economic cooperation, while leaving ten (potentially higher-growth) markets behind, can only be interpreted in one way: a Union within a Union. Whether Franco-German plans eventually stick or not remains another question. Aligning corporate tax rates, scrapping index-linked wages, harmonising pension ages, and applying debt breaks is hardly going to be to everyone's taste, particularly if they do not gain cast-iron guarantees from Berlin to stand full square behind future bailouts, or indeed underpin a Eurobond in return. In the midst of ongoing state elections, the German gambit seems clear: It is their way or the highway as far as the future of the euro is concerned.

Lacking geopolitical clout

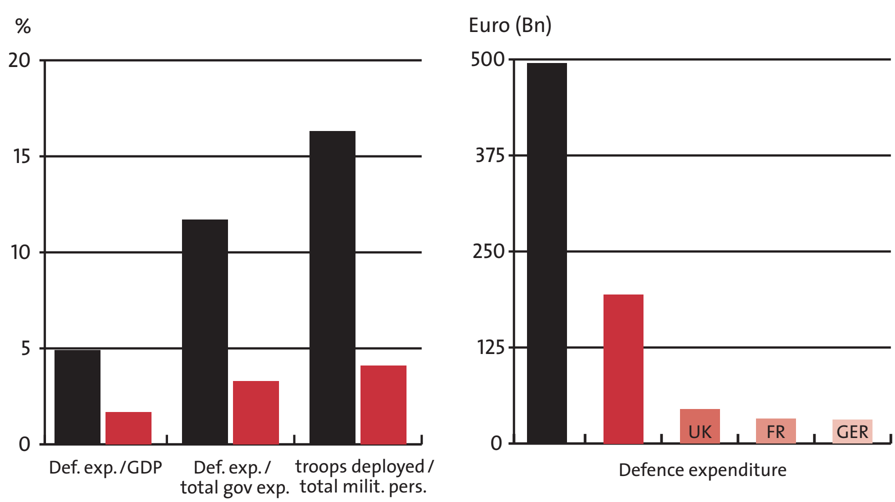
Even if things organically pan out for the euro (at some point, yields will probably become more attractive for traders to take some heat off the European Central Bank); the political damage has been done. The broader trend is unmistakable. Europe is as internally focused as it is highly fragmented in terms of national interests and priorities.

Despite high expectations from the Lisbon Treaty and longer-term aspirations to play a significant world role, Europe remains geopolitically marginalised. Enlargement has ground to a halt, neighbourhood policy is broken – not only in MENA countries, but across Eastern Europe and the Southern Caucasus in the ill-fated 'Eastern Partnership'. Even the Balkans look increasingly insecure. Talking down to Moscow or Ankara is certainly a thing of the past, as is passing over Washington. Brussels has failed to gain a credible foothold in Central Asia to diversify natural resources, and with defence budgets being sharply cut, 'crisis management' credentials look increasingly dubious in places like Western Asia and Africa. Europe's main priority in the coming years may well be to contain protests on the streets of Lisbon, Madrid, and Rome, not piecing war-torn countries back together.

Europe's global geopolitical significance today is not so much what it does in the world, but how emerging markets bilaterally interact with European capitals. Ten years ago, leaders like Blair and Chirac measured themselves by their roles on the world stage. For their successors, attracting inward investment from Asia, the Middle East, and Latin America is the benchmark of success. Sarkozy has been on a US$ 22 bn charm offensive with China of late and US$ 10 bn in Delhi, while Cameron has been wooing Indian and Gulf investment. Portugal, Spain, and Greece have been grateful for any Chinese bond market interventions. Denmark is getting on remarkably well with Brazil.

But Germany is the proof in the pudding. As economic tremors from Greece, Ireland, Spain, and Portugal shook the eurozone, it was Berlin that was first on the boat to Singapore and China in search of fresh cash. Just as they were leaving, the IMF arrived in Brussels to help save some European bacon; so much for the euro supplanting the dollar any time soon as a global reserve. In times of crisis, Europe still has to look to a beleaguered Washington for help. Even now, Chancellor Merkel pointedly reminds European colleagues that German exports are going great guns in China (in large part thanks to a weakened euro), and will continue to do so thanks to Berlin's privileged

Too much and too little: US and European defence compared

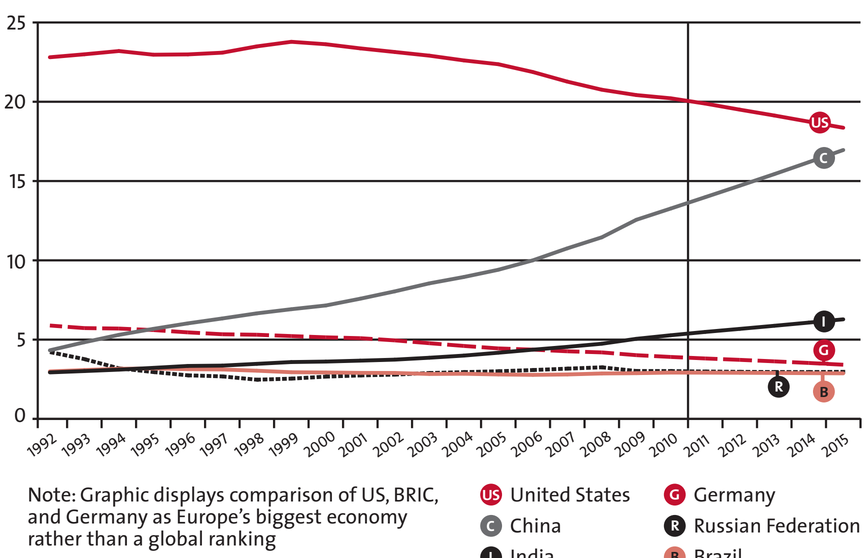


Sources: European Defence Agency 2010 (figures 2009) energy relationship with Russia. Political arbitrage some might say: Charlemagne it is not.

You could argue that none of this really matters. The fact that Europe has been unable to get its economic house in order sounds innocuous, at least from a geopolitical perspective. But assuming that more and more capital supporting European growth comes from emerging markets, the likes of India and China should have relatively little difficulty making their weight felt in Europe in future. Given the relatively small size of European economies, it will also be easy for Asia to 'drop' them at times of their political choosing. China's purchase of Greek assets was clearly not economically motivated, but strategic. Piraeus port sits aside the Bosporus and provides access to Southeastern Europe and the Black Sea region. Likewise, other emerging markets will all take greater stakes in the European game, whether it is Turkey telling France to pull their Mediterranean socks up, Brazil raising eyebrows on the Common Agricultural Policy, or Gulf states looking over their 'fractured' shoulders.

Crafting coherent European policies will be very hard in that context, as will staying aloof from emerging power tussles. It is no coincidence that in the midst of sovereign debt discussions, China has already asked the EU to

Share of global GDP: China closes on the US



Note: Graphic displays comparison of US, BRIC, and Germany as Europe's biggest economy rather than a global ranking

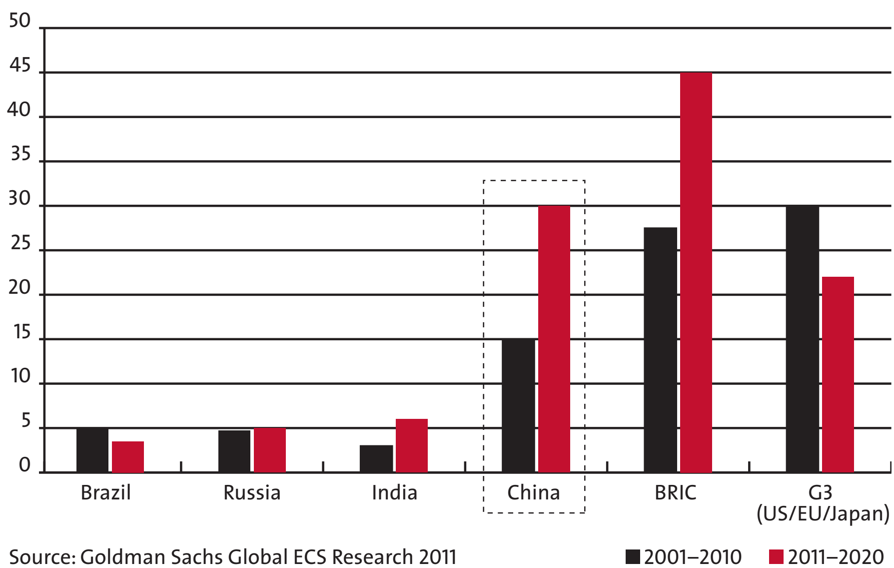
Source: IMF 2011

grant it 'market economy' status and to lift a long standing arms embargo. The EU remains a long way from mirroring Hillary Clinton's quip of 'how do you talk tough to your bank manager' but it is highly unlikely that Europe could, or indeed should stand in the way of a rising China, irrespective of how Washington might want things to play out. Europe cannot even stick to a consistent line when it comes to Russia and the vexed issue of gas supplies. Nor will it when it comes to persuading Ankara to play with a straight bat over tricky transit issues in future.

Creditor catch: China emerged

The fact that Europe is not turning into the kind of serious geopolitical partner the US has long been waiting for underlines the degree to which US power has to be measured against Asia-Pacific in future. It also draws us back to a G2 world, and the inexorable rise of China. The good news is that it is dawning on Washington that economic dependence on China could be geopolitically problematic. What if China plays up over Taiwan? What if they do not play ball on Iran? What if they start threatening Japan's maritime interests? And what of the Korean peninsula? These are some of the standard issues that tend to crop up, and on their own all have considerable merit, other than the fact that they miss the bigger point: The greatest geopolitical concern for Washing-

Contributions to global growth: China taking the lead



Source: Goldman Sachs Global ECS Research 2011 ton is not if China starts playing politics with the assets they already have, but if they start working on economic plan B to avoid US export dependency full stop.

The only thing keeping the US economy afloat right now is Chinese credit, whether measured in terms of the current account deficit or the federal fiscal deficit. China is by far the largest buyer of US treasuries ahead of Japan and the Fed. It is therefore ironic that Washington keeps telling Beijing to let the renminbi rise while Ben Bernanke is printing money like it is going out of fashion. America's global reserve status is an 'exorbitant privilege' indeed, it gives Washington the unique ability to keep financing external imbalances and live beyond their means – but one that is giving Central Banks inflationary headaches the world over.

Little wonder that every time the G20 meets, 'imbalances' become the euphemism for Sino-US currency tussles. Surplus and deficit economies take their respective sides: 'Devaluation vs. appreciation' becomes an archetypal case of 'six of one, half a dozen of the other'. 'Consumption vs. savings' sounds eerily similar. You would think that with commodity prices trading at historically high levels and a potential double-dip recession staring us in the face, the G20 could find some common ground: apparently not. Take a zero off the G'20' and you get far closer to the political reality and indeed, political dividing lines of the G2.

Beijing's global economic reorientation

Obviously, China is still dependent on US exports for the time being; it also has no truly comprehensive outlet for non-dollar securities to provide alternatives to US markets. And despite Beijing's bluster around a Special Drawing Rights vehicle pulling in currencies ranging from the euro to sterling to the yen, China is not looking to pitch the redback as any kind of reserve currency any time soon beyond ad hoc currency swap agreements and enhanced cross border trade. The renminbi is not fully convertible, and capital controls are almost certain to stay in place for now. And yes, China clearly does not want a fire sale on US dollar denominated bonds (what some term the 'nuclear option') given it holds over US$ 1.160 bn of them.

But the assumption that China will not gradually diversify its US$ 2.800 bn reserves (70 per cent of which are held in a structurally flawed greenback) away from the dollar, or reduce its exposure to Western demand in light of the financial crisis, is about as unrealistic as thinking property prices would only ever rise. Rebalancing will assuredly come one day, but it will not be in the form that the US wants: Your bank manager has just called time on you, foreclosure is imminent.

This train is already in motion, and the US can do very little to stop it. Stoking domestic and regional demand are two key pillars in China's approach. Despite all the Keynesian headlines in the West, it was China that launched a massive US$ 585 bn stimulus in 2009 that amounted to 8 per cent of GDP, alongside US$ 1.5 tr of state-enforced lending to the private sector over the space of the year. The Chinese economy not only grew by 10 per cent in 2010, it surpassed Japan to become the second-largest economy in the world. Obviously, with domestic demand on the up, China's surplus will shrink to some degree (which many in Washington will see as good news), but this is not some kind of short-term tactical play, rather it is a fundamental reorientation of Beijing's global economic position. It wants to use its financial clout to stimulate a new wave of self-reinforcing growth with other emerging markets – not just keep propping up the export channels of old. China clearly thinks that more stable investments can be made beyond Western exports – not only to drive global economic growth, but to ensure Chinese employment remains high and therefore the Chinese Communist Party (CCP) safe.

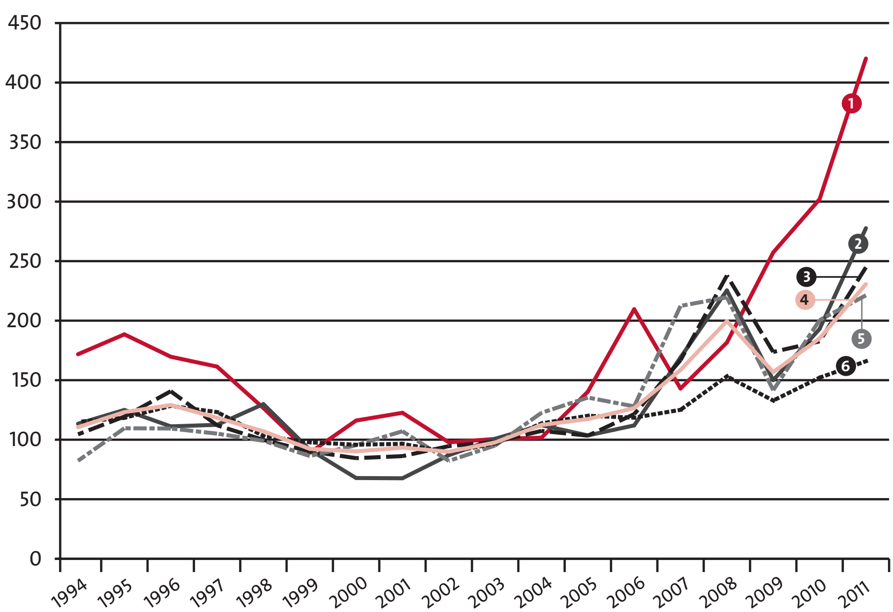
The Chinese Development Bank and the China Export-Import Bank issued loans in excess of US$ 110 bn to developing countries over the past two years – a larger sum than the key lending arms of the World Bank. China became Brazil's largest single trade partner and investor in 2010, and saw export trade increase by a staggering 73 per cent. Exports were also sharply up to India (38 per cent) and Russia (69 per cent), which buffeted an overall export increase of 30 per cent. 'Cementing the BRICs', you might say, given China's clear economic ascendency over its 'alphabetic allies', but Beijing also replaced the US as the key trade partner of Japan, Thailand, Malaysia, Singapore, Hong Kong, Australia, the Philippines, South Korea, and Indonesia.

Once you understand that, you start to understand why Chinese take-up of eurozone debt has been so tepid and why the dollar is on shaky ground. China has better games to play, not only with the BRIC economies, but emerging markets across the board. And nowhere more so than in commodities, which constitutes the third, and most important pillar of China's geoeconomic strategy.

Commodities: Strategically key

Commodities are not just a massive hedge against the dollar (deals are invariably structured in dollar-denominated assets directly filtered from foreign exchange reserves), but loans are also linked to prevailing commodity prices. As we know, Asian demand dictates fundamentals on the trading floors of New York and London these days, which means China is basically placing a bet on its own economic performance rather than the US. It also explains why close Chinese relations with resource-rich states are the biggest geopolitical drivers of global affairs today: 'Economic policy is energy policy is foreign policy'. Security of supply, diversity of supply, and reducing price risk exposure are the crucial ingredients in China's resource strategy. And it is a strategy they cannot afford to get wrong. Chinese oil import dependency will rise beyond 80 per cent over the next 20 years or so with around 40 per cent of global demand growth coming from Chinese shores alone. It already became the world's largest consumer of energy ahead of the US in 2010, an event that should have been a further 20 years down the track according to the

Commodity price increases



Price indices (2002-2004=100)

Source: Food and Agriculture Organization 2011

1 Sugar Price Index
2 Oil Price Index
3 Cereals Price Index
4 Food Price Index
5 Dairy Price Index
6 Meat Price Index

IEA. This has inevitably facilitated far stronger Chinese links to Central Asia, Russia, Africa, Latin America, and the Middle East. Such linkages will continue to recalibrate global affairs writ large; producer supply will inexorably lean towards Asian demand.

China cannily used the economic downturn as the perfect storm to make strategic resource investments when few else could. 'Loans for oil' agreements were an easy sell for those deemed to be on the critical list of resource (mis-)management. Venezuela was falling over itself to sign a US$ 20 bn credit line in exchange for up to 200,000 b/d for Sinopec and CNPC; Colombia looks similarly keen to provide an US$ 8 bn transportation outlet to China to help circumvent the Panama Canal for 'Bolivar' supplies. Russia was not much different, striking a US$ 25 bn oil export-backed loan agreement for Rosneft to supply China with up to 300,000 b/d over the next 20 years. China nipped Central Asian supply in the bud, sourcing oil from Kazakhstan and gas from Turkmenistan and indeed, Uzbekistan. Southeast Asian and Australasian supply is increasingly dominated by Chinese demand, alongside a swathe of African states joining the ranks of CCP natural resource interests. China has galvanised relations with West African producers, most notably Angola, but with Nigeria, Guinea, and Ghana firmly on the roster. This mirrors developments in Central and East Africa. North Africa is also a going concern.

The list could easily go on; China has actually made over 200 resource investments in over 50 countries. Its upstream oil portfolio increased by over 40 per cent in the past year; equity ownership now surpasses 1 m b/d, and PetroChina, CNPC, CNOOC, and Sinopec show absolutely no sign of letting up. And it is not just in 'frontier' markets where China has been investing. Brazil secured a US$ 10 bn loan to help finance its US$ 174 bn five-year strategic energy plan, quickly followed by investments in Argentina, while Canada has opened up tar sand prospects for overseas investment.

This matters economically – 5.7 per cent growth in Latin America, 4.7 per cent in sub-Saharan Africa and 9.3 per cent in East Asia and the Pacific would all be unthinkable without Chinese demand – but it also has a political edge: Resource-rich states are increasingly empowered to play off competing Western and Eastern commercial interests. This can be seen in Central Asia, where Russian, European, US, and Asian suitors all want to sit at the table; and in Africa, where resource rents invariably go to the highest, or indeed most corrupt bidders. In Latin America, it is now an increasingly fine line between those playing the market and those draining the state, while Russia clearly wants to perfect its arbitrage potential (political and economic) by simultaneously feeding Eastern and Western markets. Removing the word 'post' from Soviet space would also be nice for the Kremlin.

Middle East: A 'Chimerican' lake?

Hence the old game of Western demand and producer supply is dead. More players on both sides of the oil producer and consumer ledgers will inevitably bring far greater political complexity, and nowhere more so than in the Middle East, where China has made its resource presence firmly felt. Marginal producers are exactly that for China now: marginal. Risk, or rather tolerance of risk, plays a major part when going for juicy finds.

Beijing is well aware that some of their more exotic commodity bets might not pay off, but it is no surprise that China has been leading the charge back to Iraq to make sure they can capitalise on new prospects. Baghdad sits on some of the largest reserves in the world; getting your foot in a US-opened door is a smart long-term play. Likewise, China has major energy links with Kuwait, the UAE, Qatar, Yemen, and Oman to ensure that supplies flow East. More controversially, Beijing sees Iran as a major supply option. It has 25-year LNG supply contracts in place with Tehran, and has taken a majority stake developing the Yadavaran oil field to ship 300,000 b/d to the mainland over the next 30 years. North Pars Gas and North Azadegan are more recent additions to China's Persian collection.

On their own, such deals sound a little dry, but they could not have any sharper political resonance if you tried. It is highly unlikely that China will do much heavy lifting on international sanctions against the Iranian nuclear programme, not unless its most important regional energy supplier, Saudi Arabia, decides to call time on Tehran's nuclear ambitions and put pressure on Beijing to comply accordingly. China knows that the 1 m b/d it takes from Riyadh will be crucial to meeting long-term demand, and ultimately it is the one relationship it has to make work in the Middle East. Arab oil supplies still trump Persian output. And the US certainly gets this; it explains why the White House has been happy to let China source more and more Saudi (and Iraqi) oil to pressure Tehran.

From an energy perspective, this places Saudi-Iranian power plays at the heart of the US-China relationship in the Middle East. What is more, the Saudis know it – China's presence gives them considerable political leverage over Washington, Beijing, and ultimately Tehran. Which points us towards another inconvenient truth for the US: When it comes to political influence in awkward resource states – be it Iran, Sudan, or further afield in Asia, Africa, and Latin America, it is China that now has the critical voice, whether it always wants it, or not.

This begs the more fundamental question of how long the US will continue to underwrite global oil supplies through its naval dominance – and indeed, how long China will keep paying the US to maintain such a presence. The Middle East sits at the heart of this debate, and although the exact date is impossible to predict, the point at which the US relinquishes this role will basically signal the end of its superpower status. For the US, it has not been about controlling resources or consuming vast amounts of Middle Eastern oil for quite some time, but rather ensuring the safe flow of hydrocarbons to global markets, whether in the East or West.

Saudi-Iranian power plays are at the heart of the US-China relationship in the Middle East

Execute that role, and much else follows as the geoeconomic and geopolitical lynchpin of the world – lose it, and you start to look like a distinctly 'ordinary power' as Britain found out in the post-war period. That is before we even consider the issue of where Gulf states decide to recycle their petrodollars in future. No security, no $? It is certainly a question for the US to ponder – not only in terms of treasuries, but what currency oil is priced in, lest Washington decide to pander to 'energy independence' instincts and fall back on domestic, Canadian, American, and West African production over the Atlantic. With benchmark prices already north of US$ 100/b in 2011 and key producers in the Middle East doing very little to quell the market, gradual US disengagement from the region might not be as farfetched as once thought.

Before we get too carried away, China has little interest in ousting the US from the Persian Gulf anytime soon, nor indeed from anywhere else where destabilising conflicts could hamper Beijing's internal agenda, but it is at least working on some maritime insurance policies in the interim. The so-called 'String of Pearls' policy now spans from the Persian Gulf to the Chinese mainland via the Strait of Hormuz to the Malacca Straits with a naval presence in Cambodia, Pakistan, the South

China Sea, and the Indian Ocean. China has also been closely eying Yemen's Aden port for a base at the mouth of the Red Sea and adjacent to the Horn of Africa. With the Bab al-Mandab as another key potential maritime choke point, and potential conduit for Sudanese oil supplies, a foothold in Yemen offers Beijing numerous strategic options. Likewise, China's growing trade links with Egypt over the years hold the key to the Suez Canal at the other end of the Red Sea. Closer to home, growing Chinese influence in the South China Sea is a reality that Australia, Vietnam, and Japan are starting to understand, although Beijing has also been exploring different land-based routes. Enhancing Sino-Russian, Sino-Kazakh, Sino-Turkmen, Sino-Burmese, the Pakistan corridor, and the Kra Canal (linking the Malay Peninsula to the Gulf of Thailand) are all prospective supply routes on the table.

The West should hardly be shocked by such developments; it spent most of the 20th century trying to implement a similar blue print of linking strategic presence to the flow of oil. But the issue with China is not only that its presence provides resource-rich states with a stronger hand to resist Western pressures, but that Beijing's primary motivation is not to establish geopolitical dominance over the old guard at this stage, but merely to ensure that it holds the aces over emerging market energy competitors, and most notably India. Delhi is being squeezed so tight securing new reserves that ONGC has asked the government to follow the Chinese lead and sink its US$ 280 bn of foreign reserves to help secure resources. This might come as a 'news flash' for some, but emerging markets are no more politically aligned than the West. Not on energy, not on geopolitical interests, and certainly not on geoeconomic interests either.

Political turbulence

That of course leaves us with a highly turbulent outlook. As much as China's rise is creating political opportunities for other emerging markets to leverage, it also comes with political risks. The obvious ones relate to East Asia, where for many in ASEAN, China looks a little too dominant. The East Asia Summit has even pulled up a chair for the US and Russia as a counterweight to Chinese influence. Japan increasingly sees China an outright political threat in the East China Sea, and not to be trusted on natural resources, least of all rare earths. Moans can also be heard that as the fulcrum of six-party talks, China is not doing enough on North Korea, or helping to improve

Emerging markets are no more politically aligned than the West

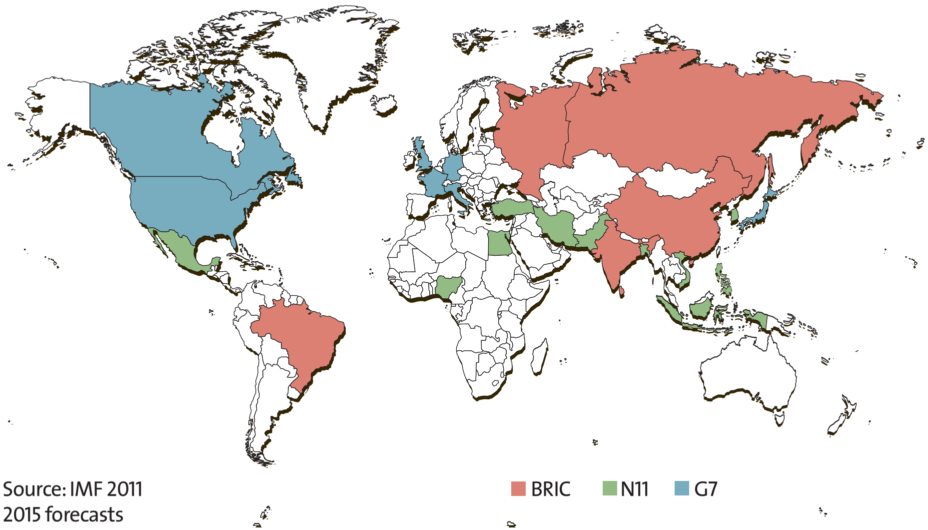
governance standards across resource-rich states. Chinese terms of trade are certainly raising African eyebrows; quips of being flooded with cheap Chinese goods can be heard from Malawi to Senegal and back. Similar messages are relayed in Asia. Even Brazil rues a low renminbi resulting in hot capital inflows and a rising real against the dollar. To be fair, complaints that China refuses to sign up to a global climate deal are a bit rich; nobody else is exactly chomping at the bit to put pen to paper, and let us not forget that the West has effectively 'outsourced' its emissions to the Middle Kingdom anyway. But the charge nevertheless stands, in some quarters at least.

Global governance: Diversity and instability

The fact that emerging markets do not see eye to eye on a range of geopolitical issues is not just significant for global governance gaps at 'the top', but actually points to the blunt fact that *this is* now global governance in action; namely China, alongside a growing number of emerging markets following their own agenda and their own interests. Whether you call that a political vacuum or merely a fleeting reflection of power shifts underway is debatable – but the trend is clear: Neither the US, nor Washington flanked by Europe and Japan will be able to underwrite regional balances indefinitely. Geoeconomic muscle of the East and chronic fatigue in the West will inevitably affect both global and regional geopolitical outlooks sooner or later. The first signs of this can already be seen.

On the global level, take the 'BASIC' grouping of Brazil, South Africa, India, and China on climate issues, or indeed far larger groupings such as the G77 or WTOG20 (distinct from the newly formed G20) on global trade talks to block Europe/US proposals. Reform of the Sister Banks and UN also tends to find collective voice across emerging markets to gain a greater share of the votes, even though consensus is badly lacking as to which nations should get the plaudits. We can also see clear signs of players such as Brazil aspiring to global roles. Brasilia provided leadership for UN missions in Haiti, it backed Turkey's position over Iranian enrichment (even though this was voted down at the UNSC) and maintained its calls for reform of international financial institutions. Compared to Mexico, Venezuela, Bolivia, Chile, Argentina, and Colombia, Brazil is clearly now the leading Latin American voice in global forums. Rousseff will use this elevated status to stand above the Latino 'left-right' political fray and stake a claim to regional leadership.

BRIC, N11, G7: GDP growth 2015 (in %): 'Chindia' ahead



1. China	9,5
2. India	8,1
3. Vietnam	7,5
4. Bangladesh	7
5. Indonesia	7
6. Egypt	6,5
7. Nigeria	6
8. Pakistan	6
9. Philippines	4,5
10. Brazil	4,1
11. Russian Federation	4
12. Korea, Republic of	4
13. Turkey	4
14. Mexico	3,8
15. Iran	3
16. United Kingdom	2,6
17. United States	2,6
18. France	2,1
19. Canada	2
20. Japan	1,7
21. Germany	1,3
22. Italy	1,3

In South Asia, a rising Indian star will continue to compete with China to some degree, but has become remarkably wary not to become a US pawn in the region. Its main aim is to entrench its regional political power – albeit with some Indian blue helmets cropping up in strange places – while playing a global economic role. The latter will need infrastructure gaps to be filled, and inflationary pressures checked, but one thing is for sure: Just like China, India's natural resource footprint will rapidly grow alongside its naval forces. Do not expect it to be pretty though; neither China nor India will move to improve the situation in places like Myanmar given the political dynamics and natural resources involved. A race to the bottom will be the result unless a gentleman's agreement can be struck on upstream acquisitions.

For the smaller South Asian players, Bangladesh will continue to register growth, but will remain as politically feeble as the likes of Nepal and Sri Lanka. Little sign of improvement will be seen in Pakistan given that Islamabad now sits at the heart of the Afghanistan-Pakistan quagmire. Southeast Asia is less politically hairy, but relations between Malaysia and Indonesia tend to be tetchy; those between Cambodia and Thailand are even worse. Like Vietnam, they will all remain growth markets, but require significant structural reform. It is only really the sovereign wealth of Singapore that gives the region global geoeconomic reach; geopolitically, its main interest is not playing a global role, but trying not to be squeezed by its larger neighbours to the North and West.

In Africa, more and more economies are finding their own path towards economic growth and political niches of late, in large part on the back of Chinese natural resource investments. Nigeria and Angola will continue to vie for ascendency in West Africa, albeit punctuated by 'tropical dictatorships' in Equatorial Guinea and extreme political instability in Ivory Coast. Kenya is rediscovering its regional feet in East Africa, even though the Horn is slipping further into anarchy. South Africa has played a more important role in the UN General Assembly, but conversely has used its regional clout to shield Zimbabwe from Western pressures in Southern Africa. Elections in Cameroon, the DRC, and Nigeria will certainly test how far Africa's democratic credentials have, or indeed have not, come. Unrest in Zimbabwe and Chad will also be important spaces to watch, particularly as many of the 'new generation' of African leaders hailed in the mid-1990s as guarantors of stability in places such as Rwanda and Ethiopia, have now become sources of concern. Although some resource-rich states such as Botswana and Tanzania have got on with the quiet business of reform, others such as the Central African Republic and Gabon look as fragile as ever. If things go awry, it remains unlikely that you will see any significant Western cavalry coming over the horizon. A weak African Union under Cape Town's and Lagos' tutelage will have to put its own fires out – albeit with subtle Chinese help – not least because the West's biggest political priority now lies to the north east; namely to try and keep a stake in the MENA game.

US authority was already being seriously tested by Iranian regional influence after the geopolitical own goal of the Iraq War, and to a lesser extent Turkey, who with the second-largest standing army in NATO is trying to play a power broker role. Although Western powers have failed to produce a consistent line on Libya amid Russian and Turkish opposition to assertive action, broader events in Tunisia, Egypt, Bahrain, and Yemen have dealt a severe blow to the old model of Western powers turning a blind eye to decrepit regimes for the sake of notional stability. They have also revealed a serious chink in emerging market amour; the issue of succession.

Emerging succession issues

While some analysts have started counting down from 22 across the Arab League, the chances are that the Gulf states will sit tight, try to ride out the storm and offer tactical concessions along the way to quell the Arab street. Changing the guard in Saudi Arabia, Kuwait, UAE, Bahrain, Oman, and Qatar is only a matter of time of course, but inviting further unrest at this stage is a risk that few regional or external players would want. Scrapping 'dynastic succession' full stop is even riskier, unless you are willing to put democracy above interests in the most critical oil-producing region of the world. US reticence to push the revolutionary envelope in Iran underpins the fact that notional stability still remains a better devil for Washington and Beijing to know. The common 'unspoken language' for external players in the region remains that of oil, geopolitical interests, and economic pull. If democracy can be a useful tool to deliver on that then fine, but it is certainly not a requirement. Oil and petrodollars sit at the core of the Gulf's global significance. That goes as much for Beijing and Delhi, as it does for Washington.

Reverberations from Tripoli and Cairo have not merely been confined to MENA markets, however. Central Asian states have been busy pushing through snap elections rather than constitutional stitch-ups. Kazakh, Uzbek, and Turkmen leaders are certainly not getting any younger. And although qualitatively different beasts, larger markets such as Russia will need to think harder about economic modernisation to ensure the political underpinnings of the state remain intact rather than erecting barricades. The BRIC acronym can only carry Russia so far; if anyone can keep playing a game of political smoke and mirrors it is no doubt Moscow, but the Kremlin still needs to get off corruption and hydrocarbons and into equitable growth if it is to stay the course.

Indeed, for all the 'excitement' around Middle East democracy, the downside risk is that many states will become increasingly harsh and repressive to contain the symptoms of social unrest rather than address underlying causes. Those in office will watch their militaries far more carefully for political cohesion and support – if nothing else, that is ultimately what put pay to Mubarak and to a lesser degree, Gaddafi. Conversely, in states where the military is the dominant political force, we should expect to see more democratic dressage to paper over the cracks: Pakistan and Myanmar offer two examples. Thailand is another, once you scratch under the surface.

The irony of all this is certainly not lost on China. Beijing remains acutely aware of its own internal problems. Inflation is worrisome, money supply needs to be controlled, labour shortages must be filled, the population is getting older, middle class aspirations are growing, and environmental degradation is showing. It also has its own 'succession' in 2012 to confront, when Xi Jinping will likely take over from President Hu Jintao – a dateline that the CCP will be desperate to maintain high levels of growth towards and beyond. China has faced these kinds of challenges before and managed to overcome them; it probably will do so again.

Unfortunately, this analysis cannot easily be shared for the US economy. China has the geoeconomic upper hand, other emerging markets will use that to great effect, either through natural resource endowments or bilateral trade. America will stagger on; Europe will fail to geopolitically matter; Asia will rise, others will ride the coattails. No common rule book will be established, and no cohesive 'blocs' formed – either across emerging markets or the West. But when the geoeconomic bite point comes and the debts are called in, emerging markets – and China in particular – will need to be ready to fully take up the geopolitical slack. The world will not wait, nor will their own domestic constituents once the world has shifted East.

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