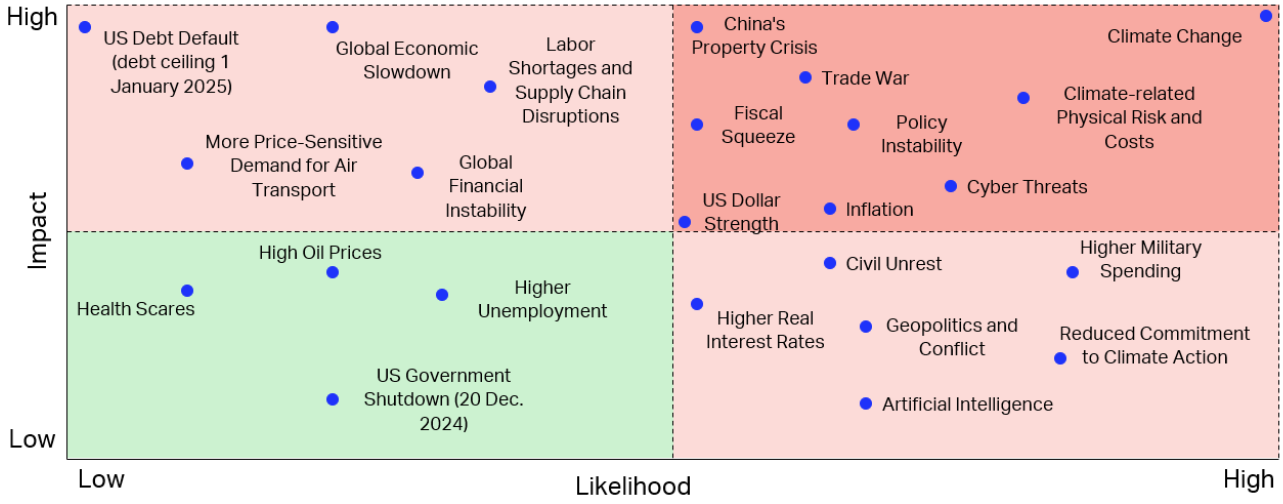
BRIEF

An assessment of risks in 2025: Heightened policy uncertainty

As 2025 is approaching fast, we assess the risks to the global economy that we are likely to face in the new year. Our assessment is purely qualitative, and perception based. It is not meant to be exhaustive nor in any way dogmatic. Our purpose is to scan the landscape, promote awareness, and stimulate conversations.

The matrix below orders potential risks with respect to their likelihood of occurrence on the horizontal axis, and the size of the negative impact one could expect on the global economy if the risk were to materialize on the vertical axis.

Risks in 2025



Source: IATA Sustainability and Economics

Many of the potential risks in our assessment are heavily impacted by the presidential election result in the US, the **policy instability** that can be expected of the incoming Trump administration, and its reverberations across the global economy. Chief among those are the promised tariffs. The recently suggested numbers include 25% tariffs on all imports from Canada and Mexico, and an additional 10% on goods from China, on top of any existing tariffs. The direct effects of the tariffs would be to increase prices in the US of the imported goods, and push the rate of **inflation** higher, unless people stop buying the goods or can find substitutes that are not affected by the tariffs. The targeted countries are most likely to retaliate in some form. This would limit US exports and dampen trade internationally, with **lower global growth** as a likely outcome. An outright trade war would be capable of plunging the global economy into recession. It is also possible that industry interests in the US will be able to influence policy in such a way that tariffs will not rise materially after all. One example of such industry interests is the US oil refineries. These tend to import heavy Canadian crude oil, and do not use the light grade produced by the US shale oilfields. As there are numerous such own-goals associated with any tariff policy, we dare to think that the risk of implementation is high but still not certain.

What does look certain, however, is the intention of the incoming administration to promote the expansion of US oil production and thereby add to an already oversupplied market. This will weigh on oil prices going forward and reduce the risk of **higher oil prices**. Volatility in oil prices is likely to stay with us, but the average price is expected to moderate. Conceptually, one can think of a Brent crude oil price of USD 80 per barrel and above as being a brake on growth. On the other hand, a price below that threshold tends to be growth promoting. It is fortunate, with respect to GDP growth, that a lower oil price will be able to offset at least partially any increases in unemployment rates around the globe. The risk of **higher unemployment** must be greater in 2025 given the impact that any tariffs would have on growth. Unemployment would rise, in such a case, from the current very low levels seen in most major economies, limiting the potential impact. Nevertheless, higher unemployment could mean **greater price sensitivity of demand** for air transportation. The fact that a record number of persons has been earning a wage in recent years outweighed the negative impact that the inflation spike had on the purchasing power of those wages. This has been very supportive of GDP growth in general, and of demand for air travel specifically. That support could wane if employment growth falters. On the other hand, demographics speak to structural **labor shortages**, to which we can add the ongoing **supply chain disruptions** that in turn are exacerbated by more inward-looking industrial policies. Costs in all these areas are likely to increase unless the global economy enters a more recessionary environment.

Outside of US trade policies potentially provoking a global economic slowdown, the greatest risk to the global economy can be seen to reside in **China's ongoing property crisis**. Efforts to stimulate the economy and deal with bad debt still have some way to go before one can call the all-clear. Of course, China would also suffer from the planned additional US tariffs, and from any retaliation it might itself decide upon. On the other hand, a more inward-looking US policy stance could leave a vacuum that China might be well placed to try to fill, if it can increase production in some areas and redirect trade flows to non-tariff trading partners. In that respect, it could be an opportunity that if missed, China would only have its own inward-looking policies to blame.

A risk that would have catastrophic consequences, but that we see as unlikely, is that of a **US debt default**. The debt ceiling has been suspended to 1 January 2025 and a new agreement is needed to avoid provoking a situation where the government is unable to pay its debt service obligations. Should the US miss debt payments, it would in all probability lead to major upheaval in global financial markets. A related risk is that of a **US government shutdown**. This is somewhat more likely to occur than a default on the US debt, but it would have limited consequences for the global economy. The US needs to agree on spending by 20 December 2024, and failure to do so could shut the government down. The US government has shut down 21 times in the past, and the impact on economic activity is mostly limited to deferring the growth to the quarter following any shutdown.

Climate change is as highly impactful as a US debt default or a global or China-triggered economic slowdown would be, but it is also a given in terms of its likelihood of occurrence – hence its position in the top right-hand corner of our matrix. The pace of climate change seems to be accelerating, and the **physical risks** are mounting with floods, droughts, wildfires, hurricanes, landslides, and other disasters causing both more frequent and greater damage than before. The frequency and associated costs of climate disasters are also potentially magnified by the **reduced commitment to climate action** that has been evident since Russia invaded Ukraine, and apparent at the recent COP29 and G20 gatherings. Countries have moved away from explicitly urging for the phasing out of fossil-fuel use and of harmful fossil-fuel producer subsidies. Energy security and other matters have gained in prominence on countries' to-do lists. Incentives and subsidies in favor of renewable energy production are mostly glaring in their absence. This reduced commitment to climate action will imperil all net-zero-CO2-emissions-in-2050 goals and will weigh on both current and future global growth rates through multiple channels including inflation, interest rates, reduced productivity, migration, food insecurity, and civil unrest. To be sure, these might only become starkly visible over time, though potentially sooner than currently acknowledged.

The risk of a **global financial crisis** does not appear pressing, though it should not be ignored. There are now 68 lower-income countries on the IMF's list of variously debt-distressed countries, 35 of which are in outright

distress or at high risk of becoming so. For the world as a whole, the IMF's latest Fiscal Monitor predicts that public debt will reach 93% of global GDP in 2024, having peaked at 99% during the pandemic.[1] Such high debt levels lead us to expect **a fiscal wall of sorts**, coming towards us with a force and speed that few might presently suspect. Fiscal austerity might become necessary but would dampen GDP growth prospects.

Lower interest rates, as per the US Federal Reserve's latest two moves that reduced the policy interest rate by 75 basis points, should weaken the dollar, all other things being equal. The risk of **a stronger dollar** should therefore now be lower, alleviating any drag it might have on global growth. However, the US stock market's favorable reaction to Mr Trump winning the US election has attracted investment flows into the US that in turn push the dollar higher against other currencies. This could be reversed if tariffs and mass deportations do materialize, with higher inflation and slower growth in their wake. But the US dollar is also a safe-haven currency to which investors flee at any sign of trouble. Domestic US issues and global geopolitical risk can both be dollar positive. Retaining the assumption that the lower interest-rate scenario will dominate other factors, the risk of added US dollar's strength should on balance be lower than 50%.

The direction of real interest rates depends on both monetary policy and the rate of inflation. Should higher inflation be the result of a restrictive trade policy, nominal interest rates will fall by less, but the real interest rate could still decline. We think that moderate reductions in the federal funds rate are still the most likely in 2025, accompanied by a gradual downward trend in inflation. On balance, the risk of **higher real interest rates** seems contained.

Policy instability is a higher risk also outside of the US and the impacts of its election results, as 2024 has been a record election year. Our survey of 58 countries where results have been announced regarding presidential and parliamentary elections, 11 countries' political majority moved to the right, and 9 moved left. Apart from these 34% of cases of opposition wins, a majority of 66% of countries saw incumbents win, though majorities were lost in close to 20% of cases overall. These outcomes could spell more marked swings in policies, coupled with greater difficulties to pass laws. The uncertainty that this might create could discourage investments and household spending, which would weigh on growth going forward. If policy changes are accompanied by increased **civil unrest**, the outcome will be more detrimental. The issue of immigration in the US and elsewhere is likely to be a case in point.

The world's power balance is shifting in part because of the elections held in 2024, as well as from influences spanning prior decades. Freedom House reports 16 years of decline in the number of democracies in the world.[2] **Geopolitics** might become less predictable and give rise to more frequent and longer-lasting **conflicts**. One very likely outcome is that countries will spend more on their military. **Higher military spending** represents an opportunity cost by taking funds away from alternative priority areas, such as education and health. Suboptimal allocation of global capital will reduce the long-term potential growth rate.

Even in the absence of pandemics, **health scares** could multiply and cause cumulative damage. The risk of the US administration opting for a more laissez-faire approach to health care than in the past is a particular concern. This could lead to insufficient, erroneous (from a science point of view), and chaotic responses to health threats. Armed conflicts in other regions of the world are also hurting health systems and the capacity to respond to crises. As many as 40 countries have reported outbreaks in infectious diseases that are 10 times higher than pre-pandemic levels.[3] Measles, polio, and whooping cough have all increased in the US recently. All this can affect air transportation via erratic policy responses, and demand for travel can fall if large numbers of people are unwell as well as if large numbers of people refrain from travel out of fear of becoming unwell.

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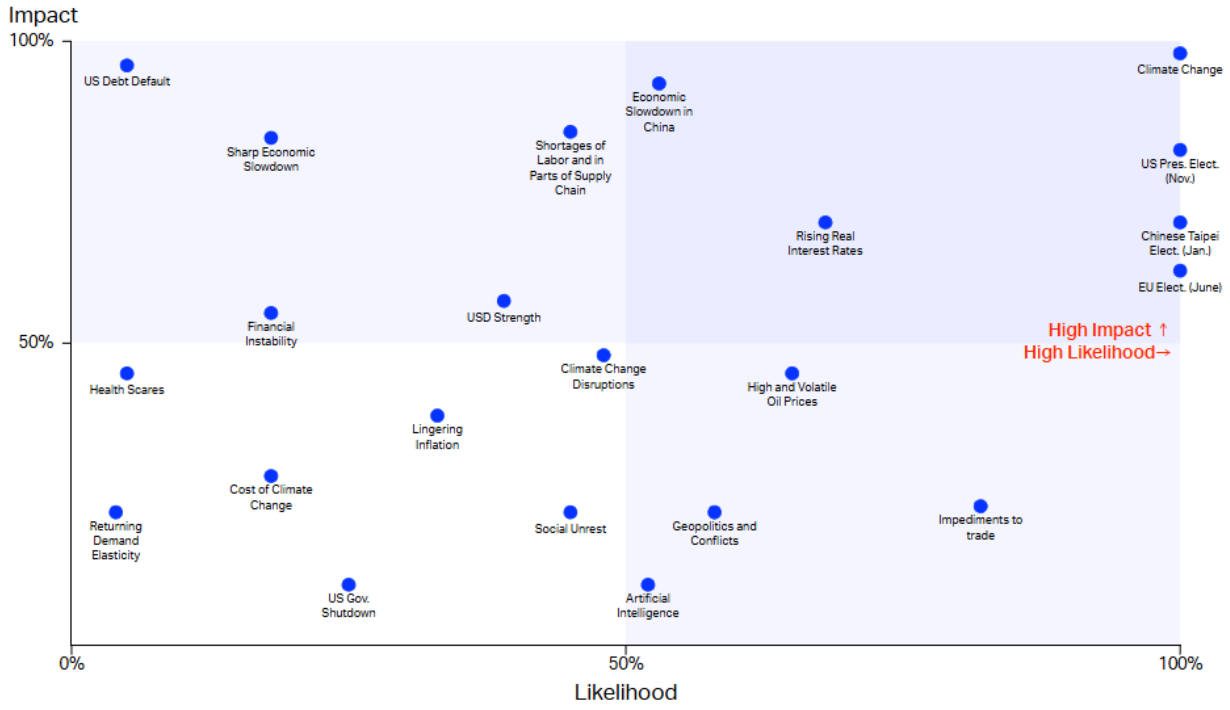
[1] **https://www.imf.org/en/Publications/FM/Issues/2024/10/23/fiscal-monitor-october-2024**
[2] **https://freedomhouse.org/sites/default/files/2024-02/FIW_2024_DigitalBooklet.pdf**
[3] **https://www.globenewswire.com/news-release/2024/06/14/2899158/0/en/Global-surge-in-infectious-diseases-as-over-40-countries-report-outbreaks-10-fold-over-pre-pandemic-levels.html**

Artificial intelligence will most likely make it harder to separate fact from fiction, and friends from foes. **Cyber threats** will in all probability become more frequent and have greater disruptive force. Artificial intelligence will also make some tasks easier and could eventually lead to productivity gains, though this is not apparent at the current junction. There is also an opportunity cost in that investments could be attracted to this space disproportionally. It has been said about tech firms' investments in artificial intelligence that the risks attached to future returns are high, but the risk of being left out from future potential returns is greater. That this thinking does not seem to apply to the renewable energy sector illustrates the problem of investment horizons. In the interim, data storage and processing have already clocked up 2.5% of global CO2 emissions, on a par with the air transport industry.

Appendix 1

Risks in 2024



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