



Vontobel

# Geopolitics & climate change

How climate influences  
geopolitics and policy actions



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# Takeaways for investors

## **The link between geopolitics & climate change**

Climate change and geopolitics are deeply interconnected, with the historical exploitation of resources largely shaping today's geopolitical landscape. The decisions made by countries that once relied on carbon-based resources now play a crucial role in either mitigating or exacerbating climate change. This in turn is impacting international relations, industrial policies, fiscal priorities and the global balance of power.

## **Climate change is shaping the relationships between countries**

Climate change impacts international relationships by causing direct damage through extreme weather events and indirectly via effects on the economy and financial markets. On the one hand, climate change is making food and water resources more scarce in certain regions, while also disrupting transportation and the economy. On the other hand, it can also open new trade routes like the Northern Sea Route. In addition, climate change is expected to increase both domestic and cross-border migration, thus heightening geopolitical tensions.

## **'Cover up' climate shift in industrial policies**

Countries may be tempted to use climate change as a pretext to implement protectionist industrial policies, such as trade barriers, subsidies, and tariffs, exemplified by US and EU tariffs on Chinese EVs. This approach could slow the green transition by raising costs and limiting access to affordable green products. Last year, almost 30% of industrial policies cited climate change mitigation as the main reason for introducing protectionist measures predominantly used by advanced economies, raising concerns about whether this is a genuine effort to effect positive change or a cover for protectionist practices.

## **What will our taxes be spent on?**

Fiscal policies in support of climate actions are at risk due to shifting geopolitical priorities. Funds could be redirected from climate goals to national security and defense. The EU, as a special case, might combine both these efforts, as reducing fossil fuel reliance could decrease its geopolitical vulnerability and energy dependency.

## **Shifts in balance and the emergence of multipolarity**

Shifting from a fossil fuel economy to an electrified one will transfer power from fossil fuel exporters to countries rich in green transition resources. However, fossil fuels will remain essential for some time, as they still account for over 80% of global energy consumption. Alongside the US-China leadership struggle, global multipolarity will rise, especially with resource scarcity. Resource-rich states may become 'swing states' between NATO-West and China-Russia-East, exploiting their bargaining power and the 'quest for resources', while some geopolitical players might support proxy wars to destabilize poorly governed, resource-rich countries in order to gain access to their treasures.

## **What to watch for and what to do as an investor?**

In the current environment, investors should closely monitor changes in the political landscape, such as the latest elections in India, the EU, and the upcoming US elections and how they might change the momentum for the green transition versus other political priorities such as national and border security or industrial policy. In this transitional period, investors should consider both the ongoing need for fossil fuels during the transition and the long-term benefits of being invested in sectors that will benefit from this transition over decades.



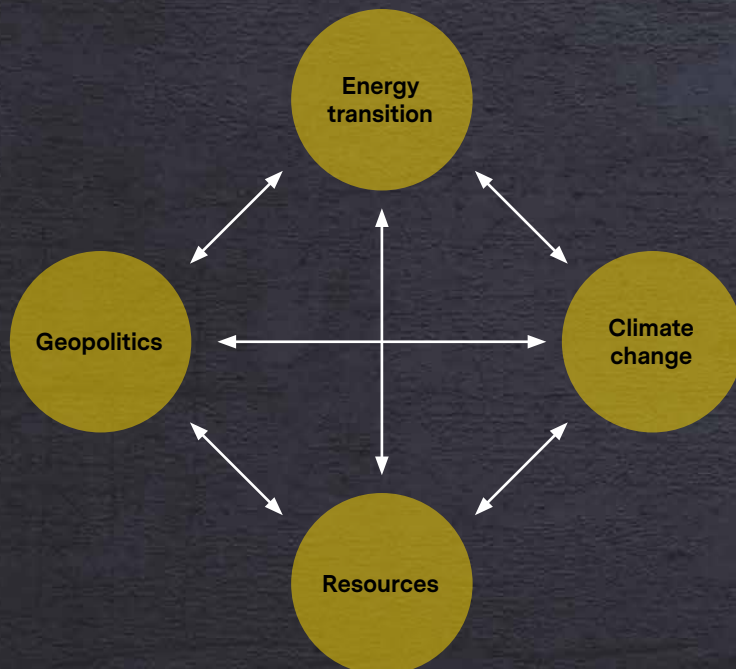
# Introduction


Geopolitics affects the life and prosperity of millions of people with spillovers to the economy and financial markets. Especially now, with intensification of conflicts in the Middle East, Ukraine, and Taiwan, the eyes of many are on geopolitical issues (Tucker, 2024). It may seem like other priorities such as climate change and energy transition have dropped down the agenda of politicians. However, geopolitics and climate change mutually impact one another. Investors should thus view them together to inform their decision making.

Here we argue that geopolitics and climate change are interlinked due to the prominent role played by resources in global relations and the wider trend towards the energy transition (see figure 1 below).

Resources have historically been one of the most frequent causes of geopolitical contests and resource-rich countries have experienced unprecedented economic growth and have often taken the central stage in geopolitics (see, e.g. Vontobel White Paper: The quest for resources, 2023). On the one hand, energy transition resulting in fast-paced economic development has shaped the world we know today, and a shift from animal and muscle power to the combustion engine during the industrial revolution, in combination with a rise in population, was a major cause of climate change. On the other hand, climate change impacts the economy via natural disasters and requires spending to shield from or repair the damage that climate change will cause. It therefore also has an effect on geopolitics.

Figure 1: Geopolitics & climate change





## **'One ring to rule them all' — Resources**

Historically, resources have frequently driven major local, regional, and global power struggles. Geopolitical conflicts often broke out over access to valuable resources such as oil, minerals, water, and fertile land, as control over these resources can significantly boost regional or national economies and influence. Beyond direct resource control, broader economic factors, including trade routes, market access, and economic dominance have also played a major role in conflicts. These factors are highly interlinked, and the distribution of resources still plays a crucial role in industrial development.

Two major resources, oil, and gas, have shaped geopolitics and the climate as we see it today, while critical minerals such as copper, cobalt, and lithium may shape the future of geopolitics and climate (see, e.g. Vontobel White Paper: The quest for resources, 2023). The longer the world relies on oil and gas, the stronger will be the position of OPEC members and other fossil fuel exporters.

However, the faster the green transition takes place, the more demand and geopolitical weight will shift to countries such as China, Chile, Australia or the Democratic Republic of Congo, all of which have and export resources essential for the green transition like copper, cobalt, lithium and other rare earth materials (Thompson, 2022).

# Geopolitics meets climate change

The relationship between geopolitics and climate change is symbiotic. While geopolitics affects climate change, the climate can also influence geopolitics via environmental factors, social dynamics, and political tensions. Climate change presents both risks and opportunities for countries and their economies.

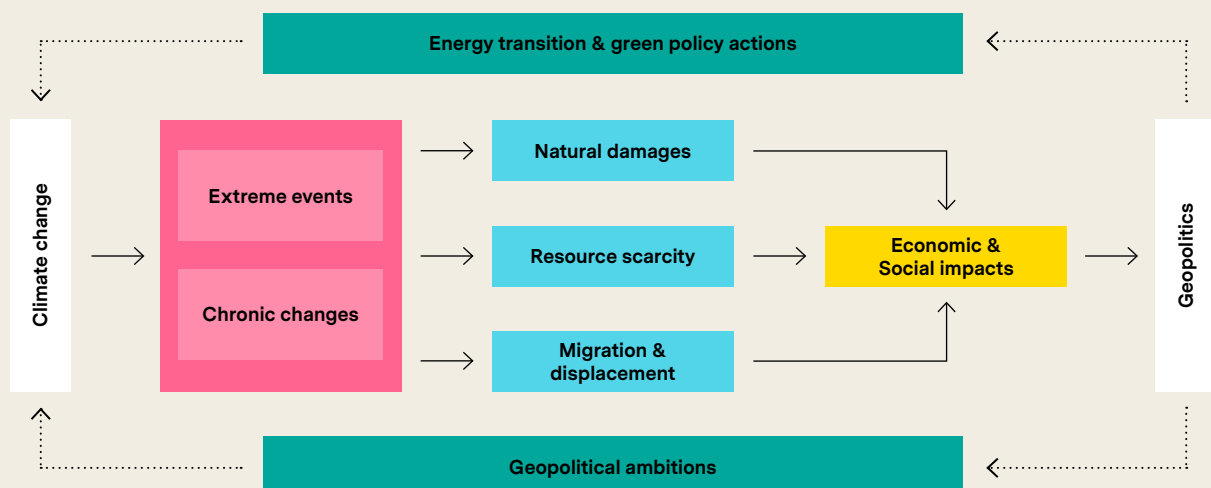
Overall, climate-change-related risks can be grouped into two categories: physical risks (associated with climate change directly) and transition risks (associated with transition to a low-carbon economy aimed at combating climate change). Physical risks are grouped into acute and chronic categories. While acute climate-change-related risks arise from climate and weather-related events such as hurricanes, extreme precipitation leading to floods and heatwaves leading to droughts, chronic risks are linked with slow changes in weather patterns such as increases in the global temperature, rising sea levels and the melting of ice sheets. Both acute and chronic risks cause significant natural damage and associated economic harm. With a changing climate, the planet is subject to an increased frequency and severity of extreme events, which are becoming more difficult to forecast and prepare for (Swiss Re Institute, “Insurance in a world of climate extremes”, 2019).

Transition risks are, however, tied to climate change mitigation. These are risks associated with the transition to a low-carbon economy and require climate policy implementation and support.

Spending on fostering the energy transition can help to curb emissions and resulting climate change, thus reducing the impact of natural disasters on regions and society. However, it comes with a cost. Yet, it is argued that such short-term spending will be much less than long-term economic damage from climate change (Stern, 2006). In addition, there is a time horizon misalignment: In the short term, any public spending that targets long-term effects may contradict the near-term incentives in the political agenda of some countries, especially those exposed to geopolitical conflicts.

The question remains: what are the areas most affected by climate change and how is climate change linked to geopolitics? This question can be answered by looking at the impact of climate change (see figure 2). Climate change impacts can be classified based on the time horizon of its effect: short-term effects are caused by extreme events while long-term effects are caused by chronic changes in weather patterns. This in turn leads to natural damage, resource scarcity, migration and displacement.

Figure 2: From climate change to the impact on geopolitics



## Natural damage

Certain regions, such as low-lying coastal areas, arid zones, and small island nations, are disproportionately affected by climate change. The intensification of severe weather events including extreme rainfall, high temperatures, increased number of hurricanes, wildfires, destruction of infrastructure and resulting fiscal spending leads to heightened unrest in the regions exposed to such events. These regions often face heightened geopolitical risks due to their susceptibility to climate-related disasters and economic vulnerabilities.

The Georgetown Security Studies Review cites the Syrian civil war as an example of this, arguing that governmental mismanagement of resources following the drought of 2006 intensified social unrest (Zack, 2019). Even regions not previously exposed to the consequences of extreme climate change impact are now suffering from them. The recent example of unprecedented flooding in Dubai, caused by an exacerbated El Niño effect, may lead certain countries to heighten their ambitions in fighting climate change, thus resulting in greater governmental and private spending on addressing emission reductions and/or development of carbon capture technologies.

The risks of natural damage also affect investments. For example, CatBonds serve as so-called 'insurance' for issuers against unpredictable natural disasters as they cover the cost of damage when a catastrophe occurs. This means losses for investors if a pre-defined catastrophe happens or high returns (which can reach up to 20%) in cases when the defined catastrophe does not occur within a specified period. This all makes CatBonds a highly risky investment that comes with the advantage of being not correlated usually with developments in financial markets, which can help to diversify an investor's portfolio.

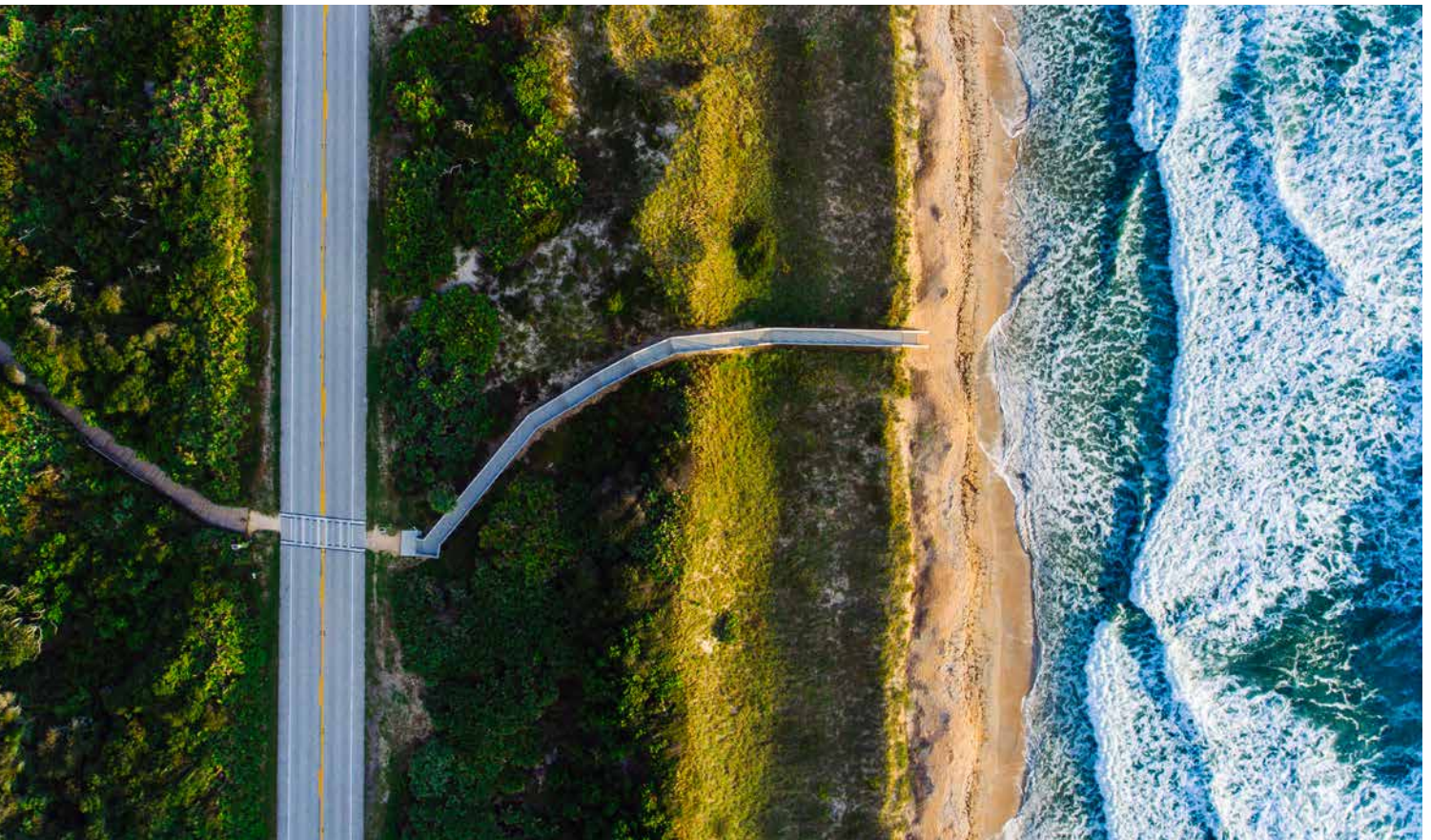


## Resource scarcity

Climate change can exacerbate the scarcity of resources such as water and arable land, leading to competition and conflicts over access to these resources. This competition can escalate into geopolitical tensions, especially in regions already prone to instability.

We expect resource scarcity to worsen shortages of key resources that are likely to aggravate over the coming decades (see, e.g. Vontobel White Paper: The quest for resources 2023). This is especially bad for the global economy at a time when global trade is hampered by geopolitical fault lines, trade is reduced, shortages are on the increase and prices too, potentially leading to disputes over resources. Think for example of the river Nile, which runs from Uganda via South Sudan and Sudan to Egypt but also carries a large amount of water from a second tributary starting in Ethiopia. Now, as climate change is accelerating, the regional powers are competing more and more for water — but also for food and energy security. As Ethiopia continues construction of its Grand Ethiopia Renaissance Dam (GERD), Egypt claims its neighbor is destabilizing the region.

As we will likely see more multipolarity on the global stage on top of the leadership struggle between China and US, this will, in combination with resource scarcity, make emerging market countries with a lot of resources turn into 'swing states' that oscillate between NATO-West and China-Russia-East. Also, the quest for resources will likely lead to a re-emergence of proxy wars, destabilizing weakly governed nations with important resources that can be exploited by other countries.



Clearly, energy-related resources are of particular importance. Climate change mitigation efforts, such as transitioning to renewable energy sources, can disrupt traditional energy markets and alliances. Countries rich in fossil fuel resources may see their geopolitical influence decline, while those mining or refining materials and minerals for renewable energy technologies are set to gain strategic advantages.

Energy security concerns have escalated since 2022 with geopolitical intensification. Europe, striving to cut dependence on oil and gas, has put several measures in place. In addition, the emergence of a number of EU regulations aimed at accelerating the transition to a low carbon economy could act as a tailwind for the energy transition. However, the current outlook is pessimistic, as there are several sources of friction. For example, the EU has proposed new import tariffs on Chinese electronic vehicles and aims to shield its domestic auto producers from Chinese competitors. This would be to the disadvantage of the consumers that will likely have to pay more for their Electric Vehicles (EVs). Such a move would most likely slow down the transition to electrified transportation in Europe.

## Migration and displacement

Climate change-induced events, such as rising sea levels, extreme weather events and droughts, can force populations to migrate in search of safer and more habitable areas.

Large-scale migration can strain resources and infrastructure in the receiving regions, leading to social unrest and potential conflict. Although migrants displaced by climate change can move both internally within their country and to another country, most climate migration stays within the country, without crossing international borders. Internal migration can also create social unrest and political turmoil in a country which can spread to other neighboring countries.

A recent IMF study showed that social unrest in one nation is likely to spill over into neighboring countries (Redl, C., & Hlatshwayo, S. 2021). According to the International Displacement Monitoring Center, in 2022, weather-related events induced by climate change displaced almost 32 million people (Ionesco, 2019). Migration also magnifies inequality because poor individuals often lack the resources needed for long-distance migration.



Regions affected by climate-change-induced migration include South Asia (India, Pakistan exposed to floods and drought, the Maldives sensitive to the rising sea levels), the Middle East (Syria and Iraq exposed to droughts), Central America and even North America (with the US, particularly California, Florida and Louisiana bearing the brunt of wildfires, hurricanes and rising sea levels).

Although the effects of climate migration are substantial, we believe they are long-term. If, at some stage, a more massive international migration caused by climate change were to occur, it would have huge implications for developing economies and could lead to social and political instability within developed countries.

Recent illustrations of such implications include the refugee crisis related to the Syrian civil war - and now the Russian-Ukraine conflict — in affecting Europe, but also the migration out of South America into and North America. This in turn may lead to changes in political stances and parties but could also find a reflection in the transition policies shaping the economy, thus affecting the future of climate change. It's important to note that even a small percentage of migrants moving internationally has the potential to cause a lot of political tension, as was illustrated by the arrival of Syrian refugees in Germany.

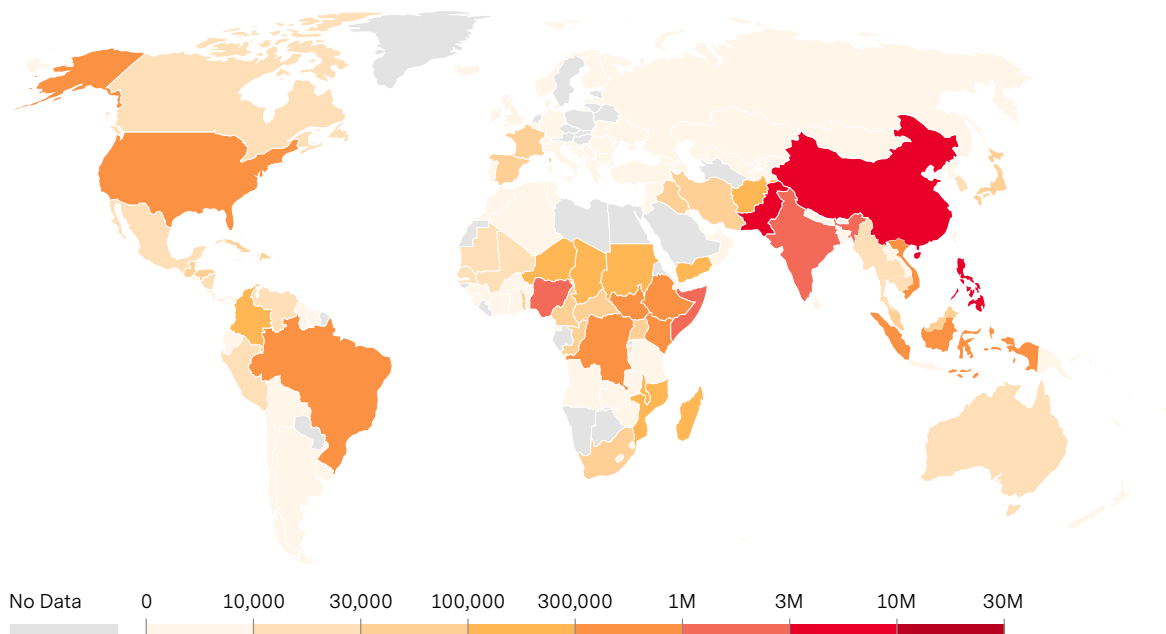
International migration is also becoming an increasingly important socioeconomic topic of wide debate in the media and policies, in e.g. Switzerland, Europe, the US and elsewhere, especially in light of its effects on migrants themselves, the countries they leave behind and the countries they migrate to.

With the impact of climate change increasing, the socioeconomic consequences caused by climate-caused migration are set to intensify with time. According to the Institute for Economics and Peace, 1.2 billion people could be displaced by 2050 due to climate change and natural disasters. This disproportionately affects poorer countries which already face many difficulties and have no means to take climate change adaptation measures.

Conflicts exacerbate the migration. According to the UN Refugee Agency, over 90% of all displacements in 2020 occurred in countries vulnerable to climate change. While climate change is not the main cause of relocation, it intensifies the problem.

**Figure 3: Natural disasters displaced a lot of people in 2022**

Internally-displaced persons are defined as people or groups of people who have been forced or obliged to flee or to leave their homes or places of habitual residence, as a result of natural or human-made disasters and who have not crossed an international border.



Source: World Bank 2024, University of Oxford, Vontobel.

## Economic & social impacts of climate change

Natural damage, resource scarcity, migration and displacement all have substantial economic and social impact. Their effects can be described as a direct result of climate-related events and indirect impact, both with various consequences for the economy.

### Direct impact of climate change

Climate-related events such as natural disasters and extreme weather events can have a significant impact on the economy. For example, the impact of El Niño on cocoa disrupted global supply chains in 2023–2024 and its effects are reflected in the recent almost doubling of chocolate prices. Floods, such that mentioned above in Dubai, can damage infrastructure and impact overall economic productivity. Hurricanes represent another example of extreme events exacerbated by climate change, with drastic consequences for livelihood, infrastructure and the economy of the affected regions. For example, Hurricane Katrina (2005) — the costliest hurricane in U.S. history — caused widespread destruction along the Gulf Coast, particularly in New Orleans. The total economic impact was estimated to be around USD 125 billion (Knabb et al. 2005).

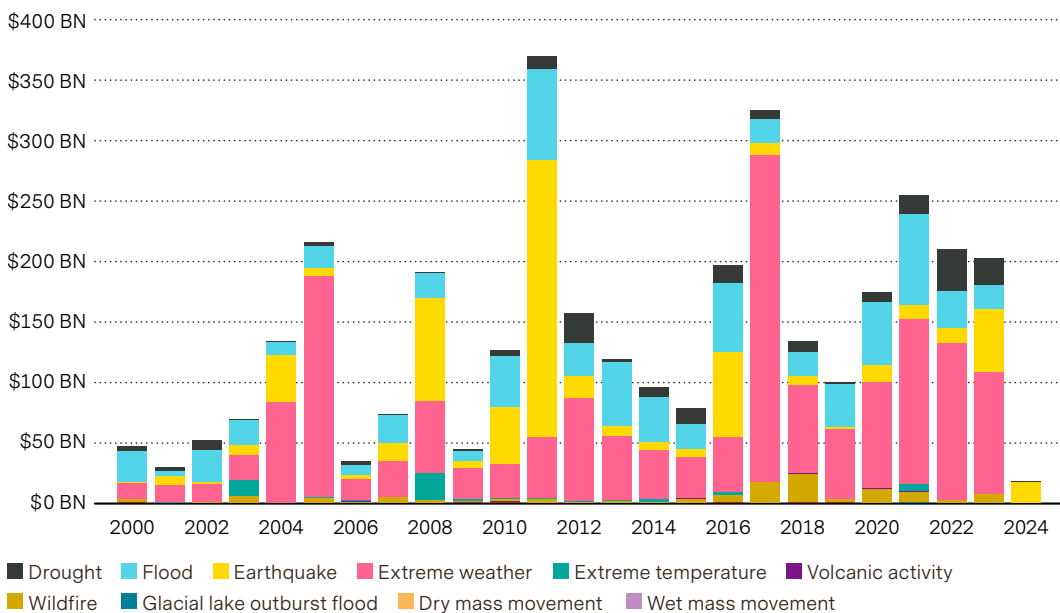
The Australian bushfires of 2019–2020 are another example of an extreme weather event with high costs. Unprecedented bushfires swept across Australia, burning millions of acres of land, destroying homes and devastating wildlife. The economic cost of the fires was estimated to be around USD 1.4 billion, making it one of the costliest natural disasters in Australian history.

Among the most recent events, European floods in 2021 were named as a significant disruptor for Europe. Heavy rainfall and flooding affected parts of Western Europe, particularly Germany, Belgium and the Netherlands. The floods caused significant damage to infrastructure, homes, and businesses, with economic losses estimated to be in the tens of billions of dollars.

Overall, damage from natural disasters has been estimated to total USD 380 billion in economic losses in 2023 alone, with only USD 118 billion of them insured (AON, “Climate Catastrophe Insight”, 2024). These direct economic shocks can exacerbate existing geopolitical tensions and contribute to political instability. Overall, direct damage from climate disasters in the past decade accounted for USD 1.3 trillion or 0.2% of global GDP per year.

**Figure 4: A lot of economic damage has been caused by natural disasters in the last years**

Global economic damage from natural disasters, differentiated by disaster category and measured in US\$ per year.



Source: Ritchie & Rosado (2022) with Data adapted from EM-DAT/ CRED/ University of Louvain, Vontobel.



### Indirect economic impact from climate change

On top of the direct impact of climate change, one needs to also think about the indirect effects of climate change on the economy, including affected transport routes for commodities and goods.

The global economy hinges strongly on supply chains for the resources necessary to produce goods and services and to keep or even increase the living standards of the population. These transportation routes and the countries that own or govern them are an important part of the geopolitical power play today and any shift in them can also alter the balance of power.

Negative effects of climate change also include long-term disruptions to economic activity and trade. For example, less water in certain regions of the world can hamper transport lines — as in the Panama Canal or the River Rhine.

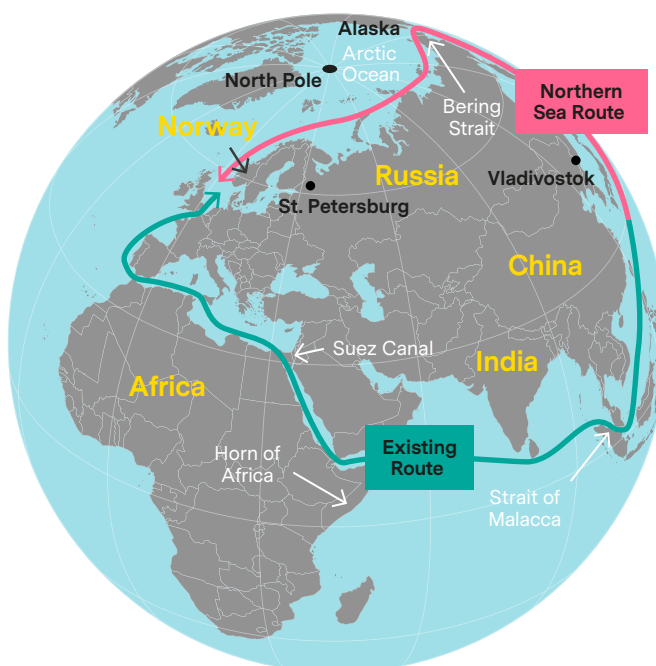
Yet warmer temperatures in certain regions can also make a positive contribution to the economy, for example in the form of shorter transportation lines. A good case in point is a thawing Northern Sea Route (NSR) that shortens the path between Asia and Europe by a factor of two in comparison with the traditional shipping route crossing the Indian and Atlantic Oceans and opens up additional possibilities for transportation (see figure 5).

As the Arctic is warming four times faster than the global average, scientific studies (Rantanen et al. 2022) project that it will become ice free in the summer of 2040 if the world does not reduce greenhouse gas emissions significantly.

However, use of the route has direct geopolitical implications: ships need to have the permission of Russian authorities to sail along the NSR, potentially resulting in restrictions for Western vessels on using it.

All these effects of climate change will affect the resource balance of countries and thus also the geopolitical balance of power. Particularly important is the energy transition that will likely disturb the current incentive system around the fossil energy trade.

**Figure 5: The positive side of higher temperatures: De-frosting the Northern Sea Route**



Source: The Economist 2024.

## Energy transition and mitigation of climate change

Climate change requires global cooperation to mitigate its impact effectively. However, geopolitical rivalries and conflicting interests among nations can hinder collaborative efforts, leading to diplomatic tensions and stalled climate agreements. This has been illustrated by multiple COP conferences, where questions of equity and fairness were raised in light of climate change agreements.

Conversely, climate change can serve as a catalyst for cooperation as countries recognize the shared threat and the need for collective action, as evidenced by the global COP meetings of the last decade. Last December at COP28, 'a global stocktake' of the world's efforts to address climate change was taken.

This year's actions will show how serious the countries are in their climate commitments. The deadline for taking action is not too far in the future, marking 2030 as a mid-point in emissions reduction, and material steps need to be taken to address climate change. In our view, the future of the Paris Agreement is in the hands of Europe, the US, China, India and Russia. It will be important for the climate agenda to track the geopolitical agendas of these countries as the conflict in Ukraine creates a dilemma for the EU on how to reduce its energy dependency towards Russia while not increasing its dependency on China because of resources needed for the green transition.

The US faces similar questions in regard to curbing China's influence: it provides military support for the Ukraine while at the same time, US and EU sanctions on Russian oil and gas imports depress the price of Russian fossil fuels for other important geopolitical players importing gas and fuels from Russia like China and India.

## Climate policy actions in different countries

When looking at the climate actions of the main players, it becomes apparent that they are introducing incentive schemes and regulations to tackle the issue of climate change. The most prominent example is the EU, with its European Green Deal — the EU strategy for reaching its 2050 goal of climate neutrality. This includes the Fit for 55 package, European Climate Law, Farm to Fork strategy and Just Transition (describing USD 55 billion over the period between 2021–2027 for communities and companies making the transition within member states or regions, European Council 2024).

The US has also made huge progress in this area by introducing the Inflation Reduction Act (IRA), which impacts power, transportation, buildings, industry, land, and the agriculture sector. Specifically, President Biden's climate agenda shows unwavering support from the current White House for EVs, and investments in clean energy sectors such as the manufacture of wind turbines, solar panels and batteries, while also boosting job creation. The IRA is expected to reduce deficits by a total of USD 276 billion from fiscal year 2023 through 2031, or 0.1% of the Congressional Budget Office's estimate of cumulative nominal GDP over that timeframe (Congressional Budget Office, Joint Committee on Taxation 2023).

China has also created several incentives for the energy transition, which could have a significant impact on combatting climate change, as it is the world's largest greenhouse gas emitter and the main source of emissions growth in the past two decades. However, China's emissions outlook remains uncertain. On the one hand, its CO<sub>2</sub> emissions will increase by at least 4% in 2023. On the other, record clean energy additions have nevertheless brought the emissions peak closer.

China's deployment of clean energy generation in 2023 has reached the scale projected in 1.5-degree scenarios. Maintaining annual additions of clean electricity production capacity at the 2023 level or increasing them further will enable China to peak and decline its CO<sub>2</sub> emissions in the coming years. But to successfully achieve a rapid decline in emissions, China will also need to increase its efforts to increase energy efficiency and engage in a successful transformation of the economic growth model.

Other important players are in the Middle East and North Africa. According to the IMF, investment of up to 4% of GDP annually is needed to sufficiently boost climate resilience and meet 2030 emissions reduction targets in the regions. Several countries in the Middle East and North Africa are already taking steps to alleviate the devastating impacts of climate change. For instance, Morocco, Jordan, and Tunisia have improved water management practices, helping to enhance their resilience amid prolonged droughts.

The UK is also stepping up its climate goals. This can be seen in the Climate Change Act, British energy security strategy, its industrial decarbonization strategy, and Energy Bill, all aiming to deliver a cleaner, more affordable and more secure energy system in the long term.

### Geopolitical ambitions may negatively affect climate mitigation efforts

Although climate initiatives by various countries play a major role in curbing green house gas (GHG) emissions and combating climate change, it is also important to consider how these pledges and regulations are affected by geopolitics.

Of course, the financial trade-off between spending more money on national security and the military and using it for action on climate will likely be intensified in light of recent geopolitical escalations.

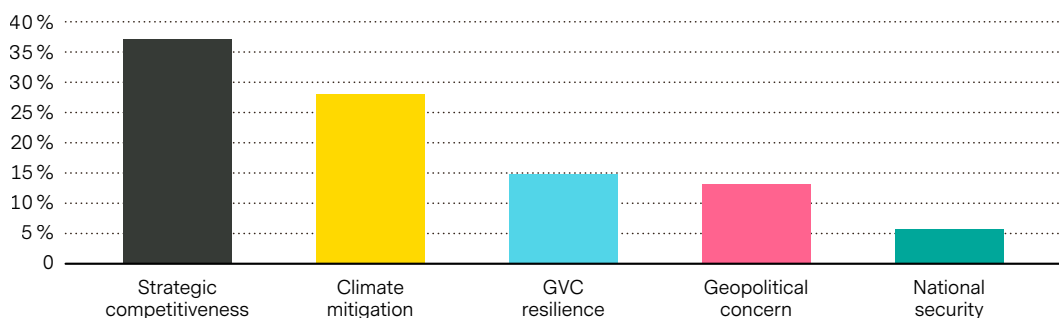
The Russia-Ukraine conflict and European and US financial support for Ukraine are an example of this. The money spent on warfare could alternatively been used to fund a green energy transition and fight climate change. Of course, not all countries face the same financial constraints and could also increase the total amount of spending in order to finance more defense but also increase spending on the green transition. But this usually comes with a higher price tag for interest payments and also intense bargaining at the political level.

Last but not least, some countries also use climate initiatives as an argument for implementing trade barriers and tariffs against other countries. They try to protect their own domestic firms within a certain sector from their foreign competitors. Countries also use subsidies or other industrial policies to protect and support their domestic firms and mask these interventions with climate reasoning.

This seems to be the case with several new interventions by the EU and the US that subsidize domestic companies and impose higher import tariffs for Chinese EV's with the aim of being more competitive in the market for electric vehicles and warding off competition in this space from China.

A new IMF report calculates that almost 30% of all the interventions in 2023 cite climate change as the most important motive among others for their actions with advanced economies account for the vast majority of these citations (see Figure 6). Advanced economies typically use subsidies for their domestic industries, but not towards the development of emerging economies (Evenett et al. 2024).

**Figure 6: 'Climate mitigation' has often been cited as a motive for distortive industrial policies**



Note: "GVC resilience" stands for global value chain resilience. Cumulative stock of measures. For measures with multiple motives, each motive is given equal weight. Source: Evenett et al. 2024 (IMF working paper), Vontobel.

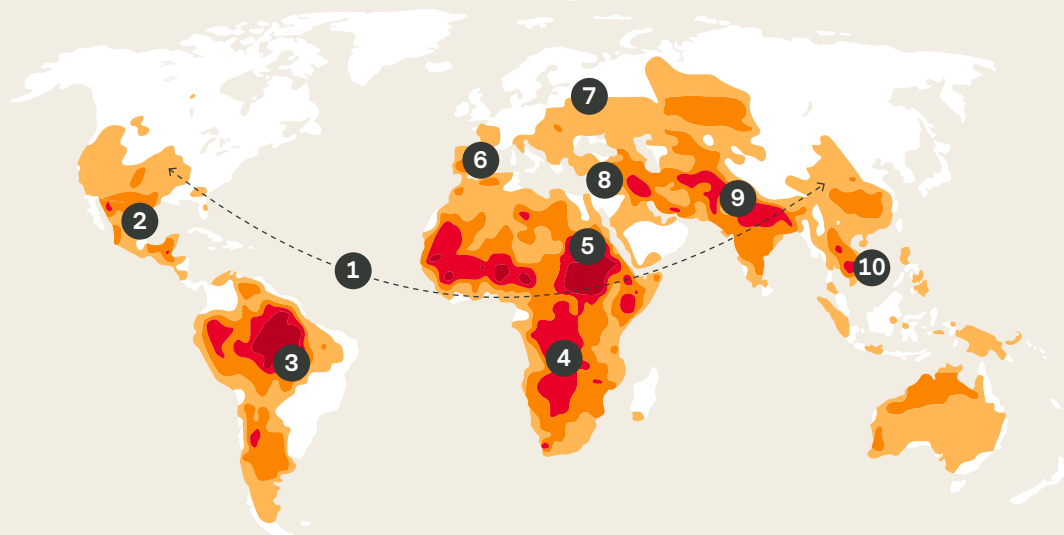
# Bringing it all together

In order to bring all the issues on climate change and geopolitics together, it can be useful to view them all on a representative map (see Figure 7).

On the one hand, it includes the regions that are expected to suffer most from a significant increase in the global average temperature and the collateral acute events triggered by long-term temperature shifts described under the extreme scenario of 4°C relative to pre-industrial levels (1850–1900, see UK Met Office 2024).

On the other hand, it also shows the current geopolitical hotspots. This representation highlights the interlinkage between climate and current geopolitical hotspots while identifying potential future issues in regions with high climate change vulnerability.

**Figure 7: When climate change meets geopolitical hot spots**



Number of high severity impacts of forecasted climate change.  
Impacts include extreme heat stress, river flooding, drought, fire weather risk, food insecurity.



Source: UK Met Office 2024 and Vontobel.

1. US-China power rivalry (arrow)
2. Migration into US from Latam (Mexico)
3. Latin America (Latam): Increased intra- and cross border migration due to extreme weather events
4. Africa: High political instability in several resource rich countries
5. North-East Africa: Political instability in several countries and struggles about resource access (Water conflicts)
6. Migration from Northern Africa to Europe
7. Conflict in Ukraine — Nato-Europe dispute with Russia & eastern EU immigration
8. Middle East conflict zone and impacts on water ways (Strait of Hormuz, Suez)
9. Central and South Asia conflict zones (particularly power struggles between India, Pakistan and China)
10. South-east Asian conflict zones and South-China sea disputes on water ways, islands and raw material deposits

When looking at the geopolitical hotspots from Figure 7, we see that climate change will also affect the US-China rivalry as both countries will be hit substantially by natural disasters, draining resources that could otherwise have been spent on their geopolitical ambitions. Similarly, the ongoing flow of migrants from Latin America into the USA may well be aggravated by climate changes occurring in Latin America over the coming decades.

Also, for Europe, the expected climate changes in Africa will probably induce more climate-driven migration across the Mediterranean Sea and aggravate the conflicts not only between African states but also within their borders due to migration, heat, droughts, flooding, and the resulting resource scarcities.

On top of that, resource-rich but politically unstable countries could become areas of proxy wars waged by geopolitically powerful nations trying to secure their access to certain resources, particularly those needed for the green transition. Several of these can be found in Africa, but also in Latin America.

The conflict zones of the Middle East are located in a region vulnerable to negative climate change impact, which can spur further disputes over arable land, water and access to other resources.

Finally, the negative climate impact predicted for South, Central and East Asia will add to the geopolitical rivalries that already exist in those regions. More extreme weather conditions in Central Asia will probably fuel more northward migration, while the negative weather impact in South Asia affects a region where India and Pakistan are already in a decades-long regional rivalry, with India also in an ongoing contest with China.

The South China Sea is another geopolitically important zone, where several countries will face substantial costs stemming from natural damage caused by climate change.

Interestingly, in many of these climate and geopolitical hot spots, there are elections and political contests going on, as we shall see in the next section.



# What comes next for investors and why does it matter?

## 1

### US elections in November 2024

If Donald Trump and the Republican Party win the election, it will most likely result in the US leaving the Paris Agreement, following the precedent set by Trump following his inauguration in 2017.

We will likely also see an attempt to reverse Biden's Inflation Reduction Act by a potential Trump administration, yet there will also be massive pushback from representatives in Republican states that currently profit significantly from the IRA.

However, we expect a Trump presidency to stifle the IRA in its current form, and in particular, to spend less in some 'green' areas and to allow more oil and gas extraction in the USA, making it difficult for the energy transition to gather further momentum.

## 2

### Hotspots: Europe, Russia-Ukraine, Middle East, Taiwan, and China

We anticipate a focus on further outcomes in the Russian conflict with Ukraine, as it will impact the EU's decision on how much it will spend on military aid and national security and how much it can spend on climate action.

The latest outcome of the EU parliamentary elections made clear that the current political trend in Europe is to place greater emphasis on national security, immigration, and geopolitics and less on climate action. In addition, ongoing tensions between Taiwan and China in combination with a US reaction may completely shift the focus from climate change to national security for several years to come.

Although we do not see such a scenario playing out in the next few years, this scenario is still worth considering for investors.

## 3

### The EU's political position vis-a-vis China

As China is an important producer of many metals and minerals (particularly rare earth elements) for the green transition, the EU's green transition and the quest for independence from Russian energy is also a balancing act with China.

It remains to be seen how the strong results for national-conservative parties across Europe will inform the EU's political stance towards China. The latest EU announcements on raising tariffs on imports of EVs point towards a more protectionist EU trade policy against China. On the other hand, China informed that the country seeks to regulate the export of rare earth elements (Woo and Holmes, 2024).

Such a policy typically makes it more costly to achieve a green transition as it stops low-cost imports from reaching targeted countries, such as China, but it might raise the domestic acceptance for public spending on a green transition.



## 4

**China's climate goals**

Investors need to watch for any further shift in China's priorities between its climate goals and its investment on national security targets linked to its geopolitical ambitions. Any *hotting up* of a potential conflict with the US, Australia, and its allies in the South China Sea or with Taiwan could distract Beijing from spending money on climate action and would obviously also trigger more defense spending on the part of all the involved parties.

Also, any shift away from China's current model of an export-orientated economy with strong public investment in domestic consumption model with elevated export tariffs would reduce global access to low-cost elements for the green transition such as solar panels, batteries or certain metals and minerals.

## 5

**India's general elections**

India's general election outcome this year did not substantially change the government, and although the country is among those regions of the world most affected by climate-change-induced natural damage, neither the ruling party that prevailed in the elections nor the opposition focused on climate action during the recent election campaigns.

Their party manifestos do not prominently feature climate action and do not aim at spending significantly more on it in the future.

It seems that India's politics will not shift its focus (and spending) away from economic growth targets, national security, and geopolitical ambitions in favor of climate policy. This also reflects the country's increasing geopolitical importance as it can leverage its position between the West — primarily the US and EU — and China.



**“There appears to be no way to escape a strong focus on ‘transition-proof’ investments for investors that are aiming to deliver ‘future-proof’ solutions for their portfolios.”**



# Final considerations for investors

The prospects of a new US presidency for Donald Trump and the anticipation of a less 'green' EU parliament after the latest elections, in combination with the conflicts in the Middle East and Ukraine, have weakened markets' sentiment for sectors benefitting from the green transition. These geopolitical effects came on top of cyclical effects such as the increase in interest rates and the depressed margins driven by global overcapacities in certain sectors instrumental to the green transition.

Having said that, any conflicts that might become more acute to an extent that would significantly hamper global supplies of fossil energy (think of a closure of the Strait of Hormuz) could, on the other hand, also foster the green transition by making plain the energy dependency of countries and governments that are not allied.

These developments are putting 'green' sectors under pressure, although the long-term transition towards a more sustainable electrified economy with renewable energy and more efficient grids seems inevitable. On the flip side, in the short and medium term, nuclear energy and fossil fuels will still be needed until the green transition is achieved.

Any substantial green transition will dramatically redistribute the geopolitical balance of power, as countries with resources that are crucial for the energy transition and the associated technologies gain greater influence in the geopolitical powerplay — to the disadvantage of the countries that have leveraged their fossil energy resources over the last century. However, this transition will not happen overnight.

In such a transitional period, investors should consider both the ongoing need for fossil fuels during the transition and the long-term benefits of being invested in sectors that will benefit from this transition over decades.

Geopolitical developments in the short but also the long-term will shape this transition and there appears to be no way to escape a strong focus on 'transition-proof' investments for investors that are aiming to deliver 'future-proof' solutions for their portfolios.

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