



# Chaos in the new Middle Ages

Monday, April 29, 2024

## Available reports

- Global Financial Markets
- Global Political Analysis
- Interest Rates Outlook
- Currencies Outlook
- Monthly Chart Pack
- Strategic Asset Allocation
- Tactical Asset Allocation
- Money Talks, Money Walks
- Fund Selection
- Technical Trend Outlook

## Questions or Comments?



Andy Langenkamp

+31(0)30 232 8000

ecr@ecrresearch.com

## Why join ECR Research?

- ✓ Outspoken mid-term analysis
- ✓ Based on world's leading research
- ✓ +40 years' experience, 3500 readers
- ✓ 10 research titles
- ✓ Tailor made subscriptions

## ≡ CONTENT

<b>1. MEDIEVAL AFFAIRS AND A GREY AREA</b>	<b>2</b>
<b>2. PEAK CHINA?</b>	<b>3</b>
<b>3. A BRUSH OR A HEAD-ON COLLISION?</b>	<b>6</b>
<b>4. CONSEQUENCES FOR MARKETS &amp; ECONOMY</b>	<b>7</b>



## Medieval affairs and a grey area

"The world today is undergoing a great change in situation unseen in a century. Since the most recent period, the most important characteristic of the world is, in a word, 'chaos,' and this trend appears likely to continue," [Chinese leader Xi Jinping said](#) in early 2021. This observation - where, incidentally, Xi mainly saw and sees opportunities for China - is in line with [a recent report by the US think tank Rand](#), which describes the current situation in the world as *neomedieval* on the basis of five trends that have strong similarities to the Middle Ages and that strongly distinguish the current state of affairs from that of the last decades:



- » **Weakening states:** governments struggle to maintain legitimacy and there are concerns about domestic security, and they struggle to maintain levels of prosperity, services and opportunities for their citizens.
- » **Fragmenting societies:** national unity is generally undermined by polarisation, discontent, culture wars and so on.
- » **Unbalanced economies:** growth will increasingly be concentrated in a few sectors, and this will exacerbate problems of entrenched inequality and stagnant social mobility, for example.
- » **Ubiquitous threats:** The proliferation of risks - such as natural disasters, pandemics and violent non-state actors and war - creates a sense of permanent threat.



» **Informalisation of warfare:** Armed forces increasingly consist of professional troops supplemented by private security companies, mercenaries and armed militias. Older combat methods are being revived, as we have seen in the trench warfare in the Ukraine.

Once powerful governments are struggling to hold the reins; politics is more polarised, attitudes have hardened and willingness to compromise is seen as a sign of weakness. Inequality, social unrest and divisions have increased. In the US, only about 20 per cent of people trust the federal government to do the right thing. The biggest challenge in recent history, the corona crisis, drove people apart rather than bringing them together.

Inequality is also rising in China and economic growth is slowing. Leaders increasingly rely on repression to maintain order and authority. China's internal security budget has exceeded its defence budget for more than a decade.

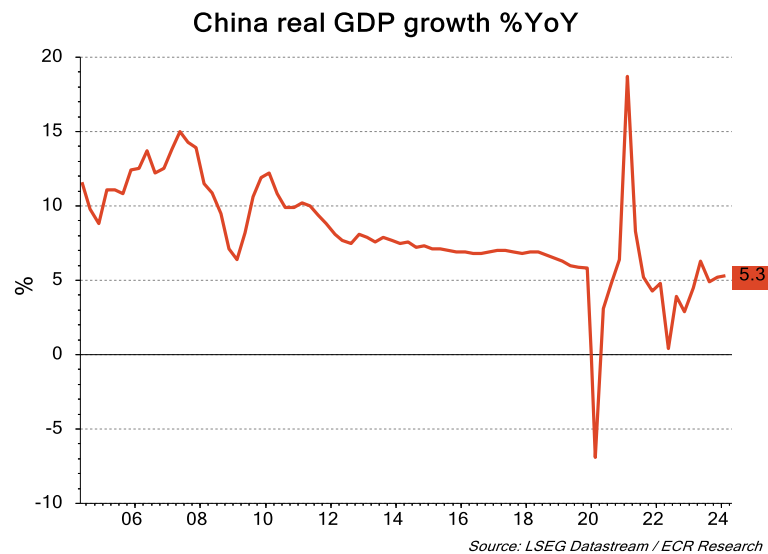
Because of this state of affairs, China and the US do not seem to be in a position to engage in full battle with each other any time soon. The weaknesses of the two states and the internal challenges they face make it too risky to enter into a conflict in which the two are directly at loggerheads; also because rulers cannot assume that citizens will rally behind a war effort that requires real and sustained sacrifices. In the process, other threats – a possible next pandemic, climate change, political unrest – will compete for attention and resources.

The above means that the US and China will be under pressure to avoid unnecessary escalation in the event of crises. The result is likely to be a (very) protracted, low-intensity conflict, rather than the all-out war regularly warned about in the most alarming analyses. This is not to say that we will not see intense escalation. For example, a Chinese blockade of Taiwan is a possible scenario. In all likelihood, however, the battle between China and the US will be fought in a grey area of cyberspace and economic arenas, among other factors.

## Peak China?

Some analysts are convinced that China is already at or past its peak (we have written about this before), but this is too premature a conclusion. And even if China stagnates, it is still an immense superpower, and one of the parties that will call the shots in the world in the coming years and decades; especially if America is terminally ill, as Xi Jinping and others in the Chinese elite seem to believe.

Supporters of the Peak-China theory base their conclusion, among other things, on weakening economic growth, the ongoing crisis in the property sector, outbound capital flows and unrest within defence (e.g. the forced departure of defence and foreign ministers and the problems within the defence department responsible for nuclear weapons, for example).



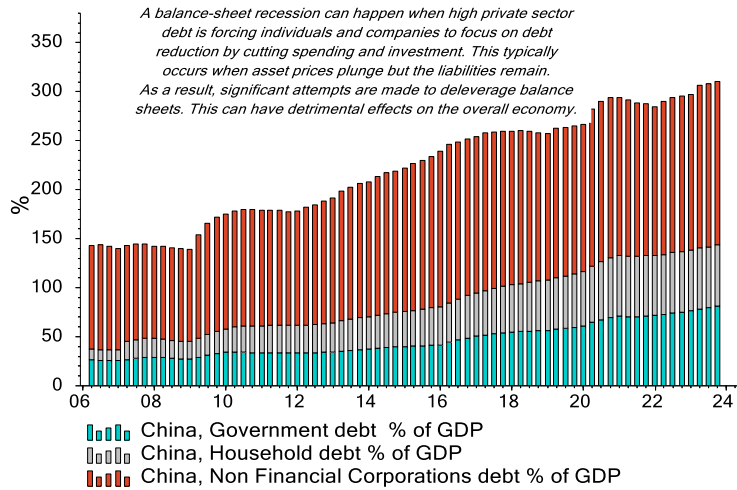
The above problems are fairly serious, but certainly do not mean that the situation will only get worse for Beijing from now on. First of all, we must remember that economic power does not equal geopolitical power. So even if China were to continue to struggle economically, this would not necessarily mean that its role on the world stage is waning. In any case, Xi will show no sign of taking a step back. In 2021, he said China is closer to the spotlight of the world stage than it has ever been and is in the process of its rebirth. China's intelligence chief added "the East is rising and the West is waning."

The aforementioned supposed signs of weakness do not even have to mean vulnerability. Xi has increasingly made himself and the CCP the centre of politics, the economy and society and has neutralised potential competing forces (think back for a moment, for example, to how former President Hu Jintao was led out of the National Congress in front of the cameras). And the ease with which Xi sidelined his confidants in China's defence and foreign affairs departments may be a sign of strength rather than vulnerability.

Also, the economic weakening seems to be partly a conscious choice by Xi. The old growth boosters – property, infrastructure and processing trade – have seen their best days and will only make China more vulnerable if it continues to rely too much on these elements. Beijing therefore chooses to shift its focus to green energy, EVs and batteries and accepts that this means it must initially suffer some pain. As [Evan S. Medeiros writes](#) in *Foreign Affairs*, "Xi has embraced austerity and tried to revive the spirit of sacrifice, self-reliance, and egalitarianism that characterized earlier eras of Maoist rule."

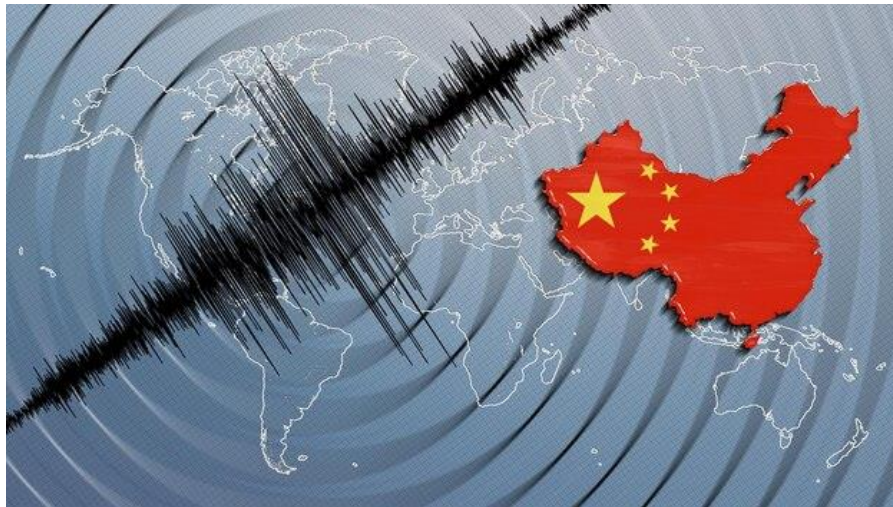


## Does China face a balance sheet recession?



It should not be forgotten that while China may be swallowing a bitter pill here and there, it is a superpower in a variety of fields whose advance is not yet over:

- » China is still the world's largest exporter.
- » It is the largest creditor on earth.
- » It leads the way in several industries that will be essential in the coming decades, such as EVs and batteries.
- » It is by far the leading player in the market for rare earths and other essential commodities.
- » It has one of the largest and most advanced armies in the world, and it conducts joint exercises with more and more countries and provides training to a growing number of states.
- » It currently has more embassies and consulates than America.
- » CNN's Chinese counterpart has twice as many foreign bureaus as CNN, and China's news agency Xinhua has 180 offices worldwide.
- » Through four [initiatives, China is anchoring](#) itself ever more firmly on the international diplomatic, economic and military world stage: the *Belt & Road* (2013), *Global Development* (2021), *Global Security* (2022) and *Global Civilization Initiatives* (2023).



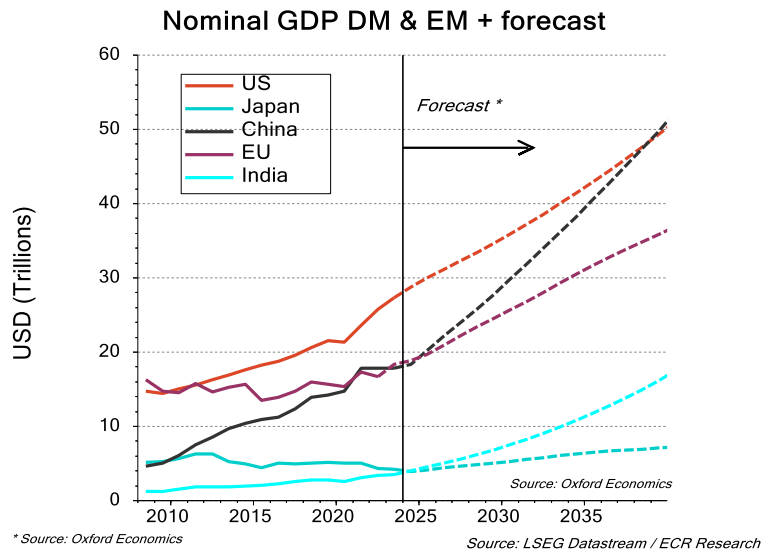
- » The BRI has greatly increased Chinese economic influence. The BRI is firmly embedded in UN structures and roughly 150 countries have joined it. For example, Huawei supplies 70% of all 4G technology in Africa. Incidentally, there are signs that the BRI is past its peak: Italy – the largest economy within the BRI project besides China itself – has pulled out, and in recent years China has invested considerably less in the initiative than it did in the early years.
- » The GDI targets development in a broad sense (poverty, climate policy, healthcare, food security) with now over 50 projects and support from over 70 countries.
- » According to Beijing, the GSI aims to prevent a Cold War mentality, bloc formation and unilateralism in international relations and, at least in words, has the support of more than 100 countries and international organisations.
- » The GCI has been the least successful so far. This initiative argues that different cultures and varying levels of prosperity also call for a variety of political and economic models.

## A brush or a head-on collision?

Not surprisingly, many US administrators and military men are getting restless in the neomedieval international climate, with an immensely strong China despite all its problems and difficulties. China is therefore one of the few dossiers on which Democrats and Republicans can still regularly find common ground. However, this only goes so far. Indeed, within the Republican party, there are also quite a few voices claiming that despite a fairly hard China line, the Biden administration is still far too soft on Beijing. For example, Matt Pottinger (who served on the National Security Council under Trump) and Mike Gallagher (Representative from 2017-2024) write: *"The Biden team's policy of 'managing competition' with Beijing risks emphasizing processes over outcomes, bilateral stability at the*



expense of global security, and diplomatic initiatives that aim for cooperation but generate only complacency. The United States shouldn't manage the competition with China; it should win it."



People such as Pottinger and Gallagher support continuing Trump's tariffs on Chinese imports, tightening export controls on high-grade chips and the machinery to make them, and establishing and driving international partnerships to rein in China (including the Quad and AUKUS). According to critics, however, it all still amounts to far too little. In their view, Xi is still able to gain ground far too easily on the global chessboard via support for Russia, cooperation with North Korea and Iran, (disguised) support for Hamas, et cetera.

Biden and his team are playing dangerous games according to Pottinger and Gallagher by opting for a détente strategy, as attempted by Nixon and Kissinger towards the Soviet Union. It was a total failure in their eyes with the ultimate proof being the Soviet invasion of Afghanistan. Only with Reagan was a harder stance adopted and success achieved.

Contemporary hardliners argue that America must first ramp up tensions by taking a harder line against Beijing in order to bring about more stability and calm in the longer term. This includes sharply increasing defence spending, restoring US primacy in Asia and more American troops within firing range of China. But it also includes removing China's permanent normal trade relations status so that an even more protectionist policy can be pursued towards China. Also, US society as a whole should wake up to the fact that China is an enemy, which would prompt Americans to stop using TikTok altogether, for example.

## Consequences for markets & economy



Given the above, tensions between China and the US are likely to increase rather than decrease (and they will likely turn into a decades-long struggle). And not just if Trump wins the election and Republicans take over (for the most part) in Congress. [For example, Biden recently said:](#) "We don't let tyrants win; we oppose them. We don't merely watch global events unfold; we shape them. That's what it means to be the...indispensable nation. That's what it means to be the world's superpower and the world's leading democracy." Such statements leave little room for China.

The measures against companies back and forth are also not to be underestimated. Beijing is making it increasingly difficult for American companies to do business with China in a normal way (what with China conducting raids on consultancy firms, forcing Apple to remove WhatsApp and Threads from its app store, et cetera). However, Washington is also tightening the thumbscrews with, for example, the recent decision that the Chinese owner of TikTok - ByteDance - must divest itself of the app within less than a year.



The biggest economic battle in the near future will focus on green technology, high-grade chips, apps, batteries, AI and so on. We will see more attempts by Washington to obstruct China's technological advance, and Beijing will try to circumvent import tariffs and so on by setting up factories in Mexico and Europe, for example. Ultimately, the tech wars may well result in the world being roughly split into two blocs with different technology (standards). This will [slow global economic growth](#) and likely impede climate change control policies.

In the event of bloc formation with the US leading on one side and China on the other, shares of Western companies that lean heavily on China will be dealt blows (e.g. the luxury goods sector) and Western companies that focus far more on domestic markets may actually benefit. European shares in particular are strongly related to exports. [According to Morgan Stanley](#), over 60 per cent of the market capitalisation-weighted revenue exposure of the MSCI Europe index is from regions outside of Europe, in particular the US, accounting for 25 per cent. Thus, with more economic and geopolitical

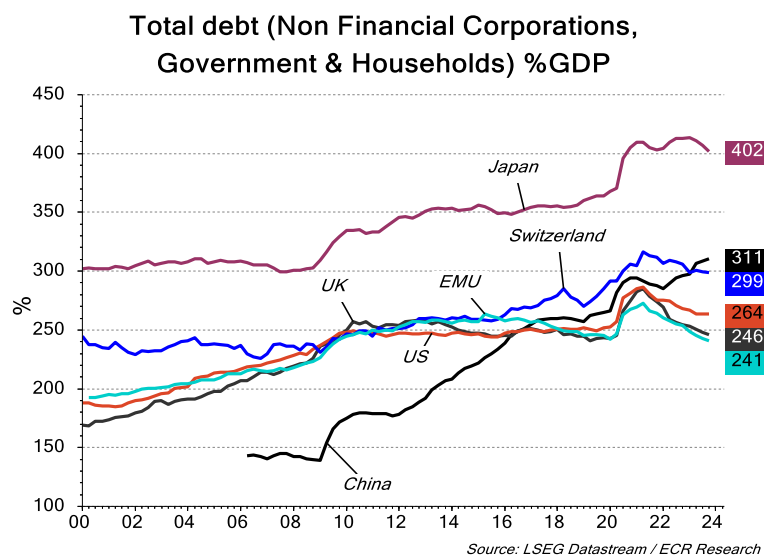




fragmentation, European shares seem very vulnerable; especially if America and Europe grow further apart in the process.

In this geopolitical climate, it is essential for the West that the US and Europe move forward together. However, the two are uncertain about how they can benefit each other, and the transatlantic relationship will come under considerable pressure, certainly in the event of a Trump victory. America has long been (rightly) pressuring Europe to spend more on defence. However, if the US increases this pressure too far, there is a chance that Europe will go overboard and become a tough superpower that can and will afford to pursue a path more independently from Washington. This, in turn, will harm the West. On the other hand, Europe does not like how America sometimes uses/abuses its dollar hegemony. But if Europe were to actively participate in weakening this dominance, it could thereby also punch holes in the US security umbrella, playing into the hands of China and Russia.

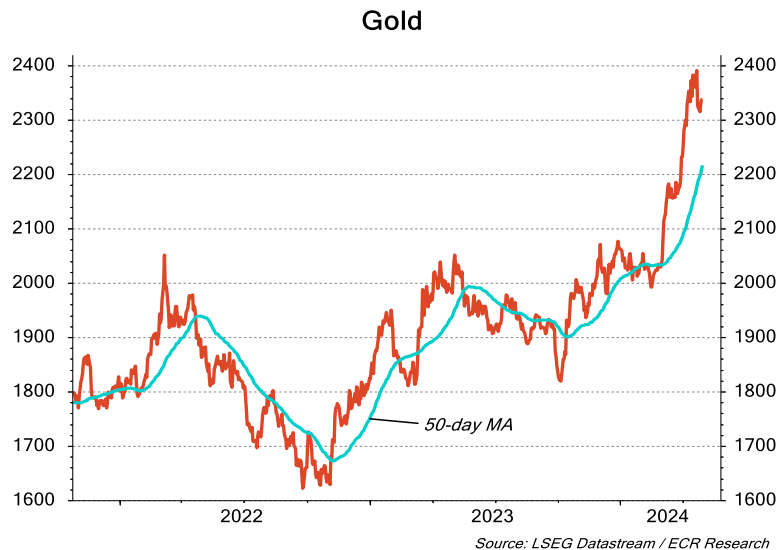
Speaking of defence and dollars, defence spending is rising sharply due to increased geopolitical tensions: up 7% globally last year to 2.3% of global GDP (adjusted for inflation). There is a risk that, in their attempts to buy more security by deterrence via more defence spending, states actually increase insecurity by triggering a spiral in which states are forced to spend more and more on their armies because others are doing it too.



Incidentally, Western countries' defence budgets are still nowhere near spending levels at the height of the Cold War, but research shows that any additional military spending is typically financed with additional borrowing. In all likelihood, this will also be the case now, as the political scope for tax hikes seems very limited, and it is also unlikely that economic growth will increase significantly any time soon. The combination of a high probability of ongoing and mounting geopolitical frictions and consequently rising military spending and a low probability of substantial tax hikes makes additional upward pressure on long-term interest rates almost inevitable. In times of uncertainty, however,



bonds from safe havens, such as the US and Germany, can benefit from an influx of investors seeking stability. This may slow the interest rate increases for these countries somewhat.



The aforementioned developments will also benefit the gold price. Gold is traditionally seen as a safe haven in times of geopolitical tensions and uncertainty. It has intrinsic value and is seen as a hedge against inflation and currency devaluation. Geopolitical fragmentation will increase transportation costs and production costs and diminish sales markets. This will exert upward pressure on inflation. This also applies to the trend of sharply increasing defence budgets without adequate financial backing.

**DISCLAIMER**

© ECR Research BV, The Netherlands. All rights reserved. No parts of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without the prior written consent of the copyright owner. This publication is intended as general background information and not as definitive recommendation. The publishers and authors accept no liability whatsoever for any damage that may be incurred in connection with this publication should you consider concluding transactions on the basis of information supplied in this report.