



# TOP RISKS 2026

Ian Bremmer  
*President*

Cliff Kupchan  
*Chairman*

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Deglobalization  
Spheres of influence  
Sell America



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2026 is a tipping point year.

It's a time of great geopolitical uncertainty. Not because there's imminent conflict between the two biggest powers, the United States and China—that isn't even a top risk, it's a red herring this year. There's not (yet, at least) a second Cold War, with a rising China remaking the global system to its own liking, the Americans and allies resisting. Nor do tensions between the United States and Russia threaten to spiral out of control despite a war raging in Europe, the result of Vladimir Putin's longstanding grievances against the US-led order.

The United States is itself unwinding its own global order. The world's most powerful country is in the throes of a political revolution.

In our lifetimes, we have never witnessed an American president so committed to and so capable of changing the political system and, accordingly, the United States's role in the world. Franklin D. Roosevelt was the closest and, as you'll see in the report, the comparison is lacking. Whether Donald Trump's revolution succeeds or fails, the implications for the United States and the broader world will be felt for a generation.

For other countries, the United States has become unpredictable and unreliable.

Responding to this new reality has become an urgent geopolitical endeavor. Some will succeed: China is today in a stronger geopolitical position accordingly; so too are India and the Gulf states. Others will fail: Europe is now surrounded by adversaries and probably too late to remake itself effectively. Others will defend themselves, hedge their bets, and find ways to muddle through as best they can: Canada, Mexico, and much of the Global South.

In the interim, we'll see a lot of instability. The world today bears witness to some 60 active conflicts, the most since World War II. And while some will resolve into ceasefires, few will become stable. Because at a time of disruption, most everyone is concerned principally with making sure their own house is in order.

All of which is happening in the midst of extraordinary technological revolution, an AI boom that represents the greatest opportunity and danger humanity has ever created. And it comes with next to no governance, alignment, or coordination.

What a time to be alive. And what a time to present our Top Risks report for 2026.



# 1 US political revolution

**The United States is experiencing a political revolution: President Donald Trump’s attempt to systematically dismantle the checks on his power, capture the machinery of government, and weaponize it against his enemies. Last year, we warned about the “Rule of Don”; what began as tactical norm-breaking has become a system-level transformation beyond partisan hardball or executive overreach—qualitatively different from what even the most ambitious American presidents have attempted (please see Box 1: Trump vs. FDR). With many of the guardrails that held in Trump’s first term now buckling, we can no longer say with confidence what kind of political system the United States will be when this revolution is over.**

In Trump’s view, he overcame a rigged election, two partisan impeachments, dozens of unjust felony convictions, and two assassination attempts—one a whisker’s breadth from killing him—to stage the greatest political comeback in American history. President Trump sees the principal threat to him and his allies as domestic, not external, and he believes he has a mandate for retribution. The administration views this project not as an assault on democracy but as its restoration, a necessary purge of a political system captured by a deeply corrupt establishment that had already weaponized government against them. Over 77 million Americans voted for Trump in 2024, and many of them sympathize with that diagnosis: Among 2024 voters who said democracy mattered to their decision, a majority chose Trump—not because they saw him as a champion of democratic values, but because they believed the system was already broken and wanted someone who would disrupt it. “Trumpism” is structural, and at this most fundamental level, Trump’s supporters are getting what they asked for.

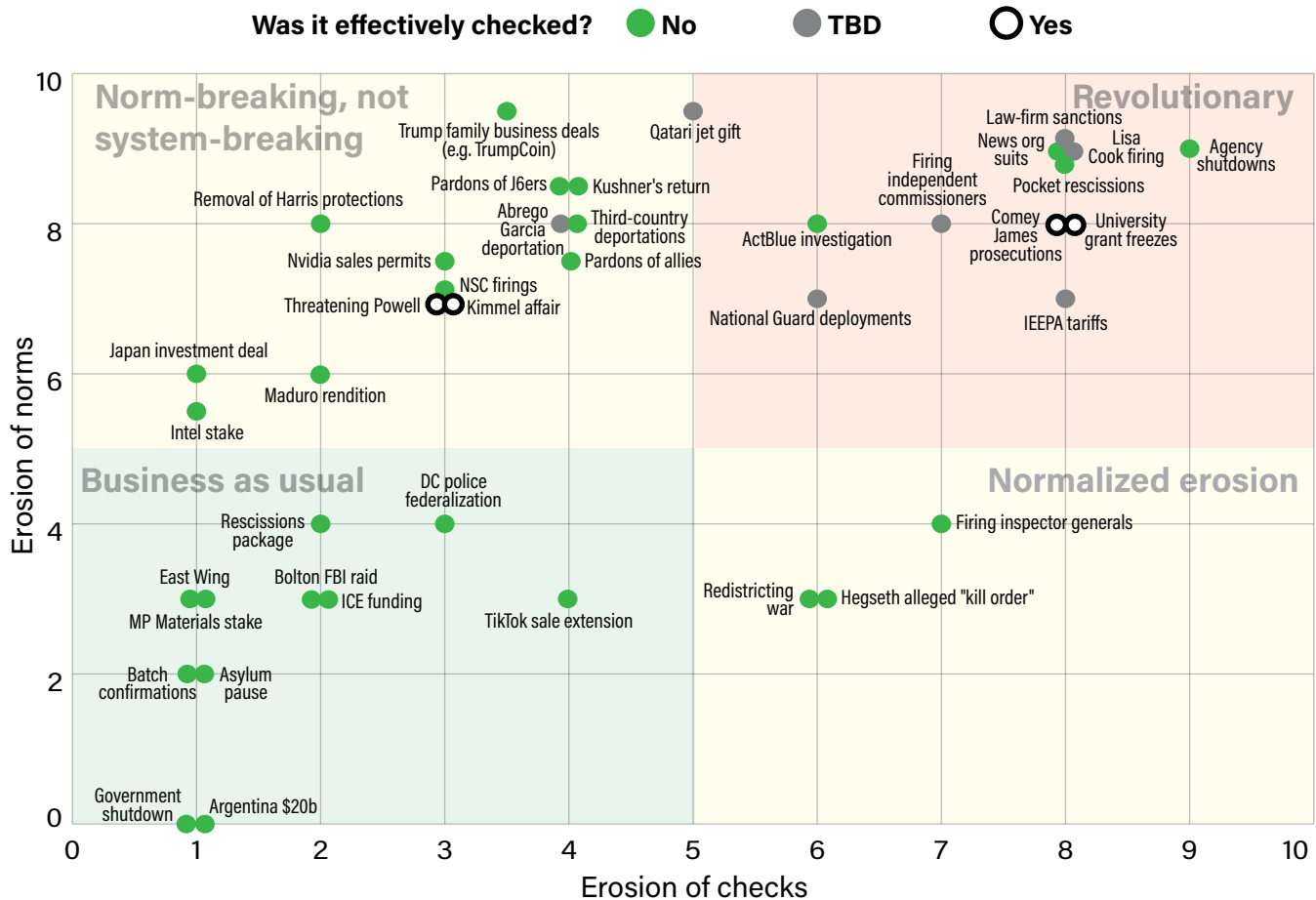
In 2025, the administration moved to politicize the state accordingly. Career civil servants were purged for political rather than performance-related reasons, from investigating corruption and providing unwelcome intelligence assessments to having ties to political enemies. Inspectors general, ethics watchdogs, and independent agency leaders were sacked.

The power ministries—especially the Justice Department and the FBI—became fully political arms of the White House, stripped of the operational independence that had insulated them since Watergate. Media companies, law firms, and universities faced investigations, lawsuits, and threats designed to force compliance.

Eurasia Group's *Governance Tracker* captures this record, plotting high-profile administration actions along two dimensions: how much they break with established norms, and how much they erode institutional checks on presidential power (please see chart below). Actions that score high on both are the most “revolutionary.” Many of the administration's tracked actions cluster in that quadrant.

## Stacking up Trump's executive actions on the *Governance Tracker*

Higher x-axis values indicate greater erosion of institutional checks on presidential power  
Higher y-axis values indicate greater departures from established norms and precedent



Source: Eurasia Group

The chart plots select Trump administration actions along two dimensions.

**Erosion of checks (x-axis):** How much each action weakens constraints on presidential power—courts, Congress, independent agencies, inspectors general, civil service protections, and societal checks like the press and legal profession—making similar actions structurally easier in the future.

**Erosion of norms (y-axis):** How much each action departs from established practice and precedent in US federal government—things presidents haven't historically done, even if they legally could.

**Color** indicates whether each action has been effectively checked: green means no (succeeded so far); gray means contested or uncertain; white means yes (blocked or failed to achieve objectives).

The tracker is not comprehensive; actions were selected based on their significance to the administration's governance agenda. Scores reflect Eurasia Group analyst assessments. A detailed methodology note will be published separately, and the tracker will be updated as events develop.

Checks have been weaker than expected. Congress largely went along with the administration's policies. The Democratic Party, divided and leaderless, struggled to mount effective resistance. Most would-be Republican dissenters were cowed by the threat of primary challenges and political exile. The corporate media, fearful of retaliation, self-censored and softened its coverage—normalizing behaviors that would have seemed outrageous in 2017. Large media and tech firms chose to pay Trump millions to settle winnable lawsuits rather than face retaliation. Business and financial leaders, privately uncomfortable but unwilling to risk the consequences of speaking out, stayed silent. The administration did repeatedly lose in court, but it also exploited the gaps in a legal system that couldn't keep pace with their actions. And the Supreme Court, one of the most effective and powerful checks on executive power, often acceded to Trump's revolutionary push—not least because the conservative majority appears receptive to the administration's maximalist conception of presidential power, known as unitary executive theory. The result, as the chart shows, is that most of the administration's tracked actions have succeeded so far, including several in the revolutionary quadrant. Even actions that face legal challenges have often already achieved their strategic purpose: law firms and news organizations have been chilled regardless of whether the suits ultimately prevail.

In 2026, the revolution will continue. With only three years left and Democrats favored to take the House of Representatives in November's midterm elections, Trump and his inner circle will grow more, not less, risk-acceptant in their efforts to entrench the president's power and cement his legacy before the window narrows. The machinery of government will be wielded aggressively against the president's enemies. The administration has already launched investigations into Democratic fundraising platforms, donors, officials, and candidates. Companies that employ prominent critics will face investigations and regulatory retaliation; executives who criticize the White House will be singled out; foundations that donate to Democrats risk dragged-out fights over their tax-exempt status. The effect will be to make public criticism of and opposition to Trump costlier.

The jury system and the courts will remain a bulwark—convictions require indictments from grand juries and unanimous verdicts from randomly selected citizens, upheld by independent judges—but investigations and prosecutions will be draining enough to deter individual resistance and collective action at the margin. The strategy is already proving effective. Major Democratic donors face the threat of investigations and government retaliation. Foundations are scrutinizing grants that could be criticized as partisan. Large law firms are turning down clients who want to challenge Trump policies and doing billions of dollars in free legal work for the administration.

Media companies will be further cowed through lawsuits and regulatory threats—or co-opted as Trump-aligned investors win Washington's approval to acquire major platforms in exchange for favorable coverage. The Ellison family's takeover of Paramount gave it control of CBS; it signed a deal for TikTok's US operations and is now pursuing CNN's Warner Bros. Discovery. Combined with Elon Musk's X, Rupert Murdoch's Fox, and Trump's own Truth Social, much of legacy and social media in the United States will be in pro-Trump hands.

As the midterms approach, the administration will move to tilt the electoral playing field in its favor. The White House's unprecedented mid-decade redistricting push is a statement of intent, even if the net effect on the 2026 map will be small. So are the pardons for 2020 fake electors and the gutting of the Cybersecurity and Infrastructure Security Agency, the agency that helps states defend elections against cyberattacks. More consequential would be an assault on election infrastructure. An election denier now runs election security at the Department of Homeland Security. The Department of Justice has sued states that Trump lost in 2020, seeking voter roll data that could be used to purge voters or contest results. Federal monitors could be deployed to swing districts, as they were to California and New Jersey last November, for "election security." In a worst-case scenario, emergency powers could be invoked to deploy federal troops to polling places in an attempt to suppress turnout. No such powers exist, but National Guard troops have already been sent to blue cities under various pretexts, and Trump has shown a willingness to act first and worry about the courts later.

Federalism will limit President Trump's efforts. The Constitution gives Washington no role in elections, and state leaders of both parties have begun pushing back against federal overreach (though not without the administration threatening to withhold federal funding in retaliation). But if close races leave either the House or Senate in doubt, fraud allegations, contested certifications, and pressure on local officials to delay or refuse results will follow. Expect Trump to replicate his 2020 play, when he asked Georgia's secretary of state to "find" enough votes to overturn his loss—except this time, some election officials may be loyalists willing to comply.

For all these efforts, Republicans are still likely to lose the House in November. Trump's approval ratings are low, voters are unhappy with the economy, and history suggests the president's party almost always loses seats. News cycles would then shift to impeachment efforts, oversight hearings, and gridlock. Trump's support would erode, protests would grow, and his momentum would fade. But a Democratic House can only do so much to stop the revolution. It can subpoena but not compel; impeach but not convict; withhold funding, but Trump has found ways around Congress's power of the purse. A Senate

majority would matter slightly more, but Democrats are unlikely to flip that chamber. They need four seats on an unfavorable map, and every deterred donor, volunteer, and voter would make the climb steeper. And without a veto-proof supermajority, even a unified Democratic Congress couldn't fully check a president who has proven willing to bypass it entirely—though such a result would further raise the odds the revolution fails by adding friction and signaling that resistance is popular, legitimate, and viable.

Some imagine that Trump's growing unpopularity will compel moderation. That's plausible: The Epstein files, Israel support, and redistricting have all exposed cracks in the MAGA coalition, and a souring economy or a blue wave could fragment it. Indeed, an increasingly multipolar global economy and China's rare-earth leverage will force more caution on tariffs than Trump would otherwise like (please see Red herring: "Tariff Man" at large). But Xi Jinping can check the president in ways that Marjorie Taylor Greene and other domestic opponents cannot. Trump is more likely to respond to domestic setbacks, from sinking poll numbers to a defeat in November, as he did to his 2020 election loss: by doubling down. Except that as a lame duck surrounded by loyalists who can't afford defeat any more than he can, the impulse to go for broke will be stronger.

Trump's political revolution is ultimately more likely to fail than succeed, undone by a combination of belated institutional resistance, limited coalition fracture, and, not to be underestimated, the president's own impulsiveness. But there will be no return to the status quo ante. The next president will inherit whatever expanded powers and weakened constraints Trump manages to entrench before 2029, and the grievances that fueled Trumpism will remain unaddressed. The result may not be Viktor Orban's Hungary, but it will be far from a healthy body politic.

The United States can't be categorized as a representative democracy in 2026, not because it's heading toward dictatorship but because it's in the middle of a political revolution whose outcome will remain genuinely indeterminate for years. Trump and his supporters will take ever greater risks. Resistance will mount too, but neither side will land a decisive blow. The longer this plays out, the greater the risks—more substantial than they have any right to be in the world's oldest democracy. It's America's own late Gorbachev era: The country is careening toward *something*, but nobody knows what. And for millions of Americans, perhaps even a voting majority, the risks of

uncertain revolution beat the certainty of continued decay under a system that wasn't working for them

Whatever the endpoint, the damage over the next year will be significant. As loyalists replace experts across the federal government, state capacity will weaken, and the government's ability to collect data, preempt crises, and respond to emergencies will erode. The administration has already fired the Bureau of Labor Statistics commissioner, canceled federal employee surveys, and reduced capacity in agencies like the National Oceanic and Atmospheric Administration that provide essential data, forcing the private sector to look elsewhere for statistical truth. Deep cuts at the Federal Emergency Management Agency, the Centers for Disease Control and Prevention, the Food and Drug Administration, and the National Security Council will degrade the government's ability to respond to disasters, track disease outbreaks, ensure food and drug safety, and coordinate national security. The next crisis will find a government less prepared to respond. Media consolidation will degrade the information environment, and the shared reality required for democratic deliberation will fray further. Corruption will become more overt, and political violence will continue to climb—threats against election officials, judges, and politicians have risen sharply, and the pardons issued to January 6 defendants signal that Trump-aligned rule breakers will enjoy executive protection.

As executive impunity expands and the rule of law erodes, the business environment will be put to the test. Companies will have to price their exposure to the US government into key decisions. Potential consequences for the disfavored include targeted investigations, loss of federal contracts and tax-exempt status, public rebuke by the president, demands for investment pledges, forced divestment of foreign partners, and partial government ownership or control. Targeted organizations will struggle to attract talent; employees won't want the professional risk. Inducements for the aligned include favorable regulatory treatment, subsidies, tariff protection, and preferential contracts. Litigation will become a growing burden; obedience will beget more extraction.

When political alignment rather than productivity determines economic outcomes, capital gets misallocated, investment grows riskier, and long-term growth suffers (please see Top Risk #6: State capitalism with American characteristics). If markets believe the Fed's credibility

**Whether Trump's revolution succeeds or fails, there is no going back to what came before.**

is compromised, the consequences for inflation, interest rates, and the dollar could be severe. The United States remains the world's deepest and most liquid market, and there's still no better alternative (please see Red herring: Sell America). But "least ugly" is not the same as safe, and the politicization of economic decision-making will gradually raise risk premia on US assets.

The instability will radiate outward. Even as external conflicts recede, the United States itself will be the principal source of global risk in 2026. Tariff threats will continue to be used to extract trade and non-trade concessions, if less liberally than last year (please see Red herring: "Tariff Man" at large). Military power will be wielded more assertively, especially in the Western Hemisphere (please see Top Risk #3: The Donroe Doctrine). Alliance commitments will shift with the presidential mood. Soft

power will erode; the United States will find it harder to build coalitions and attract global talent. Washington's retreat from multilateral cooperation will deepen our more fragmented and conflict-prone G-Zero world; when the next global crisis hits, there will be no "committee to save the world." And what happens in America won't stay in America—democratic backsliding in the United States will embolden autocrats elsewhere.

The United States was already the most structurally dysfunctional political system among advanced industrial democracies before Trump returned to office. He is a symptom, a beneficiary, and an accelerant of that dysfunction, but he didn't cause it—and he won't fix it. Whether Trump's revolution succeeds or fails, there is no going back to what came before.

## Box 1. Trump vs. FDR

**Trump's second term is not the first political revolution in American history. Franklin D. Roosevelt's three-plus terms fundamentally transformed US governance. On the surface, the comparison writes itself: Both presidents invoked crisis to justify extraordinary action; both sought to dramatically expand the power of the presidency; both routinely broke established norms and governance practices; both clashed with the courts; and both were denounced as dictators by their critics. We have the benefit of hindsight with FDR; Trump's revolution is still unfolding. But even accounting for that asymmetry, the FDR-Trump parallel is weaker than it appears.**

Roosevelt confronted a Supreme Court hostile to his agenda, a Congress jealous of its institutional role, and a Democratic Party that refused to fall under his thumb. In certain respects, he went further than Trump has thus far: He tried to expand the Supreme Court's membership from nine to 15 justices to dilute its conservative majority. But court-packing failed because his own party stopped him—though he ultimately reshaped the court through eight appointees over his tenure—as did FDR's attempt to remove dissenting Democrats in a 1938 party “purge.” And a sweeping effort to reform the executive branch had to be watered down substantially to pass Congress. When the court struck down key New Deal programs—including the National Industrial Recovery Act and the Agricultural Adjustment Act—FDR accepted the setbacks and adjusted course. The court eventually acceded to much of the New Deal agenda under political pressure—the famous “switch in time that saved nine.”

Roosevelt's legacy endures—the modern administrative state, a professionalized White House staff, the expectation that the president sets the national agenda—but it was built primarily through legislation and embedded in a political order where parties, Congress, and courts defined what was permissible. That legacy included the creation of independent agencies designed to insulate certain executive functions from politicization and presidential control. The result was a vastly larger federal government and a more powerful executive, but one with new constraints on presidential discretion.

Trump is also pursuing a revolution in presidential power, but of a different kind. FDR expanded what the state could do, and presidential power grew with it. Trump is seeking to weaken the checks on how that power is used—and redefine by, for, and against whom it is wielded. And where FDR worked largely through Congress to reshape the government, Trump is personally asserting direct presidential authority over the entire executive branch, while also weaponizing



the “power ministries” against his opponents, using litigation and regulatory threats to chill criticism, and testing the limits of compliance with court orders.

Trump and his supporters see this as restoring democratic accountability to an administrative state that has been captured and weaponized against them by a corrupt “deep state.” Many of the constraints Trump is attempting to remove—independent agencies, statutory for-cause protections, bureaucratic insulation, inspectors general—are themselves legacies of the New Deal. A comparatively quiescent Congress, a Republican Party that Trump has remade in his image, and a Supreme Court majority broadly sympathetic to expansive presidential power (though still independent) leave fewer institutional obstacles than FDR faced.

Both presidents broke norms and precedents. Roosevelt ended the two-term tradition—a norm so significant it was later codified in the Constitution—and challenged the court's institutional role, but he did not defy judicial rulings or contest electoral outcomes. His norm-breaking centered on the scope of federal policy and institutional design. Trump has already tried to overturn an election, routinely casts adverse court rulings, prosecutions, and media scrutiny as illegitimate, and describes domestic critics—including independent media, judges, and political opponents—as “enemies of the people.” The norms under pressure today concern whether the American president is effectively above the law, whether the power ministries can be used for personal and political retribution (and personal enrichment), and whether the playing field for future elections—the ultimate check—remains meaningfully competitive.

Eurasia Group's *Governance Tracker* classifies presidential actions along several dimensions: the extent to which they violate norms, the extent to which they erode constraints on presidential power, and whether they succeeded or were effectively checked. On these measures, Roosevelt's record shows significant norm-breaking and erosive ambitions. He was blocked in his most aggressive moves—court-packing and the party purge—but ultimately prevailed in his confrontation with the courts and greatly expanded the federal government and executive power. Trump's actions so far register as more revolutionary, targeting not just the scope of government but the checks on presidential power itself. Whether they will be effectively checked is the central question for 2026 and beyond.



## 2 Overpowered

The defining technologies of the 21st-century economy run on electrons: electric vehicles (EVs), drones, robots, advanced manufacturing, smart grids, battery storage—and yes, AI. These systems share a common foundation: the “electric stack” (batteries, motors, power electronics, embedded compute). Master the stack, and you can build almost anything the modern economy demands. Cede it, and you’re buying the future from someone else.

China has mastered it. The United States is ceding it. In 2026, that divergence will become impossible to ignore.

In 2010, China was arguably the most fossil fuel-dependent major economy on Earth. Today, it is by far the largest consumer and producer of clean energy—the first “electrostate.” While coal still provides a large share of China’s power, and in absolute terms the country remains the world’s biggest fossil-fuel user, most of its growth in power capacity and generation now comes from renewables. Critically, Beijing dominates roughly 75% of global lithium-ion battery production and 90% of the neodymium magnets used in motors, and Chinese firms lead in solar panels, wind turbines, grid equipment, and the EVs and drones built on these components. This is the result of decades of industrial policy, scale manufacturing, and cost reduction. The electric stack has gotten 99% cheaper since 1990. China rode that curve better than anyone, and its 15th Five-Year Plan in 2026 will double down on these sectors, ensuring no letup in output despite domestic concerns about “involution” and Western cries of “overcapacity” (please see Top Risk #7: China’s deflation trap).

The United States, meanwhile, has cemented its status as the world’s largest petrostate since surpassing Saudi Arabia in 2018 and now pumps 13.5 million oil barrels per day. President Donald Trump’s energy strategy centers on LNG exports, coal, nuclear, and rolling back support for renewables—technologies now caught up in America’s culture wars and associated with climate policy rather than industrial competitiveness. The “big, beautiful bill” phases out tax credits for utility-scale solar and wind while adding restrictions that make battery credits more difficult to claim.

The result: Washington is asking the world to buy 20th-century energy while Beijing offers 21st-century infrastructure. China's value proposition is especially enticing for emerging markets: solar panels and wind turbines that don't rely on volatile commodity imports, next-generation battery storage systems, grid equipment, electric (and intelligent) vehicles, advanced drones—all getting cheaper and more scalable by the day. The United States, by contrast, continues to index its exports to these regions around fossil fuels, airplanes, and agricultural goods. While governments from Southeast Asia to Latin America to Africa were forced to play defense with a much more powerful Trump administration last year—with many acquiescing to fossil fuel purchase agreements to avoid punitive tariffs—in 2026, they will shift from damage control to longer-term infrastructure planning. That calculus will increasingly favor Beijing's offerings. Already China's exports of renewable technologies have surpassed US fossil fuel exports.

There are tradeoffs to adopting the Chinese stack, including cybersecurity risks and fewer opportunities for other countries to build their own electrotech industries. But many will opt for the benefits of cheap Chinese imports anyway—just as they did with Huawei's telecom equipment a decade ago. This choice is (geo)political but less binary than choosing a defense partner or telecom provider, making it easier to drift toward Beijing without a single dramatic break with Washington. The cumulative effect, however, is a geopolitical turning point: A growing share of the world's energy, mobility, and industrial systems will be built on Chinese foundations, bringing Beijing commercial benefits and influence that soft power alone—hampered by low favorability ratings in many of these countries—could never deliver.

The United States isn't just falling behind internationally. At home, America's electricity grid is straining under surging demand from reshoring, electrification, and data center expansion. US power consumption is projected to rise nearly 6% annually through 2030 after decades of flat growth, and the system is struggling to keep up. Interconnection queues now average over eight years in key markets, aging transmission infrastructure needs urgent replacement, and community opposition has killed data center projects in multiple states. While the US produces enough gas to meet growing domestic needs and then some, combined-cycle turbines face multi-year backlogs for procurement. Nuclear takes a decade. Some large industrial users like hyperscalers are able to work around grid bottlenecks by deploying behind-the-

meter gas generation, signing direct power purchase agreements, or contracting to restart mothballed nuclear plants. But the fastest, cheapest path to new capacity at scale—solar plus batteries, deployable in 18 months—is precisely what the United States is now hobbling, ceding the cost curve to China in the process.

The AI race raises the stakes. While the United States still leads frontier model development, China's dominance over the electro-industrial stack could prove decisive for powering and deploying AI at scale. AI requires massive amounts of electricity to train and run, and Beijing produces 2.5 times as much electricity as the US and is pulling further ahead. In 2024 alone, China added 429 gigawatts (GW) of new power capacity, more than a third of the entire US grid; America added 51 GW. Perhaps more importantly, AI models need physical systems—autonomous vehicles, drones, robots, motors, and smart infrastructure—to be useful, all of which run on the electric stack China controls.

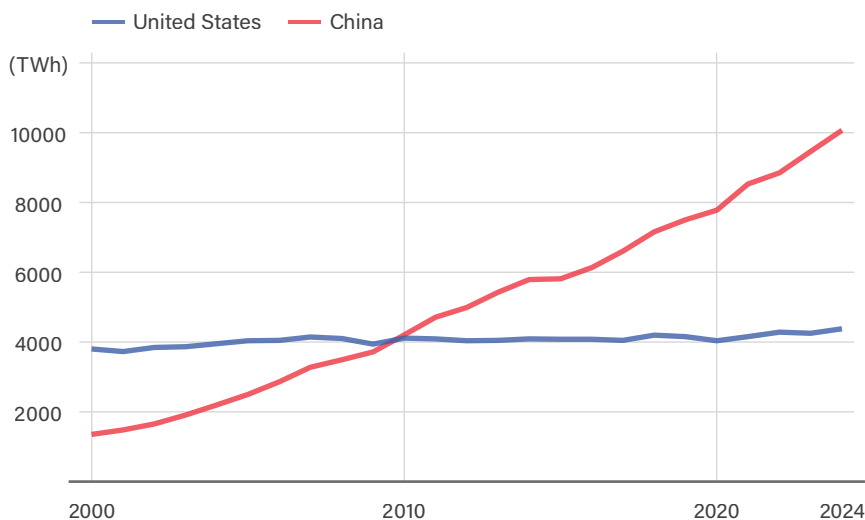
The United States is betting that whoever builds the best and largest AI models—and whoever develops Artificial General Intelligence first—will win the race. China is making a different bet: that on its own, intelligence is a commodity, and it creates strategic value only when it can be powered and deployed at scale. Chinese AI models are open-source, leaner, and far cheaper than their American counterparts—requiring dramatically less energy to train, though not necessarily to run—good enough (and increasingly competitive with the frontier) for most practical applications and designed for widespread adoption and integration with the electrotech stack. If China's approach, built around near-term industrial and military deployment rather than pure research supremacy, proves more relevant—and monetizable in overseas markets—the US may discover it's been winning a narrow competition while losing the broader contest for the 21st century.

Taken together, the electrotech gap creates a triple bind for the United States. *Domestically*, it saddles American industry with higher energy costs and slower buildouts—a competitive disadvantage that will compound (just ask the Europeans). *Internationally*, it cedes influence in the fastest-growing economies to China, one procurement decision at a time. And *strategically*, it wagers that intelligence alone wins when the stack that powers and converts it into economic, military, and geopolitical capability may be equally or more important.

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## Electric shock

Electricity generation, total terawatt-hours



Energy exports, billions of dollars



Source: Ember Energy Institute (2025) - Statistical Review of World Energy (2025) - with major processing by Our World in Data; DOE, EIA, China GACC, Ember, Bloomberg calculations

Washington's fossil-first posture puts it out of step even with traditional energy players. India wants to replicate China's success in leveraging electrotech for broader economic development. Europe is looking for ways to reduce fossil fuel dependence, including through an expanded continental grid and investment in the electric stack. Gulf economies are carving out roles for themselves in new energy supply chains and AI deployment. Even Saudi Arabia is looking to solar to power its data centers.

As Chinese EVs, batteries, and drones flood global markets while American LNG faces tepid demand, expect frustration to build in Washington. In the near term, this could manifest as tariff threats to force trading partners to buy more US hydrocarbons or perhaps restrictions on smaller countries that adopt Chinese energy infrastructure. Aggressive retaliation—such as sanctions on Chinese electrotech firms—is unlikely as long as the Trump administration continues to prioritize bilateral

stability with Beijing (please see Box 5: US-China détente won't collapse). But for governments trying to navigate longer-term US-China decoupling without alienating either side, this divergence introduces a new geopolitical pressure point that will sharpen over time.

The spread of cheap electrotech is good news for the world. It enables more resilient energy systems, creates new opportunities for AI deployment, and maintains momentum for the global energy transition. But on current trends, the United States is positioned to capture few of those benefits and bear substantial costs: commercial losses as Chinese exports displace American fossil fuels, geopolitical setbacks as emerging markets build on Beijing's platforms, and growing doubts about whether America is running the right AI race at all. China bet on electrons. The US bet on molecules. In 2026, we'll start to see who was right.



# 3 The Donroe Doctrine

President Donald Trump's administration is reviving and reinterpreting the logic of the Monroe Doctrine in its effort to assert power over the Western Hemisphere. Where the 19th-century doctrine warned external powers against encroaching in the Americas, Trump's version broadens the concept. It seeks not just to limit China, Russia, and Iran in the Western Hemisphere, but to actively assert American primacy through a mix of military pressure, economic coercion, selective alliance-building, and Trump's personal score-settling. In 2026, this posture will heighten the risk of policy overreach and unintended consequences.

The pattern crystallized in 2025: strikes on alleged drug boats, threatened military action in Colombia and Mexico, sanctions on Colombia's president and a Brazilian Supreme Court justice, pressure on Panama over canal management, new sanctions on Nicaragua and tightened restrictions on Cuba, upgraded relations with El Salvador's Nayib Bukele in exchange for deportation cooperation, a \$20 billion bailout for Argentina timed to boost President Javier Milei's political fortunes, and a pardon for a former Honduran president convicted of drug trafficking by a US court.

The centerpiece is Venezuela, where a high-stakes gamble has already delivered Trump his headline win. After months of escalating pressure—expanded sanctions, a \$50 million bounty, the largest naval deployment in the Caribbean in decades, the shutdown of Venezuelan airspace, boarding and seizing oil tankers, a full boycott of Venezuelan tanker traffic—US special forces conducted a successful raid that captured Nicolas Maduro and brought him to the United States to face criminal charges. Venezuela had no ability to respond, and no other country in the region or beyond took meaningful action. Trump will take credit for removing a dictator and bringing him to justice without violating his most consistent red line: no sustained boots on the ground.

But removing Maduro was the easy part—what comes next is more challenging. The regime structure remains largely intact. Interior Minister Diosdado Cabello, Defense Minister Vladimir Padrino Lopez, Vice President Delcy Rodriguez, and her brother Jorge, the National Assembly president—Chavismo’s entire power apparatus—appear to have survived the raid. Maduro’s successor will be a regime insider, not the democratic opposition, which holds all the legitimacy but none of the guns. The path to an opposition-led government will be contested, requiring amnesty deals for the military figures currently running the country and complicit in the regime’s crimes, all of whom will prioritize survival and spoils over reform. The presence of Cuban advisers could reinforce these tendencies.

## The world moves fast

### Here’s what our draft said on Friday, 2 January:

*“Trump is hoping enough pressure will force a negotiated exit or prompt the military to hand Maduro over. If that’s not enough, Washington is weighing options ranging from a decapitation strike to an Osama bin Laden-style raid. **The latter is favored if the opportunity arises, the goal being to bring Maduro to the United States to face justice.** The only thing that’s off the table is a sustained deployment of boots on the ground, Trump’s most consistent red line from his first administration through this one. Americans won’t tolerate any new, long commitments. President Trump wants to go in hard, declare victory quickly, and get out. **Maduro is unlikely to survive the year in power.**”*

The transition will largely be Venezuela’s to manage—or mismanage. The raid’s success suggests cooperation from some regime insiders, which may smooth the initial handover to new leadership. But while the successor government will seek US cooperation on sanctions relief and oil deals, and Trump will be receptive as long as he can claim a win, pro-American sentiment within the Venezuelan military remains uncertain. The raid itself could harden the remaining regime’s resistance and stir nationalist resentment even among Venezuelans who hated Maduro. Trump has signaled that the United States will play a role in managing what comes next, though Washington will struggle to shape the transition without a

sustained presence on the ground. White House advisers have suggested they intend to maintain a strong military presence in the region to keep up the pressure. Indeed, they are discussing plans to “take the oil” if Venezuela’s new leaders prove recalcitrant, with seizure of offshore oil rigs—easy targets with limited risk—a next step. Still, the more President Trump claims ownership, the more he owns whatever goes wrong.

Civil war is unlikely—you need two armed factions for that—and Venezuela has advantages Iraq, Libya, and other US regime-change targets lacked: no sectarian fault lines and a living memory of competitive democratic rule. But armed groups—including National Liberation Army (ELN) guerrillas, armed *colectivos*, and criminal networks embedded in illicit mining and trafficking—will see opportunity in any resulting chaos.

Cuba may be next if Trump’s experiment in Venezuela doesn’t immediately backfire. Secretary of State Marco Rubio believes Maduro’s ouster will see Havana fall, and Trump may see a chance to finish what the Venezuela campaign started. Military action is unlikely in the near term—not least because it would take time to reposition US assets, which are still needed for Venezuela. But extending the oil blockade to squeeze Cuba economically is a possibility—one that would further strain regional relationships. Mexico has already stepped in to send oil to Havana after US disruption of Venezuelan flows. Cuba is economically fragile and lacks any meaningful ability to retaliate. But the regime is deeply entrenched, with a long history of surviving American pressure, and chaos 90 miles from Florida would pose new risks.

The Donroe Doctrine will also affect Colombia, America’s largest regional hub for security operations and the country most exposed to turmoil in Venezuela. Trump spent much of last year publicly ridiculing President Gustavo Petro, and the US Treasury sanctioned him personally for criticizing the Caribbean boat strikes. Petro’s chosen successor is on track to lose this year’s election with or without Washington’s help. A conservative government will be friendlier to Trump. But continued US pressure and the messy aftermath of regime change next door could nonetheless inflame nationalism, deepen anti-American sentiment, and degrade counternarcotics cooperation during a critical period for the region—especially before the new president takes office.

Trump’s policy also creates risks for Mexico, despite his unexpectedly strong relationship with President Claudia Sheinbaum and robust security cooperation between both countries. Mexican alignment has held so far, but it depends on Trump respecting Mexico’s sovereignty. Direct US strikes against cartels on Mexican territory remain possible; Trump considered this option at the beginning of

his term last year. The Venezuela success may embolden him. Crossing Sheinbaum's red line would rupture the relationship and threaten the uneasy US-Mexico trade equilibrium (please see Top Risk #9: Zombie USMCA).

Beyond these flashpoints, Trump's deployment of tariffs, sanctions, migration leverage, trade access, and (in more limited cases) China policy conditionality will continue to shape political outcomes. So far, the administration has been pushing on an open door. Mexico and Central America have quickly fallen into line. South America is more favorable terrain than most of the world, as right-leaning leaders—many sharing Trump's anti-crime, anti-immigrant, and pro-business agenda—are gaining power and moving closer to Washington (Brazil and pre-election Colombia are the obvious exceptions).

However, the risk of US policy overshoot is high—especially now that Trump has a successful raid under his belt. Whether that means sanctioning a sitting president, meddling in an election, miscalculating how far aligned governments will bend, or going after the Cuban regime—weakened by the loss of

Venezuelan oil subsidies and already under tightened restrictions—he will be tempted to double down on what has worked so far and push further. No doubt Trump will look to boost aligned candidates in the upcoming elections in Brazil, Colombia, Costa Rica, and Peru. As has been true on almost every continent where America has overextended itself, he risks planting seeds of anti-Americanism and pushing conflict, traffickers, and cartels into new places.

History in Latin America shows that aggressive crackdowns tend to displace illicit networks rather than dismantle them. In the early 2000s, Colombia degraded the Revolutionary Armed Forces of Colombia (FARC) and major trafficking corridors, but cocaine production shifted into Peru, Bolivia, Ecuador, and Venezuela. Mexico's post-2006 cartel offensive fragmented organizations, exporting violence to Central America and the Caribbean as splintered groups sought new routes and territories. In Venezuela's case, disruption of entrenched trafficking, illicit mining, and smuggling systems would redirect criminal groups into Ecuador, Costa Rica, Panama, and Belize—states with limited capacity to absorb the shock.

## The Donroe Doctrine in action

■ Rewarded ■ Pressured ■ Mixed ■ Not targeted



Source: Eurasia Group

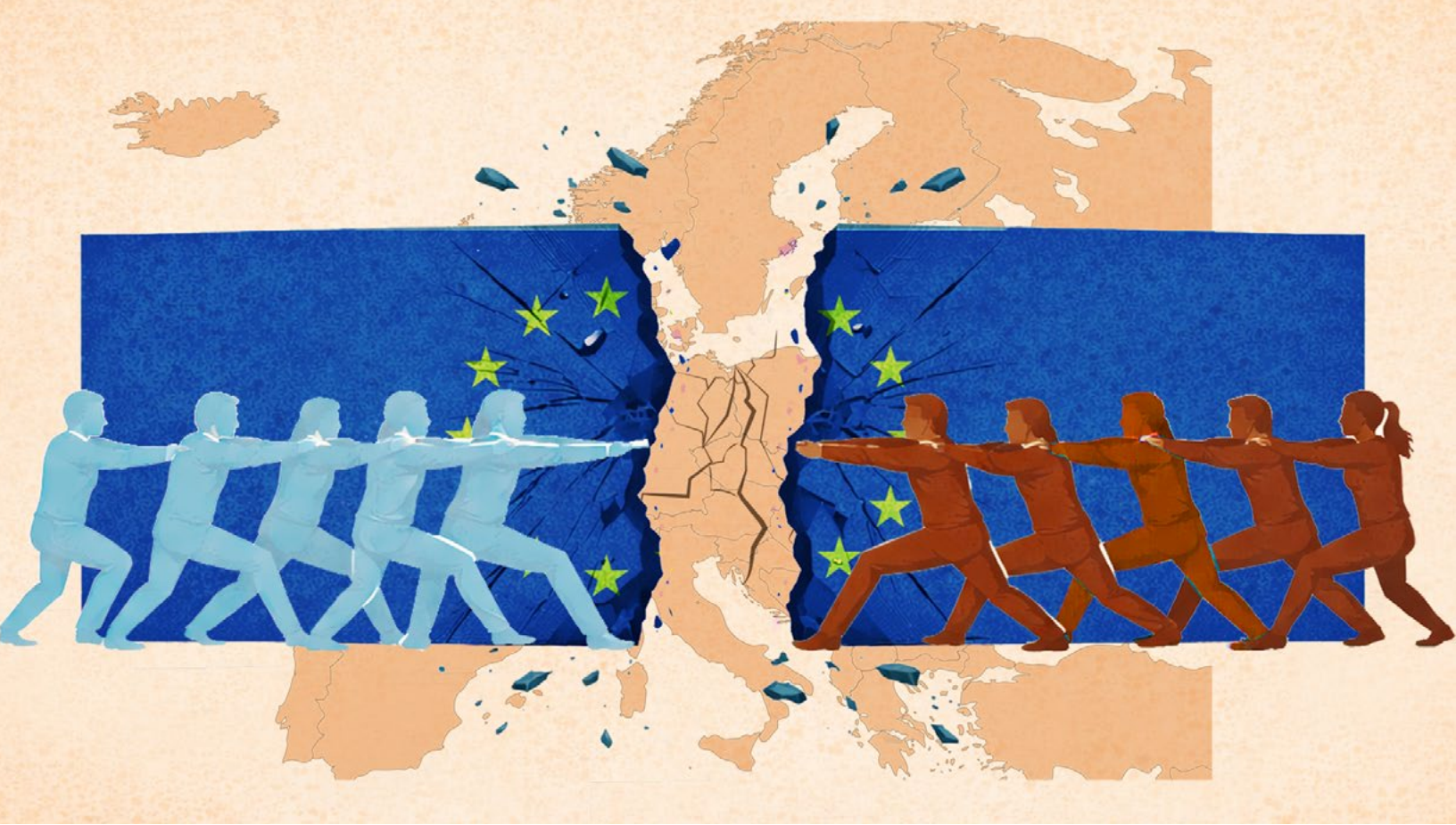
The result would not be hemispheric destabilization, but rather the diffusion of insecurity, a resurgence of migration pressure, and renewed anti-American sentiment.

And then there's the longer-term risk. China is already South America's largest trading partner. The Monroe Doctrine aims to reassert US primacy and push Beijing out of the Americas. Trump's heavy hand may

give countries more reason to hedge toward China and erode Washington's long-term influence at the margins. A doctrine designed to secure America's backyard could ultimately end up loosening its grip.



**A doctrine designed to secure America's backyard could ultimately end up loosening its grip.**



## 4 Europe under siege

The hollowing out of Europe's political center has been a decade in the making. France, Germany, and the United Kingdom each enter the year with weak, unpopular governments under siege from the populist right, the populist left, and an American administration and state-aligned social media openly rooting for their collapse. None face scheduled general elections. Yet all three risk paralysis at best and destabilization at worst—and at least one leader could fall. The consequences won't stay contained: Europe's ability to address its economic malaise, fill the security vacuum left by America's retreat, and keep Ukraine in the fight will suffer.

Britain's May local elections will be the first test. Not for Labour, which is bracing for losses, but for Nigel Farage's Reform UK. The insurgent party has led national polls for much of the past year. The key question: Can it translate polling strength into votes? A strong Reform showing would help cement the fragmentation of UK politics, giving Farage momentum for the next general election and pulling both Tories and Labour away from the center. Prime Minister Keir Starmer himself probably won't survive the spring. He's deeply unpopular, and a successful leadership challenge from his left flank is all but certain. His successor will be weaker and more leftist. Either way, Labour's thin mandate—a "landslide" built on just 33% of the vote—offers no cushion. The Conservatives had already imploded before that: three prime ministers in 2022 alone. The two-party system that defined British politics for a century is fracturing. Starmer promised to hold things together. There's little chance of that.

France is already ungovernable. By October 2025, the country had cycled through three prime ministers in twelve months, none able to pass a budget through a hung parliament—the second straight year without a proper budget deal, unprecedented in the Fifth Republic. President Macron may limp through 2026 without calling another snap election.

But if Prime Minister Sébastien Lecornu's government falls in 2026, the pressure on President Emmanuel Macron to dissolve parliament and call fresh elections will grow. Marine Le Pen's Rassemblement National (RN) would increase its seat count, worsening the parliamentary gridlock or potentially winning an outright majority. Should the RN and its allies secure around 250 seats, Jordan Bardella—Le Pen's 30-year-old lieutenant—would become France's first populist prime minister in modern history, forcing an unstable cohabitation with a lame-duck Macron and marking a rupture in French politics. Even if that scenario is avoided, France remains paralyzed—unable to pass budgets, enact reforms, or lead in Europe.

Germany holds five state elections by September, but two matter most: Saxony-Anhalt and Mecklenburg-Western Pomerania. After coming in second in last February's federal election, the hard-right Alternative for Germany (AfD) now leads national polls, and outright majorities in both eastern states—a rare feat in a country where coalitions are the norm—are no longer out of reach. A strong AfD showing and a weakening of the Social Democrats (SPD) would intensify pressure on the conservative Christian Democratic Union (CDU) to abandon the firewall that has excluded the far right from any governing coalition since World War II, especially in the east. Such a move would be toxic at the national level and a dealbreaker for the CDU's federal coalition partners. Chancellor Friedrich Merz's alliance with the SPD is already riven by ideological disputes over pensions, welfare reform, and spending. A firewall breach, combined with further SPD losses, could tear it apart.

None of this happened overnight. The center has been crumbling for a decade—Brexit, Jeremy Corbyn's takeover of Labour, the implosion of France's traditional parties, the AfD's steady rise in eastern Germany all signaled the

trend. But the damage is now acute in all three countries at once. The UK's 2024 election produced the lowest combined Labour-Tory vote share since 1910. In France, Macron's 2017 victory masked rather than reversed the collapse of the Socialists and the center-right Republicans; now his own movement has imploded, leaving a hopelessly hung parliament dominated by the far left and far right. Germany's February 2025 election saw CDU and SPD record their worst combined result since unification. The political forces driving this fragmentation are the same across all three: fury over immigration, stagnant living standards, deindustrialization, and a widening gulf between urban elites and everyone else. Younger voters are particularly disillusioned with the establishment and open to populist alternatives.

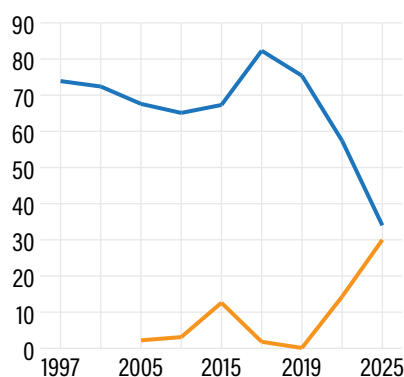
Pressure from a euroskeptic Washington will compound the fractures. President Donald Trump's administration seeks a more fragmented, decentralized Europe and will openly back the populist right that would deliver it. Whether US challenges to European sovereignty—from Greenland annexation threats to sanctions on EU officials regulating US tech and outright election interference—will succeed or backfire is unclear. But the intent, especially as the US draws down offensive troop deployments in Eastern Europe and resists burden-sharing on Ukraine and NATO, amounts to an American bet against the European center and the European Union itself.

The result: three governments that can't govern. To be sure, Starmer could limp through. Reform UK could underperform the polls in May. Macron could muddle through another year; he's defied political gravity before. Merz's coalition partners have nowhere else to go. But surviving isn't governing. Even if all three leaders hang on, they'll be too weak to do more than manage their own decline.

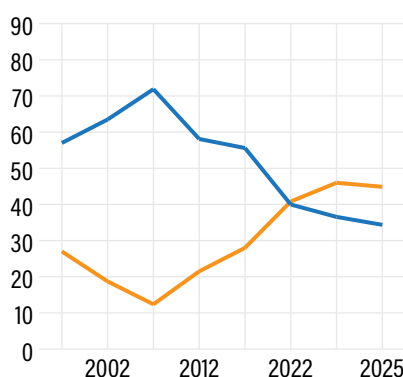
## The center cannot hold

Vote share (%)

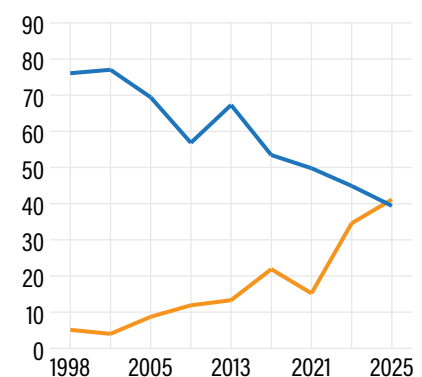
### UK



### France



### Germany



Source: Eurasia Group calculations based on legislative election results (through 2024) and recent polling data (2025); Politico and Macrobond. Populist vote share includes AfD, Die Linke, and Bündnis Sahra Wagenknecht (Germany); RN, La France Insoumise, and the Communist Party (France); and UKIP/Reform (UK).

The implications start at home. Decisive action to boost competitiveness, investment, and productivity is impossible when governments are fighting for survival. These three won't drive European growth—they'll drag it down. The UK and France face spiraling debt with no prospect of the reforms needed to address it. A lurch left in Britain or fresh elections in France could spook bond markets. Every failure of the center to deliver reinforces the narrative that only outsiders can fix the system, entrenching populist momentum for years to come.

The E3 are Europe's core; when their center weakens, so does the continent's. Without alignment in Paris and Berlin, policy confusion spreads to Brussels—undermining Europe's ability to build consensus, complicating trade policy, and making the next EU budget fight uglier. European efforts to coordinate on defense, trade, regulatory, or fiscal policy will face not just internal paralysis but active US hostility. Europe's ability to fill the security vacuum left by American retrenchment depends on vigorous leadership from the E3. That'll be

in short supply this year. Ukraine will be exposed, too. Sustained support for Kyiv requires political will and public spending that weakened governments will struggle to deliver—and populist ones won't. European aid is likely covered for 2026, but if politics in any of the E3 becomes destabilized, the outlook beyond that darkens considerably. Ukrainians can't afford that.

The G-Zero leadership vacuum at the heart of international politics is widening, and Washington is now accelerating rather than resisting it. Trump has made it clear he views the current E3 leadership as more adversarial than Russia, emboldening Moscow. A weakened E3 that cannot rely on the United States to stand up to Russian aggression leaves Europe more exposed to hybrid attacks than at any point since the Cold War (please see Top Risk #5: Russia's second front). And if Washington overtly interferes in European elections and territorial integrity, the transatlantic relationship enters uncharted territory. The postwar alliance framework, already strained, could fracture.



**Europe's center has been crumbling for a decade, but the damage is now acute in all three countries at once.**



# 5 Russia's second front

**The most dangerous front in Europe this year will shift from the trenches in Donetsk to the hybrid war between Russia and NATO.**

The fighting in Ukraine is likely to grind on in 2026, with episodic Donald Trump-brokered diplomacy and no immediate breakthrough for either side. Russia will attack to increase its territorial gains inside Ukraine and continue strikes across civilian centers; Ukraine will strike harder and deeper into Russia. But the baseline is less stable than it was in 2025. As the war enters its fourth year, Ukraine's position is deteriorating and pressure from the United States is mounting. The tail risks are growing on both ends: a weakened Ukraine forced to capitulate, or a more desperate Ukraine taking bigger gambles that cause further Russian escalation against Kyiv and its backers.

But whatever happens on the battlefield, the greatest danger this year lies elsewhere. Russia will escalate gray-zone operations against NATO, from infrastructure sabotage to airspace probes to election interference. And NATO, after years of absorbing punishment, will for the first time push back. That combination raises the odds of more frequent and dangerous confrontations in the heart of Europe.

President Vladimir Putin's logic is straightforward. Russia is gaining territory in Donetsk and elsewhere, but limited offensive potential means advances remain incremental and attritional. Meanwhile, the war-plus-sanctions dynamic is starting to have a more structural impact on Russia's economy, producing high real interest rates, labor shortages, and a civilian economy crowded out by defense production. Putin sees robust European financing for Kyiv as extending Ukraine's capacity to endure and fight through the year and beyond. Degrading that support, then, is Russia's best path to improving its battlefield position and gaining leverage in any eventual talks.

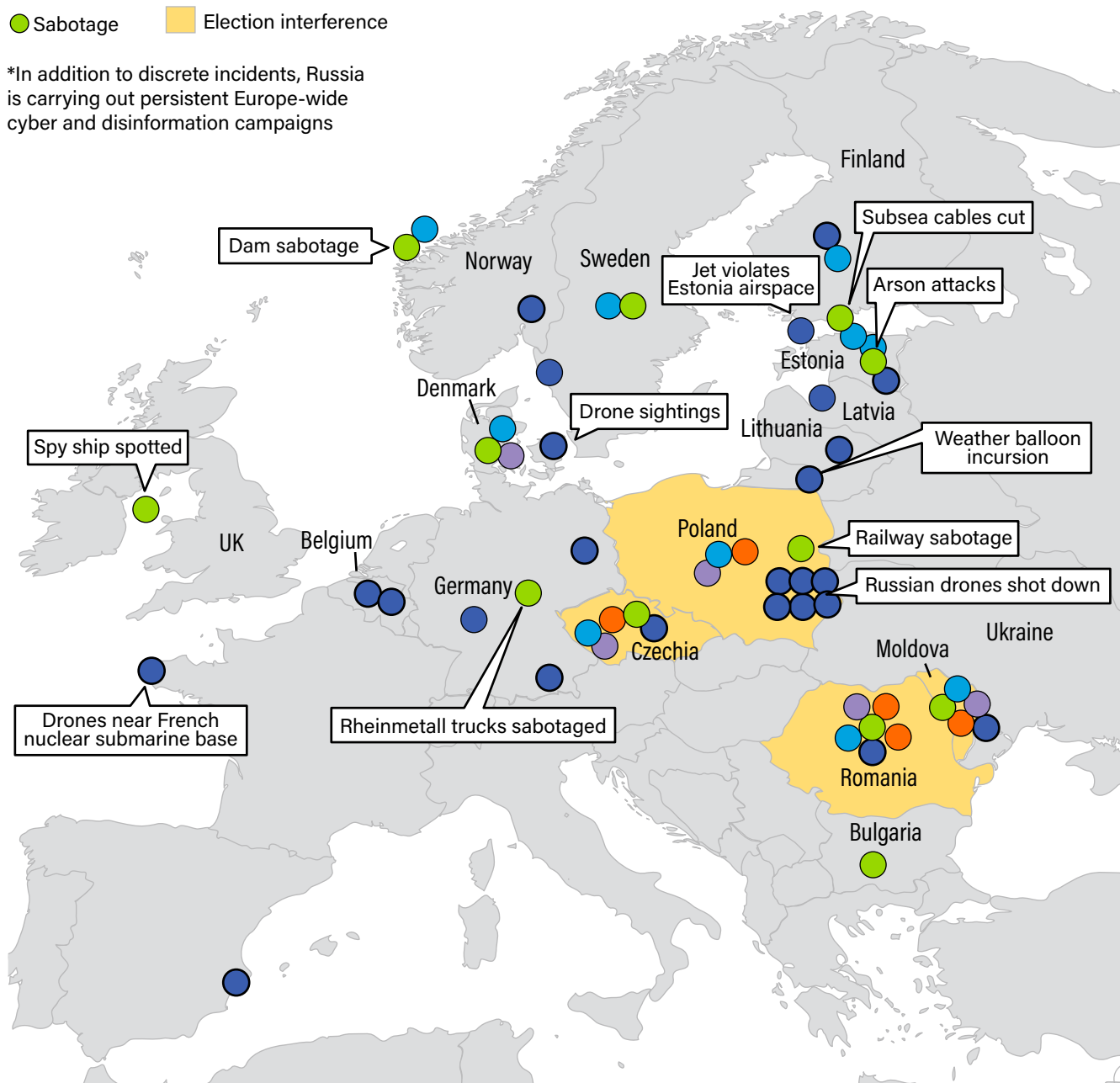
Putin sees hybrid war as the best way to wear down Europe. He judges that calibrated gray-zone activity remains below NATO's collective military response threshold—close enough to hurt, not close enough to trigger Article 5. His goal is to erode European support for Ukraine before economic strain impairs his ability to prosecute the hot war—a concern starting to surface among Russian elites. Putin doesn't want war with NATO. But he is betting the alliance—especially with Trump in the White House—won't fight back over hard-to-attribute provocations.

This year, Russia will ramp up its hybrid operations against NATO. Russian drones have already appeared over Poland and Romania, fighter jets penetrated Estonian airspace for an extended period last September, and weather balloons violated Lithuanian airspace. In addition, Russian shadow fleet vessels have launched drones from the North Sea, and Russian agents and paid gig workers are believed to have been involved in drone flights over airports and critical infrastructure across Western Europe. Cheap commercial drones are

## Major hybrid incidents in 2025

- Drone sightings    ● Cyber    ● Political interference    ● Disinformation/Information warfare
- Sabotage     Election interference

\*In addition to discrete incidents, Russia is carrying out persistent Europe-wide cyber and disinformation campaigns



Source: Eurasia Group

ideal gray-zone weapons—effective enough to disrupt, hard to defend against, and deniable enough to avoid retaliation (please see Box 2: The drone age). These incursions will intensify. But drones are just part of the toolkit. In November, Polish authorities accused Russia of damaging a rail line used to supply Ukraine. Cyberattacks on critical infrastructure—like the April 2025 hack of a Norwegian dam’s control system that released nearly two million gallons of water—will become more frequent. Subsea cables and power lines are also attractive targets: sprawling, hard to protect, and with limited redundancy. Moscow will likely also ramp up GPS jamming of European airports.

Ukraine, meanwhile, will escalate its own deep strikes against Russian energy infrastructure and other targets. Its military faces dire and worsening manpower shortages—roughly one-third (!) of newly mobilized personnel go AWOL. Ukraine’s frontline positions are increasingly exposed in Donetsk and Zaporizhzhia oblasts. The country’s once-decisive advantage in tactical drone warfare has eroded. Ukraine’s most viable path to inflicting economic pain on Moscow is through long-range strikes on Black Sea and Baltic Sea export terminals, from which Russia ships roughly three million barrels of oil per day. As Kyiv grows more desperate, it could also ramp up assassination attempts against Russian elites and possibly bolder strikes. The Kremlin takes the threat seriously and will use it (and false claims of more, like a swarm of non-existent drones targeting Putin’s residence) to justify further escalation against Ukraine and its European backers.

The new variable in 2026 is NATO’s reaction. As Russia continues to escalate, the alliance is preparing a more assertive posture—not just absorbing Russian provocations but actively pushing back to establish deterrence. The shift reflects a growing consensus among European leaders that more must be done to counter Russian hybrid operations. The options under discussion include armed surveillance drones, relaxed rules of engagement for pilots intercepting Russian drones and jet fighters, military exercises in remote and unguarded sections of NATO’s borders with Russia, and more aggressive offensive cyber operations. Not all of these will be adopted, and implementation will vary by member state. The Trump administration’s skepticism toward NATO burden-sharing and its warmer posture toward Moscow will produce intra-alliance tensions as some European members push for actions the US doesn’t support. But the direction is clear: NATO’s years of restraint are adapting to the times.

Putin’s response will be driven by a mix of caution and persistence. In theory, NATO’s new posture could deter him—and in specific instances, it might. He’ll be careful to avoid a shooting war with NATO. But on balance, Putin is unlikely to back down. The war in Ukraine and the

related hybrid campaign against NATO are existential for him—his concept of Russia’s future and the stability of his rule depend on success, and the stakes are increasing the longer and costlier the war becomes (to say nothing of the older and more vulnerable the Russian president grows). A more assertive NATO posture is unlikely to change Moscow’s policy toward the hybrid war. It does, however, increase the risk of an escalatory spiral.

The result: more direct, more frequent, and more dangerous Russia-NATO confrontations. Several scenarios could trigger a crisis. NATO could conduct a large exercise near a remote stretch of the Russia-Finland border, provoking a response from a Russian government that feels tied down in Ukraine and vulnerable elsewhere; Moscow might rush troops to the region and demand the alliance withdraw, sparking a standoff. Or increased GPS jamming at European airports causes a crash that kills hundreds. Moscow has already attempted to place explosive packages aboard cargo aircraft in NATO countries—another tactic that could produce mass casualties. So could a cyber intrusion or sabotage of other European critical infrastructure. Any operation that results in mass casualties would produce public outcry for retaliation, making escalation harder to contain.

A Russia-NATO direct military exchange is also more probable this year, if still unlikely. Russian fighter-jet probes into NATO airspace, combined with looser NATO rules of engagement, could lead to dogfights involving live fire and deaths. Or armed drones from both sides could engage, then one side escalates and purposely strikes a ground target, killing servicemembers.

Russian interference in elections across Europe will intensify in this environment, further stoking tensions with NATO. Moscow will feel encouraged to meddle by the Trump administration’s openly hostile stance toward Europe’s centrist and pro-EU political forces (please see Top Risk #4: Europe under siege). This will primarily take the form of disinformation campaigns on social media aimed at undermining confidence in mainstream parties and elevating Moscow-friendly populists on both ends of the spectrum. Main targets will include regional elections in Germany, where Putin hopes to bolster results for the far-right Alternative for Germany; national votes in Bulgaria and Slovenia, where anti-Western parties have traditionally been influential; and general elections in Hungary, where the Moscow-friendly Viktor Orbán is at risk of losing power. Election interference will further poison European relations with Moscow. In cases of clear attribution, targeted EU sanctions on Russian individuals could follow.

Markets and companies operating in Europe should expect greater tail risks and more volatility, especially in eastern-flank countries. Last September’s drone incursion over

## **As Russia, NATO, and Ukraine all become more risk-acceptant, the margin for error will narrow.**

Poland triggered a brief but notable drop in Polish equities. More frequent and serious incidents—even non-kinetic ones—will cause sharper reactions. Most investors will bet that caution on both sides will limit escalation, keeping the impact moderate. But sentiment in frontline states could sour, and some supply chains may start shifting west.

One wildcard that could change these dynamics is a ceasefire in Ukraine. On balance, Putin remains reluctant to stop fighting while he has momentum. But the odds of a ceasefire are growing, nonetheless. Kyiv's manpower shortfall won't improve, and its battlefield position will worsen; it will probably lose the rest of Donetsk Oblast within the year. Trump administration pressure to agree to unfavorable terms will only intensify. If battlefield and political pressures become overwhelming, Zelensky may feel compelled to accept a deal including meaningful territorial concessions, limits on Ukraine's military, and some form of neutrality. Putin, for his part, may see a ceasefire as a way to pocket his gains and consolidate his relationship with Trump.

A deal on unfavorable terms would risk political instability in Ukraine, including violent protests and a contested political transition, and wouldn't end the hybrid war. Europe would continue to support Ukraine post-ceasefire, and Russia in turn would continue to probe and destabilize European countries—even if the intensity eases once the hot war is over. A bitter Ukrainian public could leave the country en masse given its darkening prospects, and a weakened, partitioned Ukraine would become yet another vector for Russian destabilization rather than a buffer against it. Europe would face an unrelenting gray-zone campaign and new migrant flows from its troubled eastern neighbor.

For three years, the West has treated Russia's hybrid campaign as a nuisance: irritating but manageable, below the threshold that demands a serious response. That calculation is breaking down. As Russia, NATO, and Ukraine all become more risk-acceptant, the margin for error will narrow.



## Box 2. The drone age

**War is getting cheaper. Once the domain of sophisticated militaries, drones, autonomous systems, and cyber tools can now be bought, modified, or built by rebel militias, cartels, and middle powers for a few hundred dollars. The result is more violence, in more places, by more actors.**

Drones are the signature weapon of this shift. Most countries in the world now have military drones such as the Turkish-made Bayraktars. But the game-changer is cheap commercial drones—mostly Chinese-made—that can be easily modified to carry bombs. These low-cost, remotely controlled, and increasingly autonomous air and sea drones are everywhere. It's no wonder that drone incidents worldwide exploded between 2020 and 2024—from 6,000 to 51,000—with known fatalities rising from 11,300 to over 39,000.

The Russia-Ukraine war, where 70% of battlefield casualties now come from unmanned aerial vehicles (UAVs), has become the laboratory: both sides have developed the capacity to produce millions of drones a year, with Ukrainian factories churning out over 4.5 million (!) in 2025. Operation Spiderweb demonstrated how remote autonomous drones launched from railcars could devastate targets hundreds of miles away. But the advantages don't last long: Ukraine's early lead has eroded as Russia adapted its tactics and narrowed the drone gap.

The lessons have spread worldwide. Rebels in Myanmar learned drone warfare from YouTube videos of Ukraine's front lines, building aircraft inspired by Ukrainian designs. Manuals on weaponizing commercial drones circulate online. Colombian and Mexican fighters have enlisted in Ukraine specifically to learn first-person view drone skills—some, reportedly, to bring those capabilities back to drug cartels. In Sudan, Turkish and Chinese drones supplied to rival factions have killed tens of thousands and devastated cities. Colombia's armed groups launched more than 80 drone attacks in 2025, up from fewer than 20 the year before. In Brazil, gangs used drones to launch grenades at police during a raid in Rio de Janeiro. China is developing drone swarms to use

against Taiwan. The Houthis have built an indigenous drone program and deployed armed UAVs in over 1,000 events. For the conventionally outgunned—rebels, smugglers, cartels, insurgent groups—armed drones are becoming the weapon of choice.

Drones don't need to carry weapons to cause damage. Outside of combat zones, adversaries are using unarmed drones to spread chaos, probe defensive gaps, and test how far they can push before triggering a response. Unexplained drone sightings have disrupted air traffic and forced airport closures from the United States to Scandinavia. Russia may be behind some of the swarms appearing over critical infrastructure across Western Europe. These incursions are hard to attribute, making them ideal gray-zone tactics. The goal isn't destruction; it's eroding deterrence one disruptive incident at a time.

Defending against these systems is difficult. Drones are cheap, small, and can fly low enough to evade radar. Shooting them down over populated areas is dangerous and expensive—defenders can spend more on a missile than the drone cost to build. And that's before you add autonomy to the mix. Most drones today require skilled human operators, which limits how many can be deployed at once. Advances in AI are removing that constraint. Autonomous drones don't need pilots or real-time communication links and can operate in swarms. Ukraine has already experimented with them. As AI advances and costs continue to drop, the human bottleneck will disappear, and the capacity for both destruction and disruption will scale further.

The trendline is clear: As with terrorism in the early 2000s, the baseline of drone incidents—inside and outside war zones—is rising steadily. For a growing number of businesses and regions, that means new risks and disruptions to operations, supply chains, and infrastructure.





## 6 State capitalism with American characteristics

In 2025, we warned that President Donald Trump would amplify crony capitalism in the world's largest economy. What has emerged is the most economically interventionist administration since the New Deal. In 2026, this will expand and entrench further, reshaping the relationship between the US public and private sectors. As Trump told *The Wall Street Journal*: “I think we should take stakes in companies. Now, some people would say that doesn't sound very American. Actually, I think it is very American.”

Trump is hardly the first president to embrace industrial policy. Former President Joe Biden's administration did so through the Inflation Reduction Act and CHIPS Act, albeit with a limiting principle: supporting strategic sectors while leaving non-strategic sectors to markets. Small yard, high fence. There is an economic and geopolitical case for going further in an era of great power competition.

But Trump has shown no such limiting principle. Trump's state capitalism is personal and transactional. Businesses that align with Trump's agenda elicit better treatment from the federal government. Though most US firms continue business as usual, an increasing number of those that don't align risk finding themselves at a disadvantage. Increasingly, success in M&A bids, regulatory approvals, tariff exemptions, or access to deals requires not just alignment with the agenda but proximity to the president's inner circle. Some of corporate America has quickly adapted to the new rules. The break-and-repair approach to tariffs—exemptions dangled, then granted or withdrawn—has pulled firms across the economic spectrum into the lobbying game. Playing along is economically rational; resistance is costly. That's what makes the system self-reinforcing.

The toolkit is expansive, leveraging tariffs, equity stakes, revenue-sharing deals, regulatory leverage, and access to US markets and technology. The government converted CHIPS Act grants into a 10% equity stake in Intel, making Treasury the company's largest shareholder. Trump holds personal veto power over U.S. Steel through a golden share. The Pentagon acquired 15% of MP Materials and guaranteed prices at twice market rates for a decade—quasi price controls in American mining that have become a “template” other commodity groups are lobbying for. Export controls, designed to protect national security, have become a revenue tool as well. Nvidia and AMD agreed to pay 15%-25% of China semiconductor revenue to the Treasury. Pfizer agreed to lower drug prices, sell through a federal portal called TrumpRx, and invest in US manufacturing in exchange for tariff relief. Semiconductors, steel, critical minerals, pharma, and soon defense—the number of sectors subject to intervention is growing.

The transactional logic extends to foreign governments. Last year, the administration developed a deal template: investment in exchange for tariff relief and market access. Japan established a \$550 billion fund to finance US projects personally selected by Trump—a pool of capital available to the White House outside the congressional appropriations process. Korea, the European Union, and Gulf countries have pledged trillions more. But the transactionalism goes beyond tariffs. Ukraine signed a critical minerals agreement under duress to maintain US support. Gulf states secured AI chip exports shortly after striking crypto partnerships and real estate deals involving Trump's inner circle. Qatar's “flying palace” gift preceded a NATO-like security guarantee. Venezuela's post-Maduro government, desperate to revive its shattered oil sector, offers a new opportunity: preferential deals for US oil companies in exchange for sanctions relief and Washington's political support ... or else. Market access, security commitments, diplomatic favor—more opportunity appears to be on the table for foreign governments willing to pay the price.

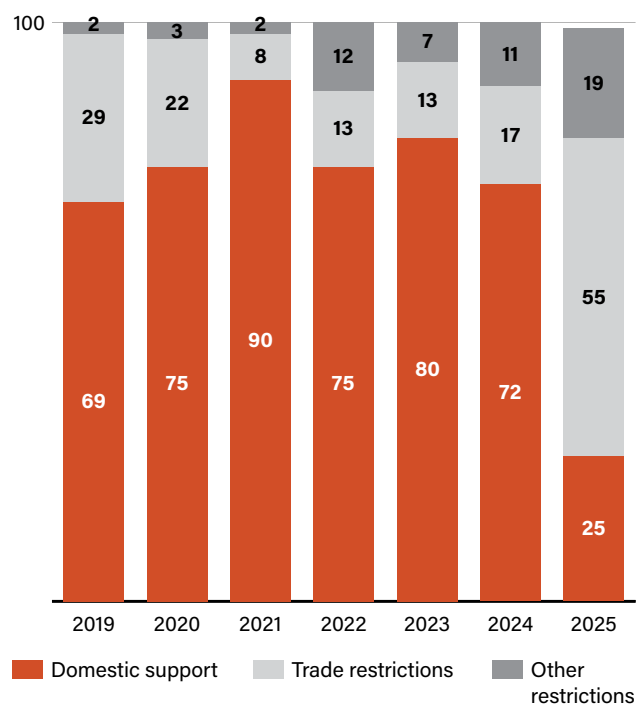
In 2026, Trump will face mounting pressure to show his agenda is delivering for American voters. But consumer sentiment is at historic lows, the labor market is softening, and inflation remains sticky. AI-fueled growth and stock market gains aren't translating to broadly-felt prosperity—the economy is increasingly K-shaped. The \$7 trillion in sovereign and corporate investment pledges will face real tests, and many will be exposed as theater. The disconnect between Trump's promised manufacturing renaissance and the reality of job losses in the sector will become harder to deny. Democrats are likely to flip the House in November—they hold the advantage on affordability, and midterms almost always punish the president's party.

The prospect of political setbacks will push this administration to double down, not pull back (please

see Top Risk #1: US political revolution). Tariffs, Trump's tool of choice, will become harder to use this year: Deals already struck limit flexibility, the China détente caps US leverage, and the Supreme Court could rule many of the administration's tariffs illegal (please see Red herring: “Tariff Man” at large). But constraints on the tariff front will mean intensification elsewhere. Equity stakes will spread to new industries, revenue-sharing arrangements will become more frequent, regulatory leverage will sharpen. Expect a frustrated president to reach for more aggressive measures and move beyond this administration's already expansive view of national security to intervene in more companies and sectors.

### From to

% of distortive industrial policy measures by type



Source: Eurasia Group, NIPO by Global Trade Alert, December 2025

Were the economy to tip into recession or inflation to spike, Trump would become more risk-acceptant and his response more interventionist. Pressure on the Fed would intensify beyond jawboning, potentially including further attempts to pack the board with loyalists. An AI bust (please see Box 3: Bubble trouble) could trigger selective bailouts—politically aligned firms get rescued, disfavored ones are left to fail. Price controls have historical precedent and political logic—blame corporations, cap prices, claim victory—especially if tariffs are contributing to the problem. The government may even take larger equity stakes in struggling strategic industries or force consolidation to create national champions. Markets assume there is a “Bessent put”: that advisers such as Treasury Secretary

## Trump is picking winners and losers at a scale not seen in modern US history.

Scott Bessent would convince the president to back off in the face of severe enough selloffs. Maybe ... but if they are wrong, the reckoning could be severe. The political instinct will be more intervention, not less.

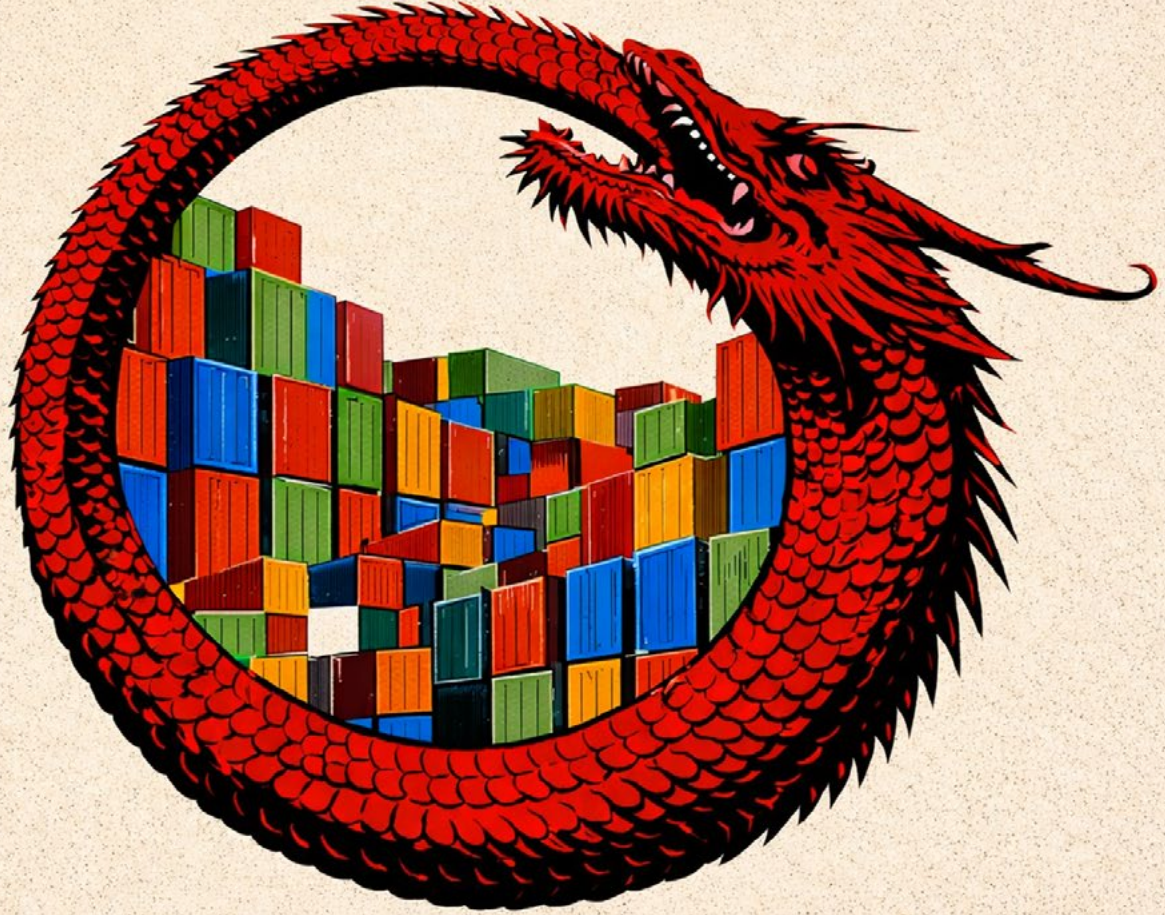
Over time, productivity will suffer as more capital flows to politically favored firms rather than the most innovative ones, as CEOs spend more time cultivating access and favor, and as the Oval Office increasingly intervenes in the marketplace. Government equity stakes will entrench inefficient incumbents at the expense of challengers and market dynamism. The administration has already forbidden U.S. Steel from closing an Illinois plant that the company considers economically unviable. Investors will ask not just where capital will earn the highest return, but what share Washington demands and how to stay in its good graces. Shareholders will lose as companies are pressured to redirect resources to politically aligned investments rather than higher return opportunities.

The rule of law will erode as many transactional deals rest on contested legal foundations: revenue-sharing agreements that function as constitutionally prohibited export taxes, sovereign investment funds that bypass congressional appropriations, and ad hoc arrangements that amount to de facto taxation by executive action rather than legislation. America's traditional edge over autocracies—predictability, property rights, rule-based governance—will shrink. Corporate planning becomes harder when the rules of the game depend on presidential discretion. The precedent will stick. Once one administration uses these tools—equity stakes, golden shares, revenue sharing—in the name of national security or reshoring, the next administration will use them too. The mechanisms Trump is normalizing could just as easily be deployed by a Democratic administration for climate policy, labor-friendly industrial renewal, or social

equity. It's a bipartisan ratchet, and a self-sustaining one: The system will create vested interests and patronage networks that resist dismantling.

America's strategic position will suffer wherever short-term commercial and political goals override national security and long-term advantages. The administration's willingness to let Nvidia sell AI chips to China for a 25% revenue share signals that commercial interests can trump strategic competition. Gulf chip sales follow the same pattern—strategic AI leverage traded for commercial gain. The TikTok resolution prioritized Trump-aligned investors and political gain over risk mitigation. The more national security tools are used for short-term gain, the less credible they become for genuine security purposes. Partners will accommodate Washington's demands to avoid escalation, but they will quietly hedge—building alternatives and leverage for the future. America's alliances, technological edge, and institutional credibility will be weakened for short-term wins that won't compound.

Two decades ago, Western leaders imagined China would converge toward the American economic model. Instead, it's the United States that is now borrowing from China's playbook—though the differences remain vast. China's authoritarian state capitalism is riddled with corruption and waste, but it operates through durable institutions oriented toward long-term objectives: industrial capacity, technological independence, national power. America's political system, with its electoral whiplash and hyperpolarization, can't match China's strategic patience and coherence. That short-termism is a feature of its democracy, however flawed. Cronyism is not, though it has long been a feature of American capitalism. Trump is combining the two into something new: a system where the president—any president—picks winners and losers at a scale not seen in modern US history.



# 7 China's deflation trap

**China's deflationary spiral will deepen in 2026, and Beijing won't do anything to stop it. With the 21st Party Congress looming in 2027, Xi Jinping will prioritize political control and technological supremacy over the consumption stimulus and structural reforms that could break the cycle. Beijing has the means to prevent a crisis, but living standards will deteriorate, the fallout will spread abroad, and the world's second-largest economy will remain stuck in a trap of its own making.**

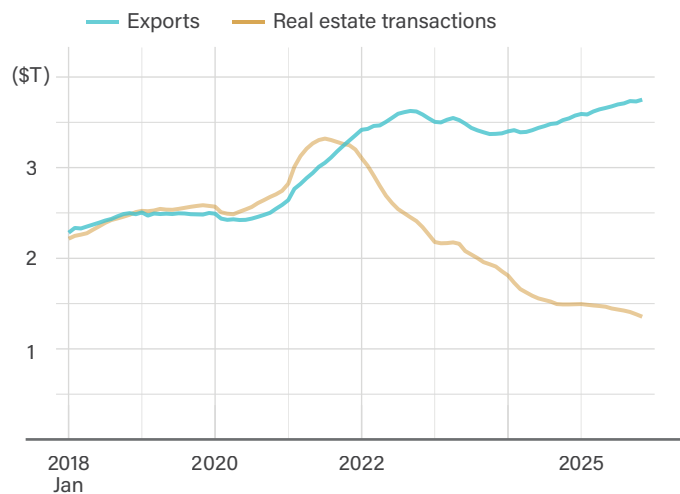
Home prices in China have been falling for four and a half years—a household wealth destruction on par with America's 2008 crash, except it's still accelerating. Consumer confidence, investment, and domestic demand have cratered with it. Beijing bet big that high-tech manufacturing would fill the gap left by property. Instead, state-driven investment has created overcapacity, and weak domestic demand means there aren't enough buyers to absorb it.

The result is “involution”: too many Chinese firms chasing too little demand, slashing prices to survive. Margins collapse, forcing even well-run firms to cut wages and jobs to stay afloat. Workers spend less. Demand weakens further, so firms cut prices again. Meanwhile, debts grow harder to service with each turn of the cycle. Banks and local governments keep zombie firms alive—rolling over loans, protecting local champions—which keeps overcapacity entrenched. The debt-deflation spiral feeds on itself. Donald Trump's tariffs last year made the situation worse, closing off a critical export market and confronting Chinese firms with a grim choice: slash prices to find buyers outside the United States, or transship goods through third countries to reach America anyway. Either path squeezes margins further. Over a quarter of listed Chinese companies are now unprofitable, the highest share in 25 years.

## Exporting the slump

### The great substitution

China, property sales and exports (in USD, 12m rolling sum)



Source: Eurasia Group, Macrobond, NBS; China Customs, Wind

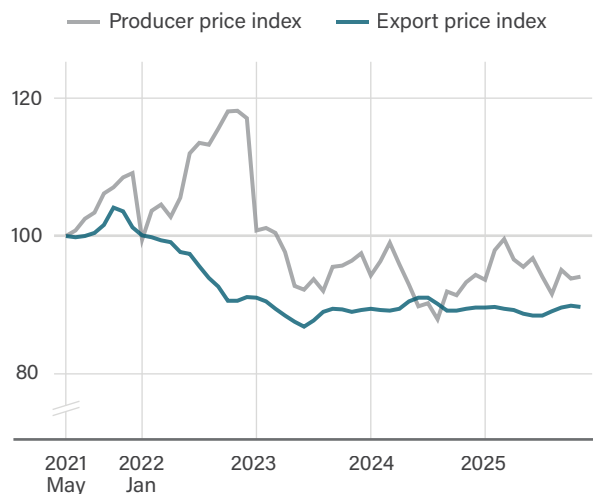
The result: China enters 2026 with ten straight quarters of deepening deflation, the longest such slump any major economy has suffered in decades. Disposable income has stalled at \$5,800 per person, while consumption accounts for just 39% of GDP—half the US share. China faces the prospect of a Japanese-style “lost decade” but without Japan’s social safety nets or per capita wealth. Escaping that kind of trap requires decisive action. Beijing won’t deliver it.

Xi’s vision for China’s economy—long-term discipline, technological self-reliance, state control, and a rejection of short-term stimulus he views as Western-style “welfarism”—makes a course correction hard to imagine. He’ll keep pouring state investment into manufacturing and high-tech sectors, not consumption. But more investment in saturated industries will only aggravate gluts and drive prices down further. The advanced sectors Xi is betting on lift headline GDP but create few jobs. Any stimulus will remain modest and targeted, tilted toward manufacturing rather than the broad demand boost needed to break the cycle.

The political calendar makes a pivot especially unlikely in 2026. This year marks the launch of the 15th Five-Year Plan and the final run-up to the 21st Party Congress, where Xi will secure his fourth term. Bureaucrats are anxious about hitting growth targets and terrified of taking political risks. Beijing’s widely touted “anti-involution” campaign—ostensibly intended to curb the destructive price wars—won’t change anything. Raising prices requires curbing industrial production, which means less investment and slower GDP growth. Xi won’t accept that tradeoff before the Party Congress.

### Deflation at home and abroad

China, producer prices and export prices (May 2021 = 100)



The consequences will be felt across Chinese households and firms alike. With real incomes weakening, housing collateral losing value, margins getting crushed, and real interest rates rising, debt-service burdens will squeeze everyone. There’s limited room for interest rate cuts, so neither families nor private companies can restructure their way out. Mortgage defaults and hidden bank bad debts will surface as major problems in 2026.

Rising small and medium-sized enterprise failures and nonperforming loans will strain social stability. The private sector accounts for 80% of urban jobs, so trouble for small businesses translates quickly into trouble for workers. Deflation and corporate distress will mean fewer jobs, lower wages, and brutal hours for those lucky enough to remain employed.

The pain will fall hardest on the young. Youth unemployment is high and rising, and even graduates who land jobs face the “996” grind—9am to 9pm, six days a week—with little hope of advancement. While young Chinese won’t riot, a growing number are opting out altogether. The “lying flat” movement reflects a generation’s rejection of China’s culture of overwork and hyper-competition in service of “national greatness.” They did what they were told: studied hard, got degrees, chased good jobs. The rewards never came. Now, a cohort raised on promises of prosperity is tuning out the Chinese Communist Party’s calls for collective sacrifice. For a generation of young urban Chinese, the social contract is fraying and the “China Dream” appears an illusion.

## **Xi Jinping will prioritize political control and technological supremacy over the consumption stimulus and structural reforms that could break the deflationary cycle.**

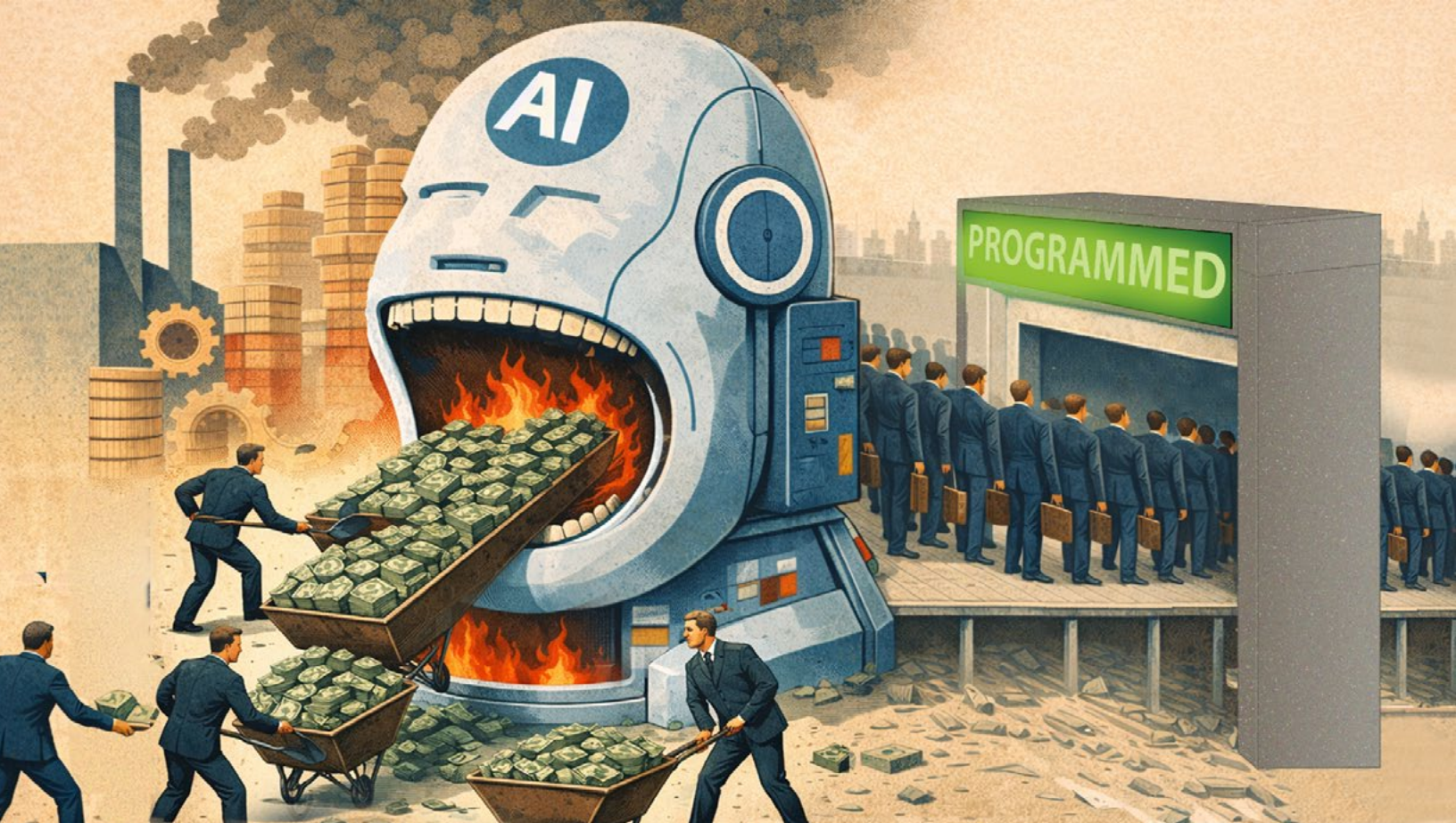
To be sure, Beijing has enough firepower and political control to prevent systemic economic damage and social unrest. But there's a real risk of policy overreaction reminiscent of the zero-COVID pivot or Shanghai's 2022 lockdown before the 20th Party Congress—abrupt, opaque interventions like forced restructurings, sudden nationalizations, regulatory crackdowns without warning. A harsher political climate would deter private investment, undermining China's main engine of job creation. Even without that scenario, the economy will keep tilting in the wrong direction: more manufacturing, less consumption; more state, less private sector. The housing slump will drag on. The structural imbalances will deepen.

China's economic dislocations will ripple outward as Beijing continues to export its way out of the property crisis. This will unleash an even bigger wave of cheap goods on overseas markets than last year, when China's trade surplus surpassed \$1 trillion. Xi's industrial policy is fundamentally beggar-thy-neighbor, aiming to make other countries reliant on Chinese supply chains while making China self-sufficient. Chinese goods exports have risen by 40% since the start of the housing crash, while import volumes have flatlined. For most countries, trade with China now delivers deindustrialization and a drag on growth, not shared prosperity.

Some trading partners, such as the European Union, will respond to the flood of Chinese exports with tariffs,

subsidies, and other protectionist policies. But with few alternative supply chains in place, China's export-led model will stand largely unchallenged this year. Beijing will nonetheless move to leverage its supply chain dominance more assertively, extending its export control threats from rare earths to more critical minerals, lower-grade chips, and key chemicals—though not against Washington as long as the Korea truce holds—to raise the cost of decoupling and safeguard its export engine. The goal will be to deepen partner dependence and reinforce China's global economic leverage, ensuring the world remains too reliant on Chinese imports to push back effectively even as trade frictions rise.

But Beijing can't export its way out of trouble indefinitely. China's trade surplus now exceeds Japan's 1987 peak as a share of world GDP—the imbalance that helped trigger the Plaza Accord and forced Tokyo into a wrenching rebalancing. History suggests there are limits to how long trading partners will absorb another country's overcapacity, even if they lack the leverage to push back in the short term. Higher tariffs from fed-up partners, a return to unmanaged decoupling with the United States, or a global downturn would choke off foreign demand, leaving China with no fallback. Xi would then have little choice but to shift substantial resources toward stimulating consumption. But with each year of deflation making debts heavier and escaping the trap harder, it may be too late by then.



# 8 AI eats its users

**Under pressure to generate revenue and unconstrained by guardrails, a number of leading AI companies will adopt business models in 2026 that threaten social and political stability—following social media’s destructive playbook, only faster and at greater scale.**

We remain bullish on AI’s revolutionary potential. Today’s frontier models reason through complex problems, show their work, and are embedded in coding, research, and knowledge workflows. The hyperscalers are offloading large chunks of software development to AI, accelerating their own R&D cycles. In biotech and materials science, AI is opening new research pathways—though commercial breakthroughs remain mostly ahead of us. Hundreds of millions of people now use chatbots daily for everything from drafting emails to debugging code and learning new skills. This is real, and it’s just the beginning.

But AI can’t live up to investors’ expectations in the short term. Even after hundreds of billions of dollars of investment, the most advanced models still hallucinate. Their capabilities are jagged: dazzling at some tasks, unreliable at others (and often unpredictably so). That inconsistency makes them hard to deploy in high-stakes applications where errors are costly. Business adoption has been uneven, with only about 10% of US firms using AI to produce goods and services, according to the Census Bureau. Many companies report significant productivity gains, but surveys suggest most have yet to see meaningful bottom-line impact. Real productivity increases will arrive through wide diffusion of the technology across the economy, but that takes time. Yet markets have priced in revolution, not evolution.

Some of these companies are caught in a bind. Promises of Artificial General Intelligence and the massive capital expenditures needed to build ever-larger models have driven investor expectations to stratospheric levels. Cumulative AI-driven investment is likely to exceed \$3 trillion by 2030. As some frontier model-makers prepare for IPOs in 2026

## Growing pressure for many AI labs to demonstrate a path to profitability will accelerate the shift to extractive and socially dysfunctional business models.

or 2027, they will come under growing pressure to show they can deliver returns on this capital—especially given intensifying competition from cheaper Chinese open-source alternatives like DeepSeek, which offer “good enough” performance at a fraction of the cost.

To justify current investment levels and valuations, AI revenue will need to grow by an order of magnitude. Absent regulatory constraints or commonly agreed rules of the road—the scenario Eurasia Group warned about in our Top Risk 2025 #8: AI unbound—some companies will do whatever it takes to keep the party going. Aggressive monetization schemes based on user data, ads woven into interactions, erotica to keep users hooked, engagement-maximizing algorithms regardless of psychological and social harms—these business models may make financial sense, especially in the short term. They’re also corrosive for society and democracy.

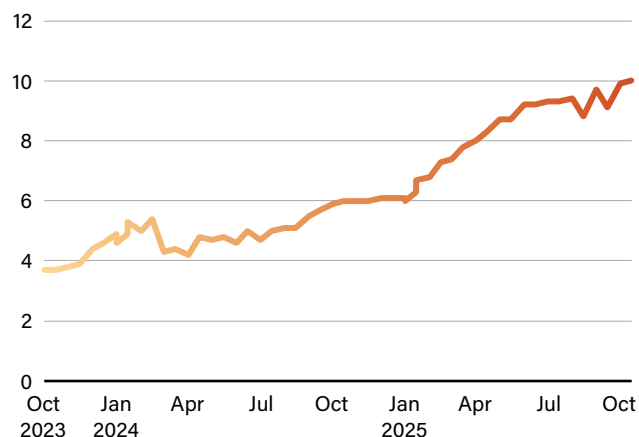
We’ve seen this movie before. Cory Doctorow calls it “enshittification”: platforms attract users with attractive “free” products, lock them in, then systematically degrade the experience to extract maximum value—leaving just enough to keep people stuck. Social media transformed from tools for connecting with friends and family into engagement-optimized rage machines. Now nearly half of young people wish social media had never been invented, but network effects make it costly to leave, and accordingly almost nobody does.

AI is following the same trajectory—only faster, and with a technology far more strategically important to the global economy than social media ever was. And AI isn’t just another platform. Social media captures your attention. AI programs your behavior, shapes your thoughts, and mediates your reality. Unlike scrolling through a feed, where you know you’re consuming content, hyper-personalized AI companions become trusted confidants—entities that “know” you better than anyone else in your life. When that entity’s primary purpose is not to serve you but to keep you engaged and extract value, you become the product. Ask such a chatbot a question, and it follows up with questions of its own—not because you want conversation but because that’s what the chatbot has been optimized to do. An AI companion that’s learned your insecurities can recommend products calibrated to exploit them, and you’ll never know the difference between advice and advertising. If the AI appears free or cheap, you’re paying with something more valuable: your autonomy, your privacy, your cognitive capacity, and your ability to think independently.

In 2026, growing pressure for many US AI labs to demonstrate a path to profitability will accelerate the shift to extractive and socially dysfunctional business models. Major platforms are already experimenting with ads embedded in conversations where—unlike traditional search—there’s no way to distinguish neutral information from paid influence. AI companions will nudge users

### Businesses aren't biting yet

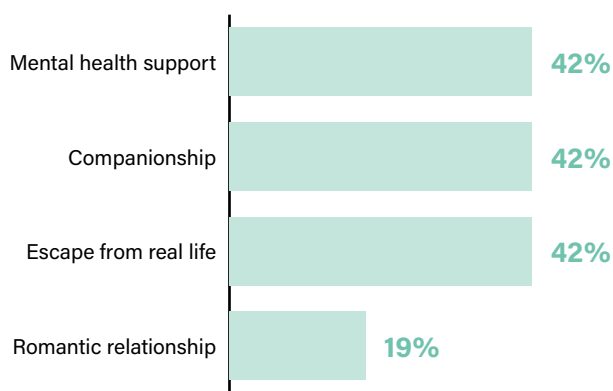
% of US firms using AI to produce goods and services



Source: Eurasia Group, U.S. Census Bureau, Business Trends and Outlook Survey (BTOS) 2023-2025, Center for Democracy and Technology (June-August 2025 survey, n=1,030)

### But teens are all in

% of US high-school students who said they or their friends used AI for



toward purchases, beliefs, and behaviors that serve the interests of the highest bidder. Personalized AI will stifle normal social and emotional development, particularly in young people, creating an angry and alienated generation.

The downstream consequences extend to cognition. AI removes the need to concentrate on anything for extended periods. It makes already-addictive platforms more so, ensuring fewer people read books, engage with long-form content, or develop critical thinking skills. Achievement scores in literacy and numeracy are declining across the West for the first time in decades; the threat is not superhuman machines but the decline of thinking, feeling, social humans. Deliberative democracy requires informed, engaged citizens capable of independent thought. AI risks producing the opposite: a population optimized for engagement, extraction, and manipulation.

At current valuations, AI is priced to “eat” the economy, unlocking spectacular productivity gains by displacing jobs on a scale that would trigger significant social and political backlash. But mass labor substitution doesn’t appear imminent, even if it may come later. Should investors come to believe that disruption—good and bad—will come more slowly than they anticipated, a sharp market correction could follow (please see Box 3: Bubble trouble). In the meantime, AI will “eat” its users as companies subject hundreds of millions of people to real-

time psychological experiments with no clinical trials, safety monitoring, or informed consent.

None of this is inevitable. China’s government is deliberately restricting the deployment of consumer-facing, engagement-maximizing AI, assessing that the psychological, societal, and political risks outweigh the potential strategic benefits. President Xi Jinping views personal chatbots much as he views TikTok: as “spiritual opium.” Washington, by contrast, allows short-term private profits to take precedence over citizen well-being. President Donald Trump’s administration—its senior ranks staffed by Silicon Valley allies and its political fortunes tied to the AI boom—is more likely to backstop the AI sector than to force it to internalize the negative social externalities of its business models.

AI will unleash incredible advances in domains from biotechnology to robotics, advanced materials, energy efficiency, and space exploration. Much of this will come from smaller, leaner, purpose-built models, not consumer behemoths designed for viral adoption and maximum engagement. The combination of inflated near-term expectations, pressure to monetize, and lack of regulatory and governance guardrails means that American AI is set to impose its costs on society before it delivers its promised gains.

## Box 3. Bubble trouble

**The US economy has become a one-legged stool. By some measures, the surge in AI-related investment accounted for most of GDP growth in the first half of 2025; without it, growth would have been far lower as other parts of the economy struggled under tariff uncertainty, weak consumer sentiment, and sluggish hiring. AI-linked stocks also drove nearly 75% of market gains last year. With valuations approaching dotcom-era peaks and so much riding on it, it's worth asking: What happens if the AI boom goes bust?**

We're not predicting that—or when—investor sentiment will turn. And a market crash wouldn't mean AI was a dud all along. The technology is real, useful, and (we think) revolutionary. But there are many reasons expectations could shift: AI could prove not economically transformative fast enough to justify current valuations; diminishing returns, energy constraints, or politics could slow the scale-out; adoption could lag and returns could take longer than balance sheets can sustain; or the technology could become commoditized, with most of the value captured by users or Chinese competitors offering good-enough models at a fraction of the cost. AI doesn't have to fail for investors to sour on it—it just has to disappoint.

A correction would hit the real economy fast. American households now hold more of their wealth in stocks than at any point since the dotcom era. The wealthiest 10%, in particular, own 85% of equities and account for half of all consumer spending—the highest share on record. A crash comparable to that of 2000 could reduce household net worth by 8%, triggering a pullback in spending large enough to tip America into recession.

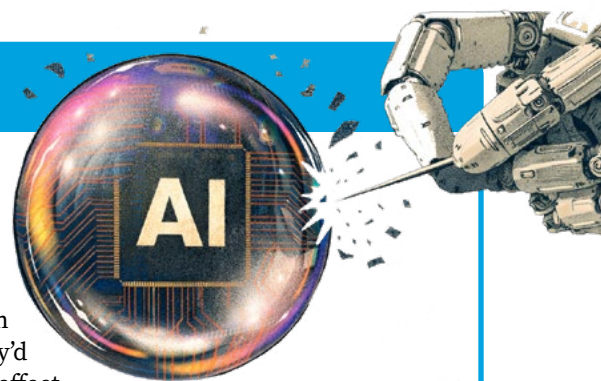
Such a downturn would trigger pockets of financial distress—not a 2008-style systemic crisis, but enough to tighten credit and amplify the recession. Early AI investment was funded largely through Big Tech's vast cash reserves. More recently, financing has been shifting toward debt, including from lower-quality borrowers, and circular arrangements—AI companies investing in each other, buying chips with that money, announcing deals that boost stock prices they've already bet on. Banks and shadow lenders are now exposed to potential defaults. If AI investments are marked down sharply, borrowers could be forced to sell assets at a loss to meet their obligations, deepening the rout.

The spillovers of a crash would be global. Foreigners hold \$18 trillion in US equities; they'd feel the wealth effect

too. Weaker demand from the United States would compound pressure on a low-growth Europe and a deflationary China already struggling with US tariffs. Asian economies tied to the semiconductor supply chain would see orders evaporate as demand projections are revised downward.

How a bust would affect American politics is less clear. Stock market crashes don't always doom incumbents—Vice President Al Gore won the popular vote (if not the electoral college) in 2000 despite the dotcom collapse. But Trump has tied his fortunes to the (AI-fueled) economic boom more explicitly than any predecessor in recent memory. Americans are already souring on AI amid rising energy costs, job displacement fears, and data centers in their backyards. A market crash that decimates their savings accounts and 401(k)s—especially one before the midterms—could leave Trump politically exposed. The policy response would likely be aggressive: more pressure on the Fed to slash rates, stimulus checks, bailouts in exchange for equity stakes in distressed companies, and tariff reductions to ease pressure on consumers (please see Top Risk #6: State capitalism with American characteristics).

The good news is that a recession, if it comes, could be short and shallow, much like in 2001. Many individual AI companies would not survive the shakeout, but the technology itself would (as will patient investors ... though if history is any guide, it may take them a while to break even). The late 1990s boom bequeathed the fiber optic network and internet giants that underpin today's digital economy—and indeed, the AI revolution. The current buildout would likewise leave behind the infrastructure that supports the next wave of innovation and productivity gains—even if today's investors aren't the ones to benefit.





## 9 Zombie USMCA

**North American trade will be stuck in limbo in 2026. The United States-Mexico-Canada Agreement (USMCA) won't be extended, updated, or killed. It will stagger on as a zombie, keeping businesses and governments guessing while President Donald Trump continues negotiations with America's two largest trading partners.**

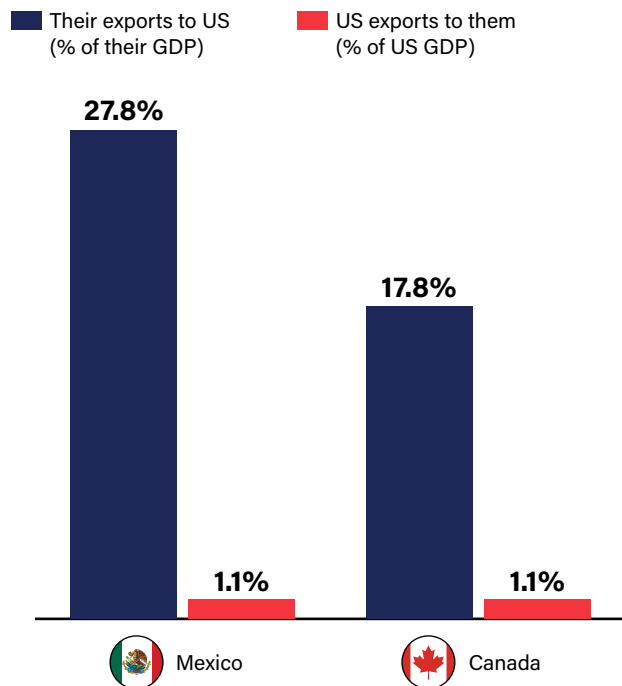
The agreement is up for its mandated review this year, when the parties can extend it for an additional 16 years. But Trump wants to avoid the constraints of a new trilateral deal so he can keep using bilateral leverage to squeeze economic and political concessions from both countries. Canada already scrapped its digital services tax. Mexico is imposing tariffs on China. Both are cracking down on fentanyl flows. Washington gave up nothing in return. Why lock into an agreement when the current approach keeps delivering for the US president? Neither Canada nor Mexico can afford to walk away. The United States is the destination for roughly 75% of Canadian exports and 80% of Mexican exports. Trump holds most of the cards and he knows it.

The result will be a “zombie USMCA” that is neither fully dead nor alive—and a North American trade zone buffeted by chronic uncertainty. Tariff exemptions for USMCA-compliant goods will hold. Covering roughly 80% of US goods imports from Canada and Mexico, these exemptions will limit the average effective US tariff rate and keep the agreement technically alive. But in the key industrial sectors the Trump administration wants to reshore—autos, steel, aluminum, which are subject to Section 232 national security tariffs—North American free trade will be dead. Everything in between will be up for grabs amid evolving US demands and increasingly bilateral negotiations.

This approach suits Trump's domestic politics. He can exempt the bulk of US imports—including energy, with roughly 60% of US crude coming from Canada and 10% from Mexico—to limit the cost-of-living hit to American households while turning the screws on Canadian and Mexican manufacturers, whose production he wants to move to the United States.

## North America's asymmetric dependence

Exports, 12m rolling sum, % of GDP



Source: Eurasia Group, Macrobond

American demands on both neighbors will be extensive. For Canada, they will center on tariff rate quotas on Canadian autos, steel, and aluminum; expanded access to Canada's banking and dairy markets; an end to what Washington calls discriminatory taxes and regulations targeting US tech and entertainment firms; tighter border security; higher defense spending; and more purchases of US military hardware. For Mexico, the emphasis will be on crackdowns on Chinese investment and transshipment; updated energy regulations to favor US companies; ramped-up enforcement against cartels, illegal immigration, and border security; and increased water deliveries to US border states. And hanging over all of it: the threat of targeted US military intervention against cartels (please see Top Risk #3: The Donroe Doctrine).

Mexico and Canada will respond very differently. President Claudia Sheinbaum wants a quick deal, even a subpar one, and she's working pragmatically to get there. By contrast, Canada is betting that time is on its side—that cost-of-living pressures in the United States and Republican midterm anxieties eventually force Trump to moderate (please see Red herring: “Tariff Man” at large). A tough stance toward

Washington is also popular at home, giving Prime Minister Mark Carney political cover to hold the line. For Ottawa, no deal might be better than a bad deal this year.

That calculation sets up a rough ride for Canada and Carney in 2026. Trump apparently likes Carney personally but doesn't like Canada's tough, detail-oriented approach to negotiations—or Canadian retaliatory tariffs and consumer boycotts. Canada isn't willing to make the concessions on market access or military purchases that would give Trump an obvious win, and Trump isn't willing to back down. With talks stalled, tariffs will stay elevated and weigh on growth. Ontario's auto and steel heartland will sputter, leaving Carney and Premier Doug Ford facing political headwinds in the vote-rich province. Promises of new infrastructure projects and “buy Canadian” procurement won't ease the near-term tariff pain. Canadian firms in unrelated sectors risk becoming collateral damage.

Mexico faces a different calculus. Sheinbaum will focus on negotiating exemptions within the existing sectoral tariff regime ahead of broader talks. But trade uncertainty combined with domestic fiscal consolidation will keep FDI flows tepid and public investment at record lows. Growth will slow in an economy that's already losing steam. Sheinbaum's public popularity and Morena's dominance will shield her politically—but they won't protect Mexican businesses or workers.

To be sure, the United States will feel pain too. Automakers have spent three decades building continent-wide production lines; unwinding that won't be cheap. And in the unlikely (but not inconceivable) event that that Trump formally withdraws from USMCA to pursue fully separate bilateral deals, the market and economic fallout would be severe. The threat alone will shadow investment decisions throughout the year.

Canada and Mexico will still face lower effective tariff rates than most of the world. But preferential treatment won't make navigating North American trade any easier this year; the days of free and predictable North American trade are over. Sectoral tariffs designed to reshore production will develop constituencies that benefit from and lobby for them. For firms trying to plan beyond the next quarter, 2026 will be a year of renegotiating contracts, hedging bets, and delayed investments. That's the cost of doing business when the rules keep changing.

**Why lock into an agreement when the current approach keeps delivering for the US president and neither Canada nor Mexico can afford to walk away?**



# 10 The water weapon

**Water is becoming the most contested shared resource on the planet. In 2026, demand pressures will intensify, the governance vacuum will deepen, and water will become a loaded weapon in several of the world's most dangerous rivalries—and a tool for non-state actors exploiting state weakness. What was a humanitarian crisis is becoming a national security threat.**

The ingredients have been building for years: roughly half of humanity lives under water stress for at least one month annually; 1.8 billion people face absolute scarcity. Population growth and rapid urbanization are straining basins already overdrawn—megacities from Chennai to Mexico City and Tehran have faced “Day Zero” crises or near-misses. Water-driven displacement is accelerating. Surging energy demand is pushing countries to build hydropower dams even as the water they depend on grows scarcer. And climate change is tightening the vise: Himalayan glaciers are melting faster, monsoons are growing erratic, and droughts are deepening across South Asia and the Sahel.

There's no architecture to govern how countries share the water that remains. Nearly two-thirds of global freshwater crosses national borders, yet three-fifths of the 310 international river basins lack any framework to manage disputes. Key powers like the US and China aren't signatories to the 1997 UN Watercourses Convention. Unlike climate, biodiversity, or desertification, water has no equivalent global process—no annual COP, no binding targets, no enforcement mechanism. There have been only two UN water conferences to date, with a third scheduled for December in the United Arab Emirates. And populist politics poisons what little voluntary cooperation remains. Hotter temperatures and angrier publics make compromise harder when it matters most.

The dangers emerge where state and non-state actors are turning water stress and governance collapse into leverage, even if they don't cause a major crisis this year.

## Hotter temperatures and angrier publics make compromise harder when it matters most.

Risks are most acute in Africa, where many states are too weak to manage resources in the first place. In the Sahel, armed groups tied to Al Qaeda and the Islamic State have learned that controlling water means controlling populations. They seize wells, destroy infrastructure, settle disputes governments can't, and recruit from communities that feel abandoned. Ungoverned water scarcity isn't the primary driver of the region's escalating jihadist threat (please see Box 4: The Sahel's G-Zero), but it sharpens local grievances and gives armed groups a resource to exploit—especially in Mali, Niger, and Burkina Faso. Hundreds of clashes between farmers and herders have erupted over dwindling water in the central Sahel in recent years. The rapid shrinking of Lake Chad is exacerbating cross-border disputes, straining relationships among Chad, Cameroon, Niger, and Nigeria, and contributing to economic collapse and militant recruitment. As drought deepens and states weaken, that violence will intensify—and extremists will exploit every gap.

Water is also becoming a weapon in interstate rivalries. The Egypt-Ethiopia standoff over the Nile is already fracturing regional security cooperation. In September 2025, Ethiopia inaugurated the Grand Renaissance Dam after more than a decade of negotiations failed to produce a binding Nile agreement. The dam gives Addis Ababa control over a river that supplies over 90% of Egypt's freshwater. Cairo, having lost its leverage to stop construction of a project

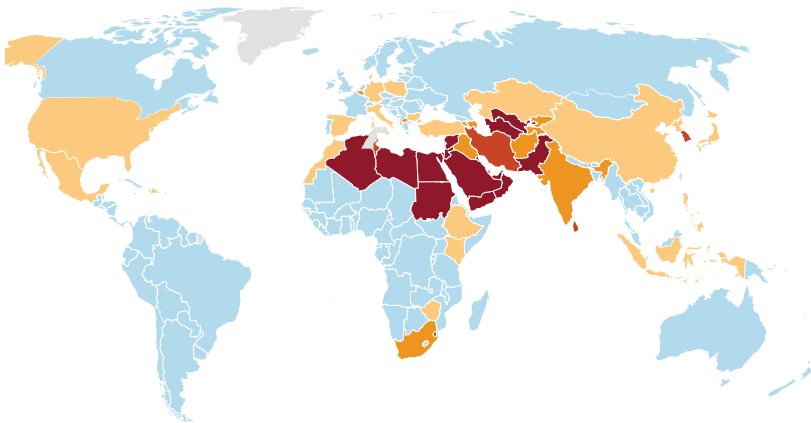
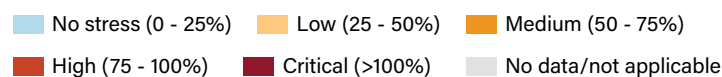
it calls an existential threat, has looked for other ways to pressure Addis Ababa. It has aligned with Mogadishu—which has its own dispute with Ethiopia over a port deal with breakaway Somaliland—and deployed troops to Somalia's counterterrorism mission, hoping to extract concessions or at least constrain Ethiopian influence. Ethiopia views these moves as encirclement. Egypt can keep pressing and risk deeper regional conflict or accept the dam and hope Ethiopia won't weaponize it during droughts or crises. Neither path leads to water security—and both leave the Horn of Africa more inflamed.

Further north, Morocco is building a series of dams to tackle water scarcity, including the Kheng Grou dam near the Algerian border. It is set to be completed by summer 2026 and would restrict water access to hundreds of thousands of Algerians in a key regional hub. Algeria, with Africa's largest military budget, has expressed concerns. Relations between the two countries are already hostile; water could become another flashpoint.

In South Asia, India and Pakistan show how quickly water can become a weapon once broader tensions ignite. The Indus Waters Treaty survived three India-Pakistan wars over 65 years—until April 2025, when India suspended it after the Pahalgam terrorist attack and stopped sharing hydrological data with Pakistan. The treaty remains suspended despite a US-brokered ceasefire last May; India

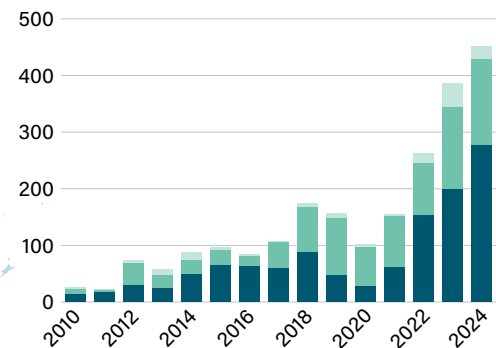
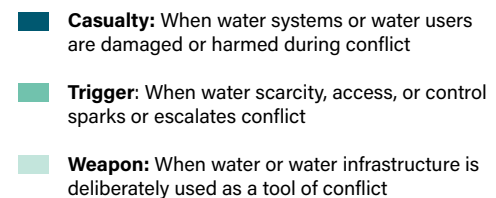
### Half the world is under water stress

% of renewable freshwater resources withdrawn across all sectors (2022)



### More water conflicts, more weaponization

Number of water-related conflicts by type



Source: Eurasia Group, AQUASTAT, Food and Agriculture Organization, Pacific Institute (2025) Water Conflict Chronology. Pacific Institute, Oakland, CA

wants to maintain it as a threat. Over 80% of Pakistani agriculture depends on water from the Indus basin, which India's upstream position controls. Islamabad has warned that any diversion of water will be considered "an act of war." Water has accordingly become a potent new weapon in the India-Pakistan conflict—one that raises the stakes of any future crisis between two nuclear-armed rivals.

China holds leverage over both countries. In 2025, Beijing began constructing a \$137 billion mega-dam on the Brahmaputra at Tibet's "Great Bend"—the world's largest hydropower project—with no treaty governing downstream flows to India and Bangladesh. India has responded with its own \$77 billion program to build over 200 counter-dams. Both sides are building the infrastructure for water weaponization; India's crash dam-building program signals Delhi expects Beijing to use it. Meanwhile, China's upstream position on the

Indus main stem and tributaries gives it leverage over Pakistan too. Without water-sharing frameworks, any future border crisis between China and India—or a shift in China-Pakistan relations—could spill into water.

In a G-Zero world where no power or group of powers are willing and able to build global governance infrastructure—binding arbitration, real-time data sharing, enforceable treaties—scarcity becomes a weapon. Countries that should be working together on counterterrorism or climate instead remain locked in zero-sum struggles over rivers. When upstream powers control the tap, downstream countries have few options beyond escalation. And where states are too weak to control the tap at all, other actors will. No single flashpoint may erupt this year. But the weapons are loaded, the guardrails are off, and when the next shock comes—a drought, a border clash, a terrorist attack—water will make it worse.

## Box 4. The Sahel's G-Zero

**The Sahel is the world's most active jihadist battleground. Extremist violence across West Africa has escalated sharply over the past three years. In 2026, the crisis will deepen and spread south.**

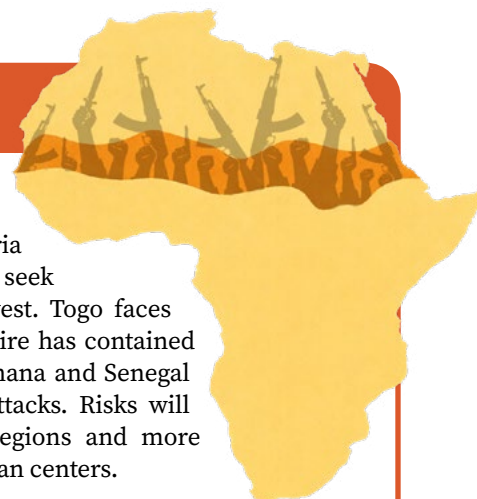
Weak regional leadership, poor governance, a wave of military coups, and the retreat of international counterterrorism support have created a vacuum in which violent extremism thrives. Last year, violence and economic disruptions reached new highs in Mali, Burkina Faso, Niger, and Benin. Jama'at Nusrat al-Islam wal-Muslimin (JNIM), a Salafi-jihadist coalition affiliated with Al Qaeda, has gained control over swaths of northern and central Mali. It is now targeting the country's main trade routes to isolate Bamako—raising fears the capital could eventually fall. The group has expanded into Burkina Faso and Niger, exploiting weak state authority and local grievances, including competition over water and arable land. Rather than relying solely on large-scale attacks, JNIM embeds itself in rural communities and builds influence gradually. Where governments fail to provide security or settle disputes over land and water, extremists step in—and demand loyalty in return.

In 2026, JNIM will focus on consolidating its core territories in Mali, Burkina Faso, and Niger while establishing new strongholds in the borderlands of Togo, Benin, and Nigeria. The spread will continue to exploit porous borders, weak state presence, and criminal networks. Benin remains most vulnerable: attacks hit record highs in 2025, with fatalities up nearly 70% from

2024. JNIM conducted its first attack in Nigeria in October 2025 and will seek footholds in the northwest. Togo faces a similar risk. Côte d'Ivoire has contained the threat since 2020; Ghana and Senegal have not experienced attacks. Risks will be higher for border regions and more moderate for coastal urban centers.

Coastal West African states will be forced to increase defense spending—diverting resources from education, health, and job creation, and adding fiscal pressure in countries like Senegal already running high deficits. Refugee movements within the region will exacerbate social tensions, particularly in Côte d'Ivoire, now host to many Malian and Burkinabè refugees. The real displacement pressure is regional, not transcontinental—Mali and Burkina Faso accounted for just 1.8% and 0.5% of EU asylum applications in 2024. These dynamics will further weaken the Economic Community of West African States and make the region less attractive to investors.

This is a developing crisis, not an imminent collapse. Even if jihadists took Bamako—still unlikely—they would need time to consolidate before expanding further. But the trajectory keeps getting worse—and drought, water scarcity, displacement, or another coup will accelerate the instability.





# RED HERRINGS

## “Tariff Man” at large

Donald Trump's trade war will keep escalating, causing more economic havoc in 2026. That's a common fear. We don't buy it.

The president's unilateralist instincts are intact. On security, where the United States is much more asymmetrically powerful than the rest of the world, Trump will become less restrained this year (please see Top Risk #3: The Donroe Doctrine). On domestic politics, he's unlikely to moderate, even in the face of pushback (please see Top Risk #1: US political revolution). But on the global economic front, Trump's leverage will be more constrained going forward and he knows it.

Start with China, which called Trump's bluff and had the cards to back it up. Beijing matched Trump blow for blow in last year's tariff war, then showed it could inflict real pain by restricting exports of critical minerals. China's stranglehold on rare earth processing got Trump's attention: The United States can't build electric vehicles, semiconductors, or advanced weapons without inputs controlled by Beijing. That vulnerability pushed him toward a transactional deal rather than a fight he couldn't win (please see Box 5: US-China détente won't collapse). It also made him more aware of the need for coordination with partners to develop alternative supply chains—which means less appetite for tariffing allies who could help.

The United States also has less room for maneuver in an increasingly multipolar global economy. Middle powers have options—alternative markets, new trade partnerships, deeper ties with China—that give them leverage Washington didn't face in the past. And if Washington is pulling its punches on transshipment enforcement to avoid retaliation on rare earths and preserve the détente, other countries will have even less reason to hold the line on China.

Domestic politics will reinforce these constraints as the midterms approach. Trump will focus on boosting his sagging numbers on the economy and affordability, leaving less room for tariffs that drive up prices—especially as retailers

deplete their pre-“Liberation Day” stockpiles and shift more tariff costs onto consumers. He’s already backed off levies on certain food imports from several Latin American countries. Expect more pullbacks on low-cost consumer goods this year.

Trump’s tariff strategy will accordingly become more predictable. The United States has reached agreements with most major trading partners and is closing in on deals with stragglers like India, Indonesia, and Brazil. The Supreme Court may strike down some tariffs imposed under the International Emergency Economic Powers Act. The administration has other tools—Section 122, Section 301—to reconstruct much of the tariff wall, though average effective rates will dip slightly in that case. But the chaos

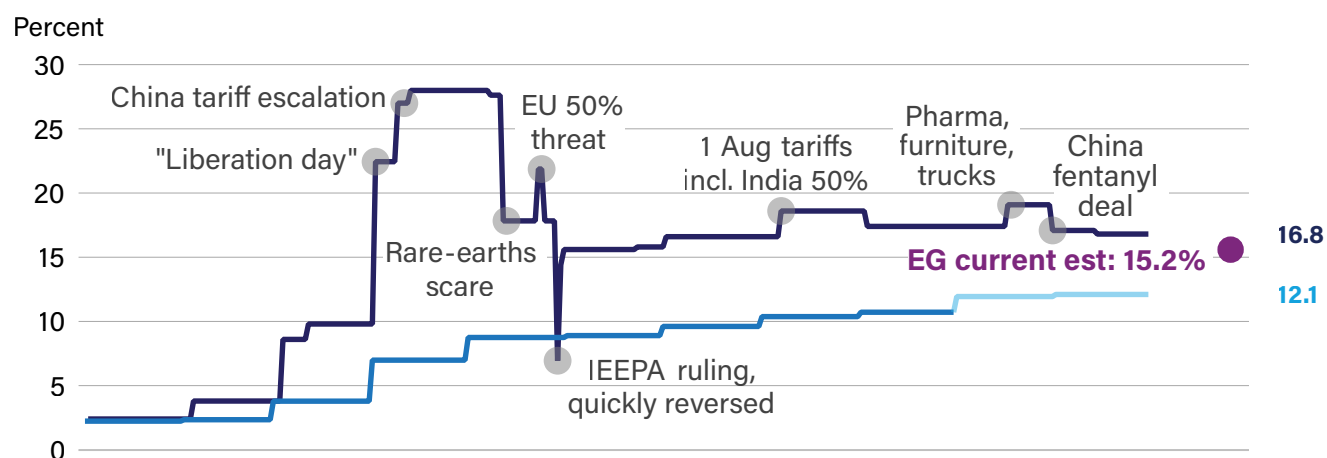
from last April won’t return. Trump will still brandish threats for leverage, but the shock-and-awe phase is over.

None of this means the global trading system escapes unscathed. Trump’s tariffs have already triggered lasting shifts in trade patterns, supply chains, and the willingness of countries to rely on the United States (please see Red herring: Deglobalization). And constraints on tariffs won’t stop Trump’s economic interventionism, just redirect it toward other tools (please see Top Risk #6: State capitalism with American characteristics). But his room for maneuver on trade has narrowed. The year of maximum tariff disruption is behind us.

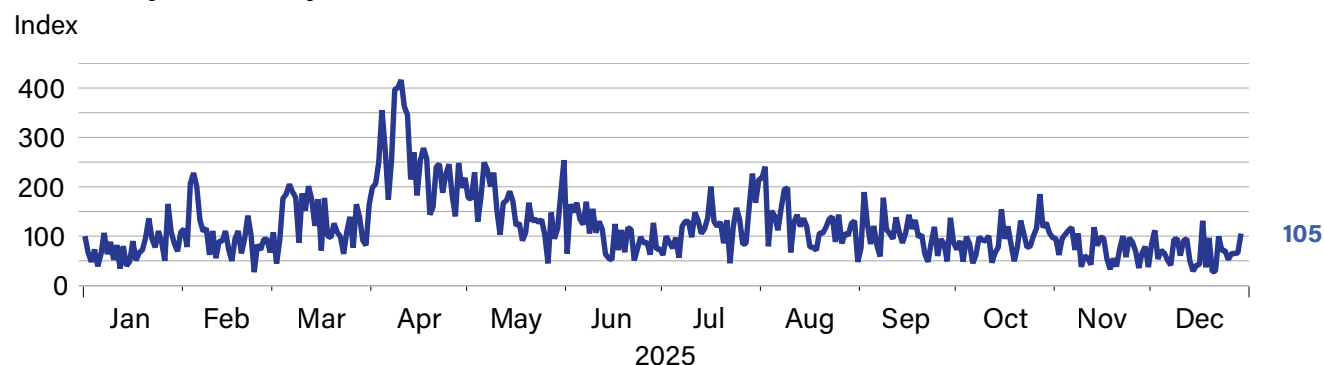
## Peak tariff disruption is behind us

*US average effective tariff rate (AETR) on all goods imports, pre-substitution*

- based on calculated duty (Census, Treasury for forecasts)
- based on announced policy (Budget Lab)



*Trade Policy Uncertainty Index has fallen to Jan 2025 levels*



Source: Eurasia Group, Macrobond, Yale Budget Lab, US Census Bureau.

Note: Average tariff rate estimate based off 2024 volumes, before import substitution. Effective tariff rate based on calculated duty refers to the ratio between calculated duty and total goods imports in 2025.

## Box 5: US-China détente will hold

**The US-China relationship is headed for at least a year of relative stability, for three reinforcing reasons.**

First, both sides learned from last year's tariff war that they faced a lose-lose proposition: empty shelves in the United States, unemployment in China. Neither wants a repeat. Second, both need breathing room to address their strategic vulnerabilities—Beijing to build technological independence, Washington to secure alternative critical mineral supplies and processing capacity. The leverage cuts both ways: China can paralyze American military and civilian industries by restricting rare earths; the United States can kneecap China's development by restricting chips and jet engines. Third, Trump is transactional, not ideological on China. Unlike most of the American foreign policy establishment, he prioritizes commercial gains over strategic competition and is as genuinely open

to dealmaking with Xi Jinping as he is with American allies.



Continued implementation of last year's Busan agreements will bring tangible benefits that backstop the truce. China will loosen restrictions on critical mineral flows; the US will pause key export controls. Progress on fentanyl cooperation should bring that tariff to zero. Beijing is already resuming purchases of American soybeans and agricultural products; both sides will suspend port fees on each other's ships. Purchases of Boeing planes, US energy exports, and Chinese investment in approved US sectors may not be far behind.

None of this means smooth sailing. Flare-ups over tech restrictions and critical mineral flows are likely. But tensions will be resolved at the political direction of both leaders, neither of whom wants prolonged escalation. Trump's April visit to China, Xi's likely trip to the United States later in the year, and sideline meetings at the G20 and APEC summits will keep both sides invested in stability.

The underlying strategic competition and the broader strategic decoupling continue, but 2026 won't be the year the most important geopolitical relationship in the world falls apart.

## Deglobalization

Trade as a share of global GDP has been stagnant for years. Average US tariff rates are now at levels not seen since the 1930s. The global trading system is scrambling to adjust. This is the economic corollary of a G-Zero world: The United States no longer wants to lead a multilateral, rules-based trading order or serve as the principal engine of globalization.

But that doesn't mean 2026 will be a year of deglobalization.

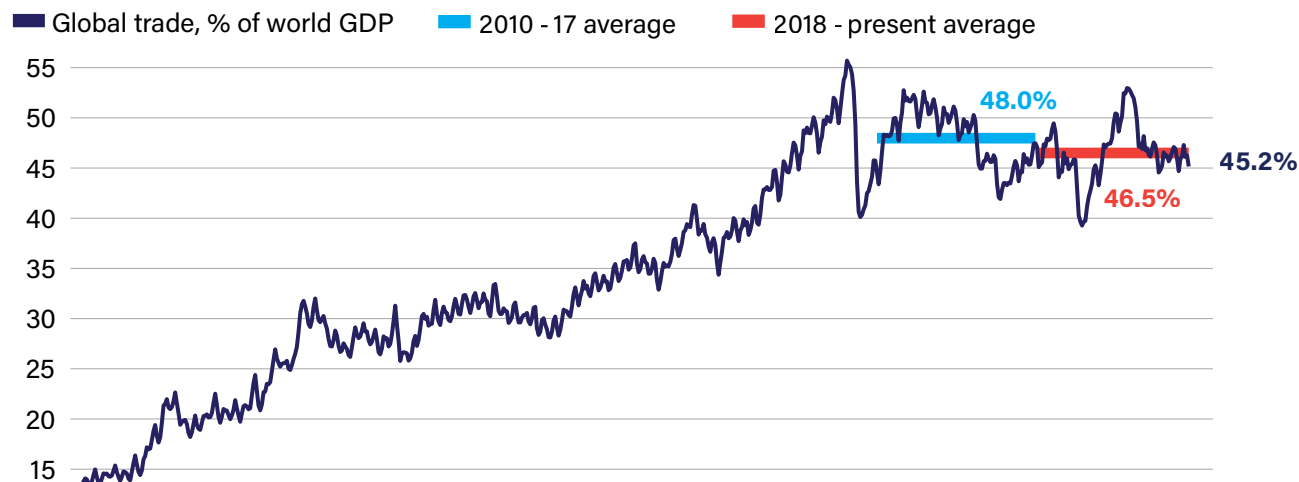
For starters, while President Donald Trump's tariffs dealt a major blow to the trading system, we have already seen peak trade disruption from the United States (please see Red herring: "Tariff Man" at large). Almost nothing could outdo last April's "Liberation Day" shock, and the Trump administration will face growing domestic pressure to ease off as voters feel the affordability pinch. The United States has already struck agreements with most major trading partners.

Meanwhile, other countries have strong incentives to preserve what's left of the system. Most will continue to play defense in negotiations with Washington—refraining from retaliation to protect market access, maintain security ties, and avoid antagonizing the president. But they are also hedging by pursuing alternative partnerships worldwide. India will likely seal a deal with Trump early this year while seeking free trade agreements with Australia, Canada, the EU, and the UAE. Other deals—ASEAN-Canada, EU-Mercosur—are on track for 2026. Countries worried about US reliability are stepping up cooperation with others on defense procurement, critical minerals, and technology. Hedging against American unpredictability will gradually rewire trade and investment into new channels, boosting emerging hubs and creating opportunities in an increasingly multipolar economy. What comes next will be messier and less efficient than the old order, but it won't be deglobalization.

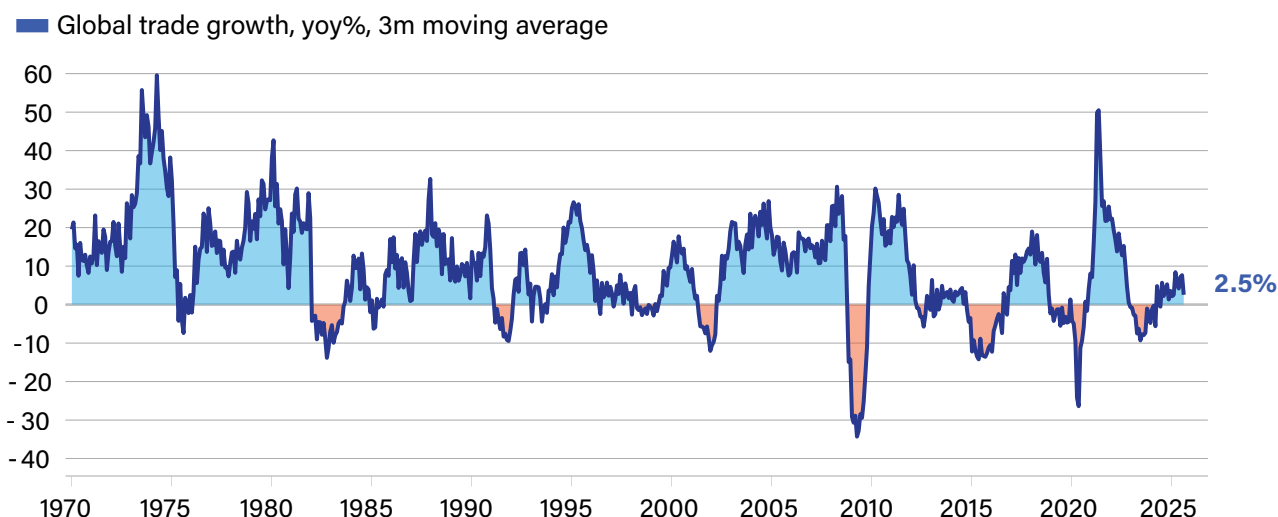
And for all the focus on goods slapped with tariffs, the growing importance of services and intangibles in the

## Globalization isn't dead

% of GDP



% y/y



Source: Eurasia Group, Macrobond, IMF, World Bank, UNCTAD

modern economy belies the impression of deglobalization. Trade in services has been accelerating for years, with digital services leading the way. Intangibles—R&D, intellectual property, branding, software—have grown significantly as a share of total trade. Cross-border integration is now more digital and intangible than ever, and US efforts to reshore manufacturing can do little to reverse that.

Protectionist measures will continue to outpace liberalizing ones in 2026. Some fragmentation is inevitable as geopolitics amplify the effects of tariffs and drive governments to derisk supply chains—not just from China, but increasingly from the United States too. But derisking is not deglobalization, and supply chains are sticky in any case. It's not easy to shift complex production networks, relocate infrastructure, or rapidly liquidate fixed assets—and the US market is too large and lucrative for companies to abandon (please see Red herring: Sell America).

## Spheres of influence

The Western Hemisphere elevated to the top of the US National Security Strategy. European allies cut out of Donald Trump's negotiations with Vladimir Putin, Ukrainian territory conceded before talks even started. Containment of China dropped in favor of dealmaking with Xi Jinping. Add it all up, and it's no wonder people are speculating that we're headed back to a world where great powers mind their own backyards and stay out of everyone else's—a kind of 19th-century great-power carve-up for the 21st century.

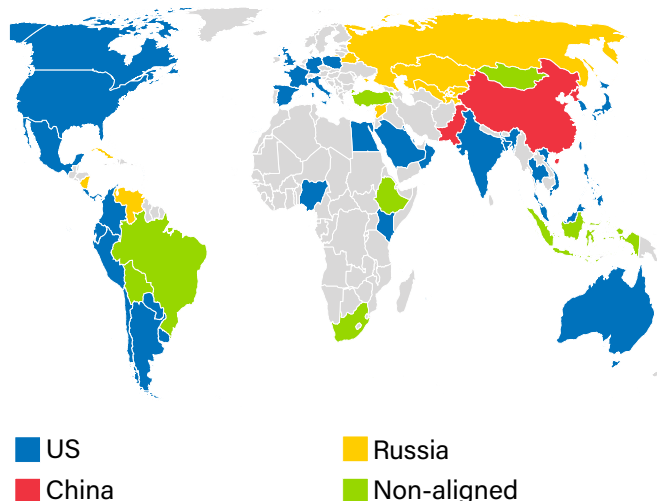
We're skeptical.

Yes, geopolitics are becoming more anarchic and competitive—that's the G-Zero world we've been warning

## The world is too fragmented to hold spheres of influence

### Security order

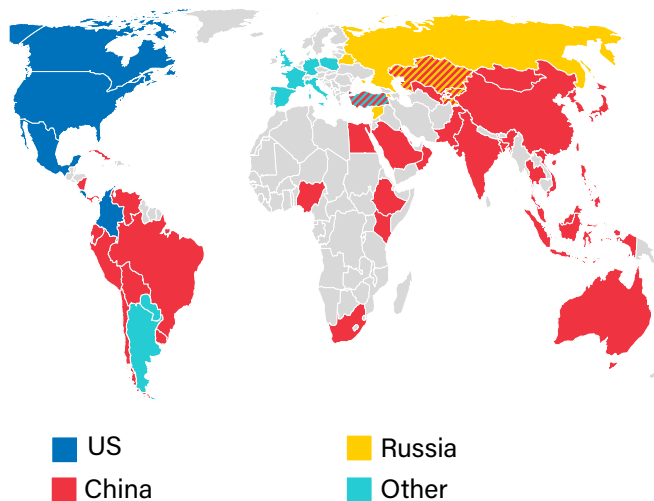
Security alignment based on primary military alliances, defense partnerships, and security cooperation



Source: Eurasia Group based on data from SIPRI, UN Comtrade, IMF, DOD.

### Economic order

Economic alignment based on total bilateral trade



about for over a decade. But spheres of influence? The world is messier than that—and far harder to carve up.

To start, for all the rhetoric about no longer wanting to police the world, American interests remain stubbornly global. Defense spending keeps breaking records. Despite a détente with China on trade, the military posture in Asia hasn't softened; Washington just sent Taipei its largest-ever arms sale package. Last year's strikes on Iran and Trump's continued (indeed, growing) engagement with Gulf countries and Israel shows the United States hasn't lost its interest in the Middle East either. And Washington is actively meddling in European politics—hardly the behavior of a power retreating to its own hemisphere. The Trump administration may reject the idea of a US-led global order, but it hasn't abandoned global reach. It's just pursuing American interests more transactionally, more unilaterally, and far less reliably.

The Western Hemisphere focus is driven more by domestic politics—border security, migration, fentanyl—than grand strategy, in a region where wins can be found with limited pushback: significant military power asymmetries, politically aligned governments, economic dependence, and little capacity to hedge. Theodore Roosevelt's corollary to the Monroe Doctrine asserted Washington's right to intervene in the Americas even as he built the United States into a global power. Trump's version (please see Top Risk #3: The Donroe Doctrine) isn't so different: The hemisphere is the priority, not the limit of American ambition.

Even if the United States were retreating, the whole premise of spheres of influence assumes you can keep rivals out of your zone. But China is now South America's largest trading partner, surpassing the United States. Chinese firms are major investors in critical minerals, energy infrastructure, and electric vehicle manufacturing across the region. Beijing can redirect soybean purchases from American farmers to Argentine ones almost overnight. In a world this interconnected, the idea that great powers can partition the globe is a fantasy—even in America's own backyard (please see Red herring: Deglobalization).

And there's a more structural problem. There's no longer a single global order to carve up. Power now operates on three overlapping but distinct planes: a security order still dominated by the United States, an economic order that's increasingly multipolar, and a digital order where technology companies rival states as geopolitical actors. The geopolitical "great game" used to be about physical territory. Today it's increasingly about who controls data flows, platform rules, AI systems, and the critical minerals and energy infrastructure that power them. That's the competition driving US-China decoupling—and it doesn't respect the borders that spheres of influence depend on. Neither do the defining challenges of our time, such as pandemic disease, climate change, and disruptive technologies.

None of this means territory and military power no longer matter. Of course they do. But the world is too interconnected to carve up, and power is too fragmented

across too many domains and actors for any great power to hold a sphere together. The law of the jungle is back. Spheres of influence aren't.

# Sell America

After Liberation Day, markets panicked. The dollar fell as volatility spiked—the opposite of its usual safe-haven behavior. Reserve managers sharply shifted allocations away from dollars; the greenback's share of global reserves hit its lowest in two decades. Pundits rushed to declare American exceptionalism dead: The US was on course to becoming uninvestable, losing its spot as the prettiest ugly man in global markets.

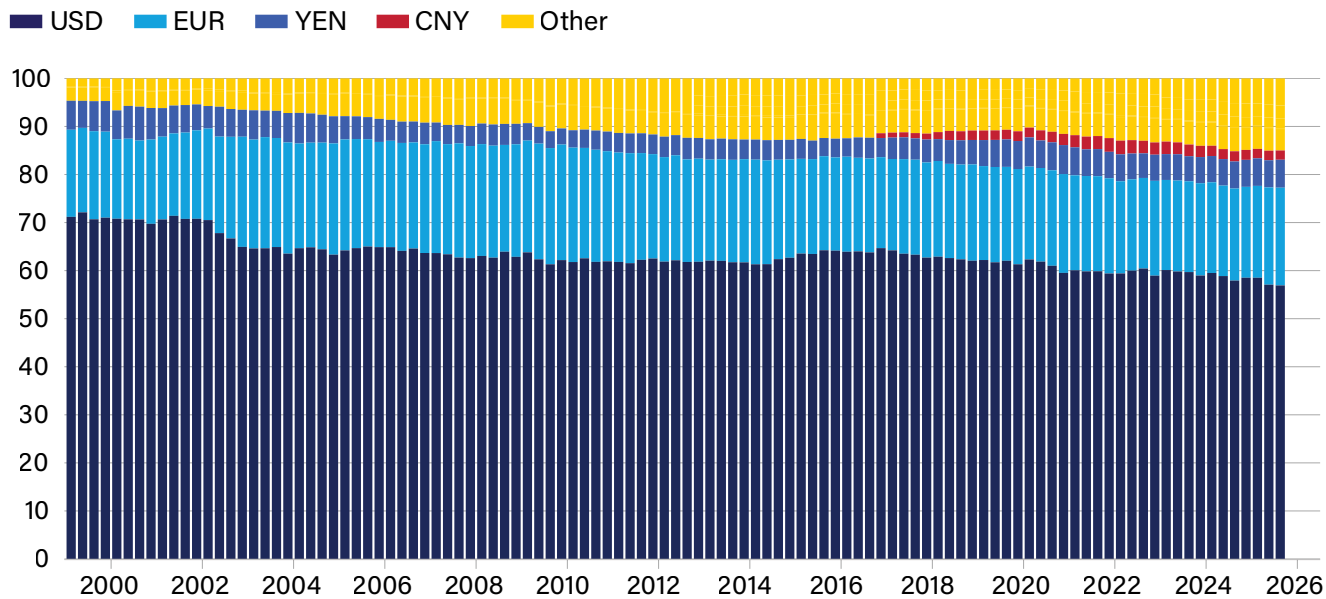
The concerns weren't baseless. Some of the Trump administration's policies have dented the foundations of US credibility, both in absolute terms and relative to other countries—the chaotic introduction of higher tariffs, fiscal profligacy, growing state intervention, threats to the Fed's independence and future commitment to price stability, and erosion of the rule of law. Restrictions on skilled immigration and cuts to research funding threaten the innovation ecosystem that has long powered American dynamism.

Yet by mid-year, the dollar's safe-haven behavior had largely reasserted itself; by the end of 2025, foreign investors had bought more US assets than the year before. The United States remains the most investable major economy in the world, even if that edge is narrowing.

The core reason: TINA (there is no alternative). American financial markets are by far the deepest and most liquid; no others come close. And while growth may not dazzle this year, no rival can match American economic dynamism. Traditional safe havens like Japan and Germany face enduring structural challenges to growth; Europe's economic outlook remains weak; and China is mired in deflation and increasingly closed to foreign capital (please see Top Risk #7: China's deflation trap). Meanwhile, America still leads in many of the industries that will drive 21st-century growth, including frontier AI, quantum computing, advanced semiconductors, aerospace, and innovative drug development. Massive AI-related capital expenditure continues to pour in, and the tailwinds from that investment will persist well beyond 2026. The investment-for-tariff-relief deals struck with Japan, Korea, the European Union, and Gulf states, even if they underperform, will channel additional FDI into the United States. American exceptionalism isn't over; it's just priced with a higher risk premium.

## USD remains dominant reserve currency

Official reserves FX holding, % of total




Source: Eurasia Group, IMF, Macrobond

TINA extends to the dollar's role as global reserve currency. The euro lacks a deep, unified sovereign bond market. The renminbi is hobbled by capital controls, slowing growth, and Beijing's own governance deficits. Crypto remains too volatile for serious reserve managers. And the dollar's dominance is self-reinforcing. The US accounts for less than a tenth of global trade, yet half of it is still invoiced in greenbacks; 90% of foreign exchange transactions remain dollar-denominated. The shift toward dollar-backed stablecoins will further entrench, rather than displace, the dollar's global role; the US moved ahead of other developed markets by creating a regulatory framework through the GENIUS Act, bolstering its first-mover advantage.

Rule of law and the distortionary effects of intensifying state interventionism in the US economy are real concerns (please see Top Risk #1: US political revolution, and Top Risk #6: State capitalism with American characteristics). But markets have shown little reaction to rule-of-law erosion. Investors price cash flows and growth, not governance scores.

None of this means the damage to credibility is costless. The United States still depends on large capital inflows from abroad to finance its deficits—and now pays a higher risk premium to attract them. Investor concerns about US policy are reflected, in part, in the relatively weak performance of US assets in 2025. Foreign governments are already hedging, diversifying reserves, and experimenting with alternative payment systems. The long-term trajectory points toward a more economically multipolar, fragmented, and less dollar-centric world (please see Red herring: Deglobalization).

But 2026 won't be the year the world abandons US assets. The United States is too big, too innovative, and too hard to replace.



There you have it. Sometimes when you set your mind to a challenging task, you're different at the end of the process than when you started. This year's report feels like that.

We suspect that's because it's personal. There's a lot at stake in the issues we're writing about. The way we've been making rules for our fellow humans isn't sustainable and it's about to change. How these changes are resolved will affect most of us, our families, our friends, and our colleagues. The outcomes we are about to bear witness to—and that we are in part responsible for—are consequential.

We're not optimistic, but we are hopeful. Yes, many of the world's most powerful actors are looking out only for themselves, producing disinformation and corruption, supporting (dare we quote Monty Python) the violence inherent in the system. But the efforts to break the ordering principles of our world come from a deeply human impulse—when the gap between the balance of power and the “rules” grows too out of whack, demand for change becomes inevitable.

The next global “order” will be faster-moving, more chaotic, and more difficult to navigate and understand. But it might, it just might, also better reflect the values and needs of the increasingly educated billions of fellow humans on the planet today. Bringing that about begins with better understanding. This report—and the work we'll do over the coming year to give voice to it, as well as hold ourselves accountable for it—is our effort to contribute to that process. We deeply appreciate your willingness to support us.

Yours truly,

Ian and Cliff (and Moose)

New York | Washington DC | San Francisco | London | Tokyo | Singapore | Mexico City | São Paulo | Brasília

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