

**PERSISTENT INSECURITY,  
INFLATION, AND GEOPOLITICAL  
COMPETITION**

**ENTERPRISE RISK MANAGEMENT & BUSINESS  
RESILIENCE**



Businesses across Europe have faced a multitude of challenges and risks that demand our attention. The COVID-19 pandemic has not only exposed societal vulnerabilities but also disrupted our ordinary way of life. The resulting health and economic crises have shed light on the risks inherent in our integrated global economy, which has been a key driver of growth since the financial crisis of 2007-2009. Moreover, Russia's war in Ukraine has brought about devastating consequences.

The economic and political fallout from the war in Ukraine has been enormous, signalling an increased level of geopolitical animosity between major powers. Additionally, the conflict has highlighted the fragility of global energy supply chains, contributing to significant inflation in Europe. Meanwhile, the ongoing geo-economic competition between the US and China has further impacted global supply chains.

Given these complex circumstances, it is of utmost importance that individuals pay attention to reports on this topic. This global risk monitoring and strategic foresight paper is an essential read for business leaders to understand the geopolitical risk landscape.

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# PERSISTENT INSECURITY, INFLATION AND GEOPOLITICAL COMPETITION: ENTERPRISE RISK MANAGEMENT AND BUSINESS RESILIENCE

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Businesses across Europe have experienced challenging times recently. The COVID-19 pandemic exposed both social, political, and economic vulnerabilities and disrupted the ordinary way of life. The ensuing health and economic crises have highlighted the risks to the integrated global economy, which has been a key driver of growth since the financial crisis of 2007-2009. In addition, Russia's war in Ukraine has displaced millions of Ukrainians, devastated the country's economy, and brought war to Europe on a scale not seen since the Second World War. The economic and political fallout from the war has been enormous; we have not seen this level of geopolitical antagonism since the end of the Cold War and, more specifically, the Cuban missile crisis in 1962.

The war has exposed the fragility of global energy supply chains, with increased energy prices contributing ca 40 percent to European inflation in 2022 and 2023. Global supply chains have been hit by recurrent crises and are still adjusting to the geo-economic competition between the US and China, which manifested in trade disputes during the Trump administration and continuing under the Biden administration.

New risks in Europe related to geo-economic competition, higher interest rates, tight labour markets and higher inflation rates are risks that business leaders need to factor into their business strategies. Inflation is one of the main challenges for all businesses, with the annual inflation rate in the euro area reaching 9.2 percent in 2022, a figure not seen since 1983. Most business leaders were young adults when corporate actors had to deal with similar economic challenges of inflation and the large-scale geopolitical shifts of the late 1980s and early 1990s.

We are currently experiencing a partial return of "old risks" with new leaders and new tools. This combination of "old risks" and "new risks" that is driving business strategies in Europe can be illustrated by the World Economic Forum's Executive Survey.

*Swedish C-suite executives have identified rapid or sustained inflation, the cost-of-living crisis, the debt crisis, the failure to adapt to climate change and the financial consequences and risks of geo-economic confrontation as the top five risks that pose a threat to current business operations and strategies over the next two years.*

And most mature business leaders are sitting up and paying attention, with 86 percent of executives recognising that they need to develop a more resilient and risk tolerant organisations.

Despite this widespread recognition of the need, only five per cent of C-suite executives surveyed said their organisations had fully integrated their enterprise risk management strategies and systems with other corporate structures and business units. The risks and vulnerabilities that have and continue to impact business actors should lead companies to implement internal mitigation measures to counter the effects of increased business costs and persistent business risks. There is an obvious desire and clear incentive to develop robust Enterprise Risk Management (ERM) processes and strategies in all businesses.



9.2%

Euro area annual  
inflation, not  
seen since 1983



## TOP RISKS IDENTIFIED BY EXECUTIVE LEADERS

The top risks identified by business executives are highly interrelated, with the current cost-of-living crises being widely perceived by executives as the main short-term risk for the next two years. Rapid or rising inflation was the main characteristic of the cost-of-living crises. The cost-of-living crises remain closely linked to the rising cost of doing business crises, as similar macroeconomic features affecting household stability and purchasing power also affect the private sector.

### **Sustained inflation and sluggish economic growth**

Europe has so far managed to avoid a recession, and vacancy and unemployment rates that reached record low of six percent in January 2023. Output gaps in advanced European economies and the euro area turned positive in 2022, while this trend was reinforced in Central and Eastern European economies, which recorded even higher positive output gaps, further signalling inflationary tendencies. Europe is currently dodging a recession, with many its economies operating above or close to full capacity. The European labour market remains tight, with several EU countries operating at full employment. Industries across the continent continue demanding talented and skilled workers, while wage pressures are currently showing upward

tendencies. In the Central and Eastern European economies, nominal wages have risen at the same pace as double-digit headline inflation, while in the euro area economies nominal wages have fallen relative to inflation. Nevertheless, the fall in real wages has led to demands for higher wages, so the risks of sticky core inflation remain.

### **Harmonised index of consumer prices (HICP) January 2020 - April 2023**



Several European economies are currently operating at full or close to full capacity, judging by Europe's ability to avoid recession and its output gaps. Needless to say, the short and medium term remains challenging for European economies. In April, the annual inflation rate in the European Union

was 8.1 percent, down from 8.3 percent in March. Nevertheless, core inflation remains above the European Central Bank's targets and forecasts. The impact of the cost-of-living and business crisis is expected to ease slightly over the course of 2023, as consumer demand gradually eases and supply balances out. Tight financial conditions will limit external demand, and subdued real wages will continue to contribute to lower growth figures across European economies. We assess that the remainder of 2023 to be characterised by low growth numbers and sticky inflation, we are already seeing these trends in action.

There are several signs of a slowdown in economic growth, as the Polish, Hungarian, Austrian, Greek, Slovenian and UK economies have experienced a significant slowdown in demand in 2023. In addition, the German and French economies are expected to experience negative quarterly growth and annual growth of less than 0.7 percent, while the Italian economy is expected to grow by only around 1.2 percent in 2023. Meanwhile, the Swedish economy is expected to contract by 0.5 percent this year. The European Central Bank is expected to continue to raise interest rates, resulting in tighter credit markets, further exacerbating the gloomy economic growth outlook, and if inflation continues to remain above expected targets and forecasts, some European economies could experience a short-term period of stagflation until growth prospects rebound in 2024 and 2025 while inflation prospects stabilise.

On average, core inflation in advanced European economies is projected to increase by 0.5 percentage points compared to 2022, reaching 5.6 percent. Meanwhile, central, and eastern European economies are expected to reach 12.5 percent on average, compared to 10.6 percent in 2022. In 2024, advanced European economies are expected to reach 3.1 percent, compared to 7 percent for the central and eastern European economies.

*Inflationary risks will continue to characterise Europe's economies in the year ahead, and higher inflationary tendencies could persist for longer if wage growth accelerates more than expected or if European energy prices rise again, in which we assess the latter as likely.*

## Prevalence of high energy prices

The European energy market continues to be characterised by uncertainty. Several factors contributed to high energy prices last year:



The economic and political consequences of Russia's war in Ukraine disrupted the European gas market, with European gas imports from Russia amounting to around 152 billion cubic metres in 2021 and falling by 66 percent to a total of 51 billion cubic metres in 2022.



A severe summer drought led to the lowest reservoir levels in the 21st century, reducing European hydroelectric power generation by a fifth compared to 2021. Last winter was the third warmest winter since 1970, which limited energy demand. However, the warmer and drier winter led to lower snow and rainfall, which meant that already low water levels could not be replenished.



Finally, nuclear power generation also experienced the largest year-on-year decline, falling by 16 percent or around 119 terawatt-hours, a number equivalent to approximately 70 percent of Sweden's total electricity consumption in 2021. This large decline in nuclear power generation was fuelled by the closure of nuclear power plants in Germany, lower output by French operators due to high river temperatures used for cooling, and extensive maintenance work on French nuclear power plants resulting in lower output.



*Looking at energy costs for Q4 2023 and Q1 2024, 2Secure assess that the situation will remain severe, and it may take until 2025 before the European energy market stabilizes to pre-2022 levels.*

The EU's Joint Research Centre has stated that water levels in 2023 are likely to be even lower than in 2022. In addition, there are several factors that could stimulate higher energy prices, such as a harsh winter in 2023/2024, further disruptions to existing Russian gas flows as they are expected to continue to decline throughout the year, reaching around 35 billion cubic metres in 2023, assuming no further disruptions.

Finally, the Chinese economy is expected to grow faster than the market anticipated in 2023, another factor that will contribute to a tighter global energy market and further increase prices, as China's demand for liquefied natural gas and oil will increase to fuel further growth.

Companies in Europe have implemented several energy efficiency measures and reduced demand in response to higher energy prices, but sustained higher energy prices will lead to reduced output. Worst case scenarios anticipate that European gas prices may increase by close to 100 percent by the end of 2023 and in Q1 of 2024. A normal winter and limited storage capacities would be the primary factors for this development. Current forecasts state that Europe is expected to face a gas balance deficit of 48 billion cubic meters in 2023 and 20 billion cubic meters in 2024 respectively.

*Europe's structural energy deficit has not yet been resolved and presents future insecurities for the continent's gas prices.*

Close to  
100%

Estimated  
increase in  
European gas  
prices by the end  
of 2023

## GEOPOLITICAL RISKS

Geopolitical rivalry will also continue to affect financial markets, inflation, and companies across industries. Current trends of increasing geopolitical division between western states, Russia and China have heightened concerns about the growing fragmentation of the global economy. This could potentially have a negative impact on global financial stability and adversely affect cross-border allocations of international payment systems, asset prices and capital allocation, further contributing to uncertainty.


Heightened geopolitical tensions have led to increased restrictions on cross-border capital flows. Financial and economic fragmentation could lead to a further sharp decline in cross-border capital flows and a fall in asset prices; such developments would be exacerbated by technology and trade restrictions and disruptions to commodity markets and supply chains.

The level of foreign direct investment and trade restrictions by and on EU countries has increased, particularly in the context of Russia's re-invasion of Ukraine. In the long term, these developments will lead to increased volatility in external financing and asset returns, and reduced diversification of liabilities and assets by international investors.


Geopolitical fragmentation exacerbates the risks of repeated supply shocks, this has been the most visible in the European energy crises, but as geopolitical rivalries intensify, we can expect counter measures within rare earth materials.



**China's control of rare earth materials** China possesses approximately 36 percent of the world's rare earth reserves, but through objective driven industrial policy China now controls 70 percent of the world's extraction capabilities and nearly 90 percent of the global processing capacity. We assess the likelihood as medium that China imposes severe restrictions on the export of rare earth metals to countries such as the US and Japan in 2024, as a reactionary response to the US limiting exports of high-technological semiconductors to China. China has employed such tactics previously, in 2010 during the Senkaku Island crisis China highly decreased its export of rare earth materials to Japan, which had adverse impacts on Japanese industries production of high-technological products such as hybrid cars, robotics and aerospace industry.

 **Increased geopolitical risks directly contribute to higher inflation, and limited economic growth. Analysis conducted by the European Central Banks suggests that fragmentation of international value chains along geopolitical axis will lead five percent higher consumer prices globally in the short term, impacting business continuity plans and growth strategies.**

## SUCCESSFUL COMPANIES, AND ENTERPRISE RISK MANAGEMENT

 The most successful businesses that aim to both mitigate the impact and develop strategic resilience against the backdrop of the identified risks. Successful businesses prioritize a **robust risk identification process** by conducting thorough assessments involving key stakeholders from various business functions. This inclusive approach enables them to identify both internal and external risks, gaining a comprehensive perspective on the scope of threats and upside potential of risks.

*The top corporations are able to efficiently integrate risk management framework with their strategic objectives and embedded risk analysis into their decision-making processes. Hence, ensuring that the proactive mitigation of risks becomes a central feature of their everyday business operations.*



Furthermore, business actors recognize that **effective risk management is a board-level responsibility**, leading the most successful businesses to ensure the active involvement of their boards in risk oversight and decision-making.



This engagement fosters a risk-resilient culture throughout the organization and promotes robust risk management practices. To track risks effectively, top businesses establish **robust monitoring mechanisms** that allow them to track risks in real-time and update risk registers accordingly. They regularly report risks to senior management and the board, enabling informed decision-making and timely risk response.



Additionally, when **regular risk assessments and risk reviews** take place helps them to **reassess and alter existing risk mitigation strategies** if necessary. Regular reviews of risk management practices assist aligning business continuity strategies to the existing business risk landscape. The example of Equinor previously known as Statoil can be used as one successful example of implementing robust enterprise risk management processes.

## EQUINOR (STATOIL) CASE STUDY

Equinor, previously known as Statoil, is a Norwegian oil and gas company that remains Scandinavia's largest corporation by total revenue. Equinor has successfully integrated enterprise risk management (ERM) processes into its business operations. Equinor's commitment to ERM became evident after an internal group investigated Equinor's hedging and foreign exchange transactions. The investigation discovered that a high number of transactions were based on silo thinking with information inadequately flowing throughout the organisation. The foreign exchange and hedging transactions lacked a comprehensive corporate perspective, resulting in heightened risk exposure and significantly increasing the companies' accounting costs. Therefore, enterprise risk management procedures had a clear economic rationale facilitating optimal resource allocation and enhance risk response decision-making.



Equinor's primary objectives were to create value along the value chain and ensure the safety its employees. Unlike traditional approaches that primarily focus on downside risk, Equinor's philosophy recognized that risk encompasses both downside risk and upside potential. Corporate directives emphasize the need to identify and analyse risks, considering both the negative and positive impacts. This value chain perspective communicates to all stakeholders that the primary objective is to generate shareholder value and enhance overall performance. By aligning risk management with the value chain, Equinor avoided "satisficing" and instead prioritized value maximization. Secondly, the value chain perspective provided a clearer understanding of the overall risk landscape as organising these risks within the context of the value chain, aligns the risks with the company's business model. Consequently, Equinor could develop a more coherent understanding of how risks interrelate.



Furthermore, Equinor's risk department and operational coordinator supported business units in managing risks. This included reviewing and analysing each business units risk maps, eventual responses to the risk maps and presenting them to executive management for consideration.



Additionally, on a quarterly basis, Equinor's board of directors have received a condensed version of the risk map prepared by the risk department. This has ensured the flow of information, and that the risk profile is regularly communicated and understood at the highest levels of the organization.

Furthermore, the risk department has actively supported each unit in developing best practices to counter and mitigate the adverse effects of risks. Ranging from advice on methodologies for quantifying market risks to assist with country risk assessments. The risk department collaborated with a consultancy firm to conduct country risk assessments, creating a knowledge base on country risks and a standardized methodology for evaluating the country risks. Consequently, such practices have constituted an integral feature of Equinor investment proposals. Such methodologies have ensured that the company makes well-informed decisions, considering specific risks associated with operating in diverse economic and geopolitical environments. Moreover, by focusing on the financial bottom line of the company, quantified risk mapping processes have identified the impact and likelihood of risks and provided impactful support for decision making.



Lastly, Equinor's implementation of a risk committee has been a key ingredient for the successes of ERM processes. Its advisory role has provided it with a distinct role separate from top management and the committee act as a cross-disciplinary advisory forum to analyse proposals and addressing general risk issues, holding quarterly meetings. The committee has provided further support and has act as an ERM filter. For instance, the foreign exchange policy that is conducted by the finance department now must be discussed and supported in the risk committee.



Overall Equinor's successful implementation of ERM processes, combining a value chain perspective with effectively centralised risk management systems together with a risk committee has enhanced the capabilities to optimize the company's total risk exposure and support its objectives of value creation while sustaining operational safety.

# 2SECURE RECOMMENDS

1. As global risk and volatility intensify in geopolitically challenging times, the incorporation of robust risk management practices into corporate governance structures becomes even more important to sustaining competitive and strategic business advantages. Implementing robust and resilient enterprise risk management structures is one significant mechanism that will help companies identify and mitigate the challenging business environment.
2. Businesses should establish and determine clear risk management responsibilities within the organisation. What unit, or committee has the primary responsibility in identifying, monitoring and mitigating risks in your organisation? Create clear structures and responsibilities to enhance risks managing process.
3. Business leaders should determine the risk appetite of your organisation. What is the risk tolerance that the executive leadership is willing to accept?
4. Business leaders should develop a risk strategy that aligns with the company's core values and mission, and that positions the company to take advantage of new opportunities.
5. Given the volatility in energy prices, the inflationary pressures, and the geopolitical competition, European businesses must understand the complexity of environment to successfully navigate the current economic and geopolitical landscape uncertainty, and evolving market dynamics. Ensure your business or risk-consulting partners develop a robust understanding of the risk landscape and conduct detailed scenario planning for possible eventualities for success and mitigate the most pressing risks.

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