

## The Resilience Preference

- Governments increasingly face a stark trade-off between economic efficiency and national security resilience.
- Building resilience involves industrial policies and supply chain reshuffles, creating winners, losers, and also inefficiencies.
- Utilities, infrastructure providers, and large "pivot state" emerging markets will be among the beneficiaries.

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What is economically rational is often politically irrational, and *vice versa* – a key aspect of political risk. While investors prioritize profit maximization, governments typically aim to maximize power. What may seem rational in the investment world, like free trade or open markets, can be politically irrational, undermining a state's stability and power. Conversely, what is rational for governments, like preserving domestic stability (e.g., ensuring employment or supporting industries) or projecting power abroad, often leads to market-negative actions (e.g., trade barriers, export controls) that often appear economically irrational.

This tension is central to one of our key drivers of geopolitical risks (and opportunities): the clash between societal/state resilience and economic efficiency.

Broadly, we identify three major long-term drivers of geopolitical change: the U.S.-China rivalry,

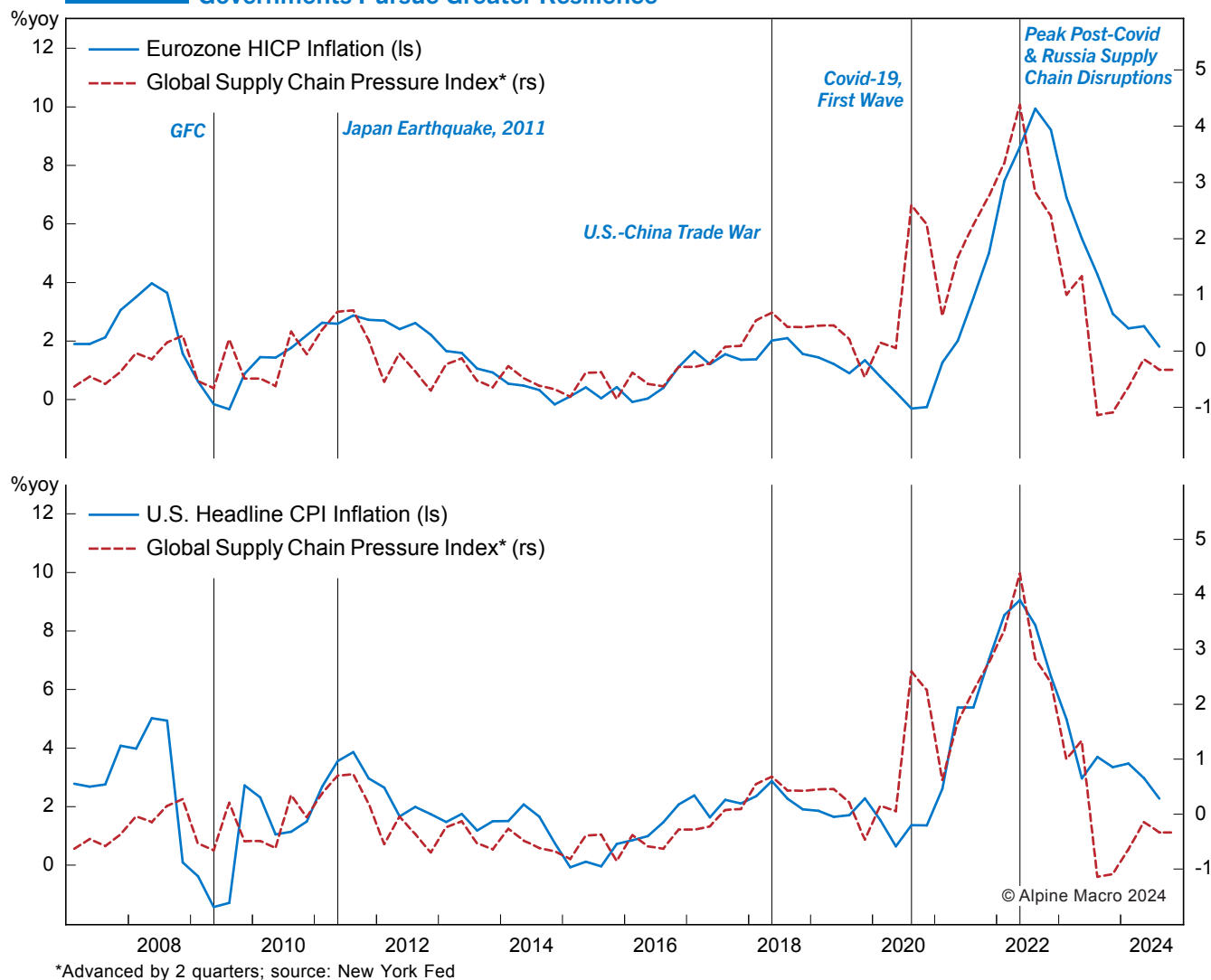
**Table 1** The Resilience Preference Drives A Number Of Key Risks This Year

2024 Key Risks*	U.S.-China Bipolarity	Long-Term Trends	
		The Resilience Preference	The Legitimacy Deficit
U.S.-China Tech War	++	++	+
Russia-Ukraine	+	++	++
European Gloominess	+	++	++
Renewables Rebellion	++	++	+
2024 Election Wave		++	++
Trump Panic of 2024	+		++
East Asia Tensions	++	+	++
Middle East/ Persian Gulf			++
Wars & More Wars	++		++
Fed Turns Political			++

\*Alpine Macro *Geopolitical Strategy* "The 2024 Geopolitical Risk Outlook" (December 6, 2023)

Note: ++ = significant risk driver, + = risk driver, no checkmark = low risk driver

**Chart 1** Recent Severe Supply Chain Disruptions That Fueled Inflation Are The Main Reason Governments Pursue Greater Resilience



governments' declining legitimacy, and today's focus – the resilience preference.<sup>1</sup> The latter reflects the tension between governments' and businesses' efforts to build resilience through stockpiling, redundancies, and inefficiencies, while trying to maintain economic efficiency. Table 1 illustrates how our key risks this year are partly driven by the 'resilience preference' dynamic.

1 Alpine Macro *Geopolitical Strategy* "The Three Long-Term Geopolitical Trends To Watch" (April 10, 2024).

## Swimming Naked

*Only When The Tide Goes Out, Do You Discover Who's Been Swimming Naked*

–Warren Buffet

What do Covid-19 medical supplies, 155mm NATO-standard artillery shells, and advanced semiconductor export controls have in common? From a geopolitical perspective, everything – they've exposed how many countries were caught unprepared when crises hit.



During the pandemic, Western nations realized they lacked sufficient production of critical items like masks and medical supplies, facing severe shortages as producers like China stockpiled for their own needs. The war in Ukraine highlighted NATO's dire shortage of basic supplies like ammunition. For instance, Europe takes over a year to produce enough 155mm artillery shells to meet Ukraine's annual defense needs against Russia. Is NATO ready for any major conflict? Doubtful.

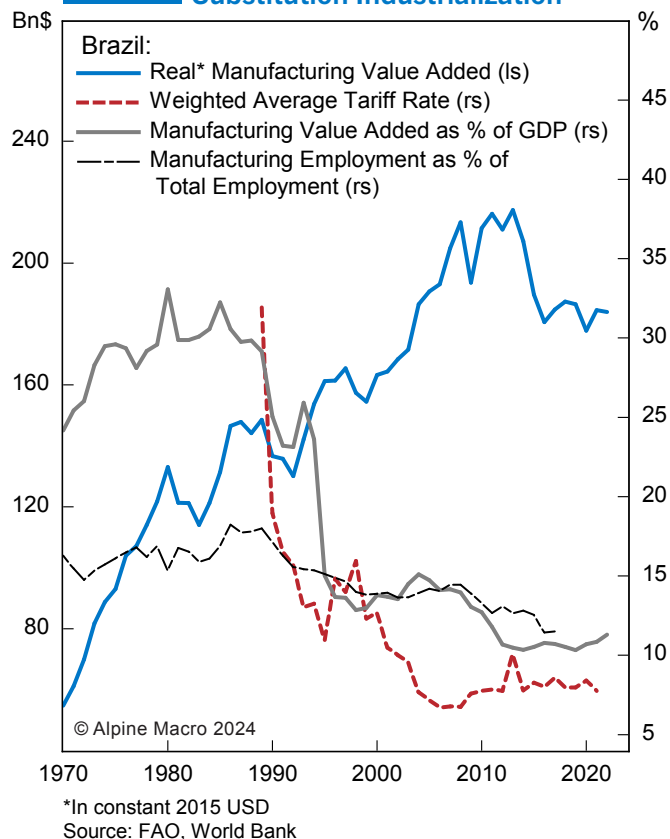
Particularly, supply chain stresses became a significant issue during Covid-19 and later with Russia's 2022 invasion of Ukraine. **Chart 1** shows how these disruptions contributed to the recent inflation surges. Fears of similar shocks and inflation, both politically damaging, have driven many countries to prioritize supply chain security and reindustrialization – often at the cost of economic efficiency.

Similarly, Western semiconductor export controls and tech investment restrictions on China surprised and prompted Beijing to accelerate its advanced manufacturing, and to try to reduce its reliance on Western tech suppliers.

This trade-off between economic efficiency and national security resilience is old, but after the Cold War, globalization thrived on freer trade and foreign investment, as governments saw few geopolitical threats on the horizon, thus allowing for outsourcing, stretched supply chains, and just-in-time production. Most Western governments accepted the risks associated with these business practices.

That's no longer the case. U.S.-China strategic tensions, the Covid-19 pandemic, the Russia-Ukraine war, and the Suez Canal disruptions (both now and

**Chart 2** Brazil's Manufacturing After Import Substitution Industrialization



in 2021) are pushing countries – including the U.S., E.U., and China – to reassess their supply chains and their broader industrial and economic policies.

## Is Western Reindustrialization A Fig Leaf?

Western countries have adopted clear and aggressive reindustrialization policies. In the U.S. and E.U., this has led to subsidies, and trade and investment barriers clearly aimed at boosting renewable energy production (e.g., the IRA, E.U. Green Deal), at expansion of semiconductor manufacturing and research (e.g., the American and European CHIPS acts), and at building infrastructure. But how much of this can actually be effective?



Government-driven reindustrialization is rarely economically efficient. A classic example is the import substitution industrialization (ISI) model from the 1930s to the 1960s, particularly in Latin America. For instance, Brazil's ISI policies peaked in the 1960s, but high tariffs persisted until the early 1990s. [Chart 2](#) shows how Brazil's manufacturing share of GDP and employment declined as tariffs fell, yet its manufacturing value added grew – highlighting how freer trade leads to greater economic gains.

Will these reindustrialization efforts in the U.S. and the West fare better than the old ISI policies? Reindustrialization and reshoring enjoy broad bipartisan support across Western countries. However, as a recent *Alpine Macro Special Report*<sup>2</sup> suggests, a full-on U.S. manufacturing renaissance is likely a pipedream. High labor costs, regulations, and long-term fiscal constraints (meaning industrial subsidies can't last forever), make a broad manufacturing revival unlikely.

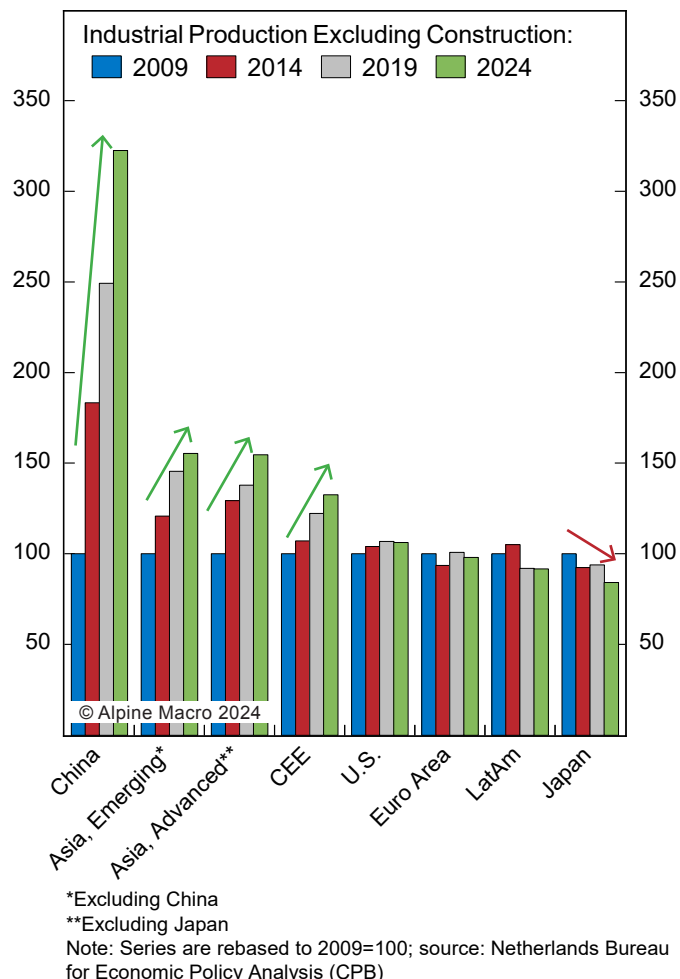
Looking at global industrial production, the U.S. and Euro area have remained flat over the past 25 years. [Chart 3](#) shows significant industrial growth in China, Asia, and Central and Eastern Europe, where regulatory and labor cost advantages prevail.

Then there's corruption and waste. The U.S. Government Accountability Office<sup>3</sup> estimates that between \$233 billion and \$521 billion is lost annually to fraud, a staggering figure (roughly 0.9-2.0% of GDP). This doesn't account for additional wasteful spending. In

2 Alpine Macro *Special Report* "U.S. Manufacturing Renaissance: Still A Mirage" (September 2, 2024).

3 U.S. Government Accountability Office, *Fraud Risk Management: 2018-2022*, (April 6, 2024).

**Chart 3** Industrial Production Growth In Select Countries And Geographies

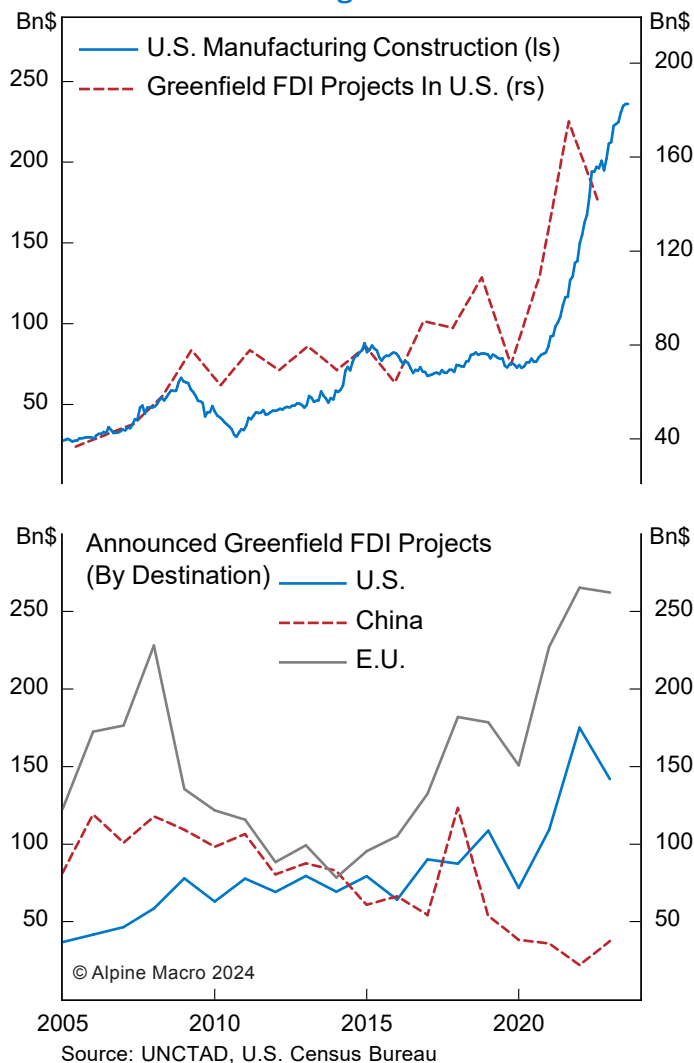
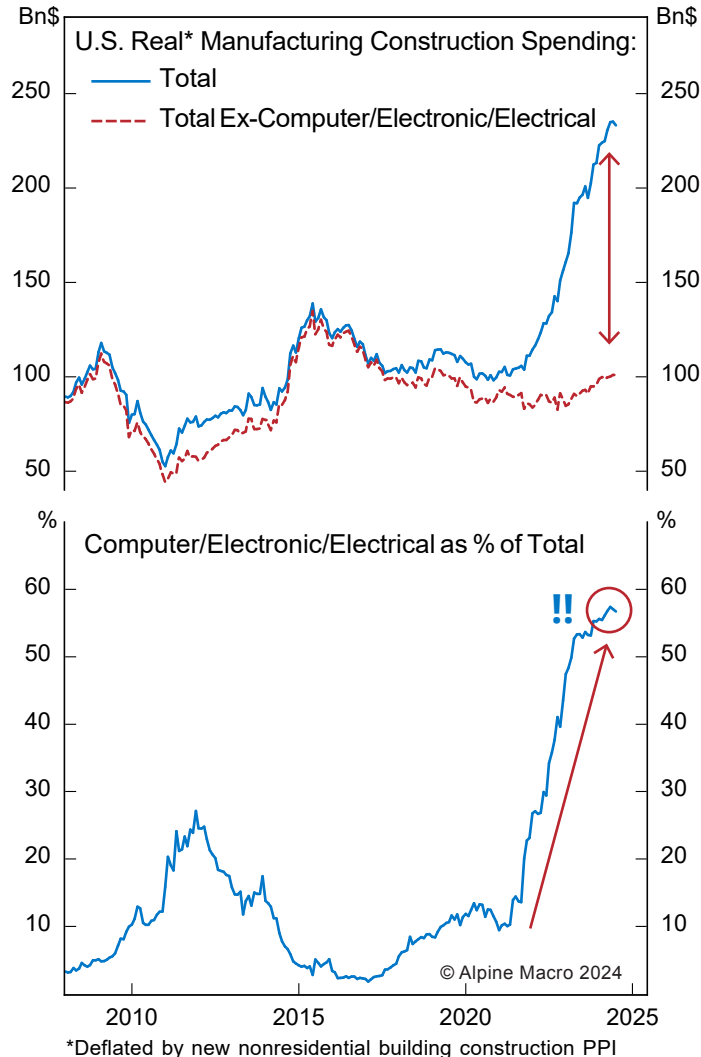


Europe this is also an issue, but in the U.S., the scale of fraud and waste is enormous, and there is very little oversight.<sup>4</sup>

This doesn't mean Western industrial policies will be a complete failure. There's too much money and too much (geopolitically) at stake for that. **Greenfield FDI in the U.S. and Europe has increased, as has manufacturing construction ([Chart 4](#)). However, in the U.S., this seems largely driven by growth in electronics ([Chart 5](#)), due to the CHIPS Act.**

4 NPR, Eric McDaniel, "The EPA's watchdog is warning about oversight for billions in new climate spending," (April 1, 2023).



**Chart 4 Western Industrial Policies Are Shifting Investment Patterns**

**Chart 5 The CHIPS Act Drives The Investment Boom**


Other parts of advanced U.S. manufacturing – especially aerospace & defense, biotech and “green energy” industries – could benefit longer-term from industrial support due to their importance for national security and resilience. However, to date, the IRA has failed to significantly boost EV production and green energy tech. Overall, Western reindustrialization efforts are inefficient, yet will persist. This means there will be selective growth opportunities.

## Is China’s Hyper Industrialization Counterproductive?

The resilience issue plays out differently in China. Beijing is doubling down on expanding its own manufacturing and tech production to reduce reliance on Western supplies and stimulate its slowing economy. However, by focusing on export-driven manufacturing growth, China risks deepening imbalances in its economy, such as deflationary pressures. This strategy is also leading to escalating trade conflicts with countries trying to protect their own industrial

bases, given their own national security/resilience concerns.

The European Commission has already begun imposing tariffs on Chinese EVs and other manufactured goods. The U.S. also imposed more tariffs on Chinese goods this summer. Secretary Yellen warned that *'China is now simply too large for the rest of the world to absorb this enormous capacity'*.<sup>5</sup>

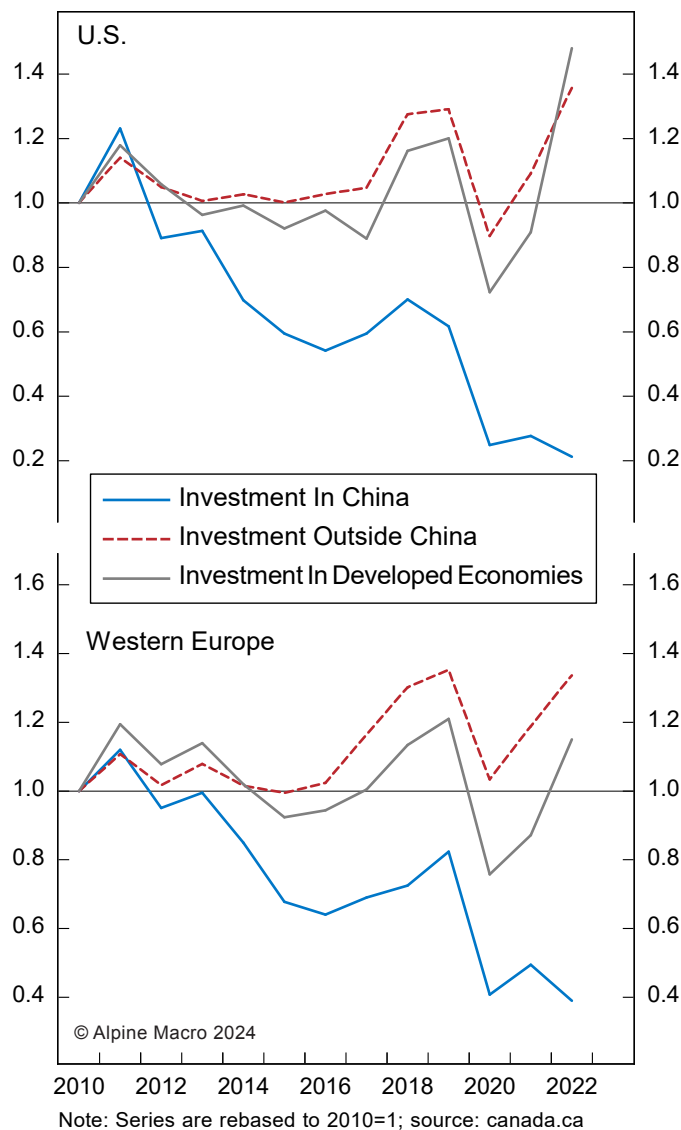
This competition extends beyond the West-China rivalry. Even emerging markets, some of which are friendly to China (e.g. Brazil) and also, Chile, India, and Indonesia have imposed or are considering restrictions on Chinese imports, (e.g. steel tariffs). These countries are also keen to preserve their own industrial capacity for political stability and national security reasons. Once again, political rationality trumps economic efficiency.

## Reconfiguring Supply Chains – Better Than A Fig Leaf

Since the West cannot fully reindustrialize but seeks to reduce its reliance on China, strategies like 'de-risking,' 'friend-shoring,' 'China plus one' supply chains, and 'ally-shoring' have gained traction. China has its own interests in securing supply chains against Western restrictions.

**Chart 6** shows how Western FDI is increasingly shifting to non-China locations, benefiting other developing economies. As noted by the BIS, global value chains are actually lengthening,<sup>6</sup> but the goal here is to make them geopolitically resilient. Countries, including China, are also moving supply chains and FDI into geopolitically friendly nations (**Chart 7**), even if they are geographically distant – a form of ally-shoring.

**Chart 6** Western FDI Is Shifting Away From China



The rise of pivot or middleman countries, acting as trade and strategic intermediaries between China and the West, adds costs (less efficient) but provides governments with some resilience against geopolitical risk. **Map 1** highlights countries (roughly) aligned with the West, China, or acting as somewhat

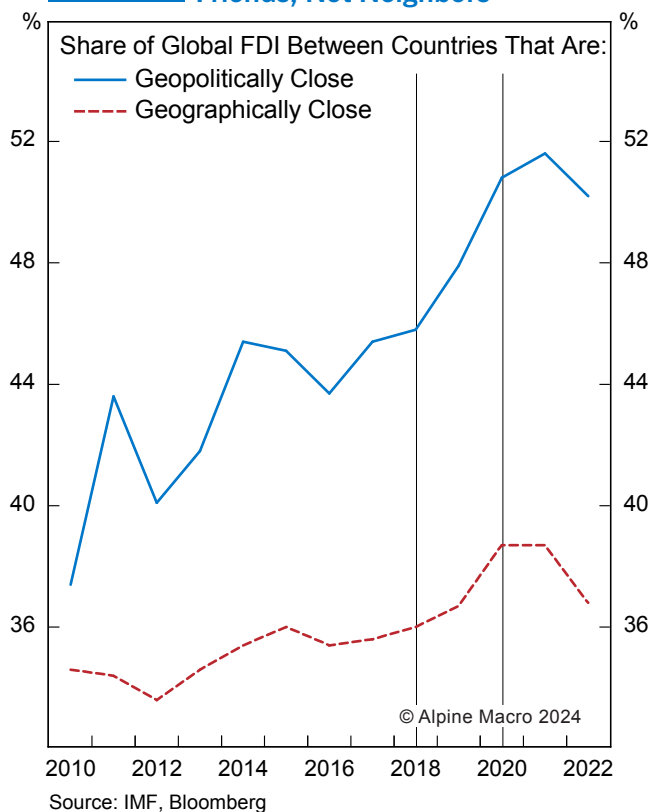
5 Foreign Affairs, Zongyuan Zoe Liu, "China's Real Economic Crisis", (August 6, 2024).

6 BIS Bulletin No. 78, "Mapping the realignment of global value chains", (October 3, 2023).





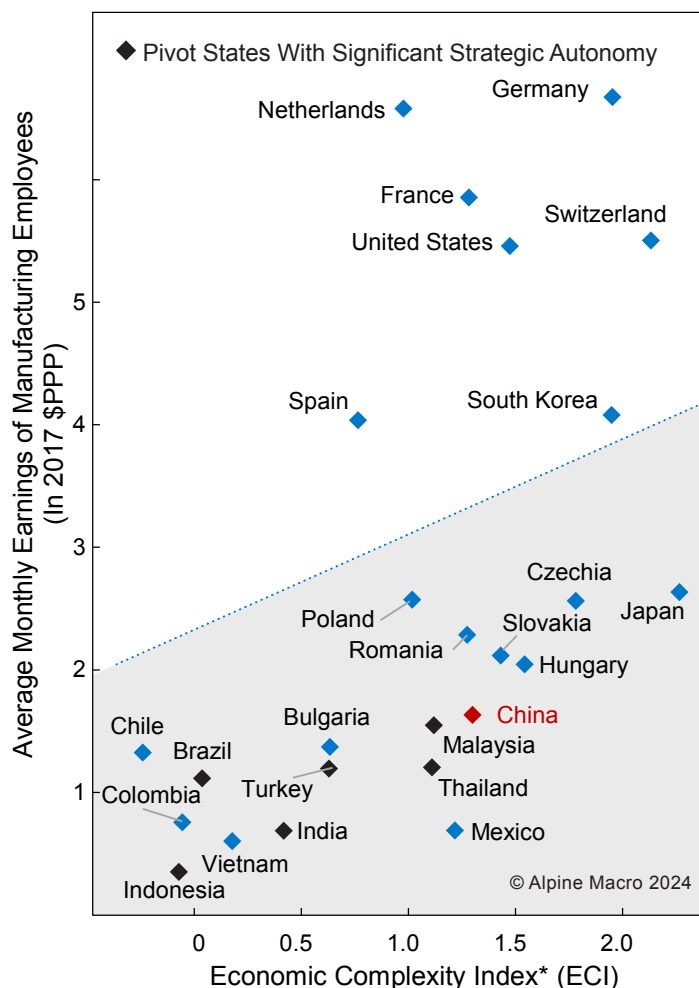
**Chart 7** Investments Favor Geopolitical Friends, Not Neighbors



neutral pivot states. Major pivot state economies stand to benefit from the supply chain reshuffling, including nations like Vietnam, Malaysia, and India which have already emerged as alternative manufacturing hubs.

**Chart 8** shows countries where manufacturing is shifting, based on wage competitiveness and economic complexity. Most are in Emerging Asia, Eastern Europe, and Latin America. Countries with greater strategic autonomy – like Malaysia, India, Turkey, and Brazil – are better positioned to resist pressure from the West or China, which makes them arguably more geopolitically relevant and "safe." While Mexico and Vietnam have also been amongst the great beneficiaries of this manufacturing and trade reshuffling,

**Chart 8** Countries That Benefit Or May Benefit From Friendshoring

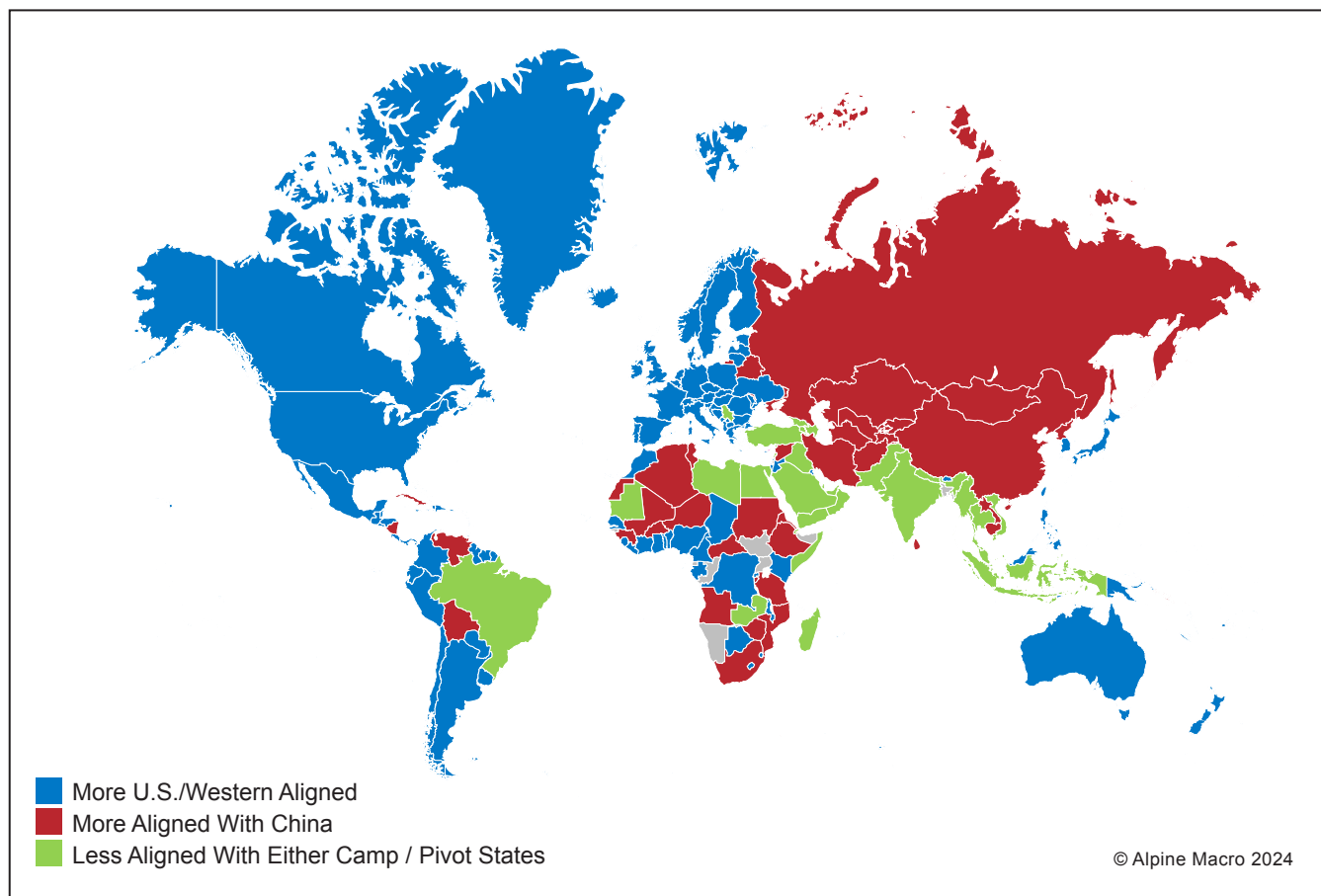


\*ECI assesses how diversified and complex a country's export basket is. A high score denotes greater diversity of productive/complex specialized know-how to produce sophisticated products. Note: Countries below the blue dotted line stand to benefit from friendshoring; source: ILO, Harvard Growth lab.

they may actually face bigger risks. Both have significant strategic vulnerabilities, as they both border the two great powers, U.S. or China, which limits their strategic autonomy. Overall though, Alpine Macro remains bullish on these nations, especially those that are more strategically autonomous as in **Chart 8**. One such example is Malaysia, subject of a recent *EM & China Strategy* report.<sup>7</sup>

7 Alpine Macro *EM & China Strategy* "Buy Malaysia: Riding On The Tech Boom?" (August 20, 2024).



**Map 1** Geopolitical Alignment: Leaning Towards The U.S, China, Or In-Between?

## Market Implications: The Renewable Energy Example

Money will continue to pour into Western reindustrialization efforts and many industries, like semiconductors, AI, and aerospace & defense.

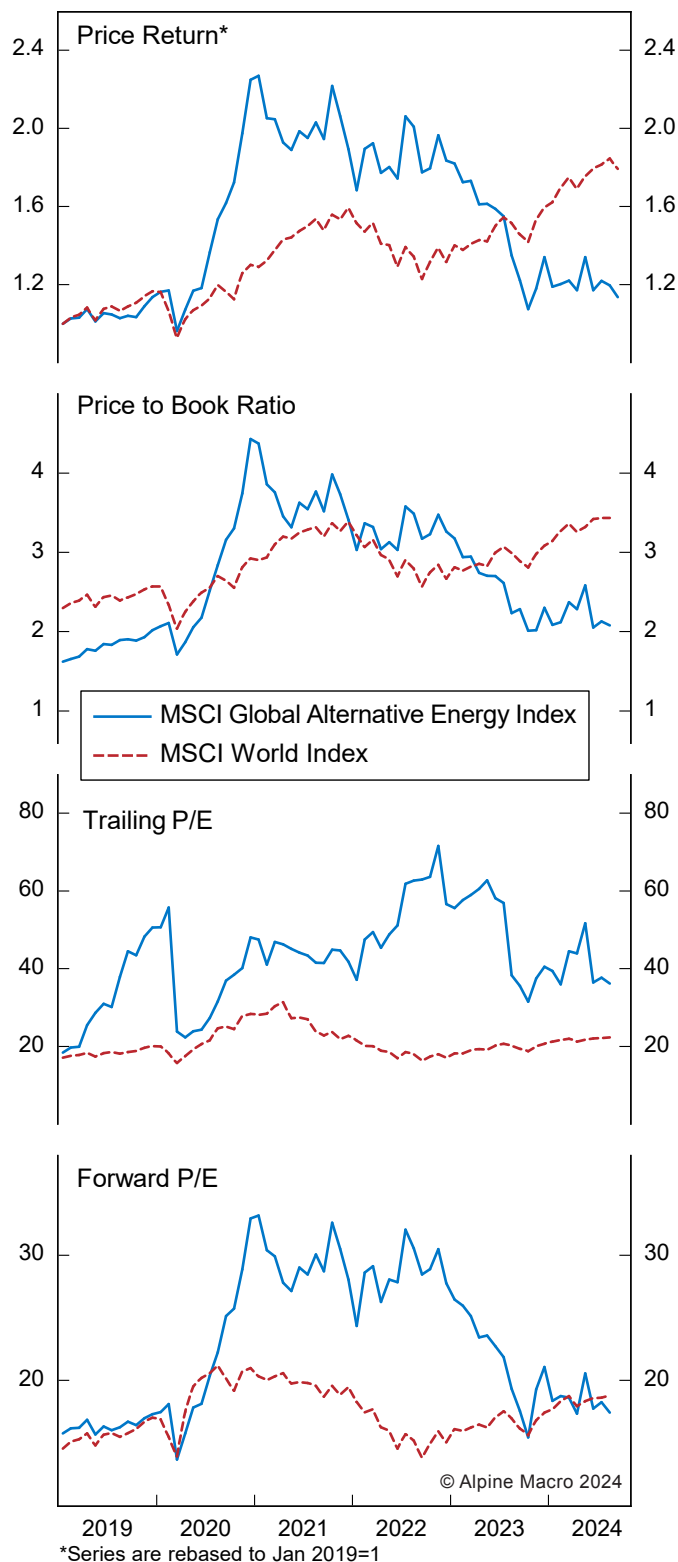
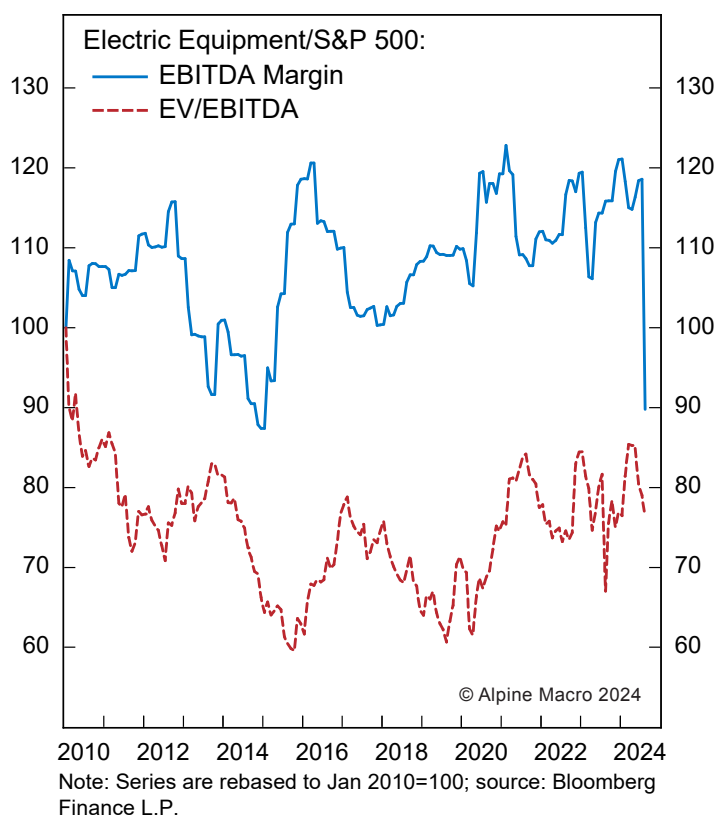
The key question will remain where will government support actually help specific industries to grow? Take the green energy and EV industries. Broadly, there are reasons to be bearish on these over the next 2 years or so.

Decarbonization is in fact, the ultimate poster child for the resilience preference, as it tries to wean countries off fossil energy and ultimately to radically

reduce the cost of energy. The problem is that it is a strategy largely dependent on government policy mandates that are both expensive and unpopular in the short-to-medium term. While many make the argument that eventually green energy will provide huge efficiencies, that is a long-term argument also contingent on future technological breakthroughs. In the shorter-term, decarbonization plays are expensive. This is a domestic economic and political problem, while governments also require cheap power for economic reasons and to stay geopolitically competitive; you cannot run navies on wind power.



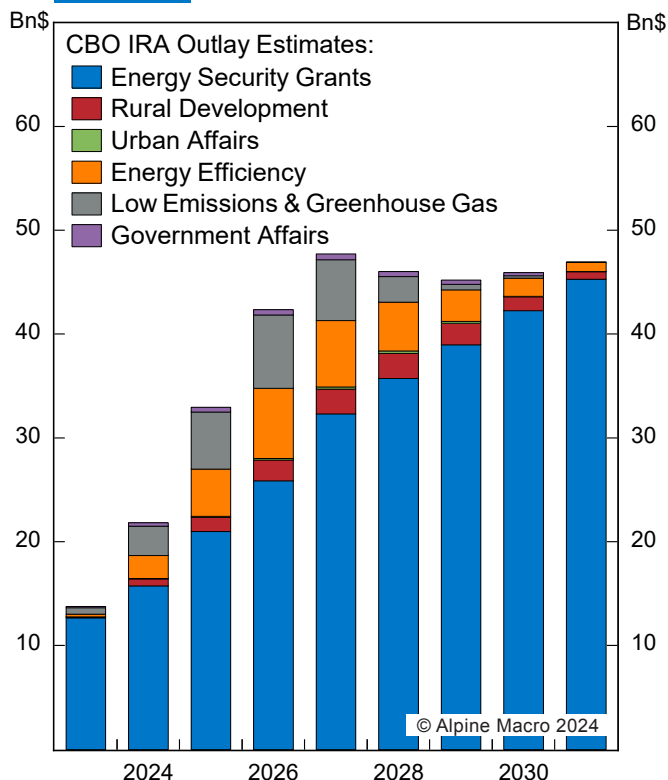


**Chart 9** Alternative Energy Has Underperformed

**Chart 10** Profitability Of Electrical Equipment Industry


Alternative energy has generally underperformed since 2021 (Chart 9), partly because of high interest rates, but increasingly because government mandates are getting watered down given economic inefficiencies that leads to political pushback.

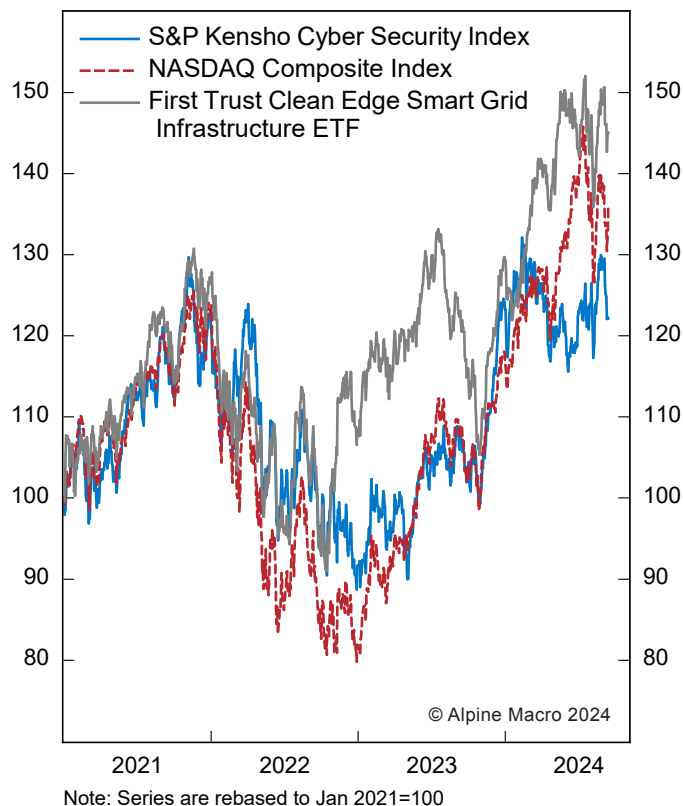
That said, there are green energy-related plays that make sense, given the amount of government support for these industries. For example, most Western governments will continue to support rebuilding electric and other critical infrastructure, which is necessary not only for decarbonization but also for national security (which is a stronger resilience preference). Even if Trump were to win the U.S. elections, critical infrastructure investments will continue apace.



**Chart 11** The IRA Will Benefit Utilities

This is a good reason to be bullish on subsectors like electric equipment (Chart 10) and construction and engineering, which stand first in line to benefit from government subsidies. More broadly, utility companies also stand to benefit from government subsidies (Chart 11).

We also think electric grid investments benefit from the resilience preference, especially as grid vulnerability is a national security risk. A longer-term related play is investing in cybersecurity. As all critical infrastructure is connected to the internet, this creates a single point of failure that in a geopolitically fraught world will be exploited. As such, cybersecurity will be a critical secondary component of any infrastructure rebuilding and reindustrialization plays, and cyber assets (Chart 12) should benefit from this.

**Chart 12** Resilient Electric Grids/Infrastructure Are A National Security Priority

Lastly, nuclear power and natural gas are less polluting energy forms that are becoming more politically acceptable.

**Dan Alamariu**

*Chief Geopolitical Strategist*

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