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Geopolitics and GDP: Structural Alignment Matters More than Near-Term Risk

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- Geopolitical risks from the war in Iran have faded since March. But broader risks around geopolitical and economic fragmentation remain, with some measures signaling the lowest level of global alignment since the 1980s. In this *Global Economics Analyst*, we explore the impact of geopolitics on the global economy, with a particular focus on the longer-run implications for global growth.
- The effects of geopolitics on commodity prices and economic outcomes are well-studied, although only a subset of geopolitical crises—typically those directly involving major oil-producing regions—have a material impact on oil prices. Outside of the commodity channel, we find that the *direct* impacts of geopolitical risk events have created only modest drags on growth due to increased caution from consumers and businesses. For example, a sustained increase in geopolitical risk indices as large as the spike due to the war in Iran would only subtract 0.3pp from global GDP growth in 2026-H1 (incremental to commodity headwinds) according to our estimates.
- The long-run impacts from shifting geopolitical alliances are not small, however. A one standard deviation shift in country-specific geopolitical alignment toward improved relations with the rest of the world (defined by the GDP-weighted alignment to all other countries)—a shift roughly as large as during the defrosting of Chinese-western relations following Nixon's visit in 1972—adds 3% to long-run GDP on the back of increased trade and investment, particularly if driven by increased alignment with western nations. We also find larger benefits in EMs than DMs, with stratified estimates suggesting that increased trade, lower resource dependence, and positive spillovers to domestic governance and institutions help EMs catch up.
- One reason why shifts in geopolitical alignment lead to long-run GDP effects that build for almost a decade is that they prompt increases in trade that lead to longer-run efficiencies. We find that overall trade volumes increase following an increase in bilateral alignment, a pattern that suggests more efficient allocations of production. We also find increases in FDI and FX reserve allocations following a positive shift in alignment, suggesting that increased capital flow enhances efficiency.
- Our results suggest that a hypothetical return to mid-2010s levels of geopolitical alignment could add up to 1% to global GDP over the remainder of the decade, with outsized benefits in EMs. In contrast, an incremental increase in

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fragmentation equivalent to that seen since 2016 would lower global GDP by 1% over the long run.

Geopolitics and GDP: Structural Alignment Matters More than Near-Term Risk

Near-term geopolitical risks appear to be receding. Despite some signs of fragility, the US-Iran memorandum of understanding lays the groundwork for a gradual normalization of global economic conditions as oil flows through the Strait of Hormuz recover. But risks around broader geopolitical and economic fragmentation remain, with some measures signaling the lowest level of global alignment since the 1980s.

In this *Global Economics Analyst*, we explore the impact of geopolitics on the global economy, with a particular focus on the longer-run implications for global growth.

Measuring Geopolitical Risk and Alignment

Recent academic research has focused on quantifying two distinct types of geopolitical exposures.

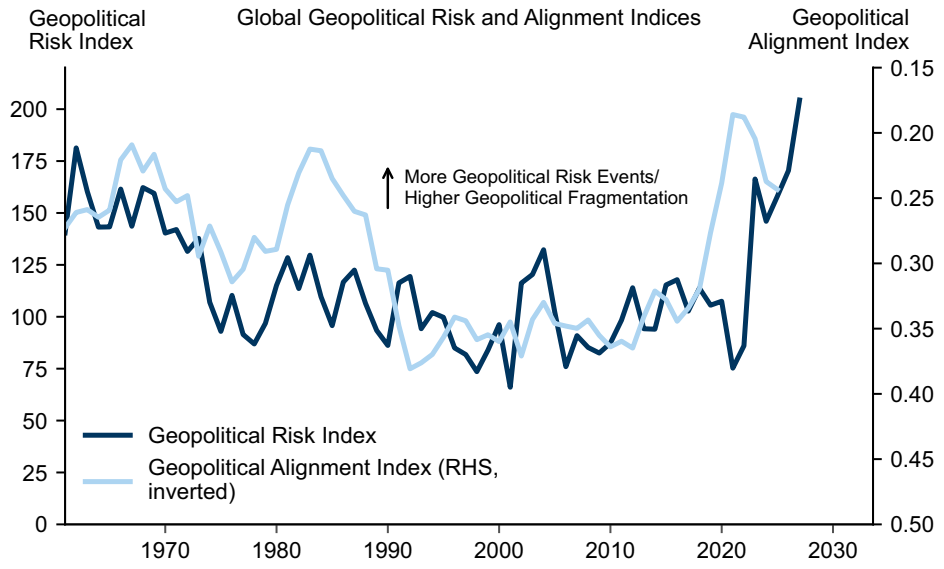
1. *Geopolitical risk event* measures capture the quantity and intensity of events such as military confrontations, political crises and diplomatic incidents. We use a recently-introduced Geopolitical Risk Index from Iacoviello and Tong (2026)[1] which analyses historical geopolitical events on a country level by applying an LLM to historical newspaper articles.
2. *Geopolitical alignment* measures instead quantify the relationships between nations—how aligned a country is to other states. We measure alignment using a Geopolitical Alignment Index constructed from the Global Geopolitical Events Database (GGED) developed by Fan (2025)[2]. GGED uses a web-search enabled LLM model to identify historical events between country pairs and assign scores reflecting relative alignment or misalignment. Following Fan (2025), we construct country-level alignment scores by taking GDP-weighted averages of the bilateral alignment measures.

Methodologically, the geopolitical risk event index and geopolitical alignment index are somewhat similar. Both combine media and other text to extract a signal of shifting geopolitical stances. Exhibit 1 shows the evolution of the global geopolitical risk index (intensity-weighted share of newspaper coverage devoted to global geopolitical risk) and geopolitical alignment index (GDP-weighted average of country-specific indices) since 1960. There are common trends—for example, geopolitical risks declined in the mid-1970s, around the same time that geopolitical alignment increased against the backdrop of US-Soviet détente. Most relevant for the current outlook, both measures have risen sharply since the 2010s—consistent with more geopolitical risk events and higher fragmentation—and stand close to all-time highs. Although fragmentation eased slightly since 2021, the latest alignment datapoint is 2024—before the 2025 'Liberation Day' tariffs and the Iran war—and therefore fails to capture a likely incremental deterioration in alignment over the last two years.

[1] Iacoviello, Matteo and Jonathan Tong (2026). "The AI-GPR Index: Measuring Geopolitical Risk using Artificial Intelligence." Working Paper, Federal Reserve Board of Governors.

[2] Tianyu Fan (2025). "Measuring Geopolitical Alignment and Economic Growth.", Working Paper.

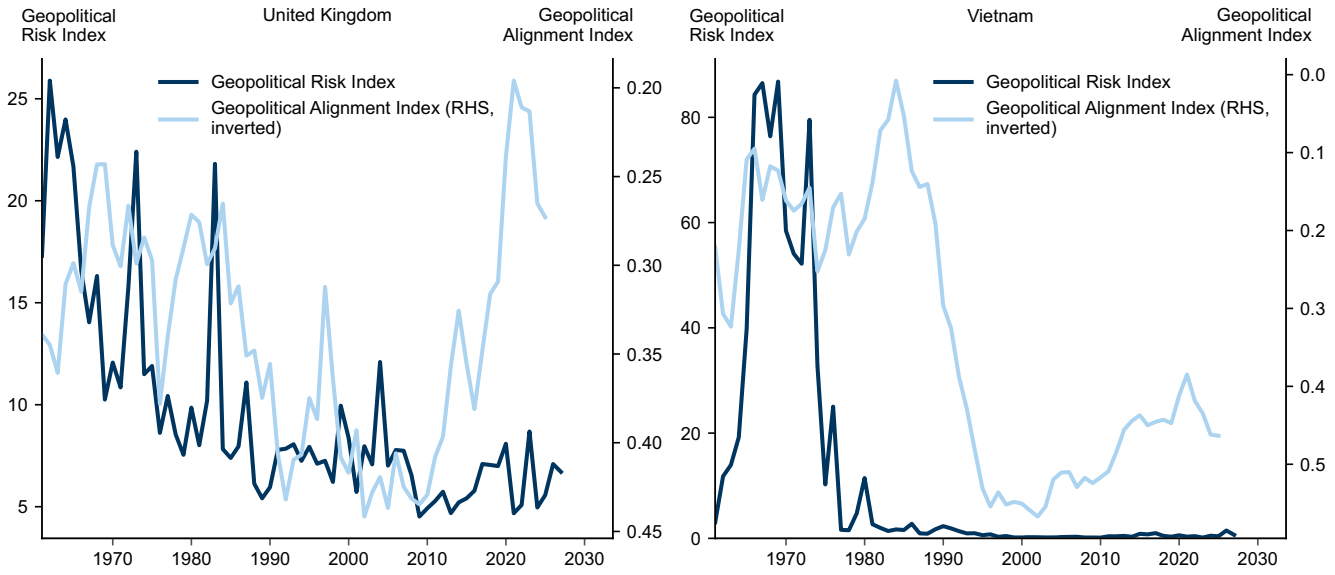
Exhibit 1: Global Geopolitical Fragmentation Has Increased Over the Last 5-10 Years



Source: Goldman Sachs Global Investment Research, Iacoviello and Tong (2026), Fan (2025)

While geopolitical risk and alignment are correlated, it is worth emphasizing that geopolitical risk is a distinct phenomenon from geopolitical alignment. This is most apparent on a national level: to illustrate, Exhibit 2 shows the two country-level indices for the UK and Vietnam (the geopolitical risk index corresponds to the intensity-weighted share of newspaper coverage devoted to UK/Vietnamese geopolitical risk; the geopolitical alignment index is defined as the GDP-weighted average of bilateral alignment between the UK/Vietnam and all other countries). In the case of the UK, Brexit led to a deterioration in overall alignment without a corresponding rise in event risk. And in the case of Vietnam, the end of the Vietnam war led event risk to decline 20 years before alignment improved.

Exhibit 2: Geopolitical Risk and Geopolitical Alignment Are Distinct Phenomena

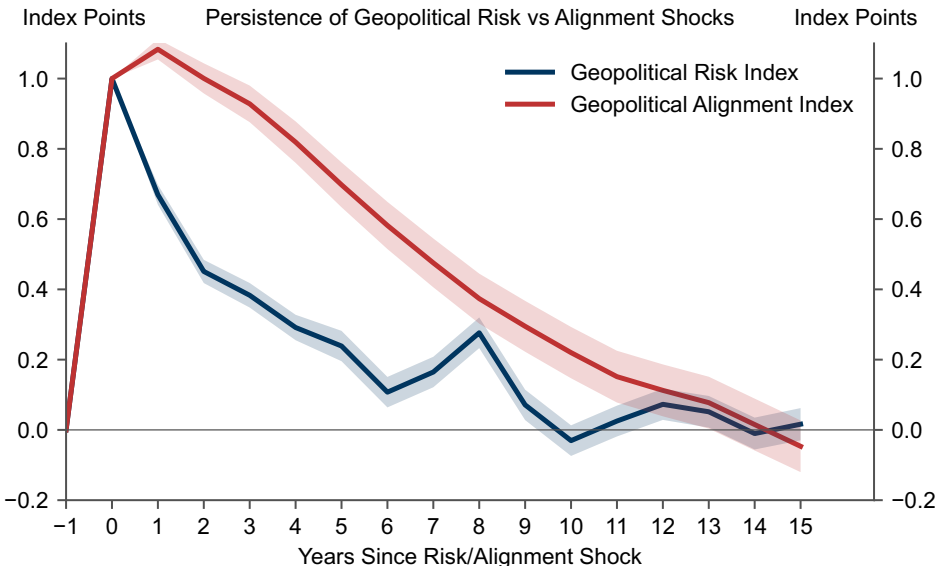


Source: Goldman Sachs Global Investment Research, Iacoviello and Tong (2026), Fan (2025)

A key differentiating factor between geopolitical risk events and changes in geopolitical alignment is their relative persistence: Individual geopolitical risk events tend to be highly salient when they occur but are most often shorter-lived. Geopolitical alignment, by contrast, is a slower yet persistent process.

To quantify this distinction, we run a local projection of the country-level geopolitical risk and alignment indices on themselves. Exhibit 3 shows that a one-unit 'shock' in the risk index exhibits some persistence but falls sharply within two years and subsides after five. A one-unit geopolitical alignment shock endures far longer, fully receding only after roughly 14 years. Wars, acts of terror and threats of interstate violence are deeply disruptive—but are fortunately usually measured in days, months or at most years—whereas the strengthening and deterioration of relations between nations is a gradual process that unfolds over decades.

Exhibit 3: Geopolitical Risk Shocks Fade Quickly, but Changes in Geopolitical Alignment Are Much More Persistent



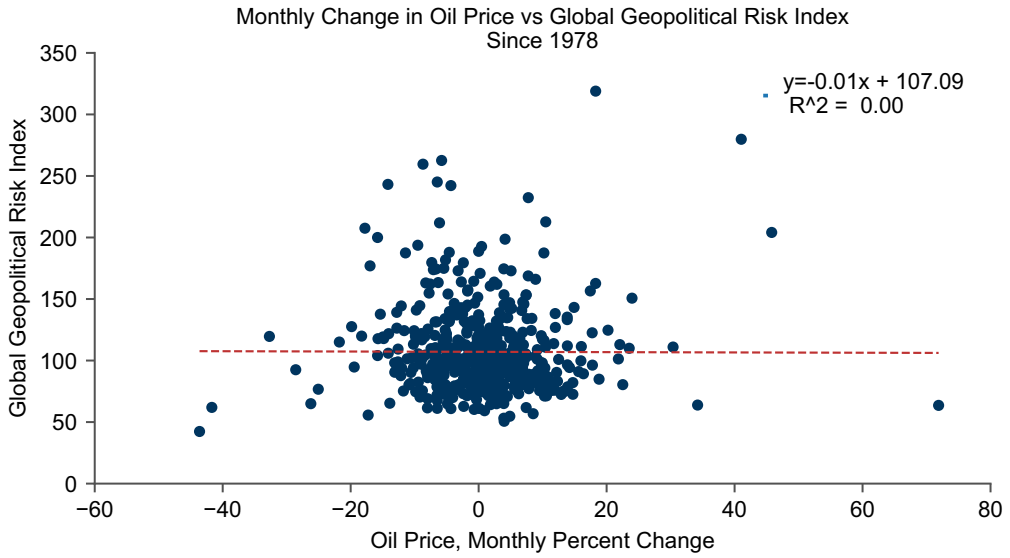
Source: Goldman Sachs Global Investment Research, Iacoviello and Tong (2026), Fan (2025)

The Short and Sharp Impact of Geopolitical Risk Events

Many well-known geopolitical crises—the 1979 Iranian revolution, Russia's 2022 invasion of Ukraine and the ongoing Iran war—hit the global economy primarily through one channel: commodity market disruptions that pushed up commodity prices. We have previously highlighted our rule-of-thumb that a 10% rise in oil prices lowers global GDP by approximately 0.1%, implying that the Hormuz closure has erased roughly 0.3% from global GDP this year. Yet most geopolitical risk events—for instance, the Falklands war, the 1999 NATO bombing of Yugoslavia and the 2025 announcement of US tariffs—have nothing to do with oil. A simple scatter plot of the Geopolitical Risk Index against the one-month change in global oil prices shows no relationship (Exhibit 4)[3].

[3] Iacoviello and Tong (2026) observe that broad geopolitical risk indices conflate events related and unrelated to oil, diluting their usefulness for studying energy markets. They address this by constructing a dedicated oil geopolitical risk index that isolates geopolitical oil supply disruptions.

Exhibit 4: We Often Focus on Commodity Price Impacts of Geopolitical Shocks, but the Response of Oil Prices to Geopolitical Events is Surprisingly Weak

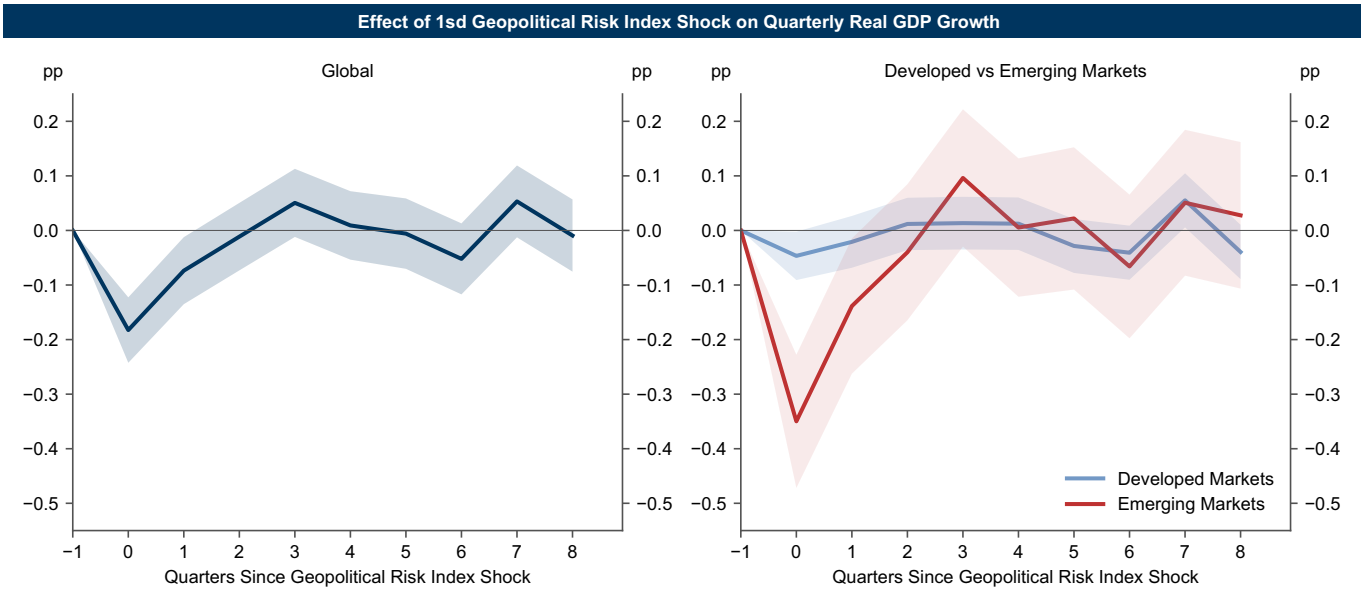


Source: Goldman Sachs Global Investment Research, Iacoviello and Tong (2026), Haver Analytics, Wall Street Journal

To estimate the *direct* short-run effects of geopolitical events on global GDP—due to precautionary saving, delayed investment and risk-off capital outflows, but excluding oil—we run a panel local projection of country-level geopolitical risk indices on quarterly GDP growth, controlling for oil prices. A one standard deviation rise in the index—an increase roughly as large as the one that occurred in China following the announcement of tariffs in early 2025—tends to lower country-level GDP growth by 0.2pp in the affected quarter and by a further 0.1pp the following quarter, before the effect subsides (Exhibit 5).

The drag is materially larger in Emerging Markets than in Developed Markets, likely because EMs are more vulnerable to risk-off capital outflows. The key takeaway from these patterns is that growth drags are generally small and only temporary. The global geopolitical risk index was 30% higher in 2025-H1 compared to 2024-H2, implying that global growth in Q1-Q2 was approximately 0.3pp lower than in a counterfactual without the Iran war, with some recovery likely in H2 on the back of the recent normalization in risks.

Exhibit 5: Geopolitical Risk Events Have a Short-Run Impact on Real GDP Growth (Incremental to Commodity Price Effects)...



Source: Goldman Sachs Global Investment Research, Iacoviello and Tong (2026)

The Larger Long-Term Consequences of Geopolitical Alignment

Geopolitical alignment shapes economic activity over a far longer horizon. To demonstrate, we run a set of local projections that exploit country-level changes in the GDP-weighted average of bilateral geopolitical alignment indices on annual GDP, while also controlling for country and time fixed effects (we include separate time fixed effects for DMs and split EMs by the seven World Bank regions). The resulting estimates therefore capture the effect of a one standard deviation shift in a specific country's alignment with the rest of the world, holding alignment for all other countries fixed. Causal identification is admittedly difficult—economic progress could lead to an improvement in alignment, while not all alignment shifts will necessarily generate significant economic benefits—but idiosyncratic time variation in alignment likely provides useful insight into the impact on GDP.

We find that a one standard-deviation[4] increase in country-level geopolitical alignment raises the *level* of GDP by approximately 3% over seven years for the average country in our panel. This effect is large but generally follows from material shifts in alignment—an alignment shock of this magnitude would roughly correspond to the shock that occurred to China after Nixon visited in 1972 or the shift in Iran's alignment after it signed the JCPOA in 2015[5].

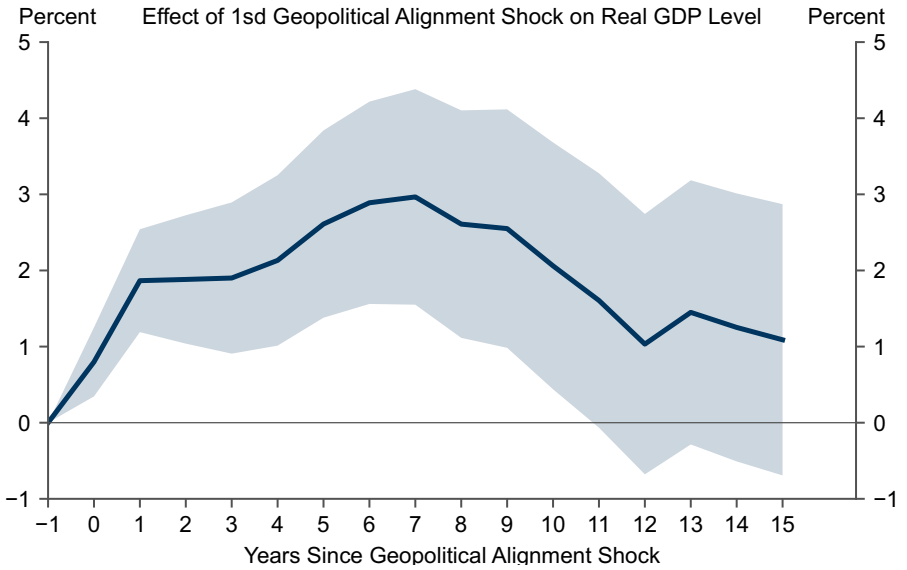
While the estimated impact on GDP is large, it aligns with a growing body of economic literature that finds large effects of alignment on economic activity. As examples, 1) Fan (2025) finds that a one-standard deviation permanent shift in alignment raises GDP per capita by 10% over 25 years, 2) Fan Wo and Xiang (2026) find that a similar shift in

[4] Since we use a panel model, there are two sources of variation: Within countries (i.e., over time) and between countries. We use the within-country standard deviation (slightly smaller than the overall standard deviation) to scale the shocks, since this has a more natural interpretation.

[5] Though in both these cases, relations had already started to improve in the preceding years, likely further raising the GDP impact associated with each event.

alignment boosts bilateral trade by 20% over 10 years, 3) Shan and Tilton (2024) find that the US does not trade much with or invest in countries that are geopolitically distant, though China has close trade and investment relationships with both geopolitically close countries and many countries that are geopolitically more distant. 4) Gopinath Gourinchas Presbitero and Topalova (2024) find that trade and FDI flows across misaligned blocs have declined by 12% and 20% more than flows within the same bloc since the start of the war in Ukraine, 5) Javorick Kitzmuller Schweiger and Yildirim (2024) find that reversing recent alignment trends and economic integration could subtract 4.7% from GDP. Additional research highlights the importance of geoeconomic power and pressure in explaining long-run economic dynamics, suggesting that such forces are increasingly recognized as an important driver of long-run activity.

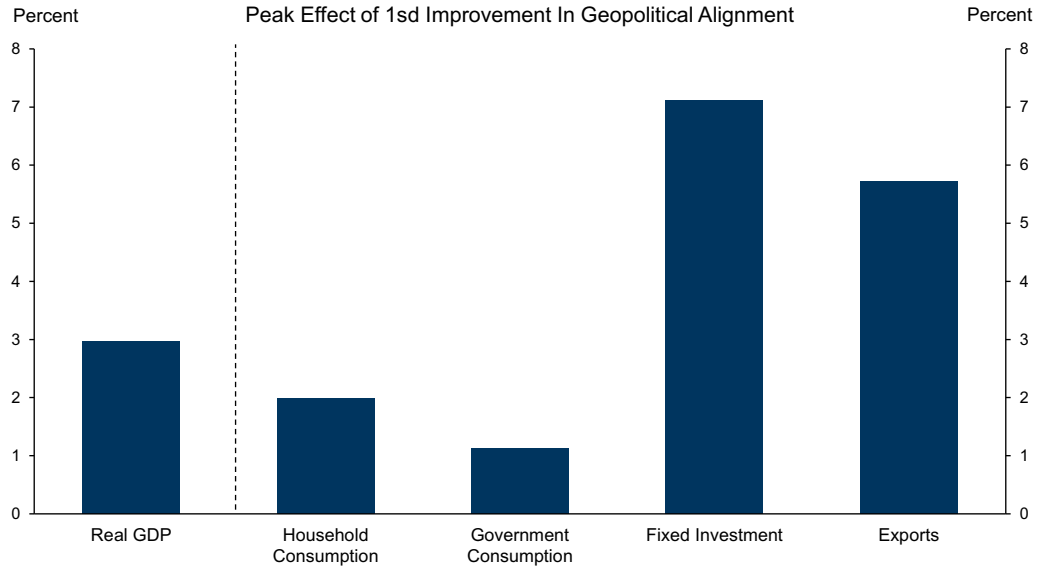
Exhibit 6: ...Whereas Geopolitical Alignment Effects Have a Long-Run Impact on GDP



Source: Goldman Sachs Global Investment Research, Fan (2025)

What drives this increase in GDP? Rerunning our model to estimate the impact of country-level changes in the GDP-weighted average of bilateral geopolitical alignment indices (i.e., alignment with the rest of the world) on the subcomponents of GDP reveals three channels. First, fixed investment rises the most, as improved relations widen access to global capital markets and lower the risk of domestic investment for local and international investors alike (Exhibit 7). Although investment may also rise in response to a *deterioration* of bilateral relations—through channels such as higher domestic defense expenditure, the nearshoring of supply chains and higher domestic energy infrastructure construction—our results suggest that larger longer-run investment gains accrue from an improvement, rather than a decline, in geopolitical alignment. Second, exports rise as improved alignment lowers trade barriers and deepens bilateral commerce. This effect is more pronounced for smaller economies—re-estimating our model only on the largest economies shows a smaller (though still significant) contribution from exports. Third, household and government consumption also rise, though by less than overall GDP, likely as a second-order effect of stronger investment and trade.

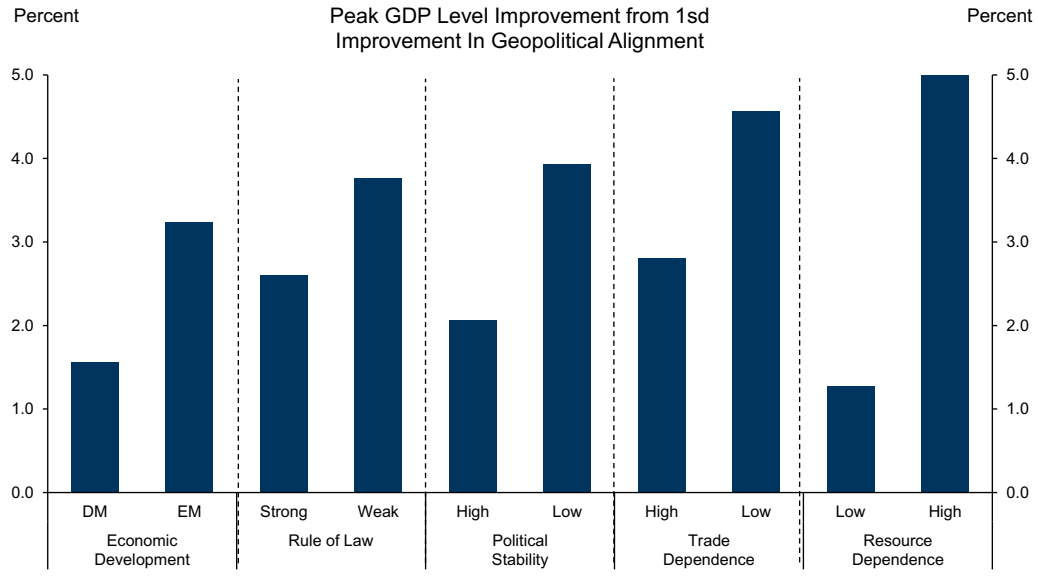
Exhibit 7: The Positive GDP Impacts from Increased Geopolitical Alignment Comes Mostly From Increases in Investment and Trade



Source: Goldman Sachs Global Investment Research, Fan (2025)

Given the importance of the investment and trade channels, it is unsurprising that emerging markets see materially larger gains from improved geopolitical alignment compared to developed markets (Exhibit 8). Stratifying our results suggests two further reasons. First, closer alignment helps EMs move away from a resource-extraction model and its associated volatility. Second, effects are larger for countries with weaker domestic institutions and governance, suggesting closer alignment with other countries generates positive spillovers beyond direct economic channels.

Exhibit 8: Less-Developed Countries With Weaker Institutions Have Tended to See A Larger Impact from Improving Geopolitical Alignment

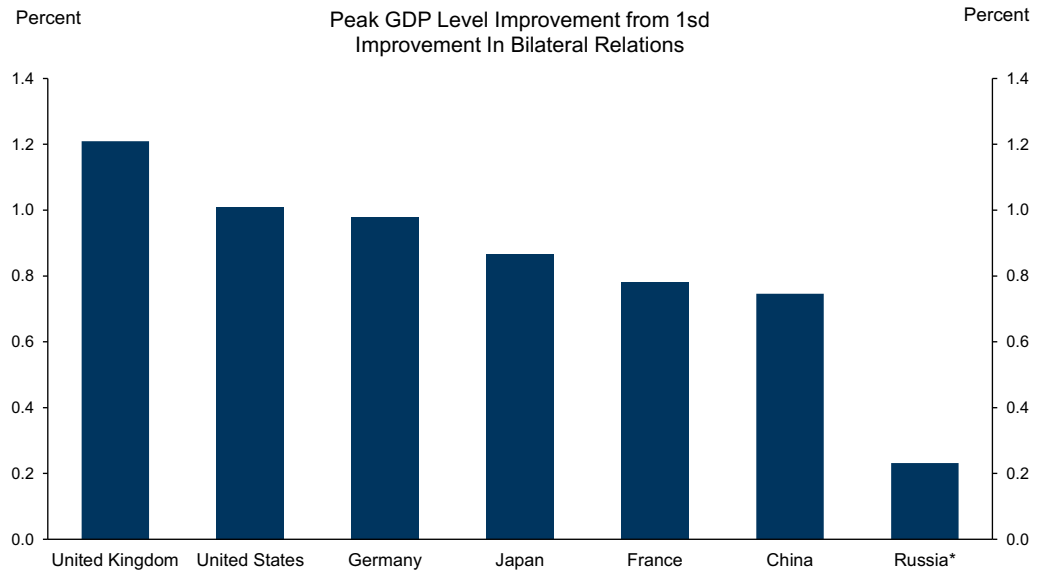


Source: Goldman Sachs Global Investment Research, Fan (2025), World Bank

Which bilateral relationships have historically delivered the largest economic benefits? We regress each country's bilateral alignment score with a given partner on that country's GDP—the US-Argentina score on Argentine GDP, the US-Brazil score on Brazilian GDP, and so on—while again controlling for country and region-time fixed effects. The takeaway from this exercise is that better relations with Western countries imply higher GDP gains than improving relations with China or Russia (Exhibit 9).

Somewhat surprisingly, our estimates suggest that the UK—rather than the US—screens as the most valuable partner to improve bilateral relations with. We see two likely drivers of this result. First, given the close historical alignment between the UK and US, increased bilateral alignment with the UK also leads to an endogenous increase in bilateral alignment with the US, such that the UK index serves as a US alignment proxy as well. Second, the UK also maintains close economic and political ties to mainland Europe, and therefore likely similarly captures simultaneous improvement in European alignment as well. Put simply, the UK's close economic and political ties to both the US and mainland Europe likely lead it to serve as the most effective proxy for other country's overall alignment with the Western bloc.

Exhibit 9: Historically, Better Relations With Western Countries Have Led to Larger GDP Gains



*Prior to 1991: Soviet Union

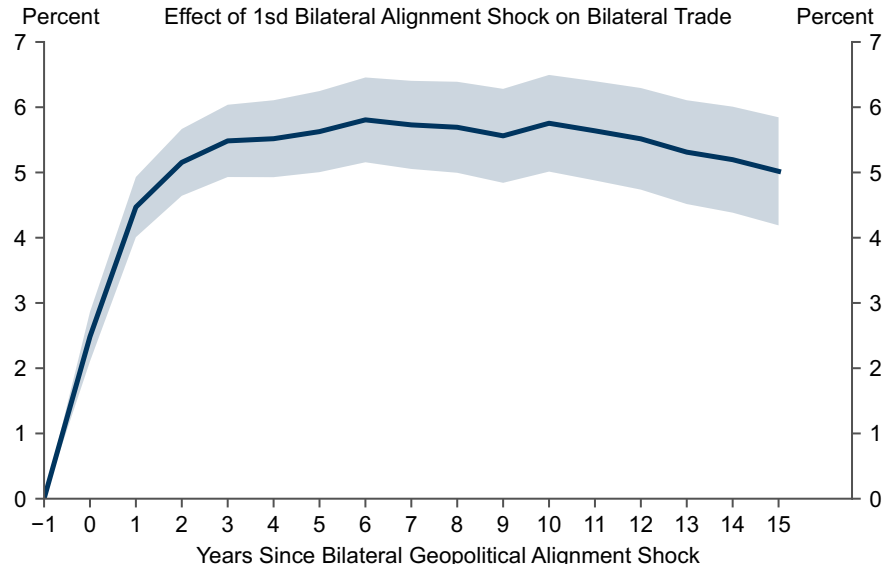
Source: Goldman Sachs Global Investment Research, Fan (2025)

Increased Alignment Improves Efficiency

The large and persistent impact of country-level alignment with the rest of the world on GDP likely reflects more than its direct effects on GDP components. By influencing trade and capital flows, alignment may also foster efficiency gains that accrue over time, amplifying its long-run effects on economic activity. We highlight three patterns supporting this view.

First, just as an improvement in a nation's *aggregate* geopolitical alignment improves its *aggregate* exports, an improvement in the bilateral relationship between two nations persistently increases bilateral trade (Exhibit 10).

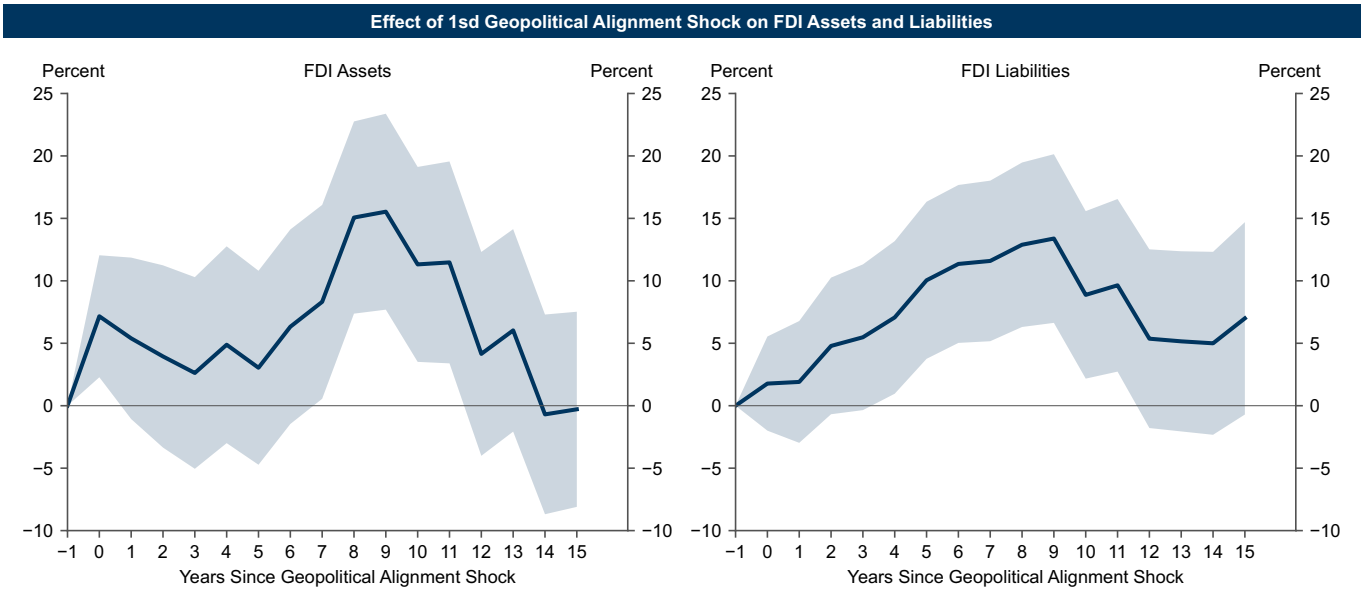
Exhibit 10: A 1sd Improvement in Bilateral Geopolitical Alignment Persistently Raises Bilateral Trade Volumes by 6%



Source: Goldman Sachs Global Investment Research, Fan (2025), IMF Direction of Trade Database

Second, we find that increased alignment also leads to an increase in foreign direct investment, suggesting more efficient allocations of capital and supply chain integration: both inbound and outbound FDI rise following an alignment shock (Exhibit 10).

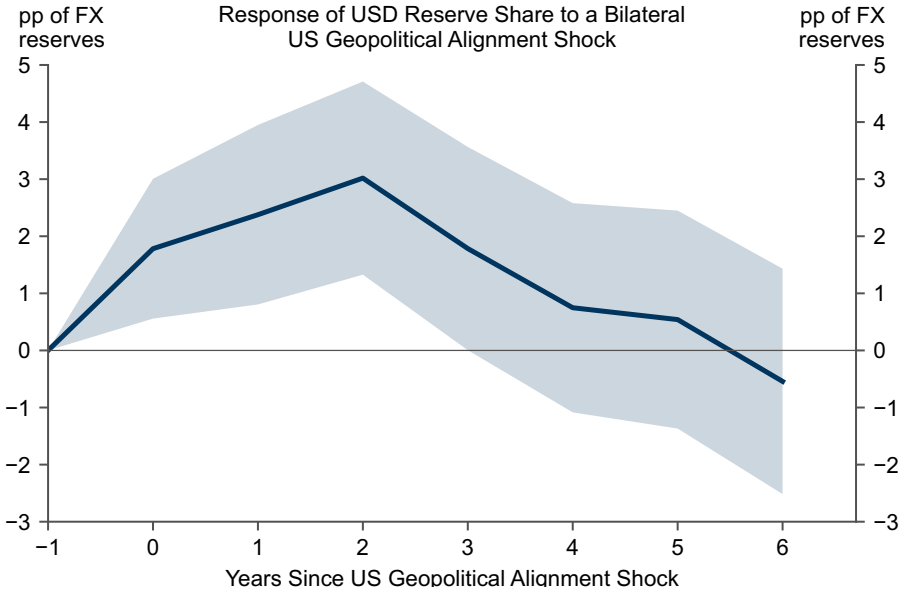
Exhibit 11: Improved Geopolitical Alignment Raises Inbound and Outbound FDI



Source: Goldman Sachs Global Investment Research, Fan (2025)

Third, we find that increased alignment increases financial flows. Although we find no significant impact on portfolio flows, we find that a 1 standard deviation increase in the US bilateral alignment index is associated with a 3pp increase in the share of USD assets in central banks' FX reserves (Exhibit 11). While changes in the composition of FX reserves do not have an obvious impact on GDP, they suggest an increase in financial relationships and access that may lead to more efficient capital allocations.

Exhibit 12: Beyond Growth, Improved Relations with the United States Tend to Imply a Higher Share of Dollar Reserves



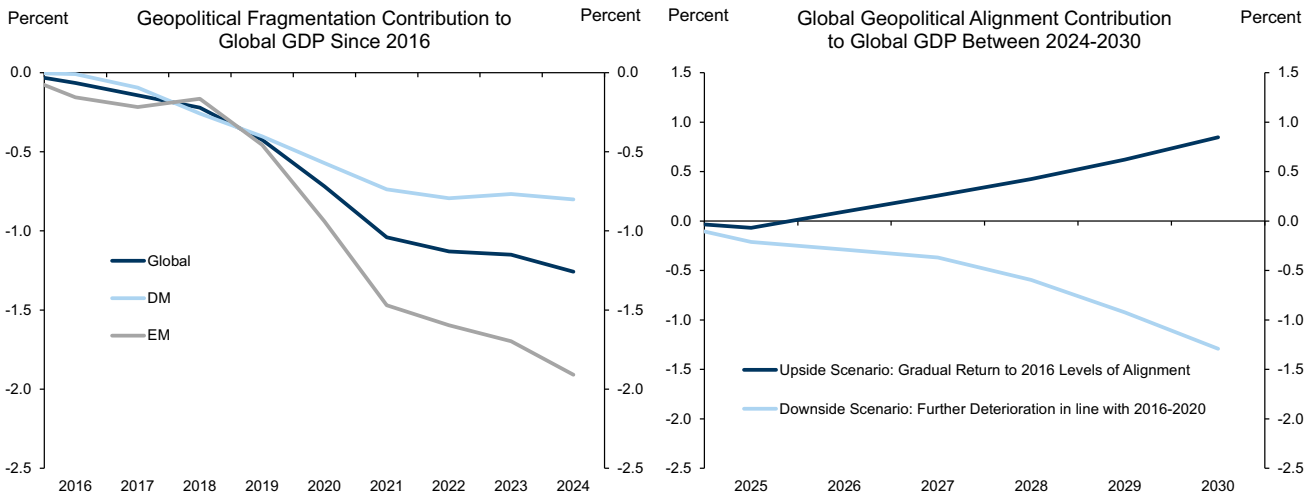
Source: Goldman Sachs Global Investment Research, Fan (2025), Laser, Mihailov and Weidner (2024)

Geopolitical Alignment and Growth: A Look Back and a Look Ahead

We decompose the contribution to GDP from changes in geopolitical alignment for the average country in our panel with the rest of the world using our estimated impulse responses. Global fragmentation began rising in 2016 and climbed particularly sharply during the 2018-19 trade war. We estimate that the increase in geopolitical fragmentation since 2016 has cumulatively subtracted 1% from global GDP, with a larger hit to EMs (1.9%) compared to DMs (0.8%, Exhibit 13).

To gauge the potential impact of alignment and fragmentation in the coming years, we assume an upside scenario where the geopolitical alignment index gradually returns to its mid-2010s level, which would imply an incremental 0.8% increase in global GDP by the end of the decade. Conversely, a downside scenario consistent with a second deterioration in line with the late 2010s would lower global GDP by an incremental 1% over the next decade, relative to a counterfactual without the deterioration.

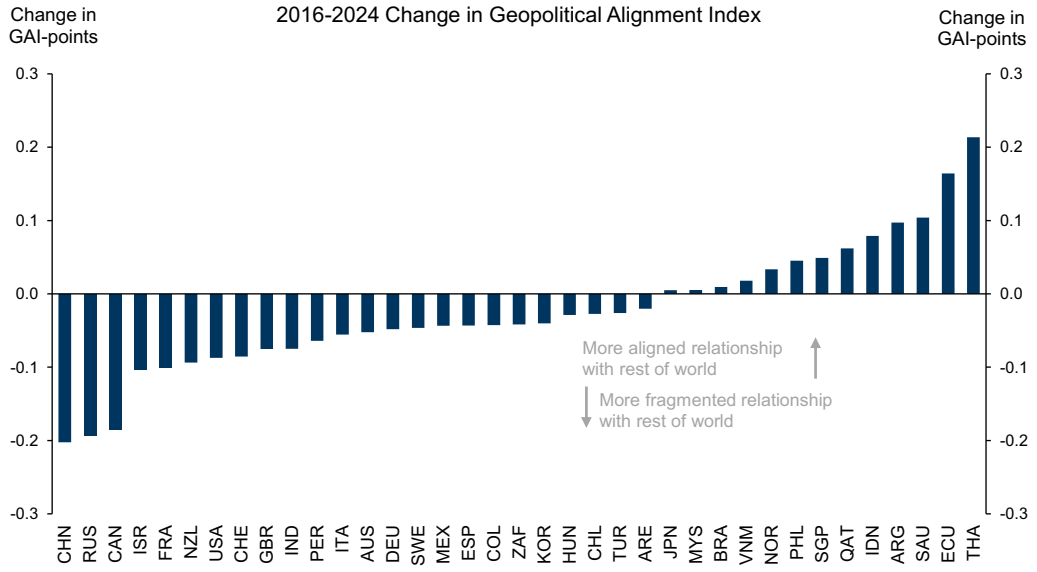
Exhibit 13: A Return to Pre-2016 Levels of Geopolitical Alignment Would Raise Global GDP by 0.8% in 2030, According to Our Estimates



Source: Goldman Sachs Global Investment Research, Fan (2025)

In which countries are these risks most relevant? In Exhibit 14, we plot the countries in our coverage with the largest change in the geopolitical alignment index between 2016-2024. China, Russia, Canada and Israel have seen the largest decline in their overall alignment scores—pointing to a drag on growth from alignment effects—while Thailand, Ecuador and Saudi Arabia saw the largest improvement, positioning them to benefit through the rest of the decade. Barring a reversal of recent trends, we expect these countries will be biggest growth beneficiaries and losers from geopolitical alignment shifts over the next few years. That said, rapid growth in some large EM economies like China and India could lead to longer-run shifts in the importance of bilateral alignment with different economies.

Exhibit 14: China, Russia, Canada and Israel Have Seen the Largest Deterioration in Geopolitical Alignment in Recent Years



Source: Goldman Sachs Global Investment Research, Fan (2025)

Taken together, our results highlight that geopolitical alignment and its implications for economic fragmentation could be an important driver of economic dynamics to watch, even if geopolitical risks associated with the war in Iran fade.

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