2025

Third Quarter Forecast Update

- Russia/Ukraine Conflict
- Middle East
- Indo-Pacific
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- Connectivity Themes

NEW LINES INSTITUTE
FOR STRATEGY AND POLICY

Rescue workers sift through rubble after an Iranian missile struck Beersheba, Israel, on June 24, 2025, killing five people and destroying multiple buildings. (Aldema Milstein / Middle East Images / AFP via Getty Images)

Introduction

(LEFT) Ukrainian flags flutter above rows of gravestones at Marsove Pole Military Cemetery in Lviv, where visitors pay tribute to fallen soldiers on June 24, 2025. (Mykhaylo Palinchak / SOPA Images / LightRocket via Getty Images) (RIGHT) Satellite imagery reveals an overview of the Fordow fuel enrichment facility following the U.S. Air Force strike on June 23. Craters are seen at several locations near tunnel entrances and along access roads to the underground complex. (Maxar Technologies via Getty Images)

The third quarter of 2025 will be headlined by the ripple effects of military escalation between Israel and Iran, as well as U.S. intervention, while regional states will seek to push for a diplomatic agreement over Iran's nuclear program. In the Russia/Ukraine conflict, limited military and hybrid escalations are likely, constraining the chances of a major diplomatic agreement in the quarter. In the Indo-Pacific, the United States and China will temper their trade war, though there will be periodic escalations in areas such as technology controls and critical minerals exports. The United States could experience an increase in political destabilization, and the conflict in Sudan is likely to intensify, while water treaty tensions will linger between India and Pakistan. The quarter will be marked by shifts from President Donald Trump's administration when it comes to global trade, with a series of agreements expected to be reached prior to the expiration of the 90-day pause on reciprocal tariffs, though certain restrictions are likely to remain. Energy volatility associated with geopolitical hotspots and advances in AI paired with intensifying technology competition will also mark the quarter.

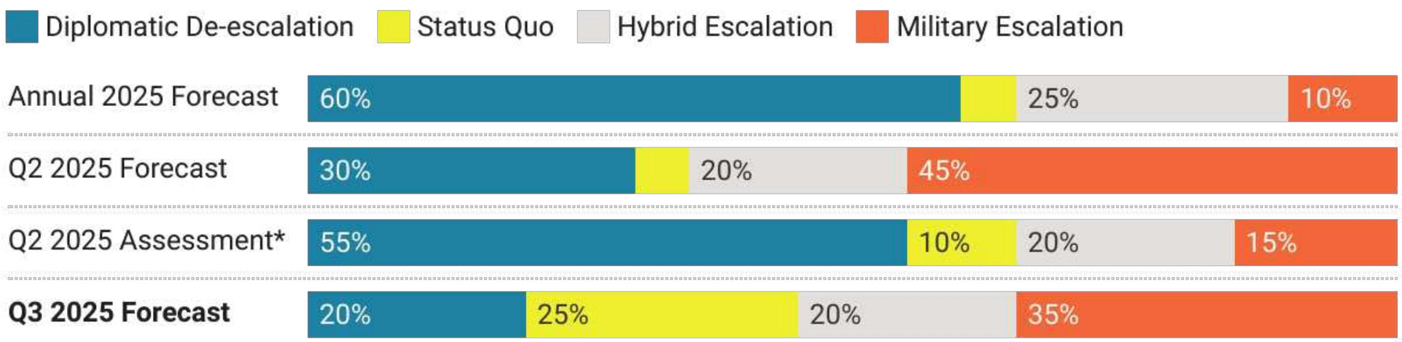
Key dates/events in Q3 2025

- **July 6-7** – BRICS+ Summit
- **July 8-11** – ASEAN Foreign Ministers' Meetings
- **July 9** – End of 90-day pause on U.S./global tariffs
- **Aug. 12** – End of 90-day pause on U.S./China tariffs
- **Aug. 17** – Bolivia general elections
- **Aug. 23** – Taiwan referendum on potential reactivation of nuclear power plants
- **Sept. 8** – Norway parliamentary elections
- **Sept. 9-23** – U.N. General Assembly

Global Hotspots

Russia/Ukraine Conflict

Scenario probability chart



* The Q2 2025 Assessment reflects the status of the region at quarter's end.
Percentages are calculated using The New Lines Institute's forecasting methodology.
Source: © 2025 The New Lines Institute

General Outlook

The Russia/Ukraine conflict trended toward the military escalation scenario in the second quarter, as Russia increased the scale and intensity of air and drone strikes throughout Ukrainian territory and Russian forces waged an offensive in eastern and northern regions of Ukraine. Meanwhile, Ukrainian forces ramped up drone strikes and sabotage operations in Russia. Diplomatic activity to end the conflict persisted throughout the second quarter, though the U.S. reduced direct mediation efforts between Russia and Ukraine as a sustained ceasefire agreement proved elusive. Hybrid activity such as sanctions and economic restrictions was limited, though the U.S. and EU warned Russia that restrictions could be ramped up if Russia continues to wage its military operations in Ukraine and stall efforts toward a ceasefire.

Forecast Scenarios

Military escalation scenario

- Moderate probability as the conventional phase of the war is likely to persist and potentially intensify over the course of the quarter.
- Russia will seek to expand and consolidate its territorial gains in the Ukrainian regions of Donetsk, Luhansk, and Sumy.
- The scope and intensity of fighting will be tempered to a limited extent by direct diplomacy between Ukraine and Russia, along with mediation from Türkiye and other states.
- European states are likely to increase military support of Ukraine as well as their own defense spending as a result of a lower level of engagement from the U.S.

Hybrid escalation scenario

- Low/moderate probability due to an anticipated increase in EU sanctions against Russia, including the use of frozen Russian assets to fund Ukraine's defenses.
- The U.S. will also consider sanctions and other economic restrictions against Russia, albeit to a lesser extent than the EU.

- Ukraine and Russia will also engage in intelligence operations and sabotage attacks against each other's critical infrastructure and economic assets.

Diplomatic de-escalation scenario

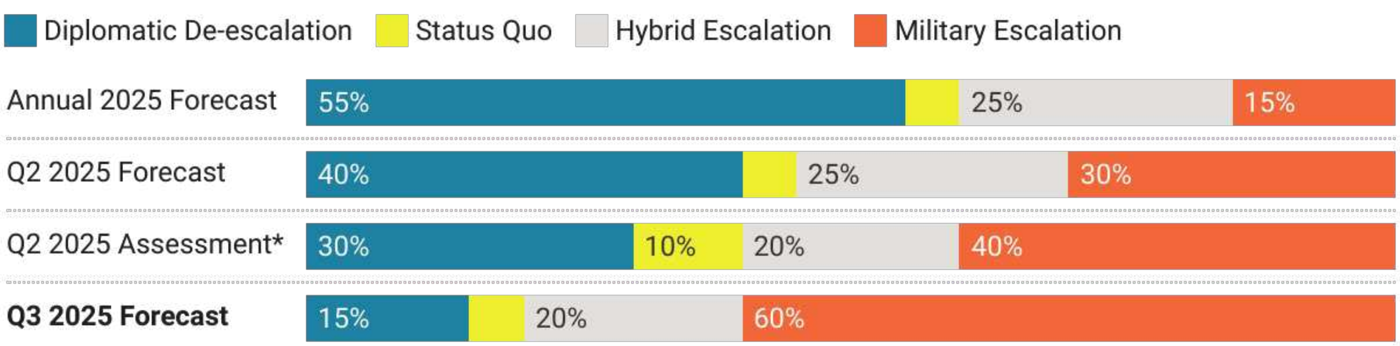
- Low/moderate probability due to U.S. limiting diplomatic mediation efforts between Russia and Ukraine over a lack of progress on a ceasefire agreement.
- Ukraine and Russia are likely to continue direct talks over tactical elements of the war, such as prisoner-of-war exchanges.
- If diplomacy does not produce meaningful progress during the quarter, there is likely to be hybrid escalation in the form of sanctions and other economic restrictions against Russia by the EU and to a lesser extent by the U.S.
- The U.S. and Ukraine will make progress toward operationalizing their critical minerals agreement, which will allow Kyiv to retain some support from Washington.

Status Quo

- Moderate probability due to unlikelihood of a major diplomatic breakthrough this quarter, while constraints remain on large-scale military or hybrid operations from both Russia and Ukraine.

Middle East Conflict

Scenario probability chart



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General Outlook

The Middle East trended toward the military escalation scenario in the second quarter, as Israel initiated a state of open conflict with Iran when it bombed nuclear infrastructure and military sites inside Iranian territory, killing numerous senior leaders of the Islamic Revolutionary Guard Corps and nuclear scientists while thwarting ongoing U.S./Iran nuclear negotiations. The United States directly entered the conflict when Trump ordered the bombing of Iranian nuclear infrastructure, drawing Iranian retaliation against a U.S. military base in Qatar. Israel and Iran agreed to a tentative ceasefire on June 24. Additionally, there was significant military escalation in the Israeli/Hamas conflict, as Israel began conventional operations aimed at achieving the complete occupation of Gaza and the relocation of its Palestinian population. There was consistent hybrid activity throughout the second quarter, primarily in the form of sanctions from the U.S. against Iran's oil sector and from the EU over Iranian material support to Russia's war effort in Ukraine. The U.K., Australia, Canada, New Zealand, and Norway sanctioned Israeli National Security Minister Itamar Ben-Gvir and Finance Minister Bezalel Smotrich over the issue of West Bank settlement expansion, while numerous European nations and other countries are considering additional sanctions against Israel over its conduct of the war in Gaza. Trump and several European leaders initiated sanctions relief and normalization efforts with Syria.

Forecast Scenarios

Military escalation scenario

- Highest probability as the conflict between Israel, the U.S., and Iran creates significant risk for regional destabilization despite a tentative ceasefire
- Direct U.S. participation in offensive operations inside Iran significantly increases the risk of regional military escalation and makes additional U.S. strikes more likely in the event of a ceasefire collapse. Iran could retaliate by once again striking U.S. military bases in the Middle East or by coordinating Houthi attacks in the Red Sea, in addition to ordering attacks against U.S. forces in Iraq from Kata'ib Hezbollah and other proxy groups.
- Israel's offensive in Iran likely will not deter or wholly prevent Iran's long term nuclear ambitions. Israel is likely to replicate its recent actions as in other theatres where it agreed to temporary ceasefires and resume offensive operations against Iran in the third quarter, possibly with the objective of regime change.
- In the event of Israel resuming offensive operations in Iran, it is likely that the U.S. directly will participate.
- Meanwhile, Israel maintains the political will to continue the war with Hamas and achieve the complete occupation of Gaza as well as U.S. support for efforts to facilitate the permanent relocation of its Palestinian population. There is a low likelihood that Hamas will agree to a temporary ceasefire or a hostage release deal in the third quarter.
- Israel is also highly likely to sustain historically high levels of military operations, settlement expansion, and forced displacement of Palestinians in the West Bank.
- Israel is highly likely to maintain its pace of direct-action operations and territorial occupations in Syria and Lebanon.

Hybrid escalation scenario

- Moderate probability due to the likelihood that the U.S. will continue "maximum pressure" policies against Iran's oil sector.
- The U.K., France, Germany, and Canada, among others, are likely to enact further sanctions in the third quarter against Israel over its conduct of the war in Gaza and its ongoing humanitarian blockade against the territory.
- Iran and/or its proxies may attempt to disrupt global trade in the Strait of Hormuz and/or energy facilities in the Gulf region as part of an asymmetrical response to Israel's conventional campaign, or in response to U.S. offensive action inside Iran.
- Iran will continue disinformation operations in Syria aimed to create and exploit distrust between minority groups and the interim government in order to disrupt stabilization efforts from Damascus.

Diplomatic de-escalation scenario

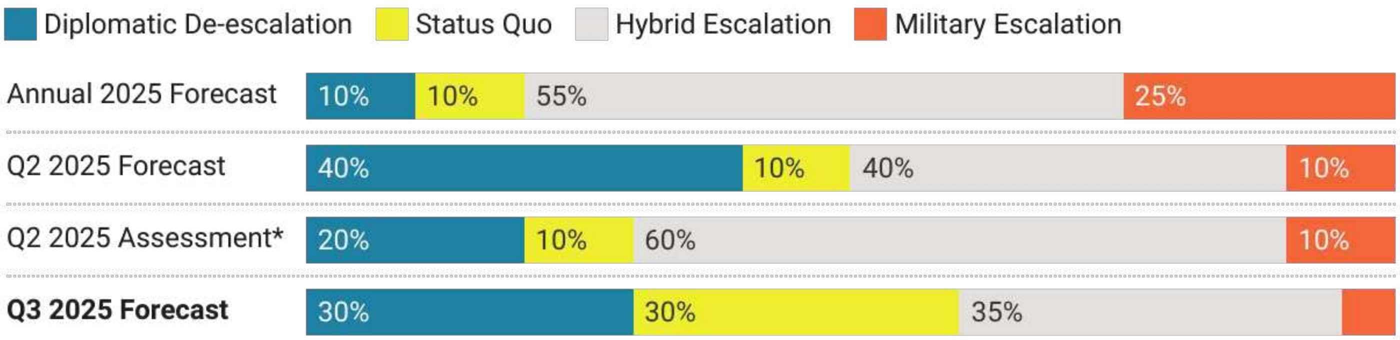
- Low probability as Israel's attack against Iran scuttled ongoing nuclear negotiations between the U.S. and Iran and significantly increased the chances of a regional war. Russia, however, could seek to mediate negotiations among the U.S., Israel, and Iran to mitigate the military fallout of the conflict or prevent the resumption of conventional conflict between Israel and Iran.
- Diplomatic efforts led primarily by the U.K., France, Germany, and the EU may increase the likelihood of the U.S. and Iran resuming nuclear talks.
- Additional U.S. military action in Iran would present significant risk for the security and economic interests of Gulf Cooperation Council (GCC) states. Recent rapprochement between Iran and the GCC, in particular Saudi Arabia, increases the likelihood that the GCC will caution the U.S. from further escalation. Additionally, the GCC will likely play a significant role if the U.S. and Iran resume nuclear negotiations.
- Due to China's high dependency on energy from the Gulf, Beijing may engage in limited security dialogues aimed at de-escalation in order to maintain open commercial shipping routes.
- It is highly unlikely that there will be significant diplomatic de-escalation in Gaza, the West Bank, Syria (as it pertains to Israeli intervention), Lebanon, or Yemen.

Status quo

- Lowest probability due to the regional instability that will likely result from Israel initiating open conflict against Iran, as well as Israel's objective to fully occupy Gaza.

Indo-Pacific

Scenario probability chart



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General Outlook

The Indo-Pacific trended toward the hybrid escalation scenario during the second quarter, as trade escalations between the U.S. and China initially culminated in the U.S. imposition of a total 145% tariffs on all Chinese imports, which China matched with a 125% tariff on all U.S. goods, along with strong restrictions on rare earth elements exports globally. The U.S. additionally kept up its secondary sanctions regime against Chinese entities trading with Iran. Elements of diplomatic de-escalation were also seen during the second quarter, as the U.S. announced a pause on tariffs for all other trading partners until July 9, as well as an agreed reduction of tariffs between China and the U.S. until Aug. 12, initiating a series of negotiation efforts by the U.S.'s trading partners. Tensions between the U.S. and China remain, as China's slow resumption of rare earth exports caused industries to encounter supply chain difficulties globally, while the U.S. imposed further restrictions on tech exports to China. In June, both countries agreed on a framework deal, cutting down tariffs and resuming certain critical minerals exports, though the trade deficit was left out of the discussion. In the military realm, China increased the number of deployments to the South China Sea, while the U.S. continued to hold military drills with its allies. The Philippines, Australia, and South Korea all held local or national elections.

Forecast scenarios

Military escalation

- Lowest probability. This scenario will largely be defined by a continuation of Chinese gray zone activities around Taiwan and potential incursions into allied airspace/territorial waters.
- The U.S. will keep the Indo-Pacific as a military procurement priority and will likely continue to work with Indo-Pacific allies, including Taiwan, on providing weapons systems and holding training exercises.
- Despite formal complaints and attempts of outreach by the Philippines to diplomatically resolve contestation in the South China Sea, clashes are likely to continue.
- China may seek to capitalize on the U.S.'s redirection of military assets to the Middle East to increase its military footprint in the South China Sea or in other contested waters. Beijing may seek to test U.S. resolve in the region by increasing instances of large-scale military exercises as intimidation against Taiwan and other regional U.S. allies.
- Sporadic instances of localized violence in Southeast Asian countries caused by state-backed militias may result in military escalation depending on their location, especially in countries and areas near sites of critical minerals mines.

Hybrid escalation

- Highest probability. Despite the U.S. and China having reached a trade framework deal, grievances remain bilaterally, including over U.S. support for Taiwan and a lack of progress on addressing the trade deficit. Beijing has set a six-month limit on critical minerals exports, subject to renewal, indicating a potential for escalation if it determines the U.S. has acted unfairly.
- Global tariffs imposed by the Trump administration under the International Emergency Economic Powers Act are currently under appeal following a ruling by the U.S. Court of International Trade. However, the U.S. will likely set some tariffs on its trading partners and on China through other legal mechanisms and regardless of the outcome of their respective trade deals.
- The EU and China have been trying to de-escalate trade tensions. However, if China does not expedite access to critical minerals, or if an agreement cannot be reached on electric vehicle sales, there may be an increase in pressure by the EU on China through the form of further trade restrictions.
- Instances of Chinese state-backed cyberattacks against the U.S. and its allies may increase in the third quarter if Iran asks for its support as a form of hybrid retaliation for U.S. airstrikes on its nuclear facilities.

Diplomatic de-escalation

- Moderate probability. Negotiations on tariffs between regional partners and the U.S. will continue until at least July 9. While trade restrictions may not be completely removed, they could be sufficiently reduced for trade relations to normalize. In diplomatic outreach to trading partners, China will frame itself as a stable alternative to the U.S.
- South Korea, Japan, and the Philippines will continue to negotiate with the U.S. on tariff reductions while offering diplomatic outreach for continued trade with China.
- Other countries will continue to negotiate among themselves, including during the upcoming Association of Southeast Asian Nations' Foreign Ministers' meeting and the BRICS+ summit.

Status quo

- Moderate probability. Q3 will likely see a continuation of the second half of Q2: sporadic instances of hybrid escalation and diplomatic de-escalation in anticipation of tariff imposition deadlines (July 9/Aug. 12) and potential court hearings on trade.

Other Hotspots



Photos: Getty Images

United States

The domestic political climate grew more polarized, including confrontations between the Trump administration, universities, and the judiciary, as well as a public feud between Trump and Elon Musk over the federal budget omnibus legislation dubbed “One Big Beautiful Bill.” The deployment of 4,700 National Guard and Marines personnel to Los Angeles in response to immigration-related protests drew criticism and fueled demonstrations across multiple cities and states. The U.S. faced an economic downturn of 0.2% in the first quarter, in part shaped by the fallout from U.S. tariffs around the world.

Forecast Scenarios:

Domestic Destabilization

- **Political:** The feud between Trump and Musk is likely to persist, as internal divisions within the Republican Party could intensify in the quarter. The Trump administration’s tensions with public institutions and the judiciary will continue to stir political turmoil, particularly as legal challenges emerge around issues of free speech, immigration enforcement, and other topics. The courts will likely remain a key arena of efforts to check executive overreach in the quarter.
- **Economic:** While global tariffs were paused shortly after they were announced due to stock market impacts, the current suspension is set to expire July 9. While there are potential agreements with multiple trading partners, including China, should trade negotiations fail or tariffs recommence, economic growth could weaken. Early signs of economic damage from the omnibus federal spending bill may emerge, potentially aggravating inflation.
- **Security:** Continued immigration operations by Immigration and Customs Enforcement agents will likely continue to lead to protests, especially in cities with large immigrant populations. As protests spread, the risk of further deployment of federal forces increases, particularly if demonstrations turn violent, greatly increasing security risks.

India/Pakistan

Tensions between India and Pakistan reached a strong military escalation following the April 22 attack on 25 Indian tourists in Pahalgam, a town in India-administered Kashmir along the Line of Control for which an offshoot of the militant group Lashkar-e-Taiba claimed responsibility. While the Pakistani government denied involvement in the attack, two weeks later, Indian Prime Minister Narendra Modi launched “Operation Sindoor,” a military operation targeting “terrorist infrastructure” in Pakistan-administered Jammu and Kashmir and in Pakistan itself, mostly with airstrikes, resulting in more than 40 Pakistani casualties. Pakistan responded with its own strikes, reporting to have hit multiple Indian air force jets. India’s top military official later confirmed at least one aircraft was lost. Following the signing of a ceasefire on May 10, military operations have ceased, though threats to restart them have remained. Tensions between the countries have continued on the hybrid front, such as from India’s suspension of the Indus Waters Treaty and a battle of narratives on the international stage waged by both sides.

Forecast scenarios

Military escalation

- Both Pakistan and India have threatened to use nuclear weapons, setting a dangerous precedent for future escalation.

- India will likely continue to put pressure on Pakistan and its allies to cooperate in counterterrorism operations.
- Pakistan's defenses exposed potential vulnerabilities in India's arsenal while demonstrating a robust defensive capability. Islamabad will likely continue to pursue closer ties with China and seek to procure more weapons systems, while India will likely pursue its own arsenal modernization.

Hybrid escalation

- India's pressure on Pakistan will likely continue to dominate on the hybrid escalation front in the third quarter, as India may capitalize on the summer to exacerbate adverse effects of its suspension of the water treaty.
- Pakistan may threaten to use hybrid actions against India, including withdrawals from other bilateral treaties or cyberattacks.

Diplomatic de-escalation

- There is strong pressure from the international community to keep tensions from boiling over again, as exemplified by calls from the U.S., Russia, and China to avoid a military escalation while condemning any acts of terrorism. This pressure is likely to remain in place over the next three months.

Sudan

The situation in Sudan continued to deteriorate with numerous attacks on civilian infrastructure by both the Sudanese Armed Forces (SAF) and the Rapid Support Forces (RSF) across the country. The RSF continued to attempt to build legitimacy for their parallel government in Darfur through local government appointments and diplomatic outreach efforts with other regional countries. Fighting between the two sides continued in the states of Khartoum, Kordofan, and North Darfur, with the SAF securing several key towns. Despite denials by the United Arab Emirates, multiple sources have confirmed that it continued to supply the RSF with drones and logistical support. The Transitional Sovereignty Council, the internationally officially recognized government of Sudan, attempted to establish legitimacy as the main governing actor in Sudan through the appointment of a new prime minister and reorganization of the government.

Forecast Scenario:

Domestic destabilization

- **Political:** The RSF's attempt to maintain control over Darfur will likely cause more political instability across the country and in the diplomatic sphere. The RSF will also likely pursue further regional control in an effort to deepen regional ties, expand illicit cross-border routes to Sudan, Chad, and Libya, and further cloud prospects for a unified Sudan. Furthermore, the Transitional Sovereignty Council's appointment of Kamil El-Tayeb Idris Abdelhafiz as the new prime minister and his appointment of new ministry heads will likely cause opposition and protest in SAF-controlled areas. Both the RSF and SAF will likely continue to arrest journalists who report on mass atrocities or convey anti-war narratives. The likelihood of any diplomatic discussions between the two sides remains minimal, as both leaders have vowed to eliminate the other side and continue to rule out peace talks.
- **Security:** The security situation will likely continue to deteriorate because of battlefield losses and war crime grievances held by both sides due to the unveiling of mass graves and the targeting of civilians by both sides. The RSF will likely increase its use of drones to target civilian infrastructure, especially in Port Sudan and other SAF-held cities as the RSF faces more battlefield difficulties. This tactic would be an attempt to degrade support for the SAF and force it to reallocate air defenses to areas behind the front. More regional actors will likely become involved as we see entities such as the Libyan National Army supporting RSF efforts at the border.
- **Economic:** The Sudanese economy will likely further deteriorate as a result of the scale of the humanitarian crises and military targeting of key transportation and trade routes. A cholera outbreak and famine occurring in many parts of the country show no signs of easing, which will likely exacerbate economic weakness and overwhelm local infrastructure, further decreasing economic output.

Connectivity Themes



Photos: Getty Images

Trade

Review/Assessment of Annual Forecast

Trade restrictions and tariffs

- The Trump administration is likely to increase tariffs on a number of countries and blocs in 2025, including China, Mexico, Canada, the EU, Russia, and BRICS. ***On track***
- It will use such tariffs – or at least the threat – as leverage to drive negotiations and address economic and security priorities, including the outflow of domestic manufacturing jobs, the dollar as a global reserve currency, immigration, and illicit drug flows. ***On track***
- The level of tariff implementation will likely be less than what Trump has initially proposed (ranging from 10% on all countries to 100% against BRICS countries) in most cases. ***Mixed (on track in some cases, off track in others)***

U.S./China trade war

- The trade dispute between the U.S. and China is likely to escalate in 2025, in terms of both tariffs and export controls on select goods. ***On track***
- The global semiconductor supply chain will be particularly affected, as the U.S. will restrict technology and advanced component exports to China, while China will retaliate by banning critical mineral exports to the U.S. and partner countries such as Japan and the Netherlands. ***On track***
- In the short term, the U.S. will likely deepen its critical minerals trade with South Korea, Southeast Asian nations, European countries, and Central Asian states. ***On track***
- The U.S. will seek trade and investment concessions from China in areas like increased imports and the manufacturing location of electric vehicles, solar panels, and wind turbines. ***On track***

Emerging trade and shipping routes

- The diplomatic de-escalation of the Azerbaijan/Armenia conflict will create new trade opportunities in the Caucasus and Trans-Caspian region. ***On track***
- Melting sea ice in the Arctic will increase economic and military competition as the region becomes more navigable. As ice rapidly melts, an estimated three new major shipping routes, all over 4,000 nautical miles, will emerge in the Northern Sea Route and Northwest Passage in 2025. ***On track***

Q2 Assessment

- The Trump administration is set to enact reciprocal tariffs on a global basis on April 2 in its bid to broaden the scope of tariffs: ***Hit***
- Countries that are most heavily impacted by tariffs, particularly China, Canada, and EU states, will increase their retaliation against the U.S., both via tariffs and by other means such as diversifying trade away from the United States: ***Hit***
- The steel and aluminum sectors will be particularly impacted by U.S. tariffs and counter-restrictions: ***Hit***

Q3 Update

- The Trump administration will resume tariffs globally following the expiration of the 90-day pause in July/August. However, the U.S. will scale back the scope of reciprocal tariffs for many countries as a result of trade negotiations while retaining a minimum of 10% tariff for all countries.
- The U.S. will implement a limited compromise trade deal with China in the third quarter, however tariffs and other forms of economic restrictions – particularly over U.S. tech controls and Chinese critical minerals exports – will remain in place.
- The U.S. will reach compromise trade deals with other countries and entities, particularly Japan, India, South Korea, and the EU.

Technology

Assessment of Annual Forecast

- The use of generative AI will continue to grow throughout 2025 in business decisions/processes as new iterations continue to develop. Microsoft, OpenAI, and Anthropic will continue to be U.S. leaders in this domain. Rival Chinese AI leaders will likely continue to be Alibaba, DeepSeek, 01.AI, and Zhipu AI. ***On track***
- The Trump administration is set to deviate from the Biden administration's approach to AI regulation. It is likely that Trump will attempt to revoke aspects of Biden's executive order on the "Safe, Secure, and Trustworthy Development and Use of Artificial Intelligence," which aimed to create a coordinated, multiagency approach to regulating AI development, if he deems them not in line with his vision for government tech regulation. Several bills addressing AI regulation in the congressional pipeline may face obstacles throughout the year if the administration favors a more innovation-heavy focus on AI as it did during its first term. ***On track***
- The European Union's first set of regulations under its AI Act will enter into force in February 2025, prohibiting "unacceptable" AI systems. The U.K. may seek closer cooperation with the EU on AI regulation and may have to conform to some of the EU's regulations given the market overlap. Both the EU and U.K. may seek openings for cooperation with China over tech policy, though EU members with restrictions on Chinese infrastructure such as Huawei systems are likely to keep them in place. The U.S. is unlikely to cooperate with China on technology and AI, and it will likely restrict technological trade and cooperation with China even further. ***Mixed (on track in some cases, off track in others)***
- There is appetite for further integration of AI into military systems, notably in the U.S., which will likely incorporate AI into military procedures and operations, as well as further the production and acquisition of autonomous aerial vehicles and autonomous weapons systems. China is likely to do the same, without cooperation from the U.S., exemplified by China's absence from September's "REAIM" summit on the use of AI in the military. ***On track***
- Funding is likely to increase for the development of quantum computing, with multiple governments and regions (U.S., China, EU) having shown interest in its integration in common computing processes. As such, 2025 will see developments in funding arrangements for the integration of quantum computing in military systems, for instance in the AUKUS partnership, which recently advocated for the integration of Japan's technological expertise in its second pillar. Additionally, recent high-level cyberattacks in the U.S. will incentivize a renewed push for developing and incorporating post-quantum cryptology in government and commercial encryption processes to bolster security against threat actors. ***Unclear***
- Trump has appointed David Sacks as his AI and cryptocurrency czar along with a number of pro-crypto government candidates, with the aim of avoiding the hindrance of cryptocurrency development and adoption. The Trump administration is likely to push for an increase in cryptocurrency regulations, aiming to "legitimize" cryptocurrency's use. In the short term, this stance will likely manifest in the appointment of aligned officials in relevant government agencies, such as the Securities and Exchanges Commission, and will likely push for less regulation in Congress. ***On track***

Q2 Update

- The revisionary period set in motion during the first quarter by the U.S. federal government will likely end, after which the Office of Management and Budget and the Assistant to the President for Science and Technology will be among those charged with implementing personnel and policy changes: ***Partial Hit***
- In terms of military application of AI, the U.S. defense budget is currently operating on funds allocated during the 2024 fiscal year, so it is unlikely to reap substantial changes from what was already allocated: ***Hit***
- Both Chinese and U.S. companies are likely to release updated and improved generational AI models this quarter. As such, Beijing may capitalize on the momentum of its newly established tech fund and continue to incentivize competition between private enterprises to enhance competitiveness with the United States. However, Beijing's "whole of nation" approach may stifle competitiveness among China's provinces in favor of tighter central government control: ***Hit***
- Taiwan will likely continue with its efforts to increase investment in the U.S. semiconductor industry, with likely further announcements of direct investment or joint ventures with U.S. companies such as Nvidia or Intel. Depending on its success, companies from South Korea and Japan may make similar moves: ***Miss for Taiwan, Hit for Japan and South Korea***
- Trump recently signed an executive order establishing a strategic bitcoin reserve, as well as a digital asset stockpile. This is likely to increase the number of bitcoin the U.S. government owns and is in line with the administration's policies on legitimizing cryptocurrencies. This is likely to produce further digital market uncertainty within users of cryptocurrencies, potentially leading to backlash against the administration: ***Partial hit***

Q3 Update

- AI will remain a key priority for China and the U.S. While the Office of Management and Budget released two revised policies on Federal Agency Use of AI and Federal Procurement, the administration will continue to work in the third quarter to consolidate these into an overarching policy framework. The U.S. will largely aim to upscale existing AI models/frameworks while integrating them further into military usage during upcoming defense budget negotiations.
- According to the U.S./China framework deal signed in London in June, China will remove all export restrictions on rare earth elements to the U.S. However, the export curbs in the second quarter have created a backlog in various industrial sectors which will continue to be felt during the third quarter, including in defense and automotive industries. It is likely that China will further ease rare earth exports to the EU as well.
- China will likely continue to work toward building domestic tech manufacturing capabilities, including in the semiconductor industry, as the threat of U.S. tech export restrictions continues. Chinese AI companies may start noticeably showing the benefits of the funding allocated after this year's plenary session, with companies such as Alibaba, Tencent, and Xiaomi releasing new models throughout the third quarter as their competition intensifies.

Energy/Climate

Energy transition

- Inadequate funding of climate change mitigation and adaptation measures for poorer nations and the energy policies of the incoming U.S. presidential administration will likely slow, but not stop, the global transition to carbon-free energy. ***On Track***
- Renewable energy capacity will continue to expand at a rapid pace, but balancing the variable output of wind and solar resources will prove an increasing headache for electric grid managers. Grid infrastructure upgrades and increasing energy storage likely will fall short of efficiently integrating renewables into existing networks in the short term. ***On Track***
- The unfavorable economics of some transitional energy technologies such as green hydrogen, offshore wind, and photovoltaic panel production will likely prompt some investors to back away from those sectors. ***On Track***
- The rapid pace of AI adoption will prompt big tech companies to increase efforts to secure sufficient electricity to power energy-intensive data centers, including deals for nuclear generation. ***On Track***

Emerging Energy Technologies

- Emissions are likely to continue to rise because the world's energy use has outpaced efficiency advancements. Governments will push for more renewable energy and efficient systems to offset emissions. These innovative digital technologies will be used to meet these challenges and advance the decarbonization of the energy sector: Data-driven distributed grid management, AI-powered energy forecasting, predictive maintenance, and digital twins for the optimization of energy systems. ***On Track***
- As global energy demand rises and environmental concerns grow, improved and innovative solar energy technologies will be adopted and developed. These new and innovative solar technologies will help to address the limitations of current solar technologies such as low electrical efficiency and space constraints. Advanced solar technologies include perovskite and tandem solar cells, floating, bifacial solar PV, and agrivoltaics. ***On Track***
- Due to the global push for renewable energy, wind energy will see substantial investment and development. Advanced wind energy technologies with higher efficiency will make wind projects promising. New technologies include floating wind turbines, AI-powered predictive maintenance, modular wind systems, and innovative offshore wind energy. ***On Track***
- The adoption of green hydrogen is projected to rise significantly for both developed and emerging economies. In developing countries, investment in green hydrogen supply chains is hindered by high capital costs and limited renewable energy development. Challenges include high initial production costs, storage, and transportation. Emerging green hydrogen technologies include advanced electrolyzers, power-to-X technologies, and advanced hydrogen storage technologies. ***Off track: Hurdles persist with high costs and policy gaps; no major cost breakthroughs or large-scale deployment reported***

Fossil Fuels and Energy Security

Oil

- Oil and natural gas markets are expected to remain volatile in 2025, influenced by fluctuating demand, supply chain disruptions, and OPEC+ strategies to stabilize prices. OPEC+ is projected to maintain its current production caps of 5.86 million barrels per day to prevent oversupply, keeping Brent crude prices within a range of $73 to $76 per barrel. However, any rapid increase in output could destabilize the market and trigger sharp price declines. ***Partially on track: OPEC+ coordination has held, and volatility persists. However, market conditions have shifted sharply in response to geopolitical developments. Brent crude prices surged to $83-$85 per barrel following Israel's attack on Iran, reflecting heightened fears of a broader regional conflict and potential supply disruptions. However, prices have since reversed, with Brent prices settling to around $70 per barrel.***
- Oil consumption growth in China will continue to slow as it shifts toward cleaner energy solutions. ***On Track***

Natural Gas

- The natural gas market is expected to tighten in 2025, with rising demand from Asia and Europe outpacing supply expansions. This imbalance is projected to drive prices higher, with Henry Hub natural gas prices estimated to average $2.90/MMBtu fueled by the growth of U.S. liquefied natural gas (LNG) exports. ***On Track but further in magnitude: Henry Hub is around 50% above the forecast. The market is also tightening, but the shifts are being driven by even deeper demand growth and export-led tightness, especially to Europe, rather than just Asia.***
- Despite policy shifts more favorable to the fossil fuel industry, investment in U.S. oil and gas development could lag because of profitability concerns. U.S. LNG production will ramp up as new export terminals move forward after the incoming Trump White House lifts the Biden administration's moratorium on permits. ***On Track***

Energy and Geopolitics

The world's energy landscape in 2025 will continue to be shaped by ongoing conflicts that disrupt markets and trade flows as tensions spark competition for vital energy resources. Simultaneously, leading economies in the renewable energy transition, including Western nations and China, will accelerate investments in clean energy technologies to reduce dependence on unpredictable fossil fuel markets, redefining the global energy landscape.

- Russia-Ukraine Conflict: Diplomatic efforts will lessen the disruption of energy trade between Russia, Ukraine, and the West, though the EU will maintain diversification of energy supplies from Russia. ***On Track***
- Middle East: Persistent unrest in the region will heighten risks at critical energy chokepoints, including the Strait of Hormuz and the Red Sea, potentially escalating risks to global energy markets. ***On Track***
- China-Taiwan: Rising tensions could disrupt global trade routes and energy supplies across the Asia-Pacific. Taiwan's planned nuclear energy phaseout in 2025 will further complicate its energy security, leaving it more vulnerable amid geopolitical uncertainties. ***On Track***
- Arctic Competition: A strategic rivalry over Arctic resources will intensify as melting sea ice opens new trade and energy exploration opportunities. The growing Russia-China rapprochement will add a new dimension, with both collaborating to expand Arctic energy projects and secure access to key resources, challenging Western interests. ***On Track***

Q2 Assessment

- Oil price volatility will likely persist, exacerbated by global trade and tariff disputes and escalating tensions in the Middle East: ***Hit***
- The removal or easing of energy sanctions on Russia, linked to a potential agreement over the Ukraine conflict, could significantly increase the flow of Russian energy, leading to major shifts in global oil/natural gas supply and pricing: ***Miss; no major easing of energy sanctions on Russia occurred in Q2, and no breakthrough agreement on the Ukraine conflict materialized***
- If Taiwan proceeds with its plan to phase out nuclear energy by May, the country's energy mix will shift, increasing pressure on the government to secure alternative sources: ***Hit. though, a bill to review the phaseout has since passed, with a referendum set for Aug. 23, possibly reopening the debate***
- Newly imposed sanctions on Iran, as well as potential U.S. interdiction of Iranian vessels, could affect the security of energy shipments in the Strait of Hormuz and could prompt Iran to retaliate by disrupting shipments through the strait: ***Hit***
- More efforts likely will be made to develop efficient and low-cost energy storage technologies. Blue hydrogen will continue to dominate the market. Green hydrogen will face major challenges in the U.S. due to the Trump administration's reduced support for clean energy, but the Middle East, India, China, and South America may increase investments into the technology. This is mainly due to the low cost of solar and wind power, government incentives, and emerging and affordable electrolyzers from Chinese manufacturers. Europe may also boost hydrogen projects for energy security and independence from Russian natural gas: ***Hit***
- AI data centers are likely to face substantial problems that might impair their efficiency, sustainability, and operational effectiveness. The second quarter will see more ideas, technology, and sustainability to solve these problems including increasingly efficient servers, smart cooling technologies, efficient data management, and clean energy systems such as nuclear and renewables: ***Hit***
- U.S.-China trade tensions may affect their critical minerals trade, which in turn may affect the development of new and emerging technologies for the energy sector, among others: ***Hit***
- Oil production from Venezuela and Iran may decrease due to U.S. sanctions and tariff threats, lowering global oil stocks and exerting upward pressure on prices. Oil prices may climb: ***Mixed; Iranian oil exports remain relatively strong despite sanctions, helped by discreet buyers (e.g., China); Venezuela had seen modest recovery due to eased U.S. sanctions earlier in the year, but that relief was recently revoked in May.***
- High natural gas usage in cold weather in January and February will reduce natural gas storage. This may increase the price of natural gas: ***Hit***

Q3 Updates

Energy Transition:

- Global investment in renewable energy, particularly for solar photovoltaic and wind, is expected to accelerate further. Continued declines in solar module and electric vehicle battery prices will enhance the affordability of clean energy solutions. Capital flows into energy transition assets, including renewables, electric vehicles, heat pumps, advanced storage, and carbon capture, are projected to rise. Electric vehicle sales are set to increase globally, advancing transportation electrification and reinforcing decarbonization momentum.
- In the U.S., the Trump administration's policy shifts and continued withdrawal from international climate frameworks will further slow U.S. climate progress. In terms of renewable energy, it will continue to grow in the U.S., with solar and battery storage driving new production capacity. The U.S. will be confronted with difficulties in striking a balance between energy security and the transition to a low-carbon economy.
- In the EU, renewable energy sources, mainly solar and wind, will add a substantial amount of energy capacity. The high increase in renewable energy penetration will draw increased investment in grid modernization and energy storage. Some EU countries will struggle to balance energy security with the low-carbon economy, resulting in increased fossil fuel generation.
- China will continue to lead globally in term of renewable electricity capacity additions and in electric vehicle production and sales. China will continue to prioritize energy efficiency and end-use electrification for buildings.
- Countries like India and Brazil are expected to ramp up investment in renewables and green hydrogen and meet growing domestic demand. While solar and wind additions continue globally, grid constraints and financing pressures (especially in developing economies) will limit full integration, especially in Africa and Southeast Asia.

Emerging Energy Technologies:

- Burgeoning technology sectors like AI data centers, electric vehicles, and heat pumps will continue to drive worldwide power demand.
- Renewable and nuclear power generation will increase with the surge of AI data center power demand.
- Rapid adoption of clean energy technologies (solar PV, wind turbines, EVs, and energy storage) will continue to boost demand for critical minerals such as lithium, cobalt, nickel, graphite, and rare earth elements.
- Demand for certain critical minerals may strain supply chains, causing shortages, higher prices, and geopolitical tensions particularly between U.S. and China. This, in turn, will intensify competition over critical minerals and tech components, spurring reshoring and efforts to secure alternative sources.
- Due to heavy investment in the U.S. market, blue hydrogen is anticipated to maintain its position as the major hydrogen demand driver in Q3 of 2025. Growth in the green hydrogen sector may lag due to higher prices and regulatory and policy hurdles.

Fossil Fuels & Energy Security:

- Oil and liquefied natural gas markets are expected to remain relatively tight, driven by elevated summer demand for power generation and travel across Asia and Europe. Geopolitical factors, such as shipping rerouting around the Red Sea, steady flows through pipelines like TurkStream, and notably the recent Israel-Iran clash, will continue to affect the reliability, cost, and direction of regional energy supplies. Spot LNG prices in Asia are expected to moderately increase from current levels of $9-$10/MMBtu potentially reaching $11-$13/MMBtu in the next three months, driven by summer heat and strong import demand, especially if European storage refilling is slow.
- Brent crude is likely to remain in the $64-$70 range, below fiscal breakeven levels for several producers, prompting cautious supply management from OPEC+ – though the recent escalation between Iran and Israel triggered a temporary supply shock. Other potential geopolitical escalations, such as renewed Houthi attacks in the Red Sea or a response from Iran could push prices higher.
- National oil companies are expected to intensify upstream exploration across Africa, Latin America, and Southeast Asia to hedge against long-term volatility and secure demand from fast-growing importers in the Global South.

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