

Forced Regionalization: The 2026 Energy-Security Shock, Tariff Realignment, and the Emerging Architecture of the World Economy

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Executive Summary

Two shocks have tested the global economic system in 2026 simultaneously. The first is an energy-security shock: the military conflict that began with U.S. and Israeli strikes on Iran on 28 February 2026 has severely disrupted oil and gas flows through the Strait of Hormuz, the largest supply disruption in the history of the oil market. The second is a trade-policy realignment: the United States has restructured its tariff regime after the Supreme Court's February 2026 ruling on emergency tariff powers, including the first-ever use of Section 338 of the Tariff Act of 1930 against Canada.

This paper asks how major industrial economies, chiefly the European Union, Canada, Japan and South Korea, are responding, and what those responses imply for the structure of the world economy over the next decade. It draws on official statistics, government documents and public reporting available through early October 2026.

Key judgments

1. **Hedging, not decoupling.** The dominant response of U.S. allies and partners is diversification at the margin while bilateral commitments stay in place. Canada, the EU, Japan and South Korea are widening their trade and investment options. At the same time, they are carrying out large investment pledges in the United States and keeping their security alliances. *(High confidence.)*
 2. **Regionalization is driven by risk management more than by ideology.** The new trade arrangements of 2026 (EU-India, EU-Mercosur, EU-CPTPP digital-trade work, the proposed EU-Canada "associate" relationship) cross traditional political lines. They reflect efforts by governments and firms to limit exposure to any single market, chokepoint or policy shock. *(High confidence.)*
 3. **Structural dependence still constrains collective economic action.** Security guarantees, dollar-based finance and access to the U.S. market remain asymmetric sources of leverage. This helps explain why widespread economic costs from Middle East conflict have produced diplomatic divergence rather than coordinated economic measures. *(Moderate-to-high confidence.)*
 4. **Financial infrastructure is changing slowly.** The U.S. dollar still sits on one side of about 89% of foreign-exchange trades and makes up about 57% of allocated reserves. Alternatives such as the multi-CBDC platform mBridge are growing quickly from a small base but remain concentrated and institutionally fragile. *(High confidence.)*
 5. **The most likely ten-year outcome is "managed multipolarity."** In this outcome, several overlapping regional economic clusters operate inside a global system that remains dollar-centred and U.S.-anchored in security, with higher costs, more redundancy and lower efficiency than the 2000-2019 era. *(Moderate confidence.)*
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1. Introduction and Analytical Framework

For three decades after the Cold War, the world economy was organized around efficiency. Firms built long, specialized supply chains. Governments relied on multilateral rules and, in many cases, on a U.S. security umbrella that made long sea lanes and open financial markets predictable. Interdependence was assumed to reduce risk.

The events of 2026 challenge that assumption from two directions. Physical chokepoints have turned out to be single points of failure. Trade policy at the system's centre has become more variable and more openly linked to bargaining over security, investment and market access. When such shocks come together, governments and firms reprice interdependence: they ask not only what is cheapest, but what is most resilient.

This paper uses three concepts:

- **Asymmetric interdependence.** Dependence is rarely symmetric. The side that is less dependent, or that controls a hard-to-replace node (security guarantees, reserve-currency clearing, a large consumer market), has more freedom to act.
- **Hedging.** States facing uncertainty usually avoid both full alignment and open rupture. They keep core relationships while building alternatives that lower the cost of a future break.
- **Forced regionalization.** This means regional and plurilateral economic integration driven mainly by defensive motives (resilience, diversification, insurance against policy shocks) rather than by the efficiency logic that drove globalization.

The paper does not judge the merits of any government's decisions. Each actor's stated rationale is reported in its own terms, and the analysis concentrates on observable behaviour and its economic consequences.

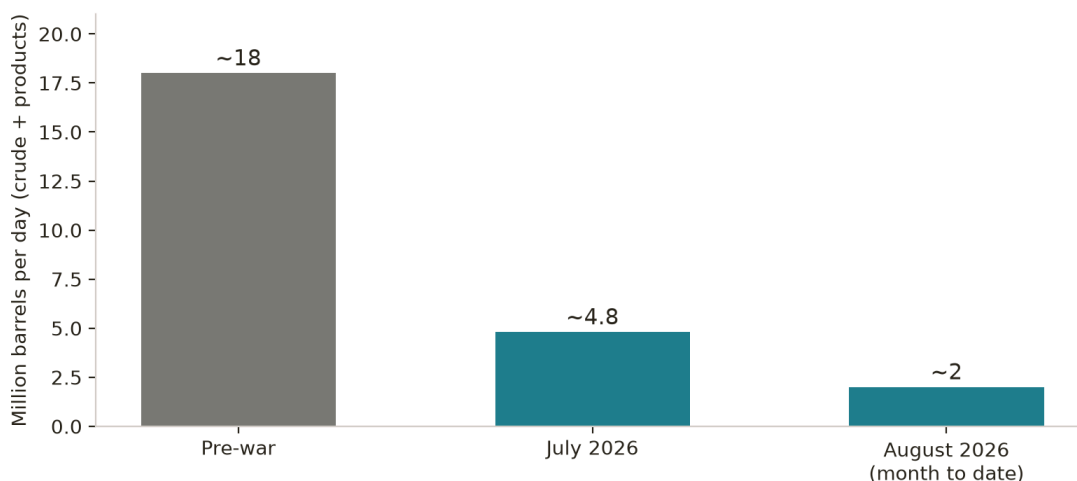
2. The Two Shocks of 2026

2.1 The energy-security shock

According to the Congressional Research Service (CRS), U.S. and Israeli strikes on Iran beginning on 28 February 2026 "sparked a wide-reaching regional conflict"; a two-week ceasefire was agreed on 7 April, and a Memorandum of Understanding signed on 17 June formally expired on 17 August amid renewed fighting.¹ As of early October no agreement is in force. Iran's foreign ministry has said that reopening the Strait of Hormuz is the central issue in negotiations and depends on specific U.S. steps.²

Before the war, roughly 20% of global oil supply moved through the strait, about 15 million barrels per day (mb/d) of crude and 5 mb/d of products.³ Reuters data show Hormuz crude and product flows falling from about 18 mb/d before the war to about 2 mb/d in August 2026.⁴ Brookings called the disruption "the largest disruption in the history of the oil market"; the International Energy Agency coordinated a record 400-million-barrel emergency stock release.⁵

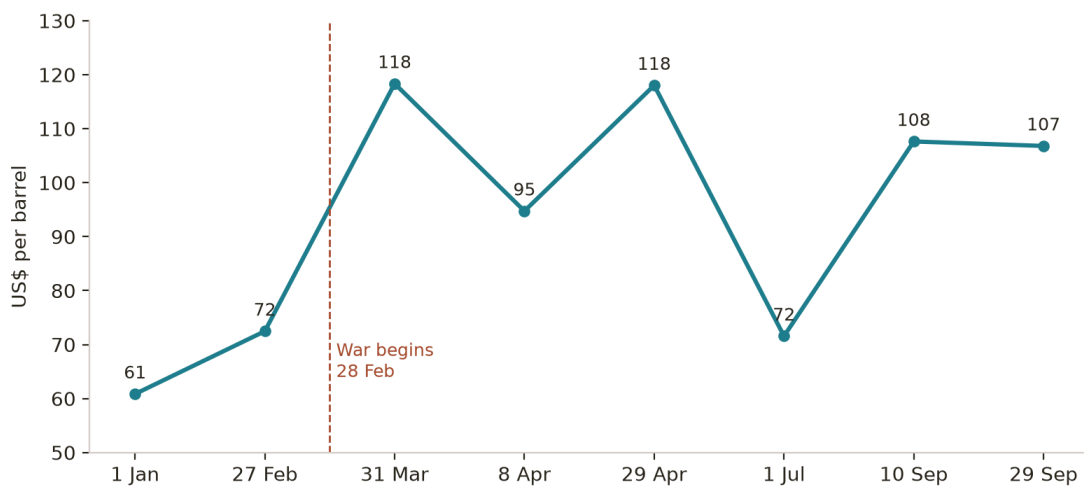
Figure 1. Oil flows through Hormuz fell ~90% from pre-war levels



Source: Reuters, "Oil market starts pricing in a prolonged Hormuz crisis," 18 Aug 2026.

Prices reflect the scale of the shock. Brent crude moved from \$60.85 per barrel on 1 January to \$118.35 on 31 March and was at \$107.63 on 10 September, according to CRS.⁶ It traded near \$106.80 on 29 September.⁷

Figure 2. Brent crude rose ~75% from January to September 2026



Source: CRS R48887 (prompt-month futures); Gulf News (29 Sep, approx.). Dashed line = war onset (28 Feb).

The burden falls unevenly. U.S. Energy Information Administration estimates cited by *Asia Times* indicate that 89% of the crude and condensate moving through Hormuz in the first half of 2025 went to Asian markets.⁸ Slightly more than 80% of Japan's crude imports passed through the strait in January–February 2026. Japan entered the crisis with strategic and commercial reserves equal to about 254 days of consumption.⁹

Maritime effects are more complex than a simple “chokepoint closed” story. Suez Canal traffic in August 2026 reached 1,232 transits, up 28% year on year, partly because tankers were rerouting around the Hormuz disruption.¹⁰ Bab el-Mandeb traffic fell 24% after the Houthis announced a maritime blockade targeting Saudi-linked shipping.¹¹ Risk has therefore moved to new routes rather than simply growing on the old ones.

Macroeconomic transmission. The IMF's July 2026 update projects global growth of 3.0% in 2026 and 3.4% in 2027, which it describes as a V-shaped pattern. It notes that “the war shock weighs on energy importers” while AI-related demand supports economies integrated into technology value chains, and that global disinflation “has stalled.”¹² Before the conflict, the January 2026 forecast for 2026 was 3.3%.¹³ The WTO's baseline forecast is 1.9% growth in world merchandise trade volume in 2026, down from 4.6% in 2025, and it estimates that the conflict could cut about half a percentage point.¹⁴

2.2 The trade-policy realignment

On 20 February 2026 the U.S. Supreme Court held in *Learning Resources, Inc. v. Trump* that the International Emergency Economic Powers Act does not authorize the President to impose tariffs.¹⁵ U.S. trade policy then moved to other statutory authorities.

The clearest example involves Canada. On 20 July 2026 the President announced 50% tariffs on certain Canadian goods under Section 338. CRS reports that this is the first time a president has expressly invoked that statute to impose tariffs, with the stated aim of offsetting what the administration described as Canadian discrimination in alcoholic beverages, dairy and motor vehicles.¹⁶ The tariffs took effect on 22 August. Canada responded with matching counter-tariffs on about C\$27.6 billion (about US\$20 billion) of U.S. goods from 8 September.^{17,18} Because some covered goods were already subject to Section 232 duties, CRS notes that combined rates on certain items could reach 100%.¹⁹

Trade policy toward other allies has been negotiated rather than escalated. The European Parliament approved implementing legislation for the EU–U.S. trade arrangement on 16 June 2026 (440 in favour, 151 against).²⁰ South Korea is implementing a US\$350 billion investment package tied to a 15% U.S. tariff rate, and confirmed its first project, a Texas gas-fired power plant, in September.²¹ Japan signed its first US\$2.2 billion loan in May under a US\$550 billion investment pledge tied to a similar 15% tariff arrangement.²²

The pattern matters analytically. Allies are not leaving their economic relationship with the United States. They are paying a negotiated price to keep it, and in parallel buying insurance elsewhere.

3. Why Diffuse Economic Costs Rarely Become Collective Economic Action

Middle East conflicts since 2023 have imposed visible costs on trade-dependent economies in Europe and Asia: freight disruption, energy-price volatility and stalled disinflation. Public debate in many countries has asked why these costs have not produced coordinated economic measures, including sanctions comparable to those imposed on Russia after 2022.

The evidence points to structural rather than purely political explanations.

Asymmetric exposure. For Europe, Japan and South Korea, the United States is a security guarantor, a leading export market and the operator of the main dollar clearing system at the same time. A disagreement over a regional conflict would put several high-value relationships at risk together, while the benefit of coordinated economic action would be uncertain and spread thin. The rational response under these conditions is diplomatic divergence without economic rupture.

Different legal and political framings. Governments disagree about how to characterize the conflicts. In March 2026 the E3 (France, Germany and the United Kingdom) did not join the initial strikes on Iran but condemned Iranian retaliation against Gulf states.²³ The Council on Foreign Relations described European responses as “deeply divided,” with France taking “a more legally critical stance.”²⁴ Without a shared legal characterization, broad economic measures are hard to agree.

Room for action varies with dependence. States with less concentrated exposure have taken more independent positions. Spain said on 2 March that U.S. aircraft would not use the jointly operated Rota and Morón bases for operations against Iran.²⁵ On 30 March it closed its airspace to aircraft involved in the operation.²⁶ On the Israeli–Palestinian question, recognition of the State of Palestine rose to 157 UN member states by September 2025, after France, the United Kingdom and others announced recognition.²⁷ These steps are consequential in diplomacy. They were taken by governments that judged their exposure manageable, and they did not take the form of coordinated economic measures.

Implication. Under current conditions, the main channel through which diffuse economic costs change state behaviour is gradual: firms and governments reallocate trade, investment and supply chains over years. The rest of this paper examines that channel.

4. The Evidence of Hedging

4.1 Canada and the European Union: institutionalizing an alternative

Canada is the clearest case of a highly dependent economy trying to diversify. Global Affairs Canada reports that in 2025 exports to the United States fell 3.7% and exports to other markets rose 11.1%. Non-U.S. markets now take 32.8% of Canadian exports, the highest share in four decades.²⁸ Prime Minister Mark Carney visited Beijing in January 2026, the first visit by a Canadian prime minister since 2017, and pledged to double non-U.S. exports over the next decade.²⁹ On 1 October he announced fast-track approval for a Pacific-coast oil pipeline intended to diversify crude markets.³⁰ The scale of the challenge is large. The United States still takes close to 70% of Canadian exports and about 90% of its crude, and Export Development Canada estimates that cutting U.S.-bound merchandise exports by 10% would require roughly doubling exports to a group of major alternative markets.³¹

The EU has responded with institutional innovation. On 16 September 2026 Commission President Ursula von der Leyen proposed opening the way for Canada to become the EU’s first “associate member,” built around a “common prosperity and economic space” covering manufacturing, technology, defence industry, the Arctic, AI, energy and critical minerals. Reuters notes that EU treaties do not provide for such a status, so it would require unanimity among the 27 member states and national ratification.³² The U.S. President called the idea “laughable” and threatened tariffs or a halt to EU trade if it proceeded.³³ The episode shows both how strong the incentive to hedge is and how costly it could become.

4.2 The EU’s widening trade network

The EU has completed or advanced several major agreements in 2026. It concluded a free trade agreement with India on 27 January, which the Commission called the largest such agreement either side has concluded.³⁴ It signed the EU–Mercosur Partnership Agreement on 17 January and moved to provisional application after ratifications in South America.³⁵ At the WTO Ministerial Conference in March, the EU and

CPTPP members agreed to speed up work on a digital-trade framework covering about \$35 trillion of combined GDP and 1.6 billion people.³⁶

Taken together, these agreements suggest the EU is positioning itself as a hub for rules-based trade among middle powers. This is neither a substitute for nor a challenge to its relationship with the United States, which it has also moved to formalize.³⁷

4.3 South Korea: alliance maintenance with defined limits

South Korea's 2026 conduct illustrates hedging inside an alliance. In August the U.S. President ordered a substantial reduction in U.S. participation in the Ulchi Freedom Shield exercise. He cited cost, his relationship with North Korea's leader and Seoul's decision not to support U.S. operations against Iran.³⁸ About 28,500 U.S. troops remain stationed in South Korea.³⁹

On 18 September President Lee Jae-myung said South Korea would not send troops or military assets to take part in the war. He added that Seoul was considering extending the operating area of its naval unit off Somalia to protect Korean-flagged and Korea-bound commercial shipping.⁴⁰ The next day the presidential office said the position "is not a refusal" and that Seoul would keep reviewing contributions in consultation with the United States.⁴¹ The precision matters. Seoul is setting the limits of its involvement, not withdrawing from the alliance.

Korean economic policy follows the same two-track pattern. In June 2026 the government and its two leading chipmakers announced semiconductor investments of more than US\$576 billion. These include an 800-trillion-won (about US\$518 billion) memory-fab cluster in the country's southwest.^{42,43} Seoul is also carrying out its US\$350 billion U.S. investment commitment.⁴⁴ Korea is strengthening its hold on chokepoint technologies (high-bandwidth memory and advanced logic) that make it hard to replace, while staying embedded in the U.S. market.

4.4 Japan: energy security and calibrated contribution

Japan's response has focused on energy resilience and calibrated security contributions. In March Prime Minister Sanae Takaichi said no decision had been made on sending escort vessels to Hormuz.⁴⁵ By April the government was formally studying whether Maritime Self-Defense Force minesweepers could be deployed.⁴⁶ Japan has also begun carrying out its US\$550 billion U.S. investment pledge.⁴⁷ The general pattern holds: alliance commitments are kept, direct involvement in combat is avoided, and investment in energy and supply resilience is accelerated.

4.5 Corporate behaviour: localization under tariff uncertainty

Corporate decisions often come before policy change, but the evidence needs careful reading. Volkswagen shelved plans for a new Audi plant in the United States in January 2026. Its chief executive said tariffs had cost the group about US\$2.5 billion in the first nine months of 2025 and that new U.S. capacity would depend on lower tariffs and stable conditions.⁴⁸ This is consistent with the hedging thesis: firms delay irreversible commitments under policy uncertainty. It should not be read as a general corporate exit from the U.S. market. Korean and Japanese firms, for example, are expanding U.S. investment under government-to-government agreements.^{49,50}

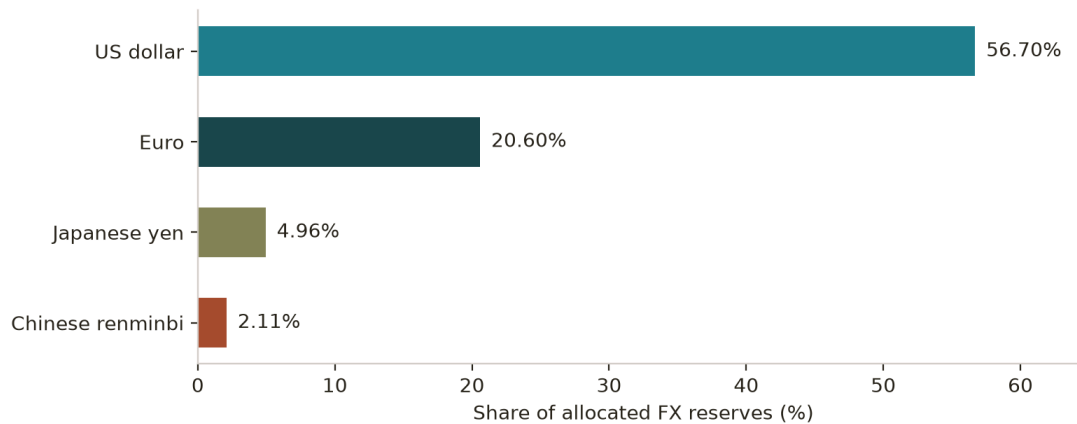
5. Financial Infrastructure: The Slowest-Moving Variable

Much of the discussion of a "post-dollar" order overstates how fast financial plumbing changes. The data point to incremental change.

Indicator	Latest reading	Source
USD share of global FX trades (one side)	89.2% (April 2025)	BIS Triennial Survey ⁵¹
USD share of allocated FX reserves	56.70% (2026 Q2), from 57.18% in Q1	IMF COFER ⁵²
EUR share of allocated FX reserves	20.60% (2026 Q2)	IMF COFER ⁵³

RMB share of allocated FX reserves	2.11% (2026 Q2)	IMF COFER ⁵⁴
Indicator	Latest reading	Source
RMB share of SWIFT payments by value	3.13%, ranked 5th (Jan 2026)	SWIFT ⁵⁵
mBridge cumulative settlement	~US\$55.5bn, 4,047 transactions	Atlantic Council via Clearing Post ⁵⁶

Figure 3. The dollar still holds a majority of allocated FX reserves (2026 Q2)



Source: IMF COFER Data Brief, 30 Sep 2026. Dollar share fell from 57.18% (Q1) to 56.70% (Q2).

mBridge in context. Atlantic Council data show the multi-CBDC platform has processed about US\$55.5 billion across more than 4,000 transactions, roughly 2,500 times the volume of its 2022 pilot.^{57,58} Three features call for caution. First, the digital yuan accounts for more than 95% of settlement volume, so the platform currently works mainly as a channel for renminbi settlement rather than a balanced multilateral network.⁵⁹ Second, its institutional base has narrowed. The Bank for International Settlements left the project, and in September 2026 the Saudi Central Bank confirmed it was “no longer a participating member” after finishing its proof of concept in May 2025.⁶⁰ Third, relative to daily global FX turnover of about \$9.6 trillion, cumulative mBridge volume remains very small.⁶¹

Assessment. Reserve diversification is real but gradual. The euro, not the renminbi, gained most in the second quarter of 2026.⁶² Payment-system alternatives are more likely to become specialized regional channels (for commodity trade, bilateral settlement and sanctions-exposed flows) than a replacement for dollar clearing within the next decade.

6. Counter-Evidence and the Limits of the Regionalization Thesis

A balanced assessment has to weigh evidence that cuts the other way.

- **U.S. economic resilience.** U.S. real GDP grew at a 2.2% annualized rate in the second quarter of 2026, supported by consumer spending and AI-related business investment.⁶³ The AI investment cycle is concentrated in the United States and continues to draw allied capital and firms.
- **Allied capital is flowing toward the United States.** The Korean (US\$350 billion) and Japanese (US\$550 billion) pledges are among the largest cross-border investment commitments of the period.^{64,65}
- **Alliances are being re-priced, not dissolved.** NATO members reaffirmed at the July 2026 summit their pledge to spend 5% of GDP on defence and related items by 2035.⁶⁶ More European defence spending strengthens burden-sharing within the alliance as well as European autonomy.
- **Regional arrangements face their own constraints.** The EU–Canada “associate” idea has no treaty basis yet.⁶⁷ Canada’s diversification goal is very large compared with the size of alternative markets.⁶⁸ Asian bypass pipelines can carry only part of the lost Hormuz volumes.⁶⁹
- **Third-party mediation has limits.** Gulf states have looked to China to use its economic influence with Iran over shipping lanes.⁷⁰ Brookings notes that Beijing has positioned itself as a “measured and ostensibly neutral actor” while its own Gulf crude imports fell sharply.⁷¹ No single external actor has shown it can restore the security of the sea lanes on its own.

These factors do not undercut the hedging thesis. They limit how far it goes. The most defensible reading is that the system is becoming more plural and more redundant, not that it is splitting into separate blocs.

7. Scenarios to 2035

	A. Managed multipolarity (base case, ~55%)	B. Fragmented blocs (~25%)	C. Re-anchored globalization (~20%)
Core dynamic	Allies keep U.S. security and market ties while building regional insurance	Repeated shocks push hedging into firm exclusion and rival standards	Durable Middle East settlement and stable U.S. trade policy reduce the hedging premium
Trade	Growth below the 2000–19 average; regional FTAs deepen; tariffs settle at higher but negotiated levels	Tariff escalation spreads beyond bilateral disputes; trade growth near zero in stress years	Trade recovers toward 3% growth; many 2026 measures are negotiated down
Energy	Structural risk premium; strategic reserves and bypass capacity expand	Recurring chokepoint crises; energy nationalism	Hormuz normalizes; oil returns toward pre-war ranges
Finance	Dollar dominant; euro gains reserve share; regional payment links grow	Faster reserve diversification; parallel payment systems cover larger trade corridors	Dollar share stabilizes; alternative platforms stay marginal
	A. Managed multipolarity (base case, ~55%)	B. Fragmented blocs (~25%)	C. Re-anchored globalization (~20%)
Technology	Allied “chokepoint” industries (memory, lithography, batteries) gain bargaining power	Separate technology standards and export-control regimes	Shared allied standards consolidate

Signposts to watch

1. Whether a U.S.–Iran settlement reopens Hormuz, and whether tanker transits return to more than half of pre-war levels.
2. Whether the EU–Canada “associate” concept gains Council support or a treaty route.
3. The pace at which the Korean and Japanese U.S. investment pledges are actually disbursed.
4. The dollar’s share in IMF COFER data; a sustained fall below 55% would be meaningful.
5. Whether any multi-CBDC platform adds new central banks outside its founding group.
6. WTO trade-volume outcomes for 2026–27 compared with the 1.9% baseline.
7. Tariff developments after the U.S. November 2026 midterm elections.

8. Implications for the Global Economic Outlook

1. **A higher cost floor.** Redundancy (extra inventory, dual sourcing, bypass infrastructure, strategic reserves) is now treated as necessary. This raises structural costs and tends to keep goods inflation above pre-2020 norms even after energy prices ease.
2. **Investment over trade.** Growth in cross-border activity is shifting from trade in goods toward foreign direct investment that places production inside protected or allied markets. Trade volumes may lag GDP even as global investment remains strong.
3. **Energy-importer divergence.** Asian energy importers face the largest exposure to Gulf disruption. Countries with large reserves, diversified suppliers or domestic production are relatively advantaged. Fertilizer and food-price spillovers deserve attention in import-dependent emerging markets.
4. **AI as a countervailing force.** IMF and U.S. data both point to AI-related investment as a key offset to the war shock.^{72,73} Economies integrated into the AI hardware value chain, including the United

States, Korea, Taiwan and Japan, are likely to outperform.

5. **Middle powers gain bargaining weight.** As hedging spreads, countries that control hard-to-replace inputs (critical minerals, advanced memory, energy transit) gain leverage. This favours Canada, Korea, Australia, the Gulf producers and parts of Southeast Asia.
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9. Conclusion

The world economy of 2026 is not deglobalizing so much as reorganizing under pressure. An energy-security shock in the Gulf and a recalibrated U.S. trade policy have raised the value that governments and firms place on resilience compared with efficiency. The response from major industrial economies has been consistent: keep core relationships with the United States, accept negotiated costs to do so, and build regional and plurilateral alternatives that lower the cost of future disruption.

This is forced regionalization in a precise sense. It is defensive, incremental and driven by risk management. It is visible in trade agreements, investment patterns and energy policy. It is much less visible in monetary infrastructure, where the dollar's position remains strong. The likely result over the next decade is a world of overlapping regional clusters operating inside a still dollar-centred system: more plural and more resilient, but more expensive and less efficient than the one it replaces.

About the Author

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Disclaimer: The views expressed are those of the author, Dr Tong Yin, and do not necessarily reflect the positions of InsightBridge Global or InsightBridge Global Lab. Scenario probabilities are analytical judgments, not forecasts. Data are current as of 5 October 2026.

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