Marsh

Marsh Specialty

Political risk map 2021
Mid-year update

A two-track pandemic is leading
to a multi-speed recovery

September 2021

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Introduction

From naval tensions in the South China Sea and resurgent unrest in Tunisia, to protests in Chile and port closures across South America, countries and regions are now facing waves of discontent. Uneven vaccine rollouts, new coronavirus variants, plus political transitions leading to a lack of policy continuity have upended even the most robust of plans.

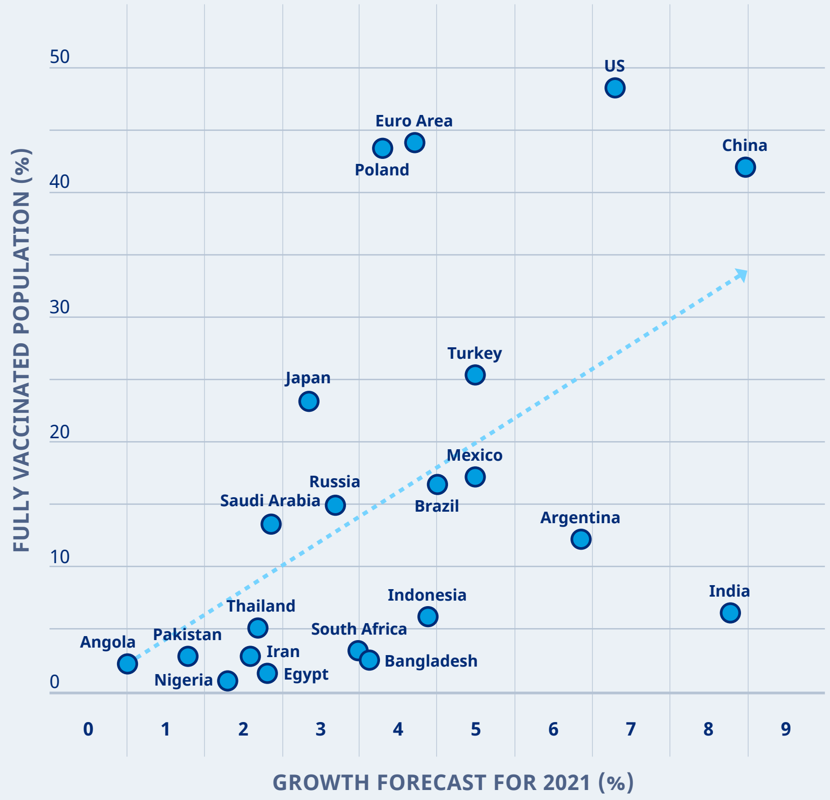
While the global economy is starting to recover, economic and political conditions continue to weigh heavily on the ability of many individual countries to meet their citizens' needs and expectations. Marsh Specialty's political risk ratings show that only nine countries' economic risk scores have worsened in the last 12 months, out of the 197 jurisdictions analyzed. But at the same time, almost 60% of countries worldwide saw a deterioration of their governments' sovereign debt profiles, and more than 50% presented a higher risk of internal violence this year, compared with mid-2020, when lockdown measures widely ceased.

A two-track pandemic is leading to a multi-speed recovery, as the divide between the global rich and poor influences vaccination rates. Vaccine inequity has become a prominent issue due to a combination of factors — primarily driven by a global shortage of raw materials and limited production capacities, especially in developing countries. Financing is also a factor to be considered, as few developing countries can afford the vaccines, especially if there are challenges in providing crucial basic services, such as clean water.

As pointed out in Marsh Specialty's Political Risk Map 2021, released in April, growth inequality between rich and poor nations — typically the "jabs" and the "jab-nots" — is widening. The growing divide will likely add social and political tension to many countries' deteriorating economic prospects.

In addition to government-backed export credit agencies and multilateral organizations, a robust private political risk insurance market has developed to help investors and businesses weather political and economic crises. Solutions to protect against non-payment risks, improve supply chain resilience, and protect people and assets in various countries can involve public programs, private insurance, or a combination of both.

01| Countries with higher rates of vaccinated populations have higher growth potential.[1]



Source: *World Bank, Our World In Data, Marsh*

1 The share of the fully vaccinated population in China requires a separate assumption, as the government declared only first-dose inoculations at the time of writing; similarly, data on the fully vaccinated population in the Euro Area refers to the European Union as a whole, possibly resulting in a slightly bearish estimate compared to the Euro Area alone.

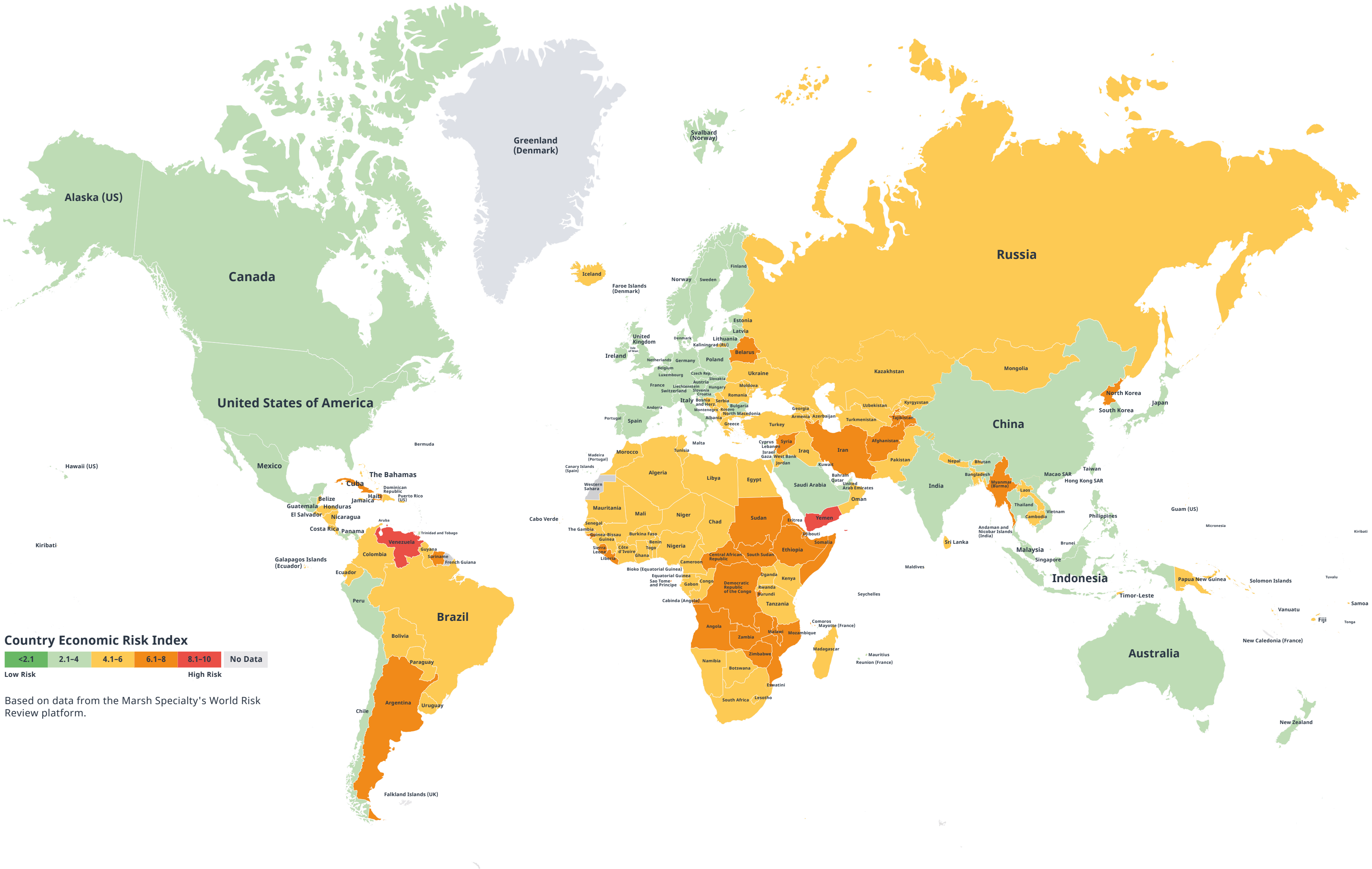
Countries and regions above the trend line in Figure 1 are proving more effective in vaccination rollout – the "jabs" markets. The main reasons for this include the development of proprietary vaccines by locally-based companies, the ability to rapidly obtain more doses, greater distribution efficiency, and government policies to encourage mass inoculation. The economic outlooks for these countries will likely be reinforced in the next months, as vaccine distribution can be also regarded as a proxy for policy effectiveness, on the recovery side. Countries below the trend line typically include the emerging market universe, which have seen limited access to costly vaccines, and a relatively higher pressure on institutions and social systems. In these countries — the "jab-nots" — economic growth and overall resilience are still driven by long-term factors such as demographics, commodity-related revenues and, possibly, some base effect of 2020 (for example, Argentina, Mexico, and India saw worse-than-expected recessions last year). Although there currently seems to be a correlation between positive economic outlook and successful vaccine roll-out programs, it is a trend to be closely watched, as political risk events that may occur in both "jabs" and "jab-nots" would have an impact on economic performance.

For countries that are lagging, notably many in Africa, social and political unrest remains a probable outcome. Pre-existing social tensions, exacerbated by the pandemic, have increased difficulties in governance, and have constrained the fiscal room to manoeuvre for African countries to appease their disenchanted publics.

As the gap widens, factors such as food security, water access, and a declining contribution from the informal economy, will only increase the level of economic and political risks.

Meanwhile, commodity prices have been driven up, principally by infrastructure spending and national recovery stimulus plans. In recent times, governments have been consolidating their hold on strategic resources as a means to raise revenue and redirect their spending to newly urgent priorities, such as damaged health and labor systems. For example, in Chile, the Congress is examining several opposition-led bills potentially affecting the mining sector, where some key agreements due to expire in 2023, will likely be reviewed by the next government. The debate on royalties has fuelled political risk in the world's top mining producing region, with higher taxes for miners proposed in both Chile and Peru. Latin American countries' economic profiles are also exposed to environmental risks combined with a relatively low level of development focused on reducing potential impact of natural disasters related to climate change.

Across all countries, the immediate consequences of the pandemic are still unfolding and may have long-term implications. In the Political Risk Map 2021: Mid-Year Update, we will explore further these foregoing themes – global vaccination inequity; increasing social unrest and political tension; Africa's growing economic exposure; and the challenges that the commodities sector is currently facing globally.

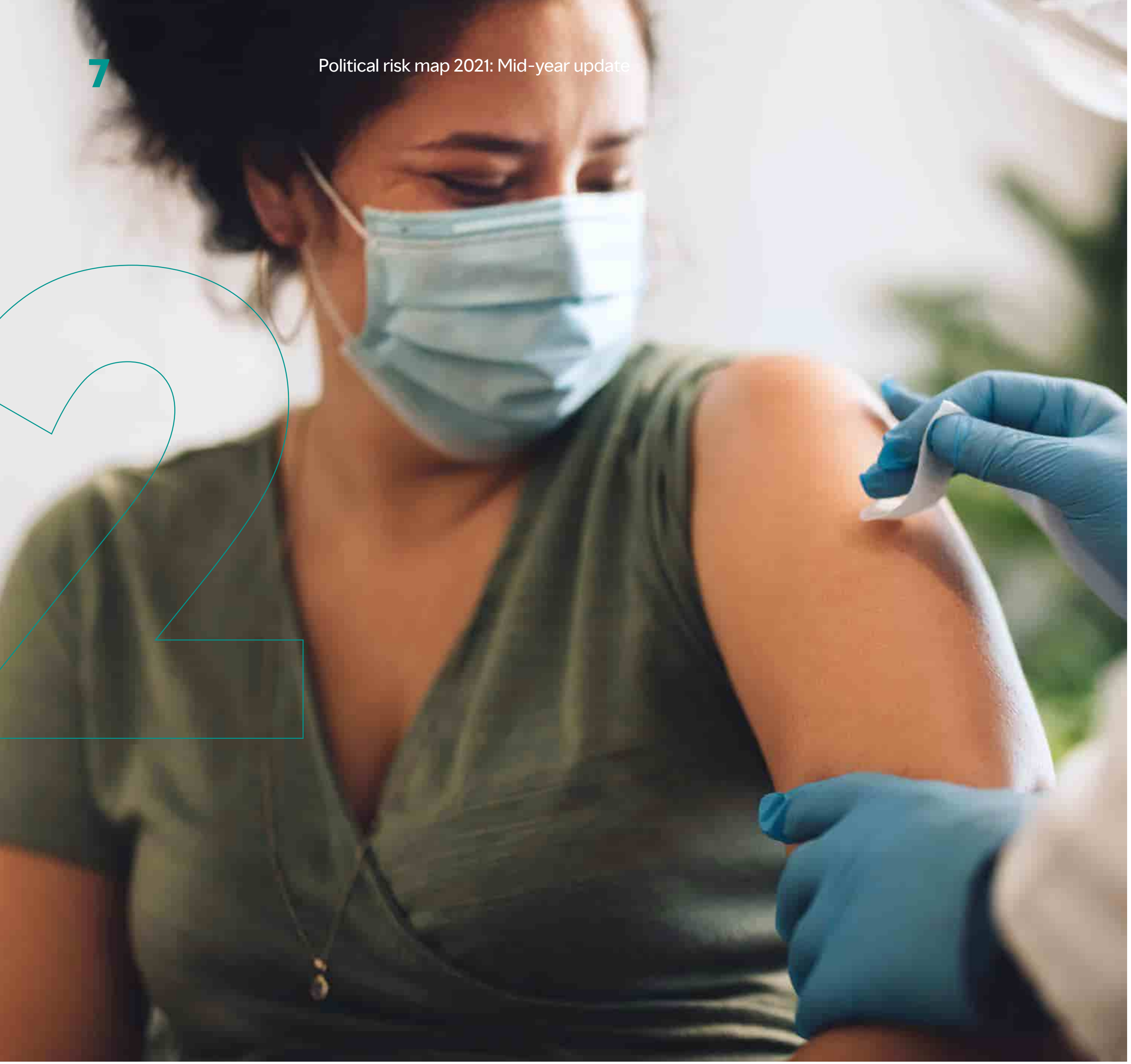


Based on data from the Marsh Specialty's World Risk Review platform.

POLITICAL RISK MAP 2021 MID-YEAR UPDATE

Our Political Risk Map 2021 is based on data from Marsh Specialty's World Risk Review platform. The country risk platform provides risk ratings for 197 countries across nine indicators relating to security, trading, and investments. Ratings are updated monthly and range along a 0.1 to 10 scale, with 10 representing the highest risk, and 0.1 the lowest risk. This World Risk Review platform is accessible to Marsh Specialty clients; for information, please contact your Marsh Specialty representative. The nine risks tracked in the World Risk Review platform are:

- Contractual agreement repudiation risk.
- Country economic risk.
- Currency inconvertibility and transfer risk.
- Expropriation risk.
- Legal and regulatory risk.
- Sovereign credit risk.
- Strikes, riots, and civil commotion risks.
- Terrorism risk.
- War and civil war risk.



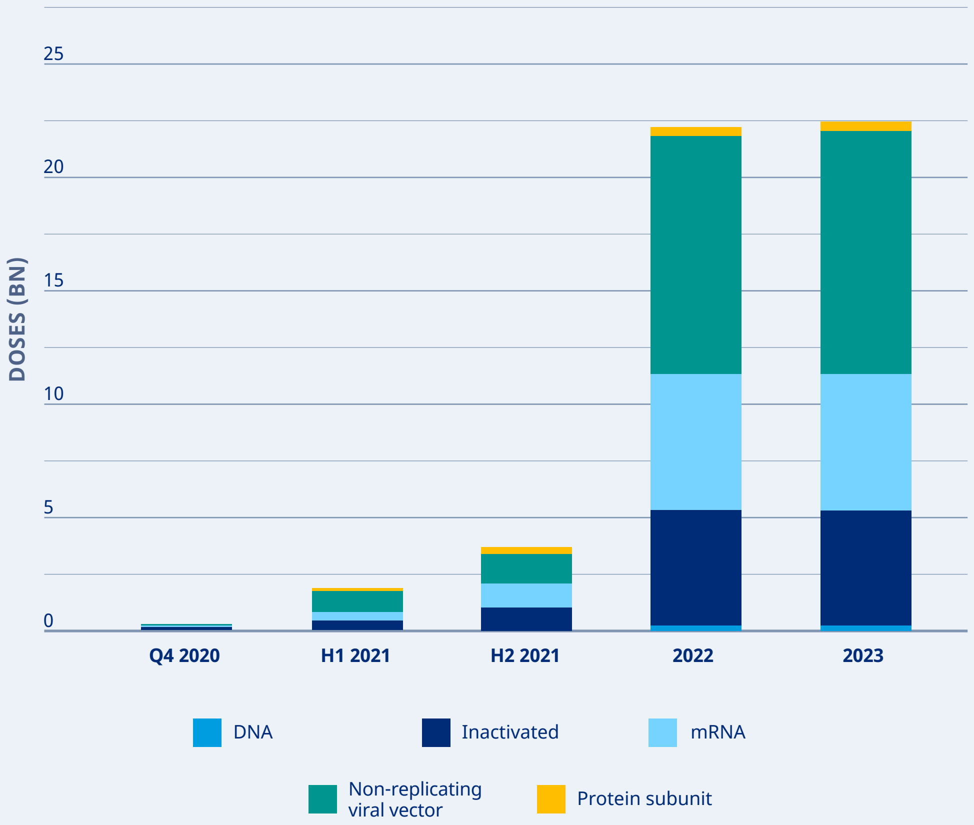
Inequity: Concerns beyond a vaccine

Vaccine production by the end of the year could reach more than 11 billion doses. Assuming a two-dose regime, this would be enough to vaccinate 70% of the world's population, which is anticipated as an approximate indicator for achieving global herd immunity.

Global production capacity for 22-23 billion doses of vaccines, already approved for use, appears to be in hand (see Figure 2 overleaf).

However, the problem lies with the inequity of distribution. G7 countries have succeeded in administering at least one dose to more than 50% of their populations, and are on course to have that figure increase to over 70% before the close of the year. But developing economies are struggling to vaccinate, evident in the many African countries that are yet to administer at least one dose to 1% of the population.

02| Vaccines approved for use could exceed 22 billion doses in 2022.



Source: *Unicef*

This divide has been driven by the ability of high-income countries to procure a higher portion of vaccines. These countries have procured more than six billion doses, approximately two-thirds of the total global procurement, despite constituting only 16% of the world's population.

The price of vaccines tends to differ by supplier, the type of vaccine produced, and bilateral deals; the difference in price point may serve to exacerbate economic pressures for developing countries, such as South Africa and Indonesia. Economic trouble proliferating throughout any developing economies is the foundation for civil unrest at a national level, evermore so during a global pandemic.

The pandemic-induced recession has profoundly afflicted emerging markets across the world, with significant changes in the economic, investment, and security environments. The inequity resulting from these pressures provoked an economic contraction of around 1% in South Korea, 7% in both India and South Africa, and 8% in Mexico in 2020. The anticipated stresses on India, South Africa and Indonesia can be primarily linked to three factors:

- An increase in the number of corporate bankruptcies, which compounds existing strains on average household incomes and banks alike. With this coming to fruition against a backdrop of relatively weak frameworks for social security in these countries, the scope for millions of people to fall into poverty remains acute.
- The preexisting low capital investment trends for these countries, further undermined by capital flows dipping below pre-pandemic levels, and more crucially, below the average for all emerging markets.
- As measures to support borrowers, such as forbearances, are withdrawn, banks' asset quality is likely to deteriorate, while the state's capability to provide much-needed support to the banking sector may be compromised. The increasing number of non-performing loans and the return of inflationary pressures could restrict credit expansion, which would weigh on investment spending.

The political turmoil in countries possessing advantageous demographics is likely to remain in the short-term, meaning that governments may be pressured to divert funds that could otherwise balance against these economic pressures, to mitigate against the discontent of younger populations. One example of this trend is the civil unrest in South Africa, where the lack of fiscal spending by the government has negatively impacted job creation and the housing sectors. The unrest also came about as a result of a perceived ineffective governmental economic response to the pandemic. Another example is the student uprisings in Indonesia — the reliance of the Indonesia government on China to deal with the delta variant of the coronavirus has increased youth disenchantment, especially because of the alleged mistreatment of the Uyghur community in China.

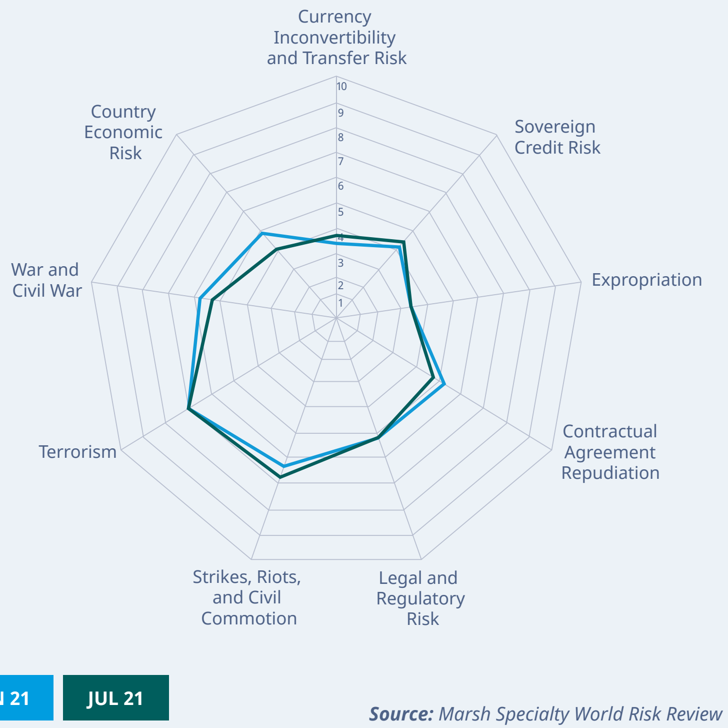
3 The factors igniting social unrest

Pre-existing tensions have been exacerbated by the pandemic, creating difficulties in governance, and limiting space for fiscal maneuvering. As the gap between rich and poor widens between nations, factors such as food insecurity, issues around water access, and the impact of lockdown measures in the economic activity of informal sectors are increasing economic and political risks between and within nations. These pressures raise the question of whether strikes, riots, and other types of civil disturbances are likely to emerge in previously unaffected territories.

According to the World Bank, **Colombia** has the second highest income inequality among the South American region's large countries. With strong economic, ethnic, and geographic barriers to a high level education and the formal job market, Colombia's social mobility is also the lowest within the Organization for Economic Cooperation and Development (OECD). The lack of redistribution of wealth and opportunity has led to social unrest and the entrenchment of grassroots demands.

On the other side of the Pacific Ocean, large economies in **Southeast Asia** are hardly regarded as centers of politically motivated disturbance. Nevertheless, military developments in the South China Sea, and tensions between Beijing and Washington, are leading countries located in proximity to strategic bottlenecks to position themselves within the geopolitical arena, with effects on local public opinion.

03| **Colombia: Social disharmony and currency pressures remain elevated.**



Source: *Marsh Specialty World Risk Review*

COLOMBIA

Social unrest and security threats in Colombia are rising, driven by faltering policies in the face of the pandemic-induced acceleration of economic, social, and political crises that pervade the Latin American region as a whole.

President Iván Duque and his center-right government already faced large protests in late 2019 and early 2020. Prior to the pandemic, economic policymaking was focused on high unemployment, the peace process, and the Venezuelan refugee crisis. Open dissatisfaction with institutions had already made President Duque's party lose political control of the largest cities, Medellin and Bogotá, and is now weakening the government as the country prepares for a presidential election in May 2022.

After 20 consecutive years of growth, the Colombian economy shrunk by 6.8% in 2020. The unemployment rate reached a record 16% of the population, with over five million jobs temporarily lost among 51 million inhabitants. By the end of 2020, 42.5% of Colombia's population was living below the poverty line. The country may not reach herd immunity until the first half of 2022, owing to delays in its inoculation program and supply constraints on vaccine production. As of July 1, the first-dose rollout in Colombia covered about 22.4% of the population, far behind Argentina (36.5%), Brazil (35%), Chile (65.5%), and Uruguay (65.3%).

At the end of April 2021, even as COVID-19 raged and in violation of pandemic lockdown measures, Colombians took to the streets in protest. Demonstrators in Cali, Colombia's third-largest city, and Valle de Cauca initiated what became a nationwide wave of roadblocks and vandalism. Over the following weeks, demands expanded to include the provision of a guaranteed minimum income, an overhaul of the healthcare system, and an end to police violence.

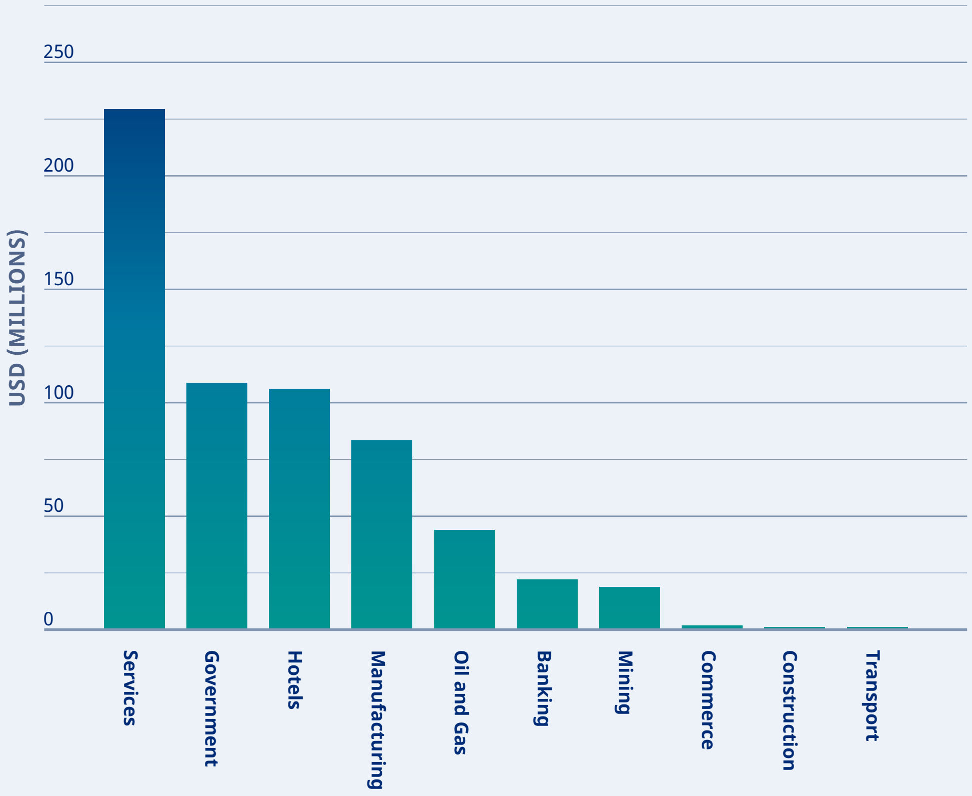
Estimates show that property claims resulting from damages between April 28 and May 20 in Colombia may have surpassed US$ 624 million (see Figure 4). Roadblocks have also interfered with the transport of food and supplies, causing shortages in some parts of the country and the deterioration of thousands of tons of food.

Police brutality has also exacerbated public anger, leading to looting, arson attacks, and commercial disruption. In July, 10 members of the military were formally accused of involvement in at least 120 extrajudicial killings and 24 forced disappearances of individuals regarded as guerrillas between 2008 and 2009. This has put pressure on institutions to tackle this issue.

The country's fiscal framework is deteriorating, as gross public debt approached 63% in 2020 — a 10 percentage-point increase in 12 months. The IMF granted Colombia a flexible credit line worth US$ 17.2 billion, without conditionality, due to a solid record of prudent macroeconomic management. In December, the Colombian government drew US$5.4 billion from that line, while the Congress approved a US$81 billion budget for 2021 – the largest in the country's history, indicating Colombia's fiscal outlook is expected to further deteriorate through 2022.

The government has recently extended some of the fiscal stimulus measures that it implemented in 2020, such as the Ingreso Solidario – a US$2.2 billion cash transfer program to informal workers and families outside existing social initiatives – and the Programa de Apoyo al Empleo Formal, a conditional payroll subsidy. Standard & Poor's, however,

04| Physical property damages reported by businesses in various sectors between April 28 and May 20 were significant.



Source: *IHS, Marsh*

lowered Colombia's sovereign rating to BB+ in May 2021, following the withdrawal of a fiscal reform due to protests; Fitch came to the same conclusion in July.

The sovereign rating downgrades have added to a perception of increased political instability. In late June, multiple bullets struck a helicopter carrying President Duque, the defense and interior ministers, and the governor of Norte de Santander when flying through the country's Catatumbo region towards the city of Cucuta.

The fact that the 2022 presidential election is approaching complicates efforts to reduce tensions. President Duque is barred from a second term; a former contender, left-wing leader Gustavo Petro, is currently leading the race. During previous presidential election campaigns, Petro has advocated the nationalization of the financial sector, and the phasing out of oil and extractive industries, while promoting a strong anti-US stance.

Additional actors that could join forces throughout the campaign period are labor unions and indigenous populations. Colombian labor unions are traditionally moderate, fragmented, and closely allied with traditional parties or the Catholic Church. Membership is historically below 10% of the country's workforce.

However, union grievances in the transportation, public employees, and oil sectors could cause significant logistical disruption. The oil workers' union, Unión Sindical Obrera de la Industria del Petróleo (USO), is highly militant and often strikes in solidarity with contract workers. USO has expressed its aspiration to create a "super union" consisting of labor unions within the extractive industry. Progress toward this goal has been limited, but if it succeeds, the likelihood of solidarity strikes across these three sectors would increase amplifying disruption by industrial action.

Colombia's indigenous population, around 4% of the total, is also organized in a sizeable number of communities. Indigenous people are grouped in some 710 reserves, occupying roughly one-third of the national territory. Environmental authorities dispute the validity of mining licenses granted by previous administrations, particularly in nature reserve areas, and popular consultations in Colombia display a categorical rejection of extractive operations.

Two rulings by the Constitutional Court have recently confirmed the right of the central government to grant extractive concessions, and denied the right of local authorities to block projects, directly or as a result of community referendums. However, a series of conflicts over infrastructure and mining investments have raised concerns that communities may delay projects under the constitutional appeal process.

Overall, the next government is expected to be subject to protests from both unions and indigenous communities, as well as the unemployed, working class, and relevant sections of the middle class. Protests over oil and mining projects are also likely in the near future, as the reduction of local authorities' powers to block extractive projects, following court rulings, may result in increased protest activities near proposed developments.

05| Malaysia: Risk of expropriation has risen drastically in reaction to pandemic pressures.

Source: *Marsh Specialty World Risk Review*

MALAYSIA AND INDONESIA

China's territorial claims in the South China Sea conflict with Indonesia's claim to the Natuna Islands, to the extent that in 2017, Indonesia named the waters to the northeast of the islands the "North Natuna Sea" — serving to strengthen its sovereignty over the area. Since then, there has been an increasing risk of controlled confrontation between both countries, concerning Chinese coast guard and fishing vessels, and their Indonesian counterparts.

The Sulawesi Sea also serves as a theatre for dispute — in this case, between Indonesia and Malaysia, over maritime boundaries relating to the oil-rich Ambalat block. Despite the tensions, the robust relations between both indicate that the risk of escalation to armed conflict is low.

There remains discord between the Indonesian government's stance on China, and pockets of the Indonesian populace. Protests of the perceived mistreatment of the majority-Muslim Uyghur population in Xinjiang have been widespread in Indonesia. This is juxtaposed with the policy prescription of the government, as China's vaccine diplomacy has created political cooperation between both countries. Around 90% of the vaccines disseminated in Indonesia have been made by the Beijing-based biopharmaceutical company Sinovac, while China has also become the prominent supplier of personal protective equipment for the country.

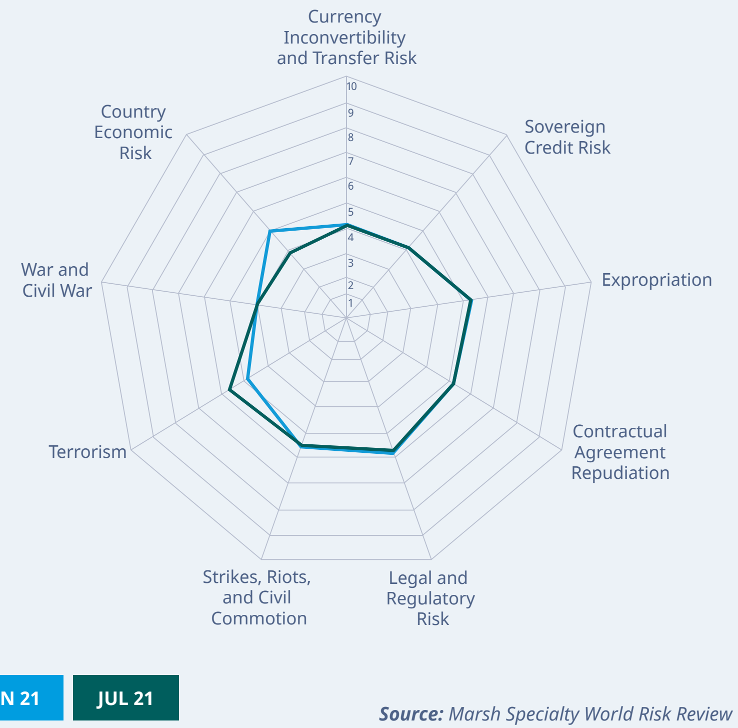
In the long term, China is expected to enlarge its military inventory substantially. The planned expansion of the People's Liberation Army Marine Corps to 100,000 personnel, plus the addition of 10 new aircraft carriers, will ensure Beijing's regional hegemony.

The anticipated improved amphibious capacity of surface vessels and aircraft carriers is also likely to increase Chinese operations across both the Indian and Pacific oceans – resulting in proportionally larger logistics bases. While neighboring countries may publicly oppose China's regional influence, they may find themselves reconsidering this stance in the face of their neighbor's strong economic influence.

Approximately 2.4 billion people, including around 300 million Indonesians and Malaysians, live within 2,500 kilometers of the Chinese coast. With the potential of a blue-water navy operating across open waters, the presence of the Chinese navy in the area not only serves as a deterrent, but also a lever to increase diplomatic leverage in negotiations with countries in the region. The Chinese navy also helps to sustain commerce by sea, as its national supply chains circumvent the world.

The continued operation of the international economy is critical to China's social stability and national prosperity, which in turn impacts Malaysia and Indonesia. COVID-19 continues to have a devastating impact on Malaysia, sparking protests over mismanagement of the crisis and the continued state of emergency, which may prompt the Malay government to pivot to Beijing as a means to reinstate an appeased populace.

06| Indonesia: Risk of terrorism rises, despite strong economic recovery.



Source: *Marsh Specialty World Risk Review*

For the most part, China's geopolitical strategy seeks to enhance the number of foreign ports available to Chinese vessels for resupply, while also pursuing physical interests and assets abroad. Likely candidates in this regard are nations from the Association of Southeast Asian Nations (ASEAN), with Malaysia and Indonesia strategically at the top of the list (see Figure 7). How this aligns with the people of both nations, however, remains to be seen, as historically there has been disharmony between China and its neighbors.

China's current stance with regard to its Muslim minorities creates discord with Indonesia. The ongoing rivalry between the US and China has put Indonesia in a delicate position, but its vital strategic position in Southeast Asia brings benefits, as the two superpowers seek to strengthen their presence in the region.

The situation in Malaysia, however, is more critical. The encroachment of Chinese coast guard vessels on Malaysia's Luconia Shoals for over five years has brought into question the nature of the special China-Malaysia relationship. The geo-strategy of China has jeopardized positive bilateral sentiments, alienating growing segments of the Malaysian public, and large parts of the country's security and foreign policy establishment.

As these developments progress, the challenges for both Indonesia and Malaysia are likely to increase accordingly, with social disharmony being the most likely outcome. As the risk of civil unrest grows, so too should the risk mitigation efforts of the many multinational and domestic-based enterprises operating there.

07| China's vaccine diplomacy has added to economic pressure in Southeast Asia.

Source: *Center for Strategic and International Studies*

4

Africa’s exposure to economic downturn

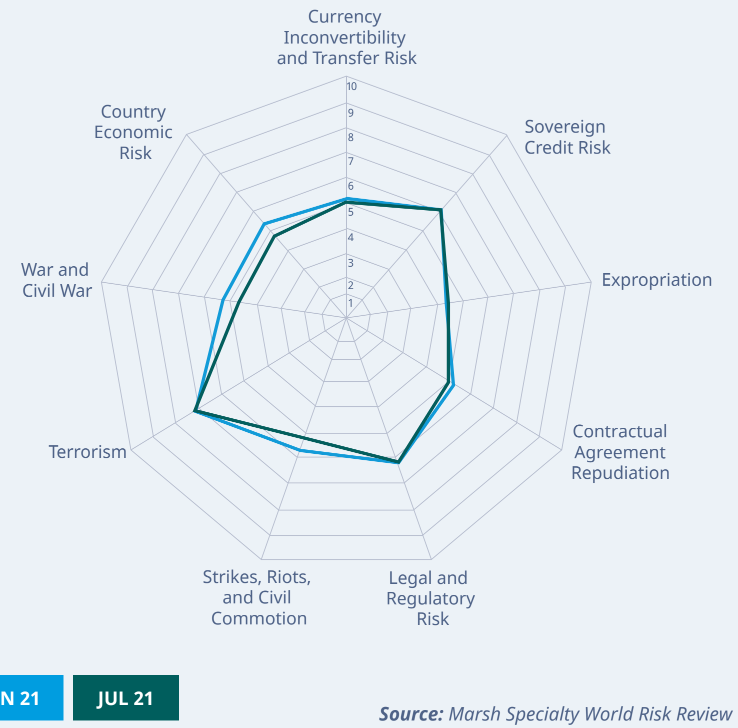
As of August 2021, only 1.7% of Africa's adult population had been fully vaccinated against COVID-19. The global economy is expected to grow by 6% in 2021, but the continent's economic growth is expected to be only half of that, at 3.2%. Interest payments reached 20% of tax revenue for the region (which is relatively high), as a whole in 2020. This has impacted debt sustainability, signaling that debt relief initiatives could ultimately lead to an increase in financial sector exposure and contingent liabilities, exacerbating macroeconomic vulnerabilities in some countries. Similarly, public debt in North Africa rose by about 12 percentage points to an average of 88% of GDP, leaving limited space for energy and environmental transition investment.

In **Tunisia**, the government's management of the pandemic (which has been seen by many as ineffective), as well as the need to introduce austerity measures during negotiations with the International Monetary Fund (IMF), left little room to prevent a new wave of nationwide protests in 2021. Long-awaited structural reforms are unlikely to be implemented fully in 2022, extending endemic social and economic problems. On the other hand, Abdul Fattah al-Sisi's firm leadership in **Egypt** seems capable of averting a new wave of protests, avoiding a repetition of the Arab Spring a decade ago, when protests from Tunisia spread throughout North Africa and the Near East.

In **South Africa**, high poverty and unemployment rates have fueled unrest. Protests began in July, in support of former President Jacob Zuma, with hundreds of vehicles burned and widespread looting. The rioting began in his political heartland of KwaZulu-Natal but has since spread to Gauteng, the country's commercial hub, halting economic activity.

Nonpayment, financial, and operational risks are rising in the region, cooling down economic prospects. The long-term effects of these events may ultimately narrow opportunities for younger generations throughout the region, with a few notable exceptions, such as Botswana, Gabon, Morocco, and Zimbabwe.

08| **Egypt: Progress in water security reduces economic and war risk.**



Source: *Marsh Specialty World Risk Review*

EGYPT

Egypt's outstanding credit to the IMF has risen to US$19 billion, the second largest amount after Argentina's, with debt now exceeding 90% of the country's GDP. Revenues from tourism and trade have diminished, with already significant potential liabilities increasing in the country's Suez Canal and Nile waterways.

Egypt remains vulnerable to shocks, due to its high public debt, and gross financing needs. Some analysts have labeled the accident that occurred in the Suez Canal in late March as a "gray rhino" event, meaning an occurrence resulting from a highly probable, high-impact, yet neglected threat. From a country risk perspective, Egypt is facing mounting government debt, reduced income from tourism, and persisting dependence on waterways — both Suez transits and the Nile basin.

According to the Central Bank, Egypt's external debt had increased by 21% year-on-year, as of June 2021, to US$134.8 billion. The Egyptian government is expected to proceed with privatizing at least 10 army-owned companies in September. The initiative is one of the conditions of Egypt's IMF program that stipulates the sale of 23 state-owned enterprises, alongside other reforms. Among those expressing initial interest in the sale are several state-backed Gulf companies, including companies from the United Arab Emirates and Saudi Arabia.

Egypt's assertive military posture and regional diplomacy on different fronts, including the eastern Mediterranean (Turkey, Libya) and the Middle East, come at a cost. Consequently, the size of new foreign loans that the government could be expected to take on to help cover military expenditures may be significant. With 439,000 staff, Egypt already employs the largest military personnel in the region and the ninth largest in the world.

Additionally, the government has received, or has committed to buy, numerous advanced major weapon systems in recent years. According to the Stockholm International Peace Research Institute, the estimated cost of these purchases totals US$16 billion — roughly 4% of Egypt's 2020 GDP and double the military spending target set by the North Atlantic Treaty Organization.

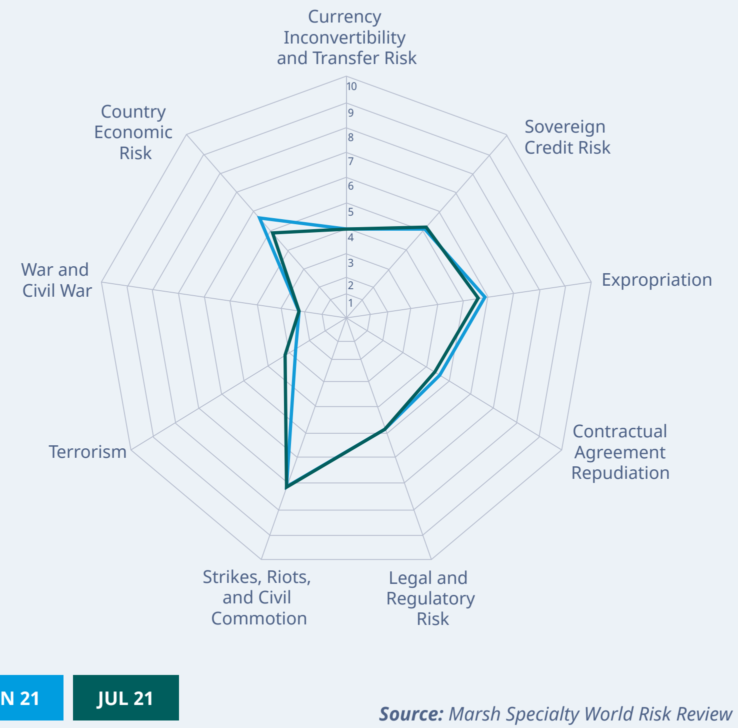
Water resources are managed by the military, meaning heightened insecurity could have severe implications for the agricultural sector, which accounts for 11% of GDP and employs a quarter of Egypt's labor force. An Egyptian-Kenyan defense cooperation agreement signed in July, is the fourth military pact penned between Egypt and other countries of the Nile Basin — namely Sudan, Uganda, and Burundi — since March 2021.

These agreements are intended to build a network of supportive states around Ethiopia, which is in a dispute with Egypt over the Grand Ethiopian Renaissance Dam (GERD). Egypt hopes to increase its advantage in the decade-long GERD standoff, and ultimately convince Ethiopia to shift its stance regarding the rate at which the dam reservoir is filled, in order to allow more water to flow to Egyptian farms.

The odds that this dispute could result in outright interstate conflict are low. However, the tension arising from this deadlock serves to maintain the Egyptian military's grip on economic sectors where they are most active — including heavy industry, construction, and infrastructure development — and to increase the likelihood of arbitrary judicial intervention, at the expense of foreign investors, in the same fields. The Ethiopian government may also seek a limited escalation, in order to realign national interests, by focusing on an external enemy.

As in many countries, Egypt's tourism industry was one of the sectors most severely affected by the pandemic. Given its considerable share in employment and foreign currency earnings, the tourism downturn has affected the entire economy, putting pressure on external balances in particular. The recovery of the tourism industry will likely take time, as global travel disruptions are expected to last through 2022.

09| **South Africa: Stilted economic recovery has increased social discord.**



Source: *Marsh Specialty World Risk Review*

SOUTH AFRICA

The pandemic and associated vulnerabilities continue to weigh down fragile economies with constrained fiscal space for maneuver and excessive dependence on commodities from controversial sources. South Africa is an example of a country where recent developments have cooled down economic prospects, narrowing opportunities for younger generations.

The South African government faces a plethora of challenges as a result of the pandemic, recent social unrest, and economic stress. The convergence of these three issues, combined with weakened state-owned enterprises, may compromise fiscal consolidation. In order to address these economic challenges, the government needs to contain expenditures on public sector wages and reduce administrative costs — measures that could intensify the current social unrest.

Furthermore, commodity exports are expected to remain affected by high production costs in the region, narrowing the potential profits for extractive operations. Although globally the demand for commodities is strong, South Africa's top three exported commodities in recent times (gold, platinum and iron ore), together with coal, are seeing diminishing demands, which will likely affect exports in the short term.

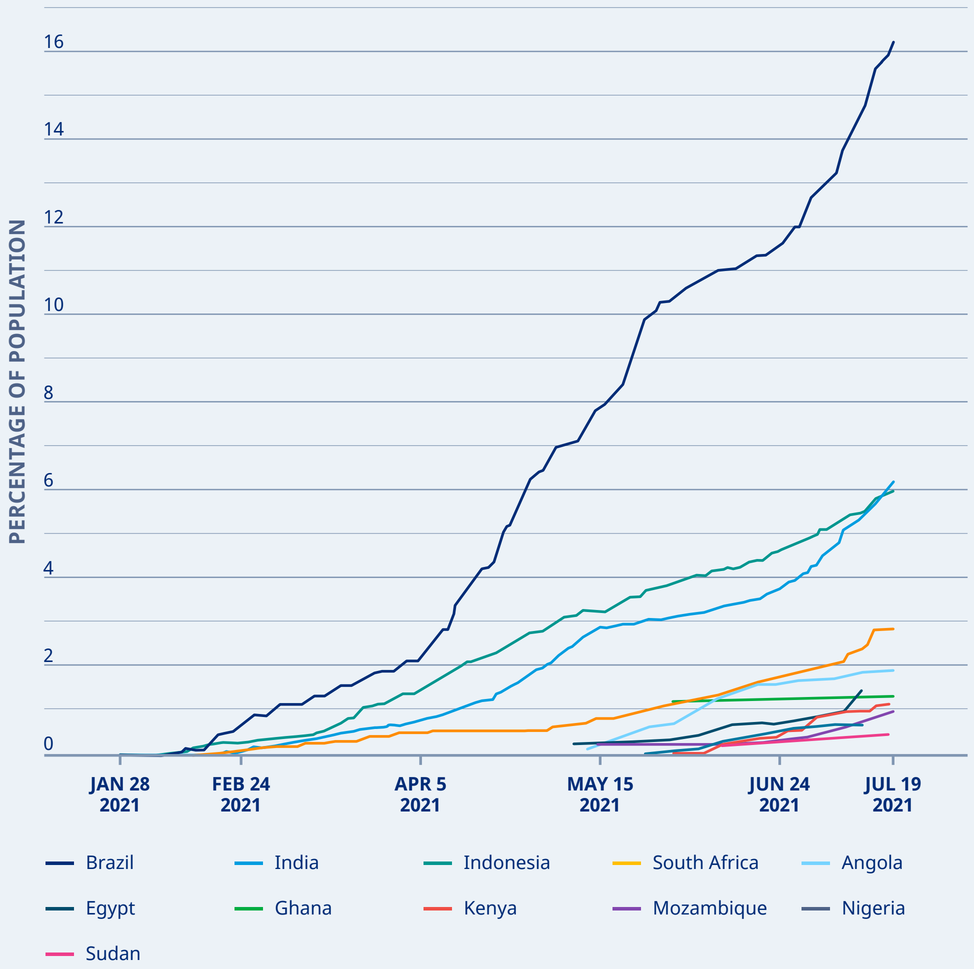
The issue is the end markets. Pre-pandemic, China, Japan, and India were the largest consumers of these commodities. However, due to the pandemic's impact on shipping, ports, and terminals, accessing these markets is now more challenging. This has been further exacerbated by the economic pressures facing countries in the Asia-Pacific region, due to demographic transitions in China and Japan, and the ongoing proliferation of COVID-19 in India.

An amalgamation of economic pressures and the jailing of former President Zuma brought about violent protests in the country in July 2021 — the worst civil unrest since the apartheid regime. The magnitude of these nationwide demonstrations presents a critical threat to the domestic economy, over the short and medium term, in a country that is among the worst afflicted by the pandemic in Sub-Saharan Africa. As of July 2021, only 2.7% of the South African population had been double vaccinated, due to the process in accessing and disseminating vaccines (see Figure 10 overleaf). With the notable exception of Morocco — where 27% of the population has been double vaccinated — the entire African continent is showing concerningly low percentages of vaccination, especially in countries with a lower median age.

The civil unrest presents a real threat to South Africa's ability to recover economically from the 7% contraction recorded in 2020. Furthermore, the disparity in domestic economic distribution underscores the palpable discord in South African society, which exacerbates the government's ability to enact its reform agenda.

Past experience in mishandling large-scale infections, such as HIV, represents a dramatic precedent for the country. AIDS-related deaths have remained prevalent in South Africa for more than two decades. At its peak in 2006, HIV infections contributed to almost 40% of South Africa's deaths; HIV has remained responsible for 15% of deaths in recent years. With 29% of the population below 18 years of age, a group that is currently excluded from COVID-19 vaccination plans, the potential for new variants to develop and for the virus to proliferate in the region is high. Between July 1, 2020, and June 30, 2021, female and male life expectancies in South Africa declined by 3.8 years and 3.1 years, respectively, to an average of 59 years for men and 65 years for women.

10| South Africa's vaccination rate trails many countries.



Source: *IHS, Marsh; USD (millions)*

A lack of transparency at an institutional level has acted as a source of disillusionment, following former President Zuma's arrest for contempt of court, and his refusal to provide evidence in an investigation into high-level corruption in the country. Protests initially started in KwaZulu-Natal, Zuma's home province, before proliferating across the country, including in Johannesburg. Outside of KwaZulu-Natal, the rates of economic inequality — South Africa is among the top 10% countries globally in this regard — and youth unemployment were the main drivers of the civil unrest.

More than 70 people died during the protests, as infrastructure vital to economic productivity was targeted. South African insurers estimated physical property damage costs at up to US$700 million, while Mxolisi Kaunda, the mayor of eThekwini in KwaZulu-Natal, said 40,000 enterprises were affected in that municipality alone. The aggregated cost of damage resulting from the unrest is expected to total 0.3% of the country's 2021 GDP.

If the unrest continues, the growing recovery recorded in the first half of the year may be put at risk. The first quarter saw a 1.1% increase in real GDP quarter-on-quarter, corroborating improved confidence indicators in both the business and investment environments. Forecasts had indicated the country would benefit from a strong global economic backdrop, low interest rates, and the rollout of the COVID-19 vaccine program in the second half of 2021.

The current situation, however, is likely to adversely affect sentiment in the consumer, business, and investment sectors. As these pressures converge with the mounting COVID-19 infections recorded in May, June, and July, the previously forecast GDP growth over the rest of 2021 is clearly at risk.

The World Health Organization has warned that a surge in COVID-19 cases may result from the widespread rioting in South Africa. The government expected to receive vaccine doses in the second half of 2021, and made plans to vaccinate 40 million people to achieve population immunity by the close of 2021. As both the AstraZeneca and Johnson & Johnson vaccines have been temporarily suspended as of July 2021, this ambitious target is more likely be met by the close of 2022.

As a result of these burdens, the government is expected to face sizable challenges in restoring public finances. Stagnation in the economy would exacerbate the already predicted reduction of tax revenues. Meanwhile, the government is likely to step in to support private enterprises impacted by the protests, in addition to paying for the restoration of damaged infrastructure.

The demographic profile of the protestors (generally young, public sector employees, crucial for maintaining the government's mandate) also constrains the scope for recovery, as existing discord between demonstrators and the government stems from prolonged negotiations on public sector wages. Policy predictability, at large, remains questionable. Land reform and the possible expropriation without compensation for stranded assets are still hotly debated topics, which divide opinion while potentially harming South Africa's image as a destination for foreign investment.

5

Balancing the need for commodity revenues with green transition

Infrastructure spending and national recovery plans are constraining commodity availability and driving prices up, with several governments tightening their hold on strategic resources to rebalance broken health and labor systems.

Today, 2.6 billion people experience high or extreme water stress — by 2040, this number will increase to 5.4 billion. If natural disasters occur at the same rate seen in the last few decades, 1.2 billion people could be displaced globally by 2050. Between March and May of this year, at least 9.2 million people in **Nigeria** faced a crisis, or increased levels of food insecurity, amid armed conflicts, the effects of the pandemic, and climate change.

In Latin America, several countries are addressing natural resources in opposing ways. In **Mexico**, the government awarded control of one of the country's biggest oil discoveries to state-owned Pemex after months of deliberation, dealing a blow to private investment and raising the prospect of international litigation. In July, however, an arbitral decision was made against the government over state intervention on a privately-operated dam basin — which can likely lead to swifter contract renewal negotiations between the government and private investors, without the need for further arbitration.

In **Ecuador**, President Guillermo Lasso issued a decree in July that aims to double the country's oil production over the next five years, via the implementation of policies designed to increase foreign investment, the reinstatement of production sharing agreements, and new bidding processes for underdeveloped oil blocks, including those in the Amazon. However, the acceleration of the decree may encounter obstacles. President Lasso's decision to bypass national assembly approval sets a precedent for unpopular policy goals, which could increase public discontent. Moreover, in January 2021, three large European banks announced that they would no longer finance the trade of oil originating in the Ecuadorean Amazon, highlighting the reputational risk attached to these initiatives.

Chile is also experiencing a new cycle of protests over concerns that include several environmental issues, and business continuity for the country's vital mining sector. The outcome of the constituent process would reveal how far Chile is willing to go to protect its environment and redistribute wealth.

In **Peru**, several members of the government have stated that mining royalties could be increased, in order to maintain robust public account metrics in the face of the pandemic-induced economic crisis and necessary stimulus measures. The Peruvian government retains the second-strongest credit rating in the region, according to the main agencies, despite recent concerns.

11| Nigeria: Social discontent and economic difficulties could easily translate into operational problems.

Source: *Marsh Specialty World Risk Review*

NIGERIA

In a credible worst-case scenario, famine could occur in Nigeria, where households are cut off from humanitarian assistance that has been the population's typical food and income source for a prolonged period. While the conflict in the northeast has persisted since 2009, nationwide violence in the first half of 2021 has increased 15%, with 4,726 fatalities reported in the first six months of the year, against 5,444 in the full year of 2020. This has led to further displacement, with the International Organization for Migration estimating that over 2.1 million people had been displaced solely in the northeast, as of February 2021.

Throughout the 2021 harvest season, Boko Haram's efforts have threatened Nigeria's agricultural activity in the northern states. The group is responsible for killing 110 farmers in Sokoto State and several more in Borno State. Attacks of this nature have exacerbated food supply chain issues, as northern Nigeria is key for the production of wheat, maize, and ground nuts.

This bottleneck has led to inflation of food prices in every month of 2021, to date. Year-over-year, prices have risen 19.6% on certain food products. With violent unrest unlikely to cool down in the closing quarters of 2021, food price growth is forecast to remain in the double digits, with overall inflation anticipated to average 14.6% in 2021.

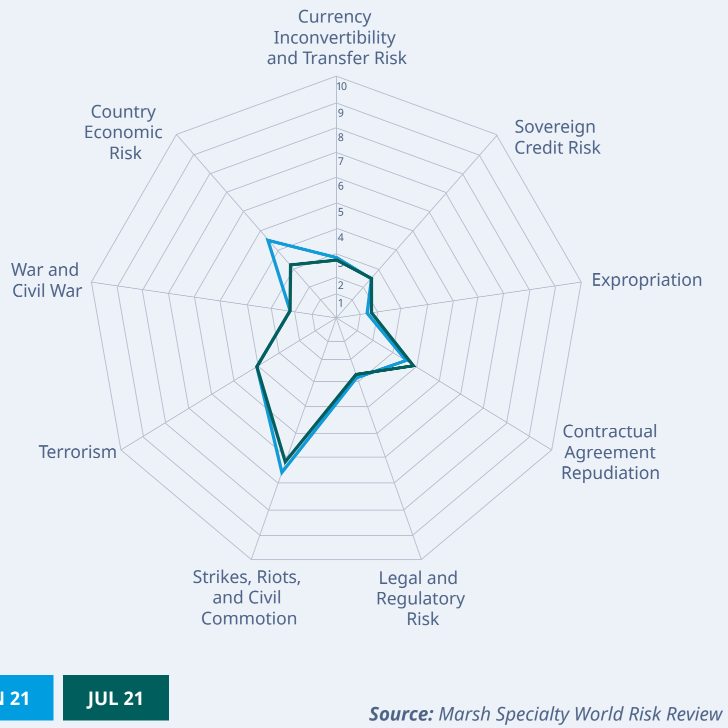
Insecurity is also likely to remain a central issue in southern and coastal areas, which could inhibit foreign investment in an ever more diminishing oil sector. Militant groups continue to threaten oil installations in the Niger Delta. Following a breakdown in January 2021 of negotiations between the militants' representative body (the Reformed Niger Delta Avengers) and the federal government, the groups have threatened to escalate the frequency and potency of attacks on vital pipelines and shipments.

In recent months, prominent oil companies have declared force majeure following attacks on assets held in the Niger Delta. Logistics companies also face threats from pirate groups that hold bases along the coast. Unrest is likely to persist in Nigeria's major metropolitan areas, though not at a scale that presents a profound threat to stability nationwide.

Lagos, Abuja, Port Harcourt, and Benin City experienced social unrest related to societal frustration concerning policy, police brutality, and corruption. Protests led to violent clashes between civilians and police, resulting in 80 deaths and significant business disruption. The government has since enacted a strict policy on protest activity through banning and arresting protesters, in addition to freezing several bank accounts and assets. Popular frustration is likely to persist, mandating that the government dedicate more resources to impending protests in the coming months. The societal discord, requiring a governmental response, would only serve to create a vacuum of resources which militants in the north can seek to exploit further through illicit activity. Such growing inequalities between the north and the south pose long-term political risks.

Nigeria maintains an acute risk exposure to carbon transition due to its reliance on oil, which comprises over 80% of the country's export portfolio. Additionally, the risks tied to water scarcity and the country's physical geography remain high, as a significant portion of the populace is exposed to unsafe water, as a result of poor waste management and pollution.Nigeria has also been afflicted economically as a consequence of the pandemic, primarily due to the volatile oil prices of 2020, serving to stress the low revenue base of the country. Over the last five years, this has constantly remained below 10% of GDP, which — combined with an extremely high debt/revenue ratio and low tax revenues from non-oil sectors — further indicates that the government is heavily compromised in its endeavors to gather revenue. The pandemic and oil price changes of 2020 also increased government debt to around 30 percentage points of GDP last year, with the scope of this substantially unlikely to be attenuated over the medium-term outlook.

12| Chile: Environmental concerns drive increased risk exposure for contracts.



Source: *Marsh Specialty World Risk Review*

CHILE

Chile is experiencing a new cycle of protests over environmental issues — potentially impacting business continuity for the country's vital mining sector as well as the outcome of government elections.

Some 60% of Chile's population live in a permanently water-scarce macro-zone that stretches for 2,000 kilometers. In recent years, water availability has dropped in the south and central-north macro-zones by 20% and 50%, respectively, and glaciers have shrunk by 8% in the last decade.

Large plantations, as well as lithium and copper production, are water-intensive industries increasingly targeted by civil society. The drying-up of water sources for rural drinking water systems and subsistence farmers in the Valparaiso Region stands in stark contrast to the green avocado plantations on the hills, irrigated by deep wells.

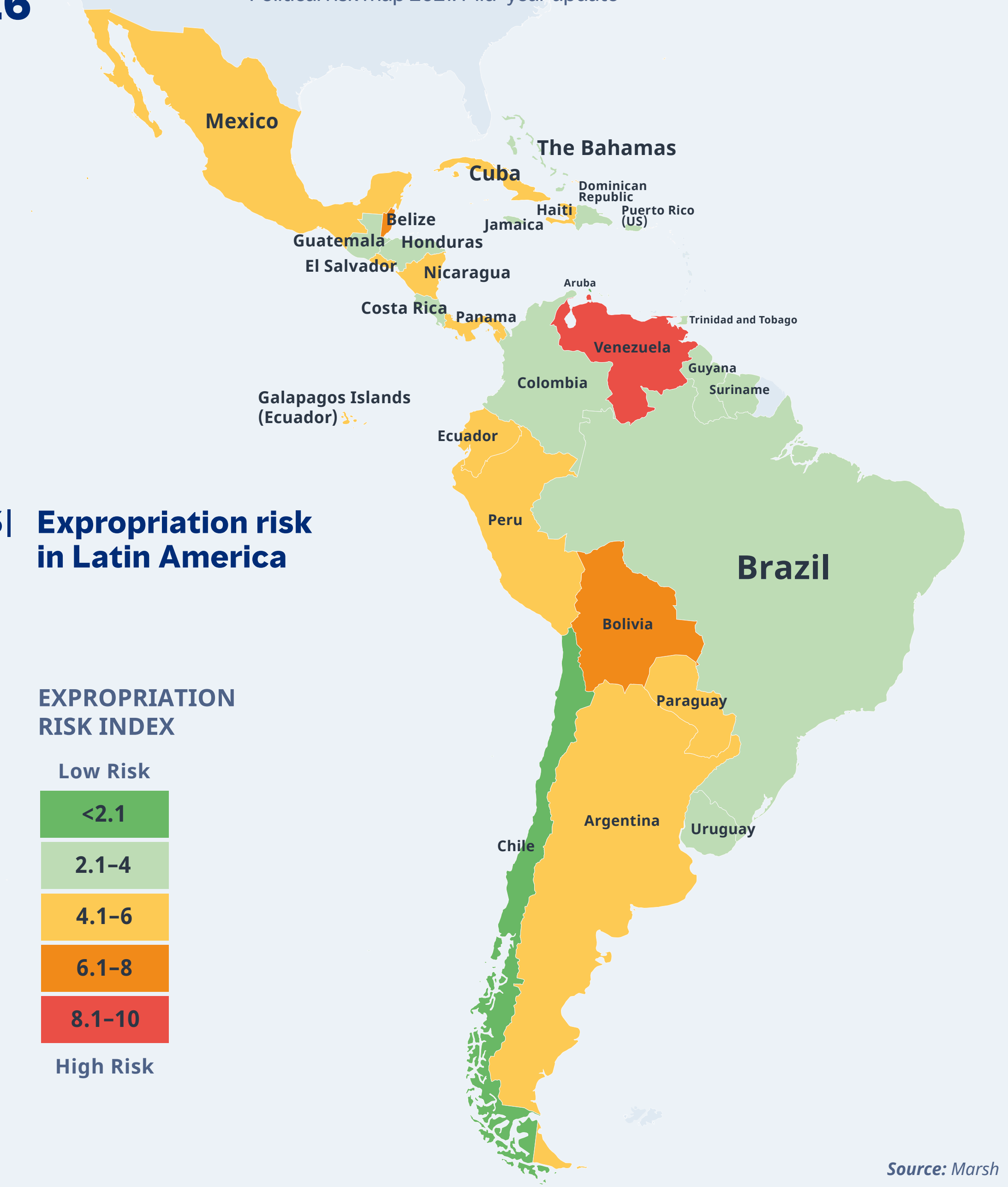
In 2018, the government paid to buy back water-use rights from private holders in the town of Petorca to give to local water services. The buy-back indicated some willingness on the part of the authorities to play a more active role in balancing private interests and those of local populations, in a country with a constitution that underscores water rights as private property.

Host indigenous communities are also fighting in court against long-term plans for the expansion of lithium production from the Salar de Atacama, since the extraction of lithium-containing brine from the salt flat is affecting the fragile ecosystem and associated water table. Australian resources company BHP announced in February 2020 that it would stop water extraction from the same salar for its Escondida copper mine, after opposition from indigenous communities. The use of desalinated water by the mining industry is forecast to rise 1.5 times through 2030 to almost half of total water consumption, compared to just one-quarter today. This will represent a significant added cost for miners.

Environmental developments may be accompanied by a political pluralism not seen for a long time and policy uncertainty. In a preview of the general election scheduled for November 2021, the consultations for the constitutional convention and regional governors in May and June 2021 saw a major rebuke of traditional parties, with President Sebastián Piñera's coalition, Chile Vamos, winning just one governor's post out of 16. This is the first time governors have been elected by popular vote instead of being appointed by the president.

The new authorities took office in July, starting terms that will last four years, with the possibility of one consecutive reelection. Policy discontinuity and changes in secondary legislation are likely, although newly elected governors have limited powers and are not entitled to review contracts or grant concessions, according to current law.

13| Expropriation risk in Latin America



Source: *Marsh*

This past May, key mining regions Antofagasta and Atacama chose independent gubernatorial candidates, Ricardo Díaz and Miguel Vargas, respectively. Major mines located in that area include BHP's Escondida, the world's largest copper mine, and Codelco's Chuquicamata. Both new governors are endorsed by left-wing parties, and advocate sustainable mining and protection of natural resources — in particular, water resources. Even though they will have no power to review contracts or cancel concessions, they are likely to become vocal against mega-mining activity, if this is considered to be damaging to the environment or water. This increases the likelihood of challenges in court or popular opposition against projects.

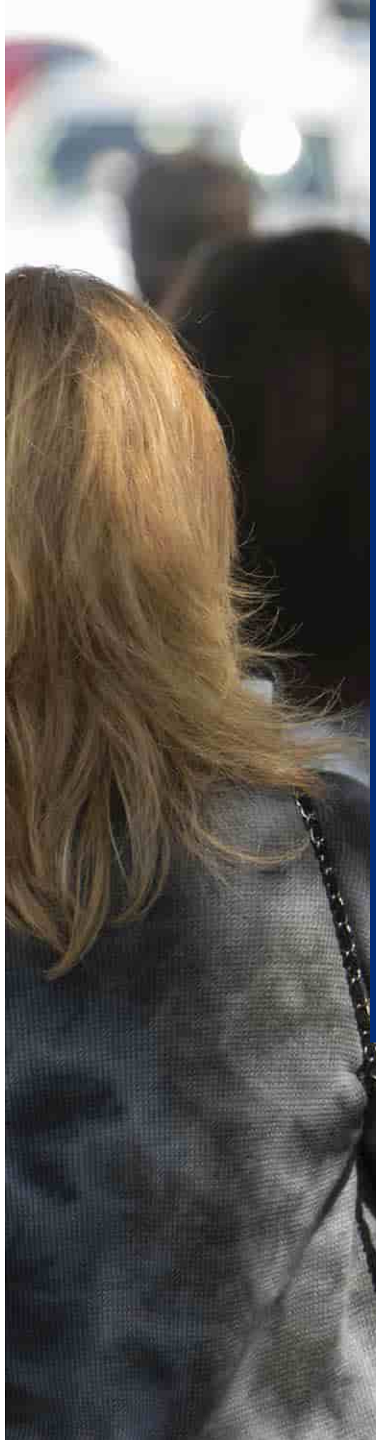
Even more strikingly, the constitutional convention election in May displayed a rejection not only of the center-right government of President Piñera but also of the political establishment in general, with a mere 43% turnout. Moreover, these results suggest that Chile's next president may not come from either of the two coalitions that have dominated national politics since 1990.

The single largest block of seats — totaling 48 — in the constitutional convention went to left-leaning candidates who ran as independents. The current center-right government coalition obtained just 37 seats out of 155, followed by an alliance between the Communist Party and the Frente Amplio coalition, which secured 28 seats. This center-left coalition that has governed Chile for much of the past 30 years ended up in fourth place, with only 25 seats. The changing balance suggests that privately held water-use rights may come under scrutiny, and stricter regulations and margins for extractive businesses could be introduced.

The political system is showing signals of transition towards diversity and environmental, social, and governmental (ESG) sustainability. A previous electoral reform increased representation within the constitutional convention. Chile's 10 indigenous groups (around 13% of the population), which were not recognized in the 1980 constitution and did not have representation in Congress, were granted 17 reserved seats in the convention, therefore entitling representatives to a national deliberative role for the first time. This presence reinforces the feeling that a reorientation of the convention agenda towards increased environmental protection, regulations, and state control is likely.

Feminist movements also played an important role in the 2019 protests and, thanks to a parity law, half of the convention's delegates are women, as compared to 23% of the Lower House and 28% of the Senate. A gradual transition is also signaled through sovereign bond issuances, with the government being the most active sovereign ESG issuer in the Americas, with four consecutive issuances in the first half of 2021. Through the first half of 2021, ESG debt constituted 16.6% of Chile's outstanding debt stock.

Between the recent elections and those due in November, Congress is expected to examine several bills that could redistribute money and affect the mining sector. The bills include additional royalties on copper sales, aiming to attract a larger share of price rises to pay for social programs, and limitations over mine operations near glaciers. The latter may put at risk 40% of copper output in these areas, according to the national mining company, Codelco. Furthermore, several key agreements on extractive activities run through 2023 and will likely be reviewed by the next government.



LATIN AMERICA AND THE CRUCIAL 18 MONTHS AHEAD

For more detailed update on the current political landscape in the Latin American region, check this 8-minute video.

6

Managing political and credit risks

Across all countries, the immediate consequences of the pandemic are still unfolding and may have long-term implications. Prior to this, some political and economic risks were unknown to many exporting companies, investors, and risk managers.

Insurance-backed political risk and credit solutions can help to secure trade and investment capital, protect balance sheets, and enable growth that will fuel and sustain the recovery from COVID-19.The potential benefits of political risk, credit insurance, and surety solutions include:

- **Supply chain resilience.** Trade credit coverage can strengthen global supply chains, helping key suppliers through improved payment terms.
- **Optimization of working capital and improvement of key financial ratios.** Trade credit insurance can support accounts receivable purchase programs, improving liquidity in hard economic times.
- **Collateral replacement for corporate clients.** Commercial and bank surety can replace cash and/or letters of credit used as collateral, releasing capacity to fund growth.
- **Bank portfolio risk distribution.** Political risk and trade credit solutions can assist many international banks in managing their portfolio risks, and avoid concentrations of risk in certain classes and countries.
- **Safety belts for investment.** Political risk insurance can secure infrastructure and other direct investments in volatile emerging markets, while facilitating bank lending, even when sovereign credit is downgraded.
- **Facilitation of long-term capital raising.** Political risk and credit insurance can serve as a bridge to future financing by enabling projects to go forward and their investors to realize their objectives. Establishing a track record of delivering value while mitigating risk can enable project owners to access additional capital for sustainable growth.
- **Mitigation of contract repudiation.** Political risk insurance can provide protection on contracts for the supply of goods or services for companies negotiating with government or private entities in emerging countries that are often exposed to a number of underlying political risks.

A variety of tools exist to manage political and credit risk, from both public and private sources. In addition to government-backed export credit agencies and multilateral organizations, a robust private political risk insurance market has developed to help investors and businesses weather political and economic crises. Solutions to protect against nonpayment risks, improve supply chain resilience, and protect people and assets in various countries can involve public programs, private insurance, or a combination of both.

Surety, political risk, and credit insurance products are widely available to meet risk management needs in many scenarios. Often, such protection is critical in enabling investment projects to proceed.

For more information on how we can help your business, please contact us at creditspecialties@marsh.com for a confidential discussion.

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