Marsh

Marsh Specialty

Political risk map 2021

Pandemic Recovery Complicates Risks

April 2021

Contents

Executive summary

After heightening economic risk in 2020, the COVID-19 pandemic will remain a looming challenge as the global economy seeks to recover in 2021.

COVID-19 has widened the divide between rich and poor, setting some countries back decades in their efforts to reduce poverty. Food security, water access, and energy costs remain acute pressures that can lead to growing nationalism and civil unrest. Societal inequality, meanwhile, will factor in electoral platforms, especially in middle- and low-income countries.

Against this backdrop, many governments have implemented fiscal and monetary policies to fuel a recovery. Marsh Specialty's *Political Risk Map 2021* shows larger increases than ever in country economic risk across all regions, driven by increases in deficit spending, adding to sovereign and commercial credit risks in less developed economies. Key themes include:

- Growth inequality between rich and poor nations.
- A continuing increase in economic risks for all countries, with additional impact on sovereign credit risk, currency risk and commercial risk.
- A rise in nationalism and its impact on strategic resources, including energy, food, technology, and water or other inputs to key national industries.

Our analysis projects a growing disparity between emerging economies and industrialized nations. Strains on public financing in emerging markets will result from increases in sovereign indebtedness and may create unfavorable conditions for domestic and foreign-owned businesses.

China's early emergence from the pandemic combined with the unprecedentedly large stimulus measures by the EU and US are widely expected to generate a near-term economic boost. This effect should benefit certain countries, including oil exporters, but the impact may be transitory and only delay a reckoning with social inequalities, unsustainable debt, and the energy sector's green transition.

Nationalism is on the rise as governments fight for strategic resources. Whether in the form of mineral resources, vaccines and other medicines, secure supply chains, advanced technologies, or trade routes, these resources are all vital to economic recovery and political competition in an increasingly multipolar world.

The pandemic response adds a new weapon to the political arsenal of competing powers: vaccine diplomacy. Nations seeking influence are offering access to the vaccines as a bargaining chip with allies and trading partners. While COVID-19 responses obscured long-simmering geopolitical tensions in 2020, older tensions are expected to resurface as the pandemic comes under control and governments relax lockdowns, removing restraints that prevented outright interstate conflict.

Marsh Specialty's *Political Risk Map* highlights the risk by region and profiles nine countries based on nine crucial risks. Although the pandemic has intensified the risk outlook, there are still opportunities for corporate entities, financiers, and investors. Insurance-backed political risk and credit solutions can help to secure trade and investment capital, unlock liquidity, and enable growth to fuel and sustain recovery.

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.

Introduction

The pandemic that heightened country economic risk for every nation in 2020 will continue to amplify political and economic challenges in 2021, as countries strive to recover amid a dramatically changing environment.

Country economic risk, like a pandemic, tends to be contagious and spread into sovereign credit risk, currency risk, and commercial risk. COVID-19 has widened the divide between rich and poor, setting some countries back decades in their efforts to reduce poverty. The ***World Bank*** estimates that globally an additional 88 million to 115 million people fell into extreme poverty in 2020, a number that could rise to 150 million in 2021.[1]

Across multiple regions, food security, water access, and energy costs remain acute pressures that can lead to flashpoints of civil unrest. These pressures may also lead to a rise in nationalism and impact strategic resources. Government policies to address societal inequality will have a more prominent place in electoral platforms on both the left and the right, especially in middle- and low-income countries for decades to come.

Against this backdrop, many governments have quickly implemented fiscal and monetary policies to fuel a recovery. Marsh Specialty's *Political Risk Map 2021* shows larger increases than ever before in country economic risk across all regions, driven by increases in deficit spending, adding to sovereign and commercial credit risks in the less developed economies of the world.

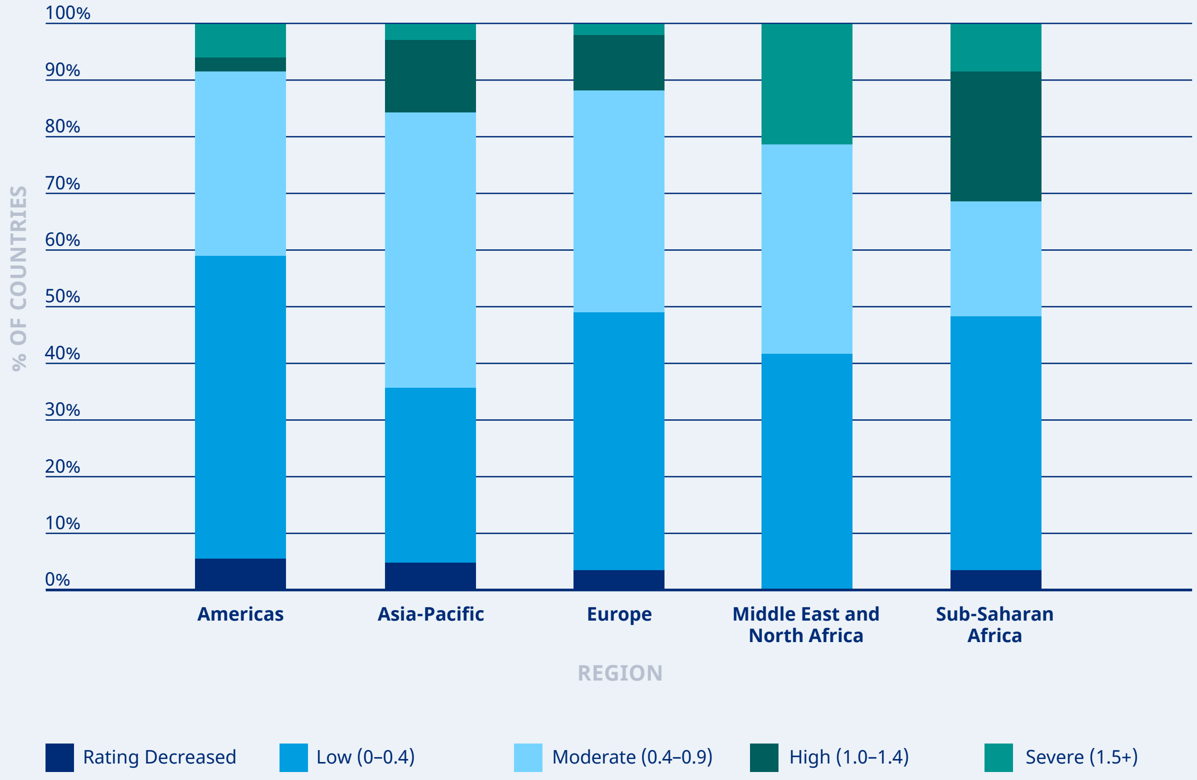
Our analysis projects a growing disparity between emerging economies and industrialized nations, with the latter enjoying the benefits of high levels of government support and low borrowing costs (Figure 1). Strains on public financing in emerging markets will result from increases in sovereign indebtedness and may create unfavorable conditions for domestic and foreign-owned businesses.

China's early emergence from the pandemic — and the unleashing of pent-up consumer demand globally — combined with the tail winds created by the passage of unprecedentedly large stimulus measures by the EU and the US are widely expected to generate a near-term, strong economic boost. While this effect should benefit certain nations (such as oil exporters), the impact may be transitory and will possibly only delay a reckoning with social inequalities, unsustainable debt fundamentals, and the green transition that is inexorably transforming the global energy landscape.

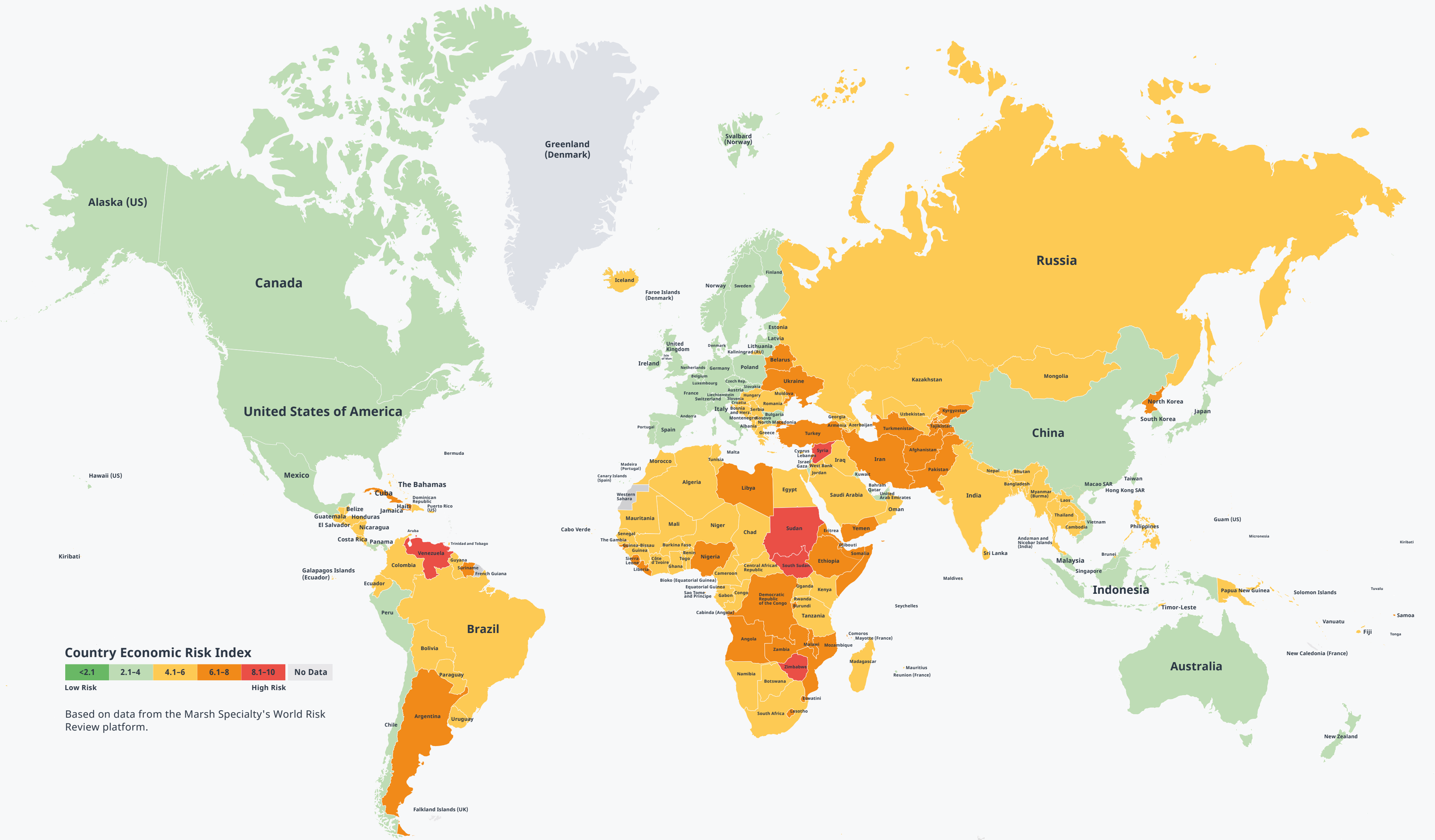
Nationalism is on the rise in both political and economic spheres as governments compete for strategic resources. Whether they come in the form of mineral resources, vaccines and other medicines, secure supply chains, advanced technologies, or trade routes, these resources are all vital to economic recovery and political competition in an increasingly multipolar world.

The global response to COVID-19 is a case in point, adding a new weapon to the political arsenal of competing powers in the form of vaccine diplomacy. As they vie to develop and distribute COVID-19 vaccines, nations seeking influence are offering access to the vaccines as a bargaining chip with allies and trading partners. While COVID-19 responses obscured long-simmering geopolitical tensions in 2020, older tensions are expected to resurface as the pandemic comes under control and governments relax lockdowns, removing restraints that prevented outright interstate conflict.

01| Country economic risk rating increases from January 2020 to January 2021 varied by region.



Source: *Marsh Specialty World Risk Review*



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

POLITICAL RISK MAP 2021

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.

3 Regions

Americas

In 2020, governments in the Americas focused on healthcare responses to the pandemic; 2021 will be about economic response and recovery.

From politicians dining out during lockdowns to substantial differences in mortality rates between racial and ethnic groups in many countries, average citizens are conscious of being asked to make sacrifices that those with wealth and power can avoid. Governments must carefully navigate increases in taxes and cuts in welfare benefits in the next year.

Protests and unrest frequently stem from inequality. In 2019, massive protests in Chile started because of a hike in transportation costs, but what sustained the unrest was the demand to address social inequities.

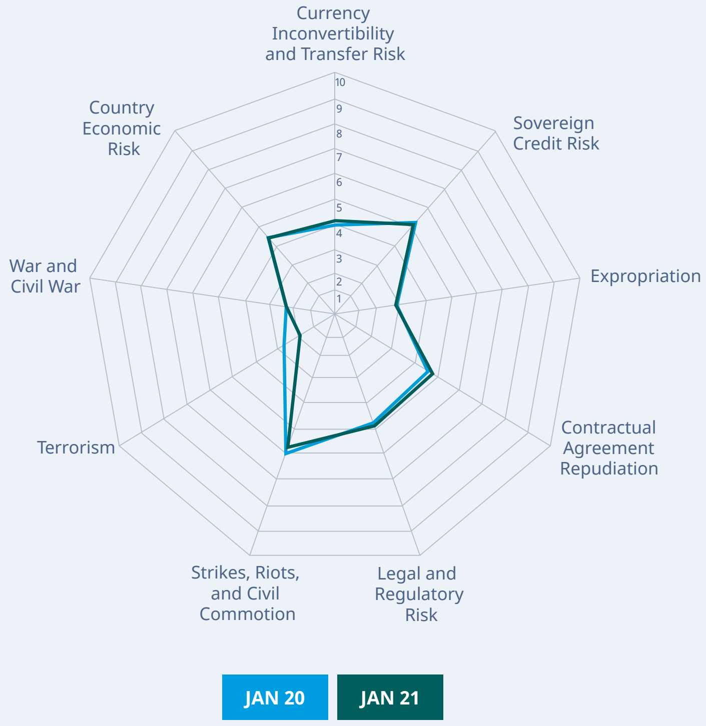
In Latin America, food security issues are contributing to increased political risk. The issue is not food production but purchasing power, which could be a flashpoint in the future for strikes, riots, and other types of civil disturbances. One consequence of such issues: Sovereign debt is less likely to be repaid, as populist pressures may cause Latin American governments to prioritize economic relief over repayment of foreign debts.

One of the keys to economic recovery in the Americas, and other regions, is the rollout of COVID-19 vaccines. With the United States leading the way in vaccine development — and aggressively distributing doses in 2021 — the phenomenon of "vaccine diplomacy" has emerged. The US, Japan, India, and Australia have ratified an agreement which will supply COVID-19 vaccines across Asia by the close of 2022. This may serve to contain China's growing influence regionally, as the Biden administration seeks to consolidate on shared democratic values across Asia while maintaining cooperation across security and cyber threats with Asia-Pacific partners. Lessening the reliance on China in Asia-Pacific could see important parts of China's grand strategy compromised.

A global rebound in commodity prices should give respite to Latin American resource-based economies in 2021, though the main driver of that being growth in China is not expected to reach pre-pandemic levels. Here again, the new US administration will have an opportunity to reassert American foreign and economic policy where the Chinese have displaced the US almost everywhere as Latin America's predominant trading partner.

In addition to the US, several Latin American nations have transfers of power in 2021. Argentina and Mexico face midterm elections in which political leaders may lean toward domestic spending instead of taking up much-needed fiscal reforms. Historically, politics in Latin America have swung like a pendulum — veering to the far left, then overcorrecting to the far right, and back again. The combination of the pandemic, uncertainty regarding vaccines, the absence of structural reforms, and other factors makes for an unpredictable political environment.

02| Terrorism risk declined in Brazil while other risks generally remained stable.



Source: *Marsh Specialty World Risk Review*

BRAZIL

A poorly coordinated response to COVID-19 has left Brazil with the world's second-highest number of cases and another surge is now underway. Dissatisfaction with the current Brazilian government over its pandemic response and high cost-of-living increases fuel the risk of unrest and supply chain disruptions in multiple industries. It is therefore not surprising that riots, strikes, and civil commotion remain Brazil's highest risk.

In February 2021, the government replaced the head of the state-owned oil company Petrobras after criticizing the company's high fuel prices as the government could not afford a paralyzing strike by the nations' truckers — the main mode of business transport in the country. The government also has tentative plans to intervene in Brazil's electricity sector, a trend that may continue as the government strives to improve chances of reelection (an eerie echo of developments underway in left-leaning Mexico). The government's moves are stoking investor fears of a return to government state intervention.

Brazil's current government is seeking reelection in 2022, but that is far from assured, as party popularity is slumping. To boost its chances, the party is trying to push through another round of cash transfers to the nation's poorest, threatening to raise sovereign credit risk even higher.

Despite its struggles with the pandemic, Brazil's economic performance appears to be rebounding. Once the economy stabilizes, the country may attract more foreign investment and open opportunities for further development. Brazil has made reforms to its pension system, which should help make it more sustainable, and has eased regulations on private ownership of key infrastructure, such as airports, highways, and railways. Trade protectionism, however, remains high.

MEXICO

COVID-19 will heavily influence Mexico's political and economic outlook in 2021. Economic recovery from the pandemic got a late start, with the government providing modest relief to the business sector only in the past few months. Austerity measures, a 15% increase in the minimum wage, and a plan to tax larger corporations are likely to create difficult operating conditions for businesses operating in Mexico.

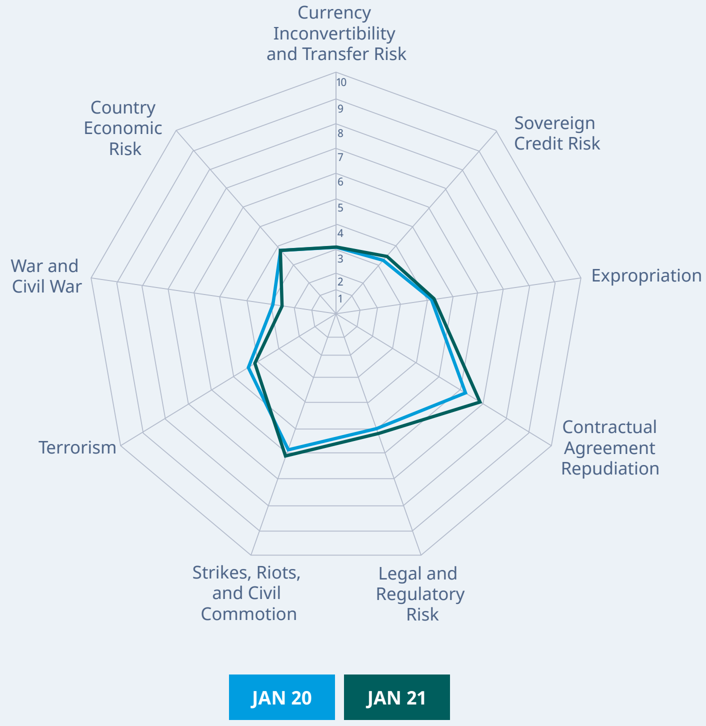
Polls show approval ratings for the current administration dropping steadily since peaking in the first quarter of 2019 at nearly 80%. As of December 2020, 61% of Mexicans approved of the government's performance. Midterm elections in 2021 may weaken the control of the majority party, potentially prolonging Mexico's pandemic recovery and hurting its ability to combat systemic issues such as organized crime and corruption. Competition and conflict among organized crime groups, particularly over drug-trafficking routes, may lead to more extortion, theft, kidnappings, and attacks on businesses.

Mexico's WRR ratings show a sharp increase in its risk of contract agreement repudiation, to 6.9 from 6.3 in January 2020 as the current administration has expressed a clear preference for state-owned enterprises. This preference was evident between June and September 2020 as the government consistently terminated contracts on renewable projects involving foreign and private investment that drew upon state energy resources.

The possibility of a rollback of Mexico's energy reforms — which were enacted under previous administrations and enabled significant foreign and private investment in the country's oil and gas and power generation sectors — remains a threat. With a plethora of regulations for private companies to adhere to, Mexico has one of the highest regulatory burdens in the world.

Another factor in the country's economic recovery is its reliance on the US, which accounts for 83% of exports. As a result, Mexico's growth largely mirrors that of its biggest trading partner. Recovery in the US will help boost prospects in Mexico especially as the US-Mexico-Canada agreement, which ensures tariff-free access to the US market, bears fruit.

03| Contractual agreement repudiation risk saw the steepest increase and remains the biggest risk for Mexico.



Source: *Marsh Specialty World Risk Review*

Asia-Pacific

Many countries in Asia-Pacific were adversely impacted in 2020. Particularly hard-hit were economies heavily dependent on textile and automotive supply industries.

According to the IMF's World Economic Outlook, regional growth for emerging market and developing economies in Asia and the Pacific contracted 1.1% in 2020 as the Asia-based workshops of the world sat idle.

Fears of reshoring due to COVID-19 have yet to come to fruition, despite economies and multinationals seeking to create more resilient supply chain mechanisms. Many car manufacturers and producers of physical goods are now building up inventories, driving up shipping rates and inflation. Some companies are adopting a China-plus-one strategy to bring more resilience and diversity to supply chains. Vietnam, with its low COVID-19 rates and open trade links, has been a big beneficiary, taking market share from China and other Asian rivals hit hard by the pandemic.

Asia-Pacific will serve as the theater of continued geopolitical tensions between the two largest populations on Earth. The China-India rivalry is anticipated to intensify over the coming years, as India's population overtakes China's — fueling resource competition and threats to supply chains vital to both. Over 70% of India's trade value and 90% of its volume is linked to maritime exports. China's Belt and Road Initiative has become a crucial facet of foreign policy for Beijing, demonstrated by the docking rights, ports, and bases it has secured along the Arabian Sea and Indian Ocean, stretching from Djibouti to Sri Lanka.

Strategic collaborations with international partners seeking to forge an economic coalition against China will be key for India. The Malacca Strait — one of the busiest shipping channels in the world, as the primary route between the Pacific and Indian Oceans — will become more vital for economic recovery in Asia-Pacific. This importance is underscored for China, as 80% of its hydrocarbon imports arrive via the strait. India's plan for military expansion on the Malay archipelago will supplement its regional power projection, while adding to the risks that balance against China's ambition of regional hegemony. The infrastructure plan is anticipated to be completed within the next 10 years, which should also strengthen India's position in the Quadrilateral Security Dialogue (QSD). A militarized archipelago may trigger an arms race.

Climate change, alongside industrialization and urbanization, threaten water security across South and Southeast Asia. As China rolls out its hydropower policy for Tibet, water scarcity will become a genuine policy issue for the downstream nations over the medium to long term. This development and other factors will likely exacerbate the stress on water security. By 2025, the United Nations predicts water scarcity will affect 1.8 billion people, with Asia acutely impacted by water stress or outright shortages. China's control over Tibet places it in a dominant position to control Asia's water sources. This leverage may be exerted to steer the foreign policies of smaller neighbors over the coming years.

04| China has continued to see rising risk of civil war and unrest.

***Source:** Marsh Specialty World Risk Review*

CHINA

Following a collapse in first-quarter 2020, economic activity in China has normalized faster than expected. Effective pandemic control, strong policy support from Beijing, and resilient exports have helped. Even as early as the second quarter of 2020, China saw a rebound in exports, due to strong demand for personal protective equipment, medical supplies, and electronic goods in response to increased remote working arrangements adopted globally.

A key to global economic activity is trade with China, and the slowing of China's economic engine is causing problems for its trading partners. As of December 2020, China fell well short of targets in its ***Phase One trade agreement*** with the United States, in which China agreed to buy more US goods and services in 2020 and 2021.[2] It remains to be seen how US-China trade will play out under a new US administration, but early signs suggest a continued tough stance by the US to contain its formidable rival. In the meantime, China continues to invest in commodity partnerships in Latin America and Africa to shore up its access to strategic resources. Such resources are necessary for China to maintain its dominance in global manufacturing, as well as pursue its ambitious Belt and Road infrastructure development vision. Pre-COVID-19 geopolitical tensions, most notably persistent bilateral frictions with main trading partners over trade and technology, will pose continued risks to China's sustained recovery and its growth prospects.

While Beijing is increasing the value of Chinese firms, their Taiwanese counterparts have stagnated. China has become a semiconductor producer and consumer, forming a vital component of Taiwan's semiconductor export-led industry. Reducing the chasm in terms of technology has been a longstanding ambition for Beijing. Exploration of semiconductor manufacturing had been stifled by legislative action from both the US and Taiwan, which prevented the export of advanced semiconductor technology. Through extensive public financing, supplemented with the licensing of processing technology from external sources, China is trending toward capabilities that were classically unique to Taiwan. Domestic companies in China currently supply 10% of China's semiconductor needs, indicating the scale of potential loss for foreign chip makers when China eventually acquires the knowledge to roll out domestic production of its own chips.

Taiwan is likely to be a primary beneficiary of an increased adherence to the China-plus-one strategy globally, as it is an ***eminent producer*** of electronics and semiconductors.[3] Taiwan hosts the largest chip-making company in the world, though it is likely the government will increase efforts with the "Invest Taiwan" strategy, further making Taiwan a lucrative base for companies with operations in mainland China. Rising tensions with China in this regard may well result in the Tsai administration decoupling its economy from China.

Looking closely at the political and commercial risk angles, the new security law, alongside the trade war and accusations of human rights infringements in Xinjiang all served to increase multiple risk perils for China, indicative in the relatively high scores for contract agreement repudiation, at 5.5; expropriation, at 5.1; and strikes, riots, and civil commotion, at 5.0. The risk of war and civil war has increased, to 3.5 from 2 on the WRR for China, principally due to the social unrest in Hong Kong and flaring tensions with Taiwan.

China has spent seven decades damming most of the Tibetan Plateau's waterways, displacing over 23 million people in the process. This heavy economic commitment has enabled the hydropower sector to grow twentyfold over the last four decades. As urbanization and industrialization rates rise in China, so too is the need for renewable energy. As such, state-owned companies are lobbying Beijing to permit hydropower ventures in Tibet, with 28 projects currently awaiting approval.

As China has approved three new projects on the Brahmaputra, India has raised concerns regarding the flow of water. As these dams become operational, the altered water flow is anticipated to damage agriculture and ecology and disrupt the lives of 1.3 billion people in downstream India and Bangladesh. Legally, there is no official agreement between China and any of the downstream countries over the use of shared river systems. However, new legislation to govern the transboundary Tibetan rivers has a low chance of coming to fruition as China will likely prioritize economic recovery and the ASEAN trade agreement over some strategic resources.

VIETNAM

Vietnam has managed to blunt the pandemic's impact, with the World Bank estimating that its GDP expanded by 2.8% in 2020. This was supported by a quick and sustained resumption of production and exports and supplemented by additional boosts from stimulus-fueled public investments and resilient foreign direct investments.

With the exception of 2020, Vietnam's economy posted 6% growth or higher every year since 2012 on the back of its manufacturing sector along with increased domestic spending. Widely seen as a growing global factory and supply chain alternative to China, Vietnam forecasts economic growth of 6.5% in 2021 — the same growth pattern experienced before the pandemic.

Vietnam has benefited greatly from its open door trade policy through participation in three key alliances. November 2020 saw the country sign the Regional Comprehensive Economic Partnership (RCEP), alongside 14 other Asian countries. The ratifying of the deal forms the largest trade agreement globally, with a consumer market of 2.2 billion and aggregated GDP value of US$26.2 trillion. This will serve to improve trade in Asia, as there are numerous free trade agreements between RCEP members that precede the new partnership. RCEP will double down on the preexisting agreements, while unifying supply chains as "rules of origin" provisions are expanded.

As a result, Vietnam should be able to liberalize its economy at a slower rate than other members of RCEP, while complying with trade facilitation, trade in commodities and services, and regulations concerned with investment. The disruption to supply chains as a result of the COVID-19 pandemic only hastened the need to ratify this pact. China's membership also indicates progress related to maritime disputes in the South China Sea and that trade and the economy is central to policy prescription from Beijing, with sea-based territorial disputes with Vietnam attenuating as a result.

Vietnam's WRR ratings have remained generally stable, but the risk of contract agreement repudiation has risen by more than 50% in the last 12 months. A key reason was a request by the country's Ministry of Defense in mid-2020 for a review of all foreign investments; the ministry is investigating whether a land acquisition involving Chinese investors may have violated Vietnamese laws. Joint ventures involving foreign investors are likely to face disruptions and contract amendments, particularly if they are located near military and naval bases.

A more positive development was the National Assembly's June 2020 ratification of the Law on Public-Private Partnerships (PPPs). This makes evident the government's aspiration to increase foreign investment in infrastructure, and is the first attempt to directly address this issue through precise legislative action. Estimates from the Asian Development Bank indicate Vietnam requires US$480 billion by 2030 in order to finance the growth of infrastructure in energy, roads, and water. PPPs will offer transparency and stability within the legal framework concerning PPP investment.

05| Contractual agreement repudiation risk rose more than 50% in Vietnam.

Source: *Marsh Specialty World Risk Review*

Europe

The pandemic has increased economic and social uncertainty in Europe, pushing EU leaders to approve €1.8 trillion in financial aid to rebuild a post-COVID-19 Europe.

On an individual country level, governments are under pressure to continue fiscal policies of extending financial support for severely affected industries, such as hospitality, airlines, retail, and small to midsize enterprises.

While Europe's developed economies can absorb rising debt amid ultra-low interest rates, sovereign credit risk is on the rise. Debt servicing and raising funds will be a key concern, as cutting or raising taxes will likely slow the recovery and stimulate political backlash. However, high public debt also means crowding out private debt and limiting financing opportunities.

European fiscal policy remains prominent during the pandemic recovery, but the monetary policy of central banks must continue to support the public and private sectors until the economic recovery is complete. This calls for another year of close cooperation between fiscal and monetary authorities. Financial institutions can be expected to shift their focus, from raising liquidity in order to meet short-term capital requirements to mitigating and managing credit risk on their obligors.

The EU's relationship with the US fundamentally changed during the past four years. Historically, the EU relied on American leadership in global affairs. But the previous US administration's policies and COVID-19 have exposed EU dependencies on supply chains for critical products and forced Europe to reevaluate the fragility of the single market, pivoting to protect employment and industries. In 2021, Europe can look to attempting a leading role in the international community. Since a new European Commission took office in 2019, it has committed to creating a stronger Europe by being ambitious, strategic, and assertive globally; it remains to be seen if internal resistance to this idea can be overcome.

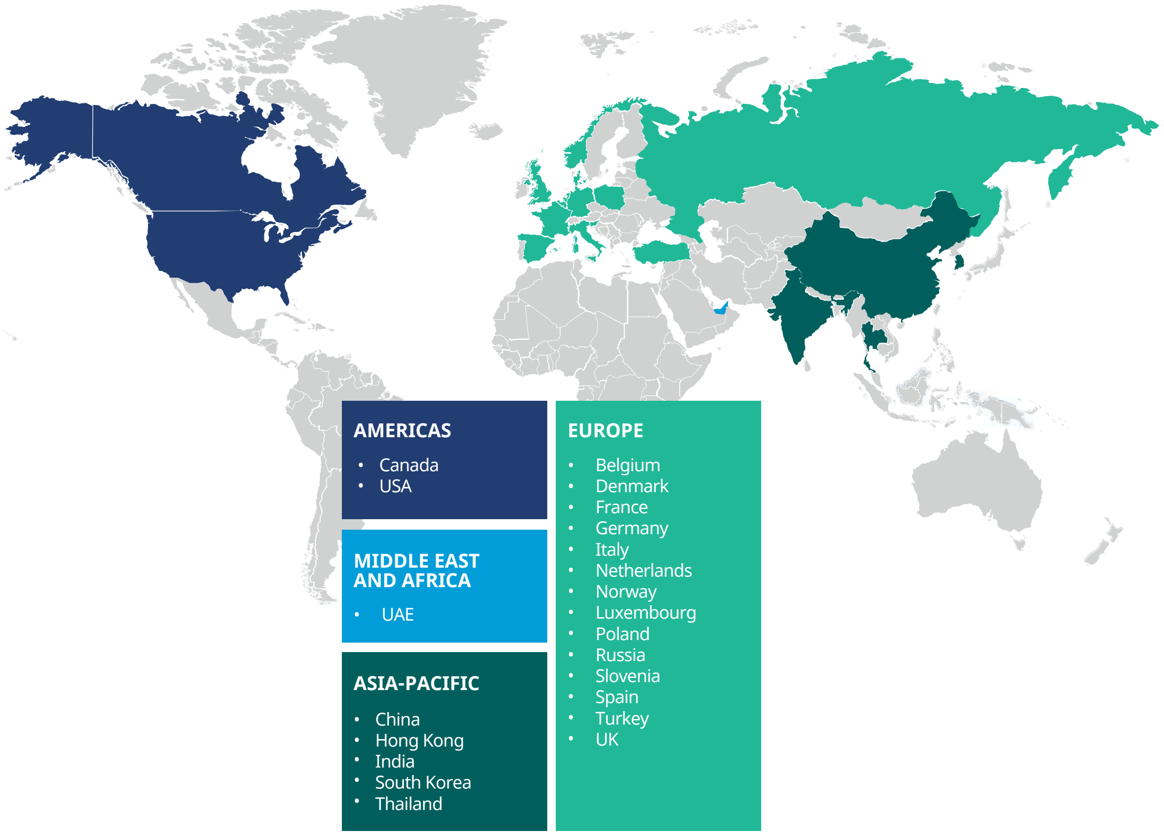
Throughout 2021, the EU can be expected to sharpen policies and regulation to rebuild a post-COVID-19 Europe that is more open, strategic, and autonomous politically and economically. This will likely include a review of trade and investment policies, as well as a new industrial strategy focused on green and digital capabilities. In addition, the EU will likely seek to balance the need for strategic supply resilience while remaining competitive and open to multilateral trade with foreign parties. Policies will focus on leveling the playing field for European companies at home and abroad, reinforcing action against unfair trade practices and producing critical goods in Europe and reducing dependency on non-EU supply chains.

One area where the EU is likely to implement this approach is in Europe's relationship with China. The EU may seek to develop a common and coherent approach, as it recognizes China as a systemic rival and economic competitor but also as a cooperation partner. This will be challenging as individual EU member states have conflicting interests and approaches to their relationships with China.

Brexit and the Financial Services Agreement

Amid the pandemic uncertainty, a welcome development was the trade agreement between the UK and Europe, avoiding the economic collapse many analysts had forecast in the event of a no-deal Brexit scenario. However, the UK is leaving Europe with more trade and regulatory barriers than when it was a member. Short-term economic pain has been cushioned, but the long-term view is pessimistic: The UK Office of Budget Responsibility forecasts an average decrease of 4% in GDP. The UK and the EU have agreed a memorandum of understanding, which provides a framework for cooperation and a joint forum for the creation and implementation of financial market regulations, in addition to the sharing of information; it is a series of unilateral rulings that either the UK or EU can make, offering market access to financial services. 2021 will be a crucial year for EU-UK relations, as both sides continue to define access to markets and the level of regulatory divergence.

06| More than 20 countries had enacted support for credit insurance as of February 28, 2021.



State-backed schemes support trade credit

In an effort to provide economic relief during the pandemic, governments across the world established or amended state-backed trade credit programs in 2020 to support both export and domestic trade.

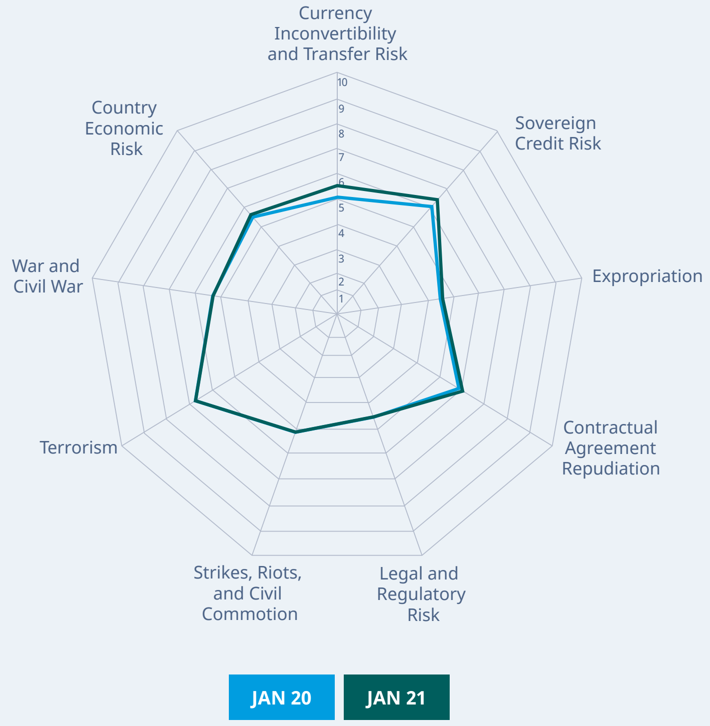
These schemes can take multiple shapes — some in the form of state reinsurance guarantees, and others relaxing eligibility requirements — but their overall effect has been similar: increased economic stability in conjunction with existing trade credit insurance. The European Commission, for example, expanded the eligibility of short-term export credit coverage by removing all countries from its list of marketable risk countries.

All state reinsurance guarantee schemes (which cover domestic as well as export receivables) have now been extended to June 30, 2021. Although the EU’s Temporary Framework for State Aid Measures now expires at the end of 2021, any extension to individual schemes beyond June 30 for EU countries would require approval by the national government responsible as well as the European Commission. Most schemes are not expected to be extended, but elections in Germany in September 2021 and in France in April 2022 may strongly influence decisions to extend relief.

Some observers have raised concerns that the pandemic stimulus and state-backed schemes are allowing “zombie companies” to keep operating. Zombie companies are unprofitable businesses with heavy debt burdens, usually low cash reserves, and an inability to invest or grow. Even before the pandemic, Europe and North America had numerous zombie companies, and their volume is likely to explode amid the impact of COVID-19. The number of bankruptcies plummeted during the global recession in 2020, a signal that pandemic relief may be propping up weak businesses. Extending loans and other support to keep zombie companies alive could prolong economic weakness and ultimately result in mass insolvencies.

In any event, governments’ temporary trade credit support will eventually end. This will require investors and exporters to find longer-term solutions for credit risks. It’s advisable to begin exploring those options sooner rather than nearer the end of state-backed schemes.

07| **Currency and sovereign credit risk increased for Turkey.**



Source: *Marsh Specialty World Risk Review*

TURKEY

2020 was a challenging year for Turkey, amid mounting opposition pressure from the government's mishandling of the pandemic, rising costs of living, high unemployment, plummeting household incomes, and a downward trend in the value of the Turkish lira, which lost about 30% of its value against the US dollar. The government managed to remain in power after appointing a new cabinet with pro-market reformists. However, market consensus predicts it will be a short-lived relief, as the administration's core constituent base are the main cost bearers of tighter fiscal policies.

Driven by the fallout from COVID-19, analysts expect a series of interest rate cuts in 2021 to ease monetary policy, increasing the likelihood of an economic crisis. However, on this occasion, world leaders are unlikely to come to Turkey's aid. Due to the growing scope of disenchantment in the Turkish population, the government may double down on nationalist rhetoric and foreign policy to placate them. The EU's position may become inflexible, primarily driven by the French president and his goal to enlist more member states to get tough with Turkey by pursuing sanctions, thereby raising the scope of diplomatic rupture. This could provoke Ankara to again open the gateway into Europe for refugees, as well as further agitation in the Mediterranean Sea, risking direct conflict.

2020 saw Turkey and Israel draft a maritime deal. Through delimitation of Turkey and Israel's maritime areas, while encroaching Cypriot waters, the border will represent a shared economic area connecting the coasts of Israel and Turkey. The Turkish maritime area will increase by 10,000 square kilometers, inclusive of the potential to access hydrocarbons. The agreement also sees Israel pivot its natural gas exports away from Cyprus, instead joining the preexisting Turkish pipelines. This will require infrastructure investment, despite the fiscal pressures brought by the pandemic.

Turkish-Israeli relations can potentially reach new strategic heights, though this presents an issue for Israel. Cyprus remains a close ally and is part of maritime agreements in line with international law. The current maritime border is internationally recognized, so annulling preexisting agreements to align with Turkey would increase political risk for Israel due to the diplomatic fallout. Likely condemnation from Greece and Cyprus, which would see their sovereignty encroached, could require the EU to engage on the issue.

Turkey's political risk ratings remain high in many areas of physical and economic security. Skeptical investors believe Turkey faces many deep political and economic issues that the government's new appointments and more market-friendly language will not solve, because it will continue to hold a tight grip on decision-making. Turkey needs international goodwill to reinvigorate its growth and will remain largely dependent on Western financing, despite Ankara's best efforts to find alternative funding sources.

RUSSIA

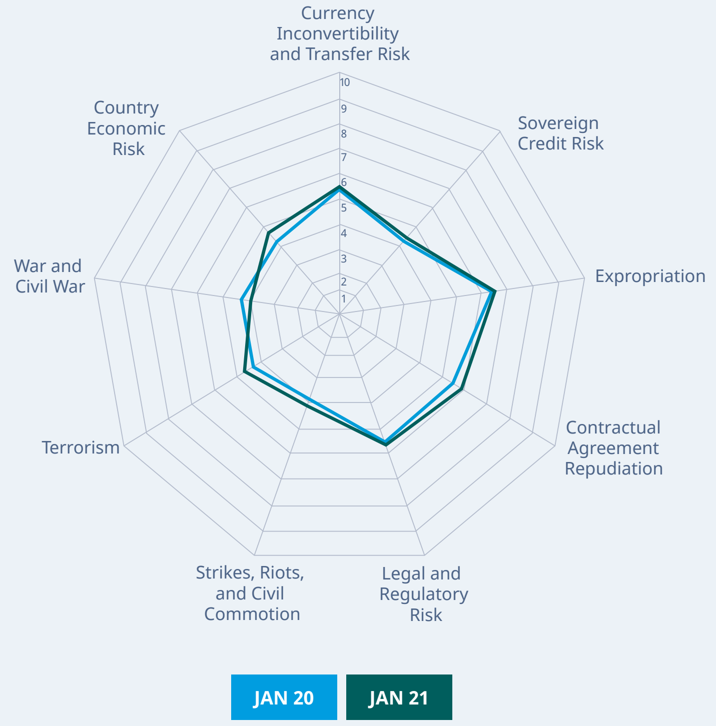
2020 was a volatile year for Russia, which was hit simultaneously with the collapse of oil prices, oil production cuts, the Russian ruble plunging to historical lows, and continuous trade sanctions imposed by Western governments. Russia's growth has been historically driven by resource extraction (especially oil and gas) and public infrastructure for national projects — both of which have come at the cost of economic activity being excessively dependent on such projects. However, the current-day cocktail of struggling with COVID-19, inherent structural weaknesses in the economy, low investment, and a weak demographic forecast has, and will continue to, put downward pressure on real GDP growth, which is not expected to exceed 2% per year in the medium term. Also, average Russian incomes have fallen over the past several years, producing a very different environment for a president whose popularity has waned.

Since late 2019, US lawmakers have signaled the potential for additional sanctions on Russia's sovereign debt, financial institutions, and energy projects, which could make Russia's position even more difficult. The new US administration could pass some of these proposed measures, considering that bipartisan support has been reinforced by recently alleged Russian cyberattacks on US institutions and by the authoritarian suppression of opposition groups in Russia (including the high-profile jailing of a presidential challenger).

The likelihood and timing of these bills is uncertain, and relies as much on the direction of Russia's own foreign policy as on political developments in the US — both hard to predict. Russia's strong balance sheet is expected to help it avoid a financial breakdown and should protect it from these vulnerabilities, including any geopolitical tensions that weigh on its medium-term outlook. Rising competition between Western countries emerging in a post-pandemic world may mean resources that were previously allocated to Russian containment are diverted elsewhere.

Russia has some geographical advantages with regard to climate change. Most of the Russian populace is based in the country's European half, far from the coastal areas. That Russia's political and economic hubs are mostly sheltered from severe damage caused by climate change is an advantage the Kremlin can seek to exploit, with the Arctic in particular holding great potential for Russia. Moderate estimates indicate that 13% of the world's untapped crude oil reserves, and 30% of natural gas reserves, are in the Arctic. The agricultural potential is also substantial — if realized, it will accelerate Russian ambitions to diversify the economy, trending away from the economic model of resource-reliant countries. As ice caps melt, the Northern Sea Route will become more accessible, extending from the Russian port of Murmansk to the Bering Strait in East Asia, serving as an alternative route for Chinese imports to enter Europe. The Arctic, therefore, has the potential to become a real flashpoint between these two nations.

08| Trade sanctions and a collapse in oil prices precipitated a stark increase in Russia's economic risk.



Source: *Marsh Specialty World Risk Review*

Middle East and North Africa

Continued conflicts, depressed oil prices, weak governance, and a slow response to the pandemic spell years of recovery for MENA countries.

Collapse of demand for energy and the corresponding effect on oil prices pose serious challenges for governments across the region. Economies such as Iraq rely heavily on oil to fund every aspect of government, and the possibility of poverty increasing is a real threat if oil prices fall further.

Low oil prices will have adverse effects on public debt dynamics and economic growth in all oil-exporting nations, but the consequences are not equal for the six Gulf Cooperation Council (GCC) states. Two in particular have potential trouble ahead: Bahrain and Oman. The break-even oil price for Saudi Arabia is US$76, but it is US$87 for Oman. With less support from the Gulf, Egypt, Jordan, and Lebanon are expected to become increasingly unstable as they contend with dissatisfied political bases.

Individual countries have responded to the pandemic with varying levels of authoritarian rule, but no major backlash has arisen. Most countries did well over the summer but are having trouble with a second wave of COVID-19. The GCC states are weathering the pandemic the best; these countries have well-funded healthcare systems, authoritarian rule, and ample cash reserves, at least in the short term.

With the reduced flow of funds from oil, Gulf nations — principally Saudi Arabia — are likely to reduce their security and financial support for countries such as Lebanon, Egypt, and Jordan, which can bring increasingly loud calls for action on security and employment opportunities. Israel and its neighbors are likely to increase their cooperation, but the conflict between Saudi Arabia and Iran has the potential to worsen still. Egypt may escalate conflict with its neighbors on the topic of water coverage concerning the Nile, and other countries may see water rights as a flashpoint for conflict.

The economic framework and geopolitics of North Africa will be heavily influenced by the race to establish commercial corridors between Africa and Europe, as the latter pivots its commodity imports away from more distant sources. China, Russia, Turkey, and the Arab Gulf states will play increasingly important roles in developing infrastructure projects to create these economic corridors in North Africa and beyond. European Union leadership will also play a key role in determining the extent of the global influence of these new initiatives.

Over the last year, China became the preeminent trading partner in Africa. Russia and Turkey, meanwhile, have expanded trade to levels five and seven times higher than the EU, respectively. The Arab Gulf states have also become prominent actors in Africa, leveraging a shared cultural heritage with their North African counterparts. Accessing North Africa's proximity to the southern shores of the Mediterranean, increased flows of goods, resources, power, and capital is anticipated to come into fruition over medium-term forecasts. Over the next year, the Maghreb will continue to serve as an arena of intense global competition, as it sits at the nexus of vital trade and energy transit routes, in addition to industrial manufacturing value chains, that connect Europe, Africa, and the Middle East.

09| Contractual agreement repudiation and economic risk have increased in Egypt.

Source: *Marsh Specialty World Risk Review*

EGYPT

After years of economic stability and expansion, ***Egypt*** is facing a slowdown in GDP growth in 2021 to 2.3%, from 3.6%, as the pandemic's longer-term effects persist.[4] Egypt does not have the same challenges as other African states that have been heavily impacted by depressed oil prices, as the country sits as a net importer. This therefore presents an opportunity for Egypt to achieve cost savings on various commodity imports. A severe hit to the Egyptian economy, however, is seen in the tourism sector. The same restrictions are also having a considerable negative effect on the region's exports and Suez Canal revenues.

Egypt's fiscal reserves have sharply declined since February 2020, due to the capital outflows required to minimize the impacts of the pandemic and the economic stimulus package of LE100 million deployed by the Central Bank of Egypt. This has prompted Egypt to raise further debt from external sources. 2020 saw commercial lending from local banks and multilateral organizations far exceed many neighboring competitors on the continent, with Egyptian sovereign risk proving to be one of the most sought-after credit coverages in the credit insurance market for the fourth quarter. Egypt's sovereign credit risk remains relatively high at 6.1; this is reflected in its B stable rating, which was reaffirmed in 2020, and will therefore undoubtedly attract close attention from external sovereign lenders.

Egypt is on the cusp of becoming a major exporter of power regionally, which may reconfigure the means of energy connectivity between Europe, Africa, and the Middle East. Simultaneously, Egypt is at the nexus of commercial transport for East Africa-Eastern Mediterranean countries. When added with the greater rail connectivity planned between Egypt and Sudan, a new north-south commercial corridor that joins White Nile countries is increasingly likely to come to fruition. A southern extension of the economic corridor, reaching Tanzania and other East African countries that coalesce at the Lake Victoria basin, means there is great potential for the fledgling East African Federation (a political union of Burundi, Kenya, Rwanda, South Sudan, Tanzania, and Uganda) to reap extensive fiscal benefits as well. With this in mind, Egypt will likely continue to shift commercial transportation from road to rail.

The Egyptian government is likely to maintain strong relations with Israel to consolidate on shared ambitions containing insurgencies on the Sinai Peninsula. Economic coupling with Israel while supplementing Gulf states also means war with Israel is highly unlikely over the medium to long term. Military aid to Libya is likely to continue, as it will serve as another avenue to neutralize the threat the Islamic State poses. This will extensively test the resources of the Egyptian military, as without Turkish military support in Libya, the army would be stretched due to preexisting military commitments in the Sinai.

Sub-Saharan Africa

The pandemic had a significant impact on ***Sub-Saharan African economies*** in 2020, with growth contracting by 3%.[5]

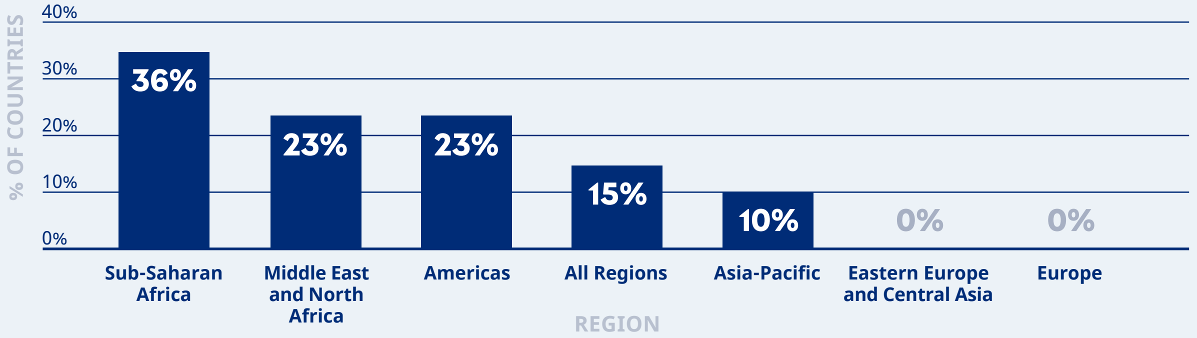
Despite this, the region is still predicted to generate growth of 3.1% in 2021, if countries can navigate significant obstacles.5 Chief among these is careful management of fiscal and monetary policies at a time when many governments have limited resources. Metal- and oil-exporting countries in the region have been the most affected by COVID-19; countries that rely heavily on tourism also have been severely impacted. More diversified economies, such as those of Côte d'Ivoire and Kenya, have fared better.

Pandemic-induced economic stress saw poverty levels across the region increase to 41%, with forecasts indicating it is set to rise another 1.2% this year. When combined with infrastructure and development challenges as climate change ensues, it will be difficult for major infrastructure to be completed without outside investment.

One positive feature of the pandemic response was the significant financial support many countries received from multilateral institutions such as the IMF, African Development Bank, and African Export-Import Bank. These institutions provide countercyclical lending at more affordable rates than private markets can offer, and they provide significant lending programs to help countries through the economic and health impacts of COVID-19. Unfortunately, the aid just may not be enough to forestall a lost decade for the countries of the region.

A looming concern highlighted by the pandemic is the difference between the interest due for government debt between developed-market and emerging-market economies. Whereas the overall servicing of interest on debt has reduced globally, it has increased for emerging economies. The percentage of 2020 S&P sovereign credit downgrades by region illustrates the heavy impact on Sub-Saharan Africa (Figure 10).

10| An outsize number of Sub-Saharan African countries saw sovereign credit downgrades in 2020.



Source: *S&P*

> **“Over the last year, Egypt and Sudan signed a new transport agreement, which will formally create rail connections between both countries.**

This means that although developed and emerging economies may have similar debt-to-GDP ratios, they have vastly different interest debt burdens. This imbalance may lead to further sovereign defaults such as the one seen in Zambia in 2020. The increase in interest repayments will also take up more and more of government budgets, making it harder to spend money on COVID-19 responses.

The emergent East Africa-Eastern European economic corridor will be reliant on both rail and road connectivity. Over the last year, Egypt and Sudan signed a new transport agreement, which will formally create rail connections between both countries. The first rail link will be funded by Kuwait, further demonstrating the strong importance Sub-Saharan Africa holds for external actors.

The Trans-African Highway, spanning from Cape Town to Cairo, also serves the ambitious plan well. However, the ensuing conflict between Egypt and Ethiopia over the Grand Ethiopian Renaissance Dam (which will severely reduce Egyptian access to freshwater from the Nile), coupled with the ethnic-driven insurgency in Ethiopia’s Tigray province, pose significant perils to Trans-African Highway users.

Despite the above issues, there is cause for optimism because Africa has been affected less than other regions by the pandemic. Low interest rates in Western economies could encourage institutional investors to chase higher yields on the continent. The African Continental Free Trade Area (AfCFTA) may also be a conduit to accelerated development provided that infrastructure projects maintain access to finance.

The size of China’s GDP is likely to grow by about US$2.3 trillion next year and beyond, equaling the size of the entire African market. This growth could help drive commodity price increases and provide a huge lift to the African continent.

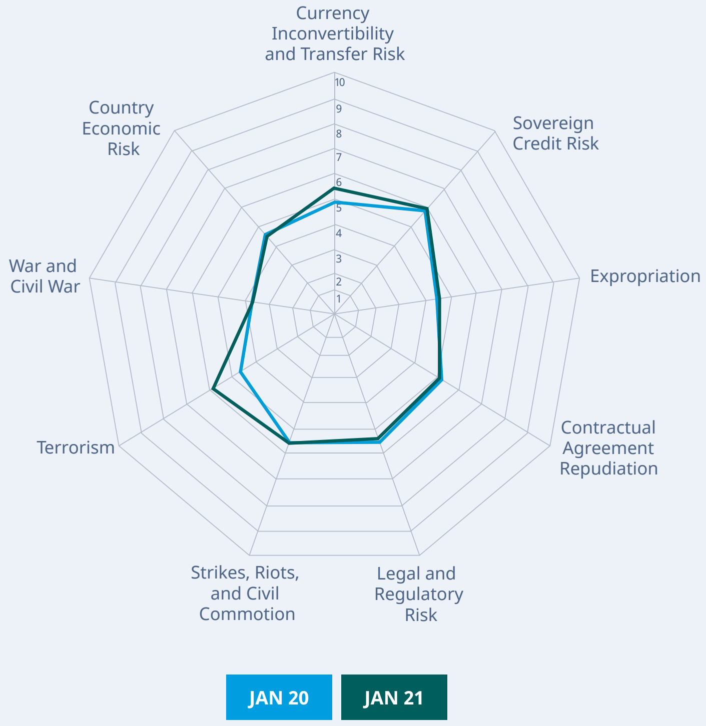
CÔTE D'IVOIRE

Côte d'Ivoire's rapid economic growth and ambitious infrastructure program should continue to generate investor interest, but the risk of terrorism and political violence is intensifying. In October 2020, the current president was elected to a third term in a controversial election that saw dozens killed during violent political conflicts and the arrest of some political opponents. Despite a largely investor-friendly approach, political intervention and corruption are persistent issues for businesses in Côte d'Ivoire.

COVID-19 has affected the Ivorian economy less than others in the region, though the economic downturn may increase the potential for social unrest. The country's response to the pandemic relies on its military and police, which are frequently occupied combating the terrorism threat, including deployments in neighboring Mali and Burkina Faso. As a result, terrorists such as al-Qaeda in the Islamic Maghreb (AQIM), ISIS, and other insurgent groups are conducting attacks inside Côte d'Ivoire, with military and infrastructure targets at high risk. Reflecting this reality, terrorism had Côte d'Ivoire's largest WRR rating increase, reaching 5.9 in January 2021, up 25% from January 2020.

The country's stable credit rating balances strong economic growth prospects and relatively low fiscal deficits and debt ratios against enduring political risks, low development indicators, and high commodity dependence. Côte d'Ivoire's largest traded commodity is cocoa, which accounts for 40% of its exports. Overall, while political tensions and terrorism pose a significant risk, Côte d'Ivoire's economic growth should remain robust if it continues to invest in counterterrorism initiatives.

11| Terrorism and currency risk rose sharply for Côte d'Ivoire.



Source: Marsh Specialty World Risk Review

12| Heavily dependent on oil exports, Nigeria's economic risk continued to increase.

Source: *Marsh Specialty World Risk Review*

NIGERIA

Nigeria's economy faces a future of slow growth and recovery after a sharp contraction in 2020. Its GDP is forecast to grow between 1.1% and 2% in 2021, with recovery largely dependent on the price of oil, which generates 50% of government revenue and 90% of foreign exchange earnings, success in vaccinating its population, and the government's ability to ***restore law and order*** over insurgent groups threatening the economic recovery.[6]

The oil price drop has deprived Nigeria of funds to improve its poor healthcare infrastructure and provide resources to its army, which is struggling to counter attacks by terrorist groups on civilian and military targets. A reported alliance between Boko Haram and ISIS will keep the risk of terrorism high, while widespread outrage in rural areas over terrorist attacks may lead to social unrest.

The Central Bank of Nigeria took steps to protect the nation's banking sector from the impact of COVID-19 via quantitative easing, debt moratoriums, devaluation of the naira, and cuts in interest rates. Nigeria's high cost of external borrowing, combined with poor revenue generation and little to show in terms of capital expenditure, remain major concerns and are reflected in the increased risk ratings across these areas.

Like many African countries, Nigeria has been strategizing how to take advantage of the African Continental Free Trade Area, which commenced trading on January 1, 2021, and is predicted to create a US$3.4 trillion economic trade bloc. This new area should facilitate the expansion of intra-African trade and new trade routes for Nigeria's growing domestic industries, such as cement, fertilizer, and refinery businesses. However, a smooth transition for Nigerian businesses will require close cooperation between the public and private sectors.

The scope of Islamic militia to proliferate attacks within Nigeria has markedly increased against a poorly resourced Nigerian army that, in recent times, have been on the front line of the state's response to COVID-19 pressures. The attacks on convoys, inclusive of the destruction of weapon deliveries, appear to coalesce well with the aims of undermining the tactical and operational capability of troops. Further, the diversion of resources to alleviate the COVID-19-induced economic collapse that Nigeria has faced (due to the reduction in the price of oil) suggests the Nigerian army is not well-positioned to form a concerted plan of action to mitigate against this threat.

Insecurity is also likely to remain a central issue in southern and coastal areas, which is likely to reduce foreign investment in a diminishing oil sector. As militant groups continue to threaten oil installations in the Niger Delta, a breakdown in negotiations between the militants' representative body — the Reformed Niger Delta Avengers — and the federal government in January 2021 means that groups have threatened to escalate the frequency and potency of attacks on vital pipelines and shipments.

In recent months, oil companies have declared force majeure following attacks on assets held in the Niger Delta. Logistics companies also face security threats from pirate groups that hold bases along the coast. Recent data from the International Maritime Bureau indicates that 2020 saw a steep rise in piracy, with the Gulf of Guinea accounting for approximately 95% of all incidents of kidnapping crew members globally.

> **“Our aspiration is to ensure that clients who are engaged in sustainable activity are supported by similarly minded insurers in growing their business and securing capital and thereby act as an accelerant to positive change.**
>
> **NICK ROBSON**
> Global Head of Credit Specialties at Marsh Specialty

Political risk and credit solutions

TOOLS FOR SUSTAINABILITY

Forecasts state that roughly 143 million people are expected to be displaced as a result of climate change, triggering a refugee crisis which will continue to strain political institutions. A hallmark of political risk and credit insurance is its ability to help sustain investments and growth goals amid uncertainty. Looking at this topic more broadly, political risk and credit solutions can provide significant support for sustainable development that enhances the current and future potential of projects designed to meet human needs.

From climate change, to food and water security, to environmentally sound energy, governments and businesses around the world are focusing on sustainability in their operations, investments, and business relationships. But there are risks in the transition toward sustainable development and resource utilization. Political risk and credit insurance itself is evolving from a method of risk distribution to becoming a driver for sustainability.

Marsh Specialty is working with our insurance company partners and clients to drive real change, with sustainability-linked credit insurance (SLCI). Our aspiration is to ensure that clients that are engaged in sustainable activity are supported by similarly minded insurers in growing their business and securing capital, and thereby act as an accelerant to positive change.

Toward this goal, Marsh Specialty is working with insurers to establish a sustainable deal classification, reflecting clients’ environmental, social and governance (ESG) credentials, as well as an SLCI facility to provide positive and creative approaches to the risk challenges of sustainable development projects.

5 Managing political and credit risks

As the world recovers from the effects of COVID -19, we expect the issues of social inequality, country economic risk, and strategic resource nationalism to take center stage in influencing political decision-making.

This year's *Political Risk Map* highlights many of these areas of heightened risk, which the COVID-19 pandemic has intensified.

Still, many opportunities remain for corporate entities, financiers, and investors. Insurance-backed political risk and credit solutions can help to secure trade and investment capital, unlock liquidity, 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 difficult 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, with ample capacity, flexibility, and long-term coverage periods to meet risk management needs in many scenarios. Often, such protection is critical in enabling investment projects to proceed.

For more information, please visit ***marsh.com*** or contact us at ***creditspecialties@marsh.com*** for a confidential discussion.

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Marsh

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