

MARSH JLT SPECIALTY

INSIGHTS

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Political Risk Map 2020

Trade Tensions Threaten Political Stability





Political Risk Map 2020: Trade Tensions Threaten Political Stability

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About this report

Introduction



Businesses operating in both developed and emerging markets face a complex and often volatile political risk landscape in 2020. Issues related to global trade will continue, resulting in persistent political and economic uncertainty for businesses. Drawing on data from Fitch Solutions, Marsh's *Political Risk Map 2020* explores the changing risk environment, highlighting the implications for firms operating globally.

The transition toward a multipolar world order seen in 2019 — with multiple challenges to multilateralism and free trade — is expected to continue. Although the US and China have reached a “phase one” trade deal, it is unlikely to permanently resolve their trade dispute. The two countries are likely to remain strategically opposed on issues such as protection of intellectual property and state support for certain industries. Indeed, the World Economic Forum's *Global Risks Report 2020* states: “Economic confrontations between major powers is the most concerning risk for 2020.”

Sino-American rivalry is expected to deepen in 2020, particularly as the US presidential election approaches in November. The tech industry is expected to emerge as a particular battleground for the two countries, as both look to reduce technological dependence on the other. Businesses will be caught up in this rivalry, as the two countries politicize trade and investment relationships. Chinese telecoms firm Huawei embodies these challenges — the US has increased pressure on allies to not use the company's technology — a situation that is unlikely to change in 2020. Economies globally will increasingly have to choose between US and Chinese technology partners.

Geopolitics will dominate the risk environment in the Middle East. At the time of writing, Iran and the US appear to be pursuing de-escalation following a significant flare-up in early 2020, which saw the targeted killing of an Iranian general by the US followed by ballistic missile launches against US facilities in Iraq. However, the US-Iran relationship is unlikely to improve and will generate instability in the region. Iran's accidental shooting down of a passenger plane during the recent incidents with the US is likely to

strain relations with the international community, while European governments have formally triggered a dispute mechanism in the 2015 nuclear deal, increasing pressure on its sustainability. Iran may use its asymmetric capabilities to retaliate against the US, using its proxies to carry out targeted assassinations or bombings, including cyber-attacks, across the region. Iran may also look to pressure the US's regional allies, asserting itself in the Strait of Hormuz, where any significant disruption could impact oil supplies and thus the global economy. Iraq is likely to be the immediate focal point for US-Iranian confrontations, elevating political risk in the country. For example, one result of the January clash between the US and Iran has been increased calls within Iraq for US troops to leave the country, a move that could contribute to resurging terrorism risks in Iraq.

Elsewhere, tensions between Russia and the West are expected to continue in 2020. Russia's increased role in the Middle East will continue through, for example, its support for the Syrian government. As the US presidential election plays out, much attention will be placed on any Russian attempts to interfere as it did in the 2016 election, straining relations further. In Europe, although the UK left the EU on January 31, its future relationship with the EU — from economic to political to security — will take years to address.

The US presidential election also looms large in 2020. The US electorate is highly polarized, with President Trump's impeachment exacerbating divisions, despite his acquittal on February 5. The election may also see deep fake media adding to the risks.

Economic Uncertainty

Economic and political risks will be intertwined in 2020.

Trade tensions continue to present the major risk to the global economy, while the novel coronavirus (Covid-19) outbreak may also disrupt trade and supply chains. The World Bank forecasts global growth of 2.5% in 2020, a small rebound from 2019's 2.4% estimate. Trade disputes could cost the global economy US\$700 billion in lost output this year, and businesses remain pessimistic about the outlook. Of respondents to the World Economic Forum's *Global Risks Perception Survey 2019-2020*, 78% expected economic confrontations to increase in 2020. Global debt levels remain a cause for concern, with debt in emerging markets reaching 170% of GDP by the end of 2018. Elevated debt levels pose notable risks to financial stability in many markets amid a more fragile global growth outlook, tendency toward fiscal and current account deficits, slowing productivity growth, and a growing preference for riskier borrowing.

At the same time, resilience to economic shocks is likely to be reduced in 2020. A move away from multilateralism and global cooperation means that governments may be unwilling to form a coordinated response to a global economic crisis, while there is reduced scope for monetary and fiscal stimulus.

Amid these headwinds, many governments face a difficult balancing act. They must address economic imbalances through structural reforms, yet doing so poses risks to social stability. In late 2019, many Latin American countries were confronted with this dilemma, exemplified by protests in Bolivia, Chile, Colombia, and Ecuador. At the core of unrest has been dissatisfaction with falling standards of living, growing levels of poverty, and prolonged periods of austerity measures. Protest risks have not been confined to Latin America — incidents also occurred in Iraq, Iran, Lebanon, France, and Hong Kong SAR. The need to balance social and economic stability is likely to continue in 2020, elevating political risks for firms operating in a range of countries.

Managing Risk

While the *Political Risk Map 2020* highlights a challenging geopolitical and economic outlook, there are pockets of significant opportunity. Emerging markets are expected to perform well in 2020, with real GDP growth of 4.3%, up from 3.9% in 2019. Markets across Sub-Saharan Africa, Asia, and beyond require investment in transport infrastructure, logistics networks, and power assets. Foreign expertise and financing can be critical in developing such assets.

However, firms looking to capitalize on such opportunities must navigate a complex and dynamic risk environment. Businesses can be exposed to political risks including currency inconvertibility, trade embargoes, seizure of assets by host governments, and political violence. Similarly, elevated levels of sovereign debt and weakened macroeconomic fundamentals elevate non-payment risks when engaging in contracts with host governments.

Political risk insurance (PRI), alongside a sophisticated understanding of the political risks facing a business, can help firms to manage their exposure and realize opportunities.

The private PRI market offers a set of credit and political risk coverages that policyholders can buy individually or together to create a bespoke insurance program. Underwriters offer tailored policy wording to cover default on loan payments, or loss of equity investment, assets, and cash flows, caused by perils including:

- Abandonment of assets due to war, terrorism, and other forms of political violence.
- Physical damage to assets due to political violence, including war, and resultant losses of business income.
- Confiscation, expropriation, nationalization, and deprivation of physical assets or equity investment.
- Forced divestiture of foreign investment on order of the investor's home government.
- Wrongful cancellation by government of permits, licenses, or concessions.
- Contract frustration or cancellation due to default by government, or other government acts.
- Blockage of cross-border cash flows due to currency inconvertibility and non-transfer.
- Export/import restrictions, causing losses on trade transactions.
- Non-honoring of an arbitration award by a government entity (breach of contract).
- Non-payment of debt by a private entity.

Amid dynamic geopolitical conditions and economic uncertainty, insurer appetite for political risk is strong. The PRI market has developed considerable depth in recent years, and available insurance capacity has never been better.

Businesses can find potential solutions to various aspects of political risk through three related, but distinct, marketplaces. In addition to the PRI market outlined above, firms can cover associated security and people risks through political violence and terrorism coverage, as well as kidnap and ransom insurance.

Regional Overviews

Europe

Political risk in the UK improved, following a December 2019 election that gave the Conservative Party the largest parliamentary majority in a decade, boding well for overall stability. Following the UK's departure from the EU on January 31, focus will shift to negotiations over its future relationship with Europe. A transition period will come to an end in December 2020, and pressure to reach a trade deal will increase throughout the year. The EU will look to offset Brexit's financial impact by seeking increased member contributions to its budget, while the new European Commission President, Ursula von der Leyen, will seek to launch plans for a European "Green Deal" in 2020.

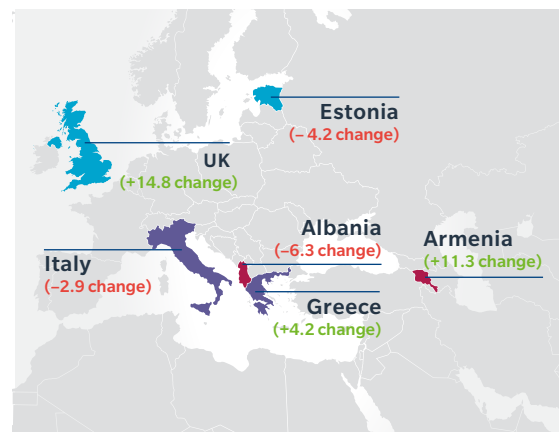
In Greece, the center-right New Democracy party secured a majority in the July 2019 elections, allowing it to progress with a pro-business agenda and improve the country's fiscal position, easing relations with creditors. As a result, Fitch Solutions increased Greece's short-term political risk index (STPRI) from 61.0 to 65.2, one of the largest improvements in Europe. A higher STPRI score represents increased political stability and is one piece of Fitch Solutions' overall political risk index score.

In Italy, the coalition between the Democratic Party and Five Star Movement will come under strain in 2020 as the parties have diverging views on many issues. Their coalition of convenience, designed to prevent a snap election and sideline the League party, may be short-lived. The coalition will face pressure ahead of a referendum on parliamentary reform and negotiations on the future of the Ilva steelworks.

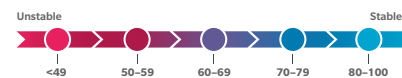
FIGURE
1

The UK saw the region's largest increase in short-term political risk score.

SOURCE: FITCH SOLUTIONS



Short-Term Political Risk Index



North America

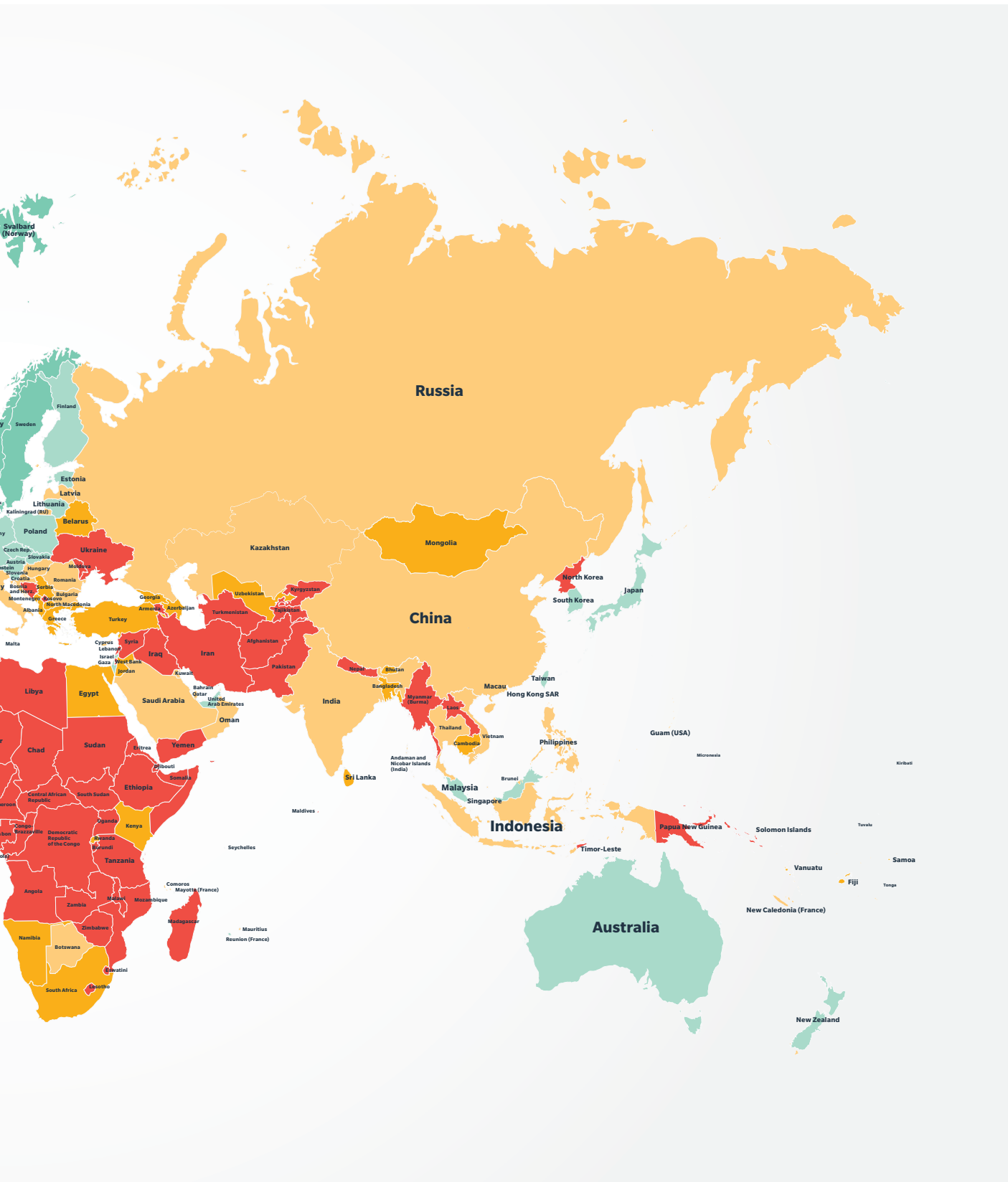
US politics in 2020 will focus on the November 2020 presidential election, which will likely reflect a highly polarized electorate. Policy formation will slow as both parties look ahead to the election and the impeachment trial against President Trump deepens political divisions, already evident in the split control of Congress.

Meanwhile, US-Mexico tensions are likely to ease in 2020. Both countries have approved the US-Mexico-Canada Agreement, NAFTA's successor. With Canada also expected to sign the deal into law shortly, its implementation may alleviate concerns among businesses of supply-chain disruption in North America. However, risks remain elevated within Mexico. President Andrés Manuel López Obrador displayed economic pragmatism in 2019, but headwinds may push him towards increasingly populist policies in 2020.



SOURCE: FITCH SOLUTIONS







Latin America and Caribbean

Political risk has increased in a number of Latin American countries, as governments find it increasingly challenging to balance economic reforms and social stability. In late 2019, destabilizing anti-government protests occurred in Colombia, Chile, Ecuador, Haiti, and Bolivia. Incidents were notable because of the level of violence that occurred in some instances. In Chile, long one of Latin America's most stable operating environments, Fitch Solutions decreased the STPRI score from 74.8 to 66.7, the largest reduction in the region and third largest globally. Unrest is expected to leave the economy 4.5% smaller at the end of 2020 than was projected before the protests. In 2020, President Sebastián Piñera's government will implement a US\$5.5 billion spending package and pursue constitutional reforms in a bid to quell protests.

Although the triggers for protests are unique to each country, many of the underlying drivers — poor service provision, economic reforms, falling standards of living, and inequality — will remain in 2020, making further protests possible. Fiscal challenges will limit governments' ability to respond to protesters' demands.

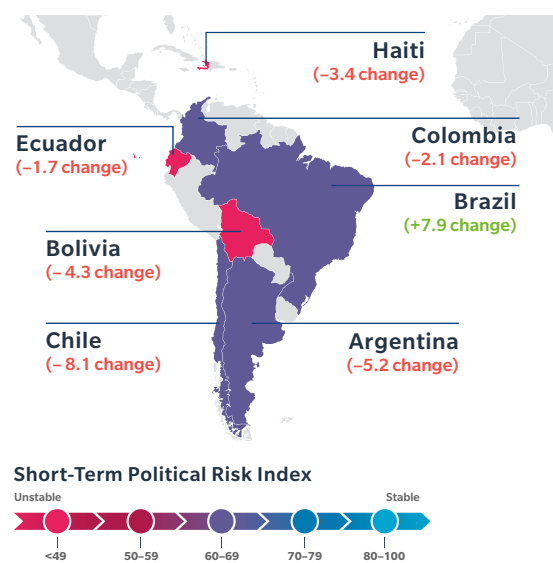
Bolivia's political environment will remain precarious in 2020, following the resignation of President Evo Morales in November 2019 amid allegations of electoral fraud. Fresh elections in early 2020 may be a flashpoint between Morales supporters and the country's emergent center-right. Venezuela's political crisis is unlikely to be resolved in 2020. Opposition figure Juan Guaidó has struggled to dislodge President Nicolás Maduro from power, despite being recognized as president by 50 countries.

In Argentina, 2020 will provide clarity on President Alberto Fernández's policy priorities, as investors remain wary of a possible return to state interventionism in the economy. Amid an economic recession, high inflation, and currency depreciation, Fernández is expected to begin debt renegotiations. In contrast, Brazil is likely to continue investor-friendly economic reforms, although municipal elections in October 2020 may slow progress.

FIGURE
3

Chile saw largest change in short-term political risk score.

SOURCE: FITCH SOLUTIONS



Asia/Pacific

Hong Kong SAR experienced the second largest deterioration in STPRI score globally, as the territory was beset by months of disruptive, violent protests, which strained Hong Kong SAR's relationship with mainland China. The government is unlikely to meet protesters' demands in 2020, and if unrest continues there is a growing risk of Chinese military intervention in Hong Kong SAR.

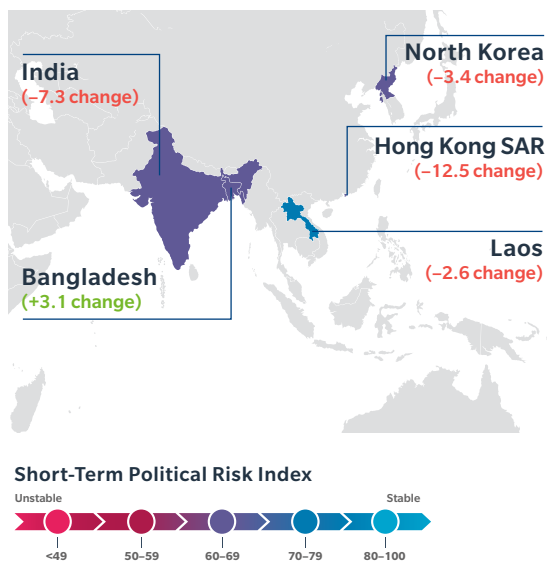
Political risks are also rising in India. The Citizenship Amendment Act triggered protests beginning in December 2019, and may generate disputes between India's state and central governments in 2020, challenging the authority of Prime Minister Narendra Modi.

Progress on denuclearization on the Korean peninsula will be slow as US-North Korean relations have reached an impasse, following a rapprochement in 2018. North Korea will be cautious to maintain personal goodwill between its leader Kim Jong-Un and President Trump, but will be reluctant to give up its nuclear weapons program in exchange for sanctions relief.

FIGURE
4

Hong Kong SAR saw the region's largest change in short-term political risk score.

SOURCE: FITCH SOLUTIONS





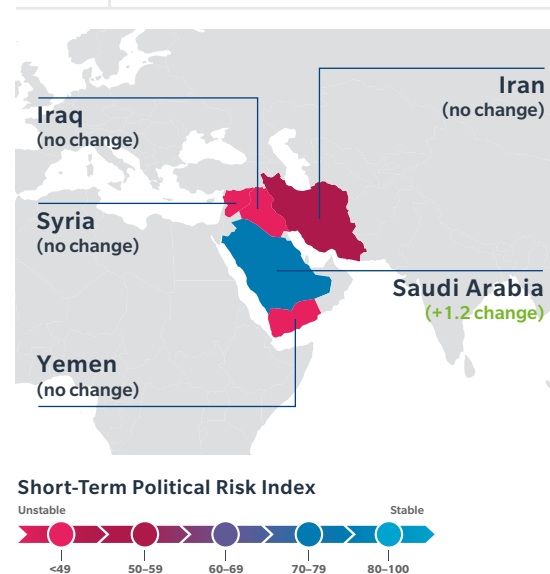
Middle East

US-Iran relations are likely to dominate the risk landscape in 2020. While neither side is expected to seek a direct military confrontation, an unintended escalation is possible. Iran may use its proxies in the region to increase pressure on the US and its Gulf State allies, with Iraq a potential focal point of activity. Targeted assassinations, attacks on military bases and/or critical energy infrastructure are all possible, while Iran may also intensify its activity in the Strait of Hormuz, generating risks for commercial shipping. The Joint Comprehensive Plan of Action will come under further pressure in 2020, after European states triggered a dispute resolution mechanism in January 2020. Iran's economy will also struggle in the face of stringent US sanctions, spurring protests.

Elsewhere in the region, tentative progress toward a ceasefire in Yemen appears possible as Saudi Arabia moves towards de-escalation – reducing airstrikes and engaging in talks with Houthi rebels. A permanent resolution is unlikely in 2020, however. In the region's other major conflict, Syrian President Bashar al-Assad will consolidate territorial gains made in 2019, with the support of Russia, making peace negotiations with the opposition unlikely.

FIGURE 5 Little change in Middle East short-term political risk scores.

SOURCE: FITCH SOLUTIONS





Africa

Amid a challenging global outlook, Africa is expected to be an economic outperformer in 2020. The International Monetary Fund forecasts growth in Sub-Saharan Africa to accelerate to 3.5% in 2020/21, up from 3.3% in 2019. However, downside risks stem from the continent's rising sovereign debt load.

West African states will struggle to manage security risks in 2020, as Islamist militants increase activity in the Sahel. In 2019, deaths in the region due to armed conflict reached their highest figure since 2012, as armed groups took advantage of porous borders and weak regional institutions. In January 2020, in a mark of the escalating violence, 89 Nigerien soldiers were killed in a single militant attack. Insecurity will continue in 2020, despite increased security cooperation and promises of more French troops.

Moreover, elections in Togo, Côte D'Ivoire, Guinea, Burkina Faso, and Mali could generate political instability. In Côte D'Ivoire's October 2020 general election, candidates have already invoked north-south regional divides, increasing the risk of election-related violence.

South Africa will struggle to significantly boost its economic performance in 2020, despite a government economic recovery plan, while contingent liabilities for state-owned enterprises remain significant. Divisions within the ruling African National Congress are also likely to weigh on reform momentum.

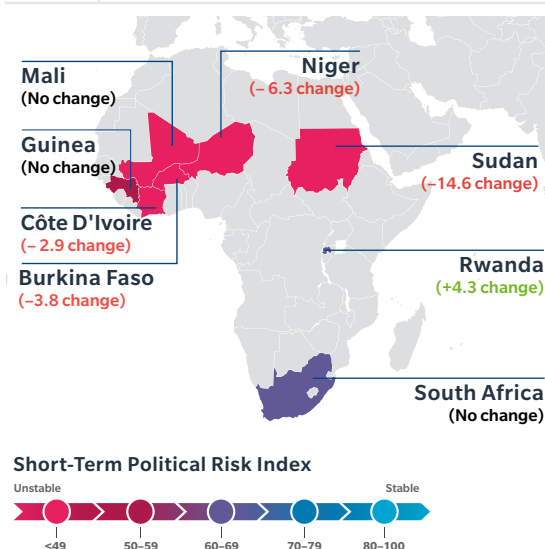
Rwanda experienced the largest improvement in STPRI score in Africa, increasing from 64.2 to 68.5. This reflects President Paul Kagame's dominant political position and policy stability, which supports continued economic growth and a stable business environment.

Sudan posted the most significant global deterioration in STPRI score, falling to 21.7 from 36.3. Political instability has spiked following the removal of President Omar al-Bashir in a coup in April 2019. A transitional power-sharing agreement was reached between civilian groups and the military, yet tensions between the two will remain elevated in 2020. It remains possible that the military will seek to delay the transition to democracy.

FIGURE
6

Sudan experienced significant deterioration in short-term political risk score.

SOURCE: FITCH SOLUTIONS







ABOUT THIS REPORT

Drawing on data and insight from Fitch Solutions, a leading source of independent political, macroeconomic, financial, and industry risk analysis, *Political Risk Map 2020* presents a global view of the issues facing multinational organizations and investors. This map rates countries on the basis of political and economic stability, giving insight into where risks may be most likely to emerge and issues to be aware of in each country.

To view an interactive version of *Political Risk Map 2020*, visit marsh.com

Under Fitch Solutions' method, a country's score is ranked out of 100 — the higher the index, the less political risk. This report considers the changes in the short-term political risk index (STPRI), a measure that takes into account a government's ability to propose and implement policy, social stability, immediate threats to the government's ability to rule, the risks of a coup, and more.

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