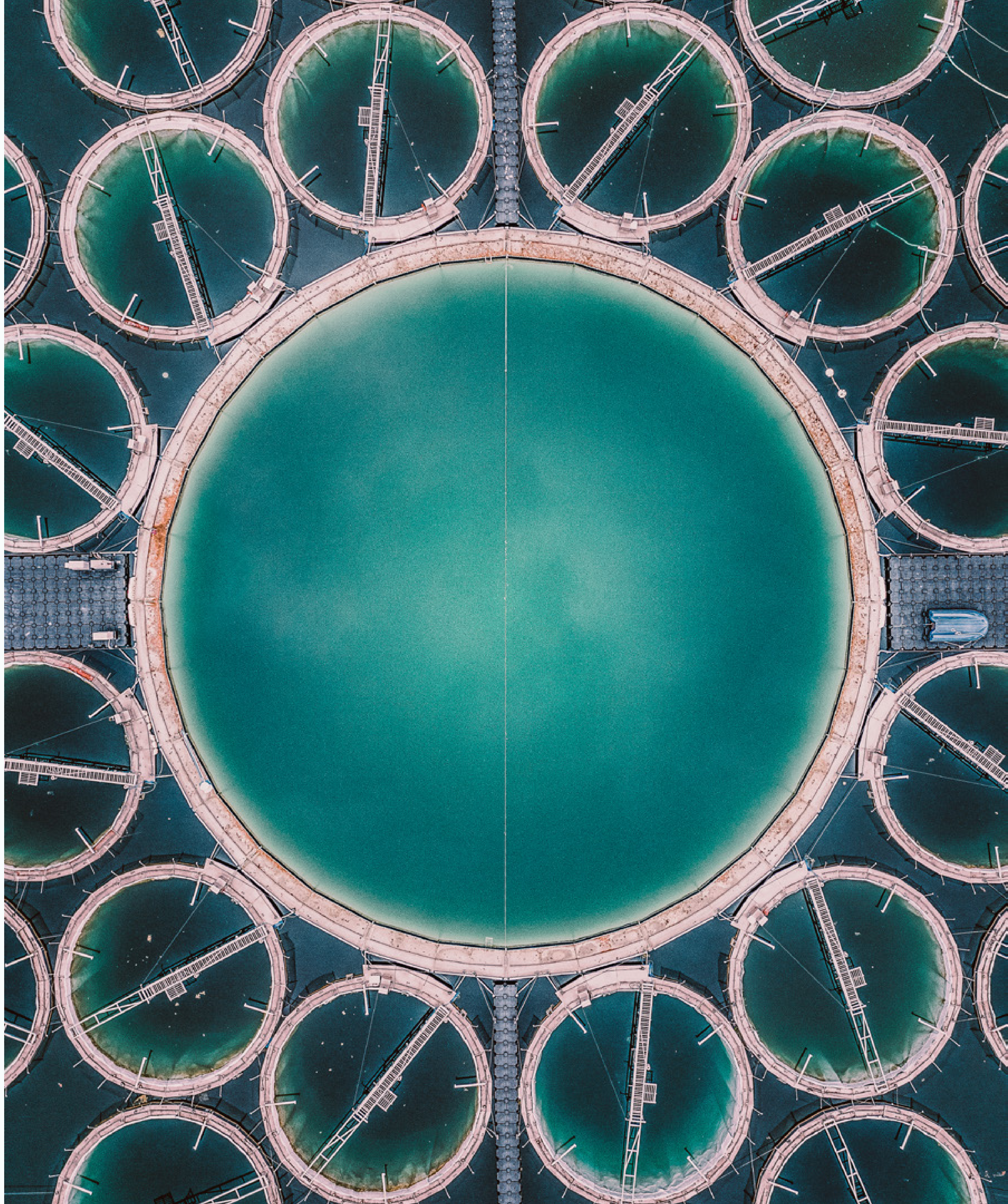
# Political Risk Maps

Quarterly Newsletter: January 2023

# Contents





# 1

# Summary

# 1 Summary

This quarter it has become ever more apparent that emerging markets and frontier markets are increasingly caught between two trends which are clouding their prospects — one structural and the other cyclical. On the one hand, COVID-19 and conflict in Ukraine have both accelerated a process of deglobalization, with developed markets (DM) either re-shoring or "friend-shoring" supply and thereby cutting emerging markets (EM) off from a major pathway to economic development.

On the other hand, the nascent threat of stagflation casts a long shadow on EM's more immediate prospects. While some EM such as Brazil started hiking early and are approaching the end of the tightening cycle — Russia is the exception, having even shifted into easing given it is set for a 9 percent contraction this year — the majority of EM still have further tightening ahead, at a time when the U.S. Federal Reserve is expected to raise interest rates further. Emerging and frontier markets are more vulnerable in the short-term to the current jump in food and fuel prices, However, the scope for these increases to result in second-round effects that displace inflation expectations is reduced by the fact that wages are not showing signs of overheating in general to the same extent as in DM.

Rather, it is the low-growth aspect of stagflation that is more concerning for EM and it is also intensified by the structural process of deglobalization itself. Finally, as the World Bank has emphasized, frontier markets are particularly vulnerable to Fed tightening at this juncture, in terms of their debt sustainability, which has already been tested by COVID-19 and the alleviation of food and fuel price rises through subsidies.

This quarter, we saw a change in the overall risk rating of five countries. One saw its levels change due to an overall arithmetic effect, namely Swaziland to high. Azerbaijan and Lesotho ended up at medium-high risk on the basis of changes to sovereign non-payment, exchange transfer and inability of government to provide stimulus. Hong Kong's risk level fell to low on the basis of a reduction of the inability of government to provide stimulus.

Finally, Montenegro saw its level fall to medium as a result of wide-ranging reductions in risks associated with sovereign non-payment, exchange transfer, banking sector vulnerability and inability of government to provide stimulus.

# 2

# Under the Spotlight: Ukraine and the Unraveling of Globalization

# 2 Under the Spotlight: Ukraine and the Unraveling of Globalization



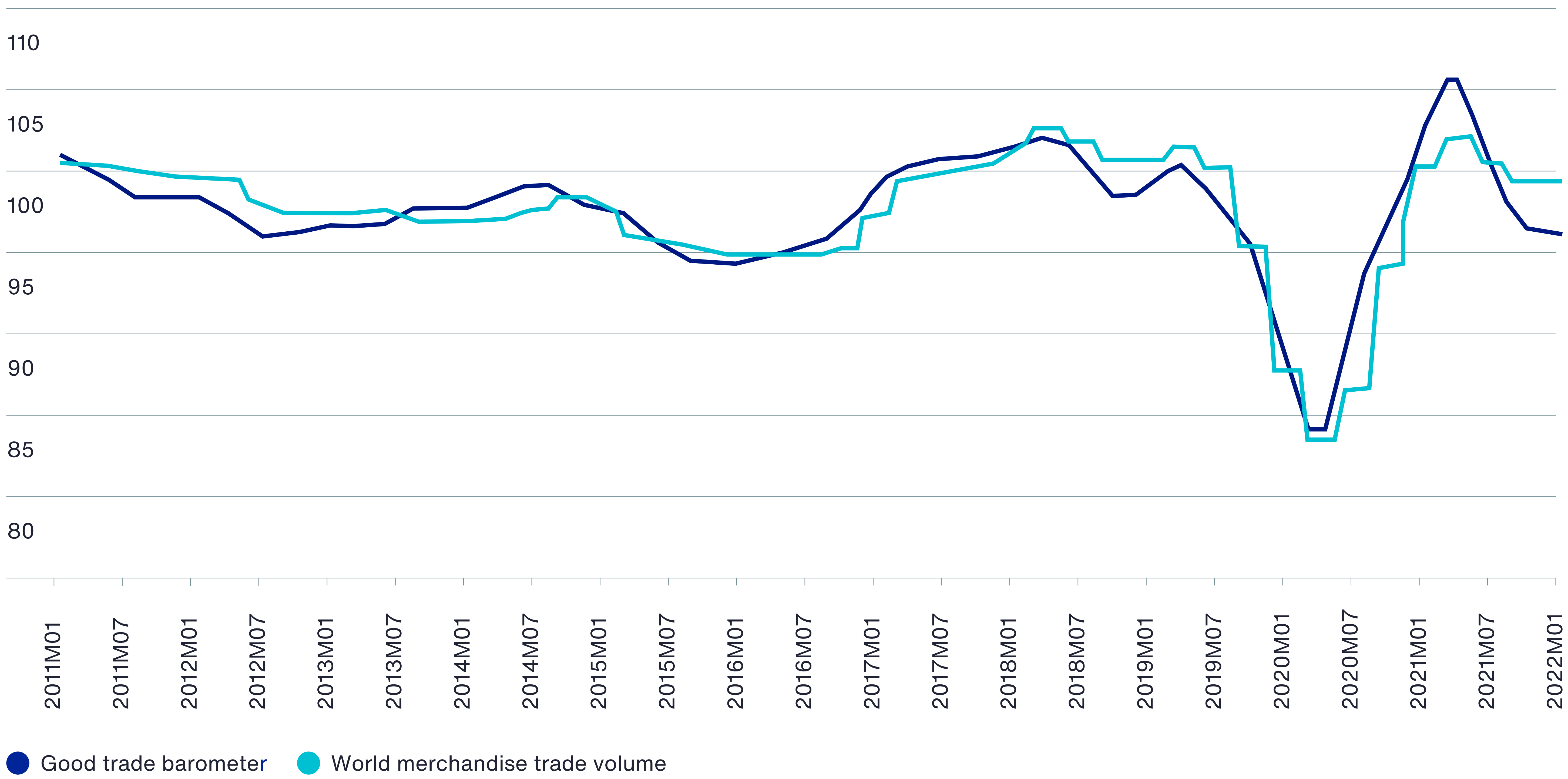
When I wrote a piece forecasting the demise of globalization in September 2020, at the height of COVID-19 hysteria, it was greeted with a degree of skepticism. Two years on, and the COVID-19 trigger has been extended by the shocking conflict in Ukraine, which is proving to be the ultimate deglobalizer, especially as it is accompanied by a growing fear of stagflation which increases commodity prices.

The World Trade Organization (WTO) Goods Trade Barometer shows that trade flows were weakening before the war and the conflict has exacerbated their retrenchment. The era of free market globalization is giving way to politicization of global trade, whereby flows are organized no longer on the basis of comparative advantage but on that of political alliances of 'friendly' states.

We find that while this holds some opportunities for individual EM that suffer from the competition of China as a preferred location in the value chain, it will make economic development prospects dependent on political connections, which will make EM more vulnerable.

**Figure 1 — WTO Goods Trade Barometer**

Index History, trend = 100




Source: WTO, Continuum Economics

# 2

Even on a short-term basis, a trade globalization measure such as the WTO Goods Trade Barometer, whose baseline value is 100, remained under the baseline for the second time in a row at 99 in its latest March reading (see Figure 1). The barometer combines data on export orders, air freight, container port throughput, auto production and sales, electronic components and raw materials. In particular, the container port throughput dipped below trend as port congestion was an ongoing problem, even before the Ukraine war.

Then, Russia's navy moved quickly to close off the Sea of Azov and control the Black Sea, sealing off shipping traffic, and allowing Moscow to exert a naval blockade that has all but halted Ukrainian grain exports and suffocated its main export industry. Furthermore, the cost of marine insurance in the Black Sea has soared. The EU is setting up a plan to help Ukraine export 20 million tons of grain via rail over the next three months while escorted naval convoys through a protected marine zone have also been flagged as a possible solution. But given how hesitant NATO was to establish no-fly zones over Ukraine, we doubt that it would be too keen to risk escalation with Russian warships.

On a longer-term basis, evidence of deglobalization is provided by the secular rise in the share of global trade affected by export and import bans (see Figure 2).

This trend started accelerating sharply with the U.S.-China trade war, which saw U.S. tariffs on Chinese goods rise from 3 percent to 15 percent under former U.S. President Donald Trump, only a minority of which have been removed by the new President Joe Biden, and it has only intensified with China's zero COVID-19 lockdowns, putting a break on global exports due to supply chain disruptions. Then the Ukraine war saw the introduction of severe sanctions on Russia and a growing self-sanctioning trend amongst corporates. Finally, in the face of increasing costs and scarcity of food products, we are seeing some EM, including Russia and India, banning wheat exports in the hope of facilitating the achievement of food security.

The principle of the new trade policy is turning into "each man for himself," or at best "only trade with politically friendly nations," which may or may not be skilled at producing the goods that countries need. The protectionism of the interwar period sadly comes to mind... The trend is worsened by the growth of populism (as was visible in the tight nature of the French May Presidential elections, where populist candidate Marine Le Pen managed to receive 41.5 percent of votes in the second round), which seizes on the large cohorts of the population that feel left behind. Ironically, deglobalization will only raise prices and increase their cost of living further.

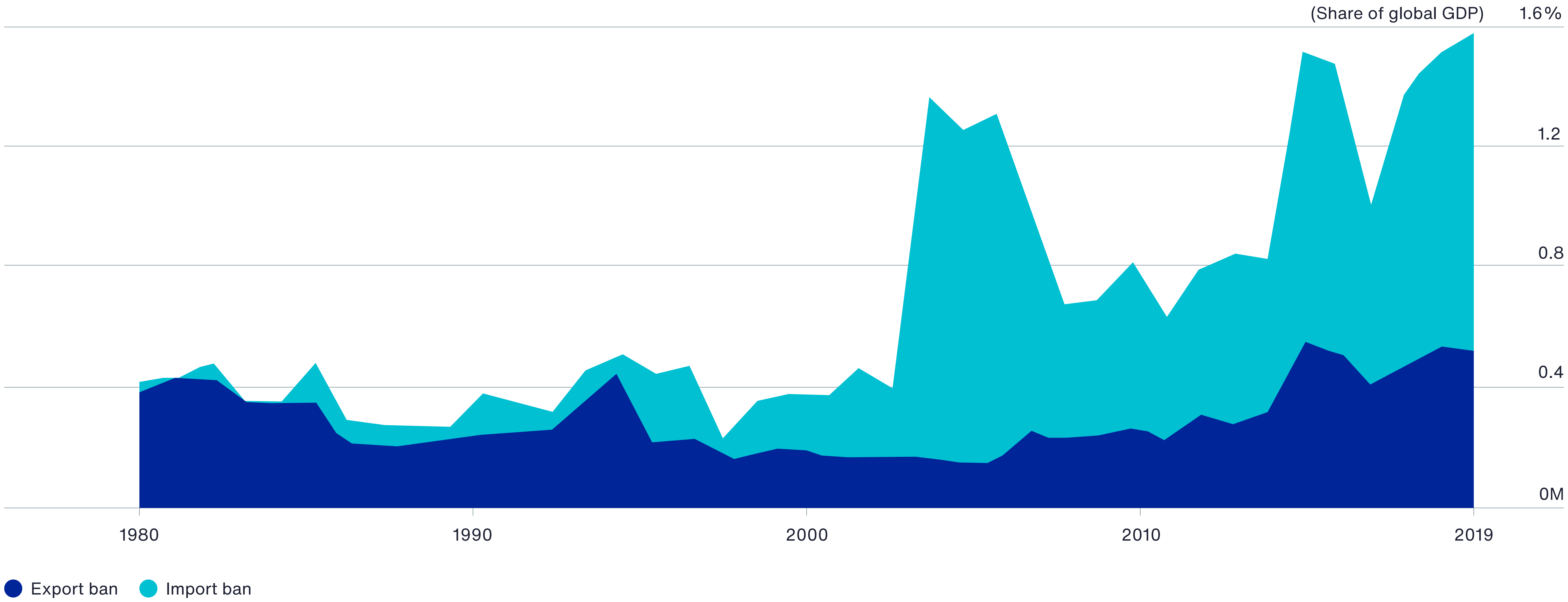
*In a Foreign Affairs article*, Adam Posen identifies three reasons behind the Ukraine war's precipitation of the end of globalization. First, while China is attempting to avoid confrontation in its response to the Russian invasion to avoid the retaliation which would occur if it were to help Russia avoid sanctions, it has not joined the sanctions and hence it is exacerbating anti-Chinese policies in the West, reducing its economic integration.

Second, many countries do not want to risk crossing the U.S. and incur its economic wrath in the event that it turns against them, as has been illustrated by the arbitrary freezing of Russia's central bank reserves. Hence they will prefer to limit economic dealings with the U.S. Third, even beyond the specific fear of economic interaction with the U.S., many countries see Russia's woes and want to limit economic interaction with global trade partners at large in order to achieve self-reliance.

## Figure 2 – Share Of Global Trade Affected By Export And Import Bans %

Sanctioning Trade

**Export and Import bans are hitting a rising share of global trade**




Source: Bloomberg, Continuum Economics

2



Regardless of the deep-seated reasons behind the generalized withdrawal from globalization, the overarching theme in our view is that politics trumps economics in the global allocation of resources. And the role of EM in the mix is quite interesting.

As we have noted previously, Russia's invasion of Ukraine has not been widely criticized across EM, many of which have remained neutral, which is by default supportive of Russia, not least because of historical diplomatic and military assistance from Russia. One way of simplifying the divisions that are appearing is to suggest that Russia is mobilizing autocratic countries, while the U.S. is mobilizing the democracies in a good versus evil conflict.

While this can be viewed as a caricature that lends itself to manipulation by politicians, it creates a division between countries which largely fits the current world map. Yet what is most interesting is the impact this division is having on trade flows.

According to Bloomberg, $6 trillion, or 7 percent of global gross domestic product (GDP), is currently traded between democratic and autocratic countries. Bloomberg examines the consequences of a worst case scenario of a 25 percent tariff being introduced on this $6 trillion trade between democratic and autocratic countries. It finds that global trade would plunge by 20 percent relative to a scenario without the decoupling between democracies and autocracies, returning to levels of trade last seen at the end of the Nineties before China joined the World Trade Organization. While the 25 percent tariff assumption is on the excessive side, the conclusion is nonetheless chilling.

Unfortunately, it would not just be the quantity of trade that would suffer but also its quality, as countries would shift resources towards activities which they are less good at, just on the basis of political blocs. In other words, Adam Smith's comparative advantage theory would be displaced. The lower costs and higher efficiency achieved through the global supply chain would vanish and if one considers that productivity is largely increased through trade, productivity would fall as well. With supply chain bottlenecks intensifying, inflation would also rise further, even beyond what we are witnessing now. The inefficiency of such an approach is best illustrated by China's issues with COVID-19 vaccination: had China-Western relations been less conflictual, Chinese leaders would have acquired more effective Pfizer and Moderna vaccines, which would have succeeded in tackling Omicron and avoided the recent spate of inhumane lockdowns in China.

On the other hand, as had been pointed out by Esther Duflo, in this new economic philosophy, parts of value chain production occurring in China could be shifted to production in Mexico for instance (although probably not India given its pro-Russian inclinations), as it is a Western-friendly state. Hence it would imply less a deglobalization per se than a change in the terms of globalization, and would improve the prospects for non-Chinese EM to join the development ladder. Obviously, apart from the fact that Mexican production processes might not be as efficient as Chinese ones, there is something problematic about an EM's development prospects being dependent on its political alliance, whether it is with the West or with a Russia-China axis. It is tantamount to the politicization of the global economy, which is increasingly accompanied by a return of the state in the domestic economy, which I have commented on previously.

The underlying message becomes: markets cannot be trusted, whether at the global or the domestic level. What an irony that the country that gave us communism is now, despite its own economic collapse being driven by a forced withdrawal from global capitalism, accelerating the demise of one of the foundations of capitalism itself, namely free trade.

$6 Trillion

or 7 percent of global GDP is currently traded between democratic and autocratic countries.

# 3

# Regional Overview of Political Risks

3

# Regional Overview of Political Risks

## Asia

Political risks have surged in the context of high inflation. The region was already struggling with high inflation caused by a combination of global supply chain bottlenecks, and adverse weather conditions. The shock in commodity prices and disruptions in the supply of fertilisers and cooking oil emerging from the Russia-Ukraine conflict meant that the region was caught in a vulnerable situation. This vulnerable situation has caused protests and social unrest in some Asian nations, as high food and energy prices make the cost of living difficult. In Indonesia, hundreds of smallholder farmers orchestrated a protest in Jakarta and in other parts of the country, demanding the government end a palm oil export ban that has slashed their incomes.

On April 28, Indonesia, the world's top palm oil exporter, halted shipments of palm oil and some of its derivative products to control rising prices of cooking oil, rattling the markets. Across the Bay of Bengal, Sri Lankan President Gotabaya Rajapaksa declared a state of emergency in May, following anti-government strikes and protests over the ever-worsening economic crisis.

Hit hard by the war, rising oil prices, and government tax cuts, Sri Lanka has been left with as little as $50 million in operational foreign reserves. As a result, Rajapaksa has been asked to step down. However, he refused to do so and a no-confidence motion put forward failed after 119 MPs voted against it. Meanwhile, in India, leftist parties orchestrated nationwide protests against rising inflation and unemployment.

The signatory parties stressed that the prices of petroleum products have increased by 70 per cent, vegetables by 20 per cent, cooking oil by 23 per cent, and wheat by 14 per cent in the last year alone. Most of these price hikes are caused by the war in Ukraine, with the exception of wheat, which rose due to extreme temperatures scorching production.

In India, communal tensions between members of Muslim and Hindu communities over remarks made by a local Bharatiya Janata Party (BJP) leader insulting the Prophet Muhammad during a debate on TV. Some Muslim groups held demonstrations across several states and union territories. While demonstrations were mostly peaceful in some states, outbreaks of violence were reported in Uttar Pradesh, West Bengal, Bihar, and Jharkhand.

In Afghanistan, violence between the Taliban and anti-Taliban groups — led by the National Revolutionary Front (NRF) — continues to worsen as the NRF killed three taliban members in Paroon district. The majority of these clashes took place in the provinces of Badakhshan, Baghlan, Balkh, Kandahar, Nuristan, Panjshir and Parwan. Additionally, the Taliban beheaded three NRF prisoners in Panjshir and killed civilians in Baghlan and Kapisa, accusing them of having links with the NRF. In Khenj district, 100 people were arrested on June 1, including minors and the elderly, despite local residents' contending that the detained did not have any links to the NRF. The recent earthquake in Afghanistan has killed at least 1,000 people and flattened homes in remote villages close to the Pakistani border. Now the earthquake risks exposing the limitations of an administration largely isolated from the outside world and desperately short of aid and resources.

Neighbouring Pakistan bears the brunt of Afghanistan's issues as well. Since August 2021, Tehrik-i-Taliban Pakistan's activities in Pakistan have grown manifold through fundraising, recruitment, and attacks in Khyber Pakhtunwala. Concurrently, the Islamic State-Khorasan Province has also been attacking parts of Pakistan and was responsible for an attack on a Shia mosque in Peshawar in March 2022. Furthermore, in the neighbouring region of Baluchistan, Baluch separatists conducted remote explosive and direct attacks against security forces last week. Multiple fatalities were reported in separate attacks involving Baloch separatist groups. Pakistan recently underwent a political crisis as the ex-prime minister, Imran Khan, lost a no-confidence vote in parliament after a dramatic week in which he violated the constitution in an attempt to stop the move going ahead. The opposition parties secured 174 votes in the 342-member house in support of the no-confidence motion, making it a majority vote. Khan's removal extends Pakistan's unenviable record of political instability, as no prime minister has completed their full term since its independence.

On June 5, North Korea conducted its 18th test missile launch in 2022, as eight short-range ballistic missiles were test-fired from multiple locations near Pyongyang towards the ocean. The test was in response to South Korea and the U.S. ending their joint military exercises. As a response to North Korean aggression, South Korea and the U.S. fired eight surface-to-surface missiles off South Korea's east coast on June 6 and flew warplanes on June 7 over waters around the Korean peninsula. On June 29, U.S. President Joe Biden, Japanese Prime Minister Fumio Kishida and South Korean President Yoon Suk-yeol met on the side-lines of the NATO summit in Madrid and agreed that in response to the aggression, the trilateral security partnership between Japan, the U.S., and South Korea needs to be further strengthened.

# 3



On May 25th, Ferdinand Romualdez Marcos Jr. was announced to be the next president of the Philippines, following a landslide election where he won by 58.7 percent. This victory comes 36 years after his dictator father was ousted in a pro-democracy uprising. Additionally, his vice presidential running mate, Sara Duterte, has won by 61.5 percent. She is the daughter of ex-President Rodrigo Duterte, whose controversial six-year term ended on June 30. They will lead a nation that has experienced multiple shocks through COVID-19 lockdowns, poverty, gaping inequality, and Islamist and communist insurgencies.

In Myanmar, the military has continued to carry out raids and attacks on civilians across the country. In the Sagaing region, the military and the Pyu Saw Htee militia abducted eight Ta Ohn villagers on June 10; the latter were used as human shields before being shot dead by the military. In the Magway region, the military abducted, tortured, killed, and burned five civilians, including a school principal, a pregnant teacher, and a nurse, who were participating in the Civil Disobedience Movement. The military has cut off internet access and mobile service in several townships in these two regions. Additionally, the junta has chosen to carry out death sentences against former National League for Democracy (NLD) lawmaker Phyo Zayar Thaw, and he is expected to be the first of many to receive the death penalty.

Meanwhile, on June 19, activists commemorated Aung San Suu Kyi's 77th birthday with protests in the Kachin state, Yangon, Mandalay, Sagaing, and Tanintharyi regions. On June 22, she was moved to a prison cell in Nay Pyi Taw as she continues to be tried by the military on corruption charges. She has been sentenced to 11 years in prison thus far. The military has cut off internet access and mobile service in several townships in these two regions. Additionally, the junta has chosen to carry out death sentences against forme (NLD) lawmaker Phyo Zayar Thaw, and he is expected to be the first of many to receive the death penalty.

# 3 Eastern Europe and CIS



## Eastern Europe and CIS

In Eastern Europe and the Commonwealth of Independent States (CIS), only Azerbaijan and Montenegro saw their overall risk rating change this quarter, improving to medium-high for Azerbaijan and medium for Montenegro, on account of a decrease in a variety of sub-components of risk. However, these improvements are isolated and recent developments in the region as a whole have confirmed it as the epicenter of EM risk. As a result of Russia's invasion of Ukraine, it is not only Ukraine and Russia that are fast becoming untouchable for investors. Economically, output in the region is set to shrink this year, as the war in Ukraine and its repercussions reverberate through commodity and financial markets, trade and migration links, and business and consumer confidence.

In addition to obviously major economic contractions in Russia and Ukraine, four other economies in the region are expected to shrink this year — Belarus, Kyrgyz Republic, Moldova, and Tajikistan — while most of the rest are projected to experience a sharp growth deceleration.

Politically, the region remains a powder keg, as Russia's new position as global pariah causes it to zero in on its natural sphere of influence in Eastern Europe and the CIS, clashing with the aspirations of many countries in the region to integrate with the West.

Azerbaijan has seen its overall risk level fall to medium-high. Its sovereign non-payment risk has fallen to medium, as high energy prices benefit the country's public finances. Exchange transfer risk has also fallen to medium-low from medium, as the net sovereign asset position should rise 12 percentage points in 2021-23 to 80 percent of GDP, reducing the risk of a disorderly devaluation of the de facto exchange rate peg. Finally, inability of government to provide stimulus has fallen to medium-low from medium. Indeed, sovereign foreign-currency assets rose to $52.4 billion at end-Q1 2022, equivalent to 29.8 months of current external payments, which includes sovereign oil fund assets of $45.3 billion.

Montenegro's overall risk has fallen to medium, as a variety of risk measures have improved. Sovereign non-payment risk has fallen to medium from medium-high, as the a timely issuance of a seven-year 750 million euro eurobond issuance in December 2020 at a highly favorable yield of 2.95 percent covered baseline financing needs for 2021 and 2022, so that government has commenced repayments on its dollar-denominated Bar-Bolijare highway-related loan with Exim Bank of China, and in July 2021, it secured a currency risk hedging arrangement on this loan with several international banks. Similarly, inability of government to provide stimulus has sizably fallen to medium from high, as the fiscal deficit in 2021 narrowed significantly, with the economic rebound boosting revenues alongside lower expenditures, resulting in the authorities comfortably meeting their end-2021 fiscal target of 3.8 percent of GDP. Exchange transfer risk has also fallen to medium-low from medium-high, as the partial rebound of tourism in 2021 supports a recovery in the current account and the reserve buffer at end-2020 peaked at 1.7 billion euro (42 percent of GDP) boosted by financing from the eurobond and Macro-Financial Assistance from the EU. Even banking sector vulnerability has fallen from medium to medium-low, as headline banking system metrics indicate resilience, with a well-capitalized and liquid overall banking system as of the third quarter of 2021, fueled by strong deposit growth and private credit recovery.

In Macedonia, exchange transfer risk fell to medium, as the de facto peg has served as an anchor of stability over the past decades, and the level of international reserves remains appropriate to support the peg. Bulgaria's new prime minister, Kiril Petkov, had signaled that he would withdraw Bulgaria's obstruction of North Macedonia's bid to join the EU. However, the Bulgarian government just lost its parliamentary majority, which will make it much more challenging to maintain this course poses renewed risks to near-term prospects of EU accession.

In contrast, in Uzbekistan exchange transfer risk has risen to high, as lower remittances and financing from Russia, and to a lesser extent a reduction in trade, are increasing Uzbekistan's external risks. Further supply chain disruptions are also reducing consumption and investment. Inability of government to provide stimulus has risen to medium-high from medium, as the budget deficit widened to 6 percent of GDP in 2021. On the upside, Uzbekistan remains at low risk of debt distress, given the new debt law, which will limit public and publicly guaranteed debt to 60 percent of GDP. Politically, the country continues to be led with a strong hand by President Shavkat Mirziyoyev, who was re-elected as President in October, against four candidates from government-loyal parties.

# 3 Latin America



### Latin America

Over the past few months, the quality of democracy has deteriorated in a number of countries in Latin America, along with the satisfaction with how democracy is working. Venezuela, Cuba, and Nicaragua are all ruled by authoritarian governments repressing the political opposition. Human rights organizations have expressed concerns about democratic backsliding in several other countries including Guatemala, Honduras, Peru, Haiti, El Salvador, and Ecuador.

These countries are currently experiencing social unrest, fueled by political factors such as weak democratic institutions, politicized judicial systems, unstable penitentiaries, corruption scandals and high levels of crime. Consequently, this is leading to declining or stagnant economic growth, high levels of income inequality, and an increase in the poverty rate. Other important themes include: COVID-19's comeback in the Southern Cone; tension between China and the U.S. over influence in Latin America; increased Central American migration; the Summit of the Americas; and the political implications of the economic impacts caused by the conflict in Ukraine.

Political risks surged in the context of high inflation. Beyond triple-digit inflation in Venezuela and double-digit inflation in Argentina, frustration about price increases has become widespread in the region. The region was already struggling with high inflation caused by a combination of a change in consumption patterns, global supply chain bottlenecks, and adverse weather conditions. The shock in commodity prices and disruptions in the supply of fertilizers emerging from the Russia-Ukraine conflict meant that the region was caught in a vulnerable situation. This vulnerable situation has caused protests and social unrest in some Latin American nations, as high food and energy prices make the cost of living difficult. Mass protests occurred in Peru between April 1 and April 18 amid rising fertilizer and fuel prices caused by sanctions on Russia during the war. While most demonstrations remained peaceful, some turned violent as demonstrators burned tires, clashed with police, and looted stores. Following the outbreak of demonstrations, authorities declared a one-month state of emergency and imposed a curfew in the departments of Lima and Callao.

The proposed measures led thousands of people to the streets in Lima in defiance of the curfew and demanded the resignation of President Pedro Castillo. Minor protests over prices also occurred in Argentina, Chile, Ecuador, Venezuela and Panama.

Confirmed cases of the BA.2 version of the Omicron variant are surging in the Southern Cone nations of Chile, Argentina and Uruguay. In Chile, the number of weekly confirmed cases more than doubled in late May, compared to the beginning of the month. Argentina's cases rose by 150 percent in the same period, while Uruguay's rose by almost 200 percent — although positive cases remain far lower than previous waves. In Uruguay, the number of beds in intensive care units occupied by patients has doubled to 3 percent. Only 53 percent of Argentina's population have received the booster shot. This number is fairly low due to difficulties in finding active testing centers, and a high percentage of the population having a defiant attitude towards the vaccine. Nonetheless, officials in these countries are not worried about deaths from this wave as overall vaccination rates are very high.

Guatemala has back-pedaled on democracy as the autocratic government of President Alejandro Giammattei has dismissed and threatened prosecutors that are not aligned with the government, thereby threatening judicial independence. Giammattei is backed by Congress and has effectively taken control of the three branches of the government. Giammattei had recently reappointed Attorney General Consuelo Porras for her second term. She is renowned for her backsliding on corruption investigations and protecting political figures, including the president, from corruption investigations. Similarly, Guatemalan judge Miguel Ángel Gálvez, who on May 5, ordered nine former police and military officers to stand trial for alleged crimes during that country's civil war, has received death threats from far-right groups and reports suggest he fears the government is trying to build a case against him because he works on sensitive corruption cases. A number of respected judges and prosecutors who worked on corruption cases have fled into exile.

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# $100 million

increase in security spending in El Salvador

# 17,000

soldiers deployed in El Salvador

Security conditions have worsened in populist President Nayib Bukele's El Salvador as in late March, 87 murders were registered within three days. On March 26, 62 homicides were reported, the highest so far since the civil war ended in 1992. In response, the Legislative Assembly approved an initial 30-day state of emergency that truncated civil liberties, including the right to free association and assembly. Additionally, the assembly approved of reforms that increased prison sentences for gang members, approved $100 million in security spending, and increased the number of soldiers to 17,000. The government has authorized special powers under the state of exception, and carried out mass detentions of 25,000 suspected gang members. The conditions of prisons for these detainees have been harsh. On May 25, the state of emergency was pushed back by an additional 30 days.

Furthermore, among the gang crackdown, the quotas for arbitrary arrest of innocents have increased, seemingly opposing the broad stroke approach implemented by the authorities. Bukele's administration had previously been championed for his drastic drop in murders, but investigations had shown that the government officials allegedly held meetings with gang leaders, offering money benefits, including lower sentences, in exchange for lower homicides. However, in March, the rivalry between MS-13 and its main rival, Barrio 18, was reignited, with a full-fledged war occurring between both parties. The administration's aggressive security policies have also raised concerns about growing authoritarianism in the region, especially given his removal of a few political opponents.

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However, Bukele's approval rating remains at about 72 percent, the highest of any Latin American leader, and recent polling by polling agency CID Gallup shows that 91 percent of Salvadorans approve of the government's aggressive response to the March killings.

Correspondingly, Ecuador's domestic security conditions have deteriorated due to alarming rates of drug-related violence. This intensified drug war has shocked the once-peaceful Ecuador. Drug trafficking in Ecuador has led to a surge in crime, with 1,200 people killed since January. In response, on April 30, Ecuadoran President Guillermo Lasso initiated yet another state of emergency for 60 days in the coastal provinces of Guayas, Manabi and Esmeraldas. Around 9,000 police and soldiers have been deployed to patrol the three provinces during the two-month state of emergency. This situation has exacerbated violence inside Ecuador's prisons in the past two months, as consecutive clashes between rival Ecuadorian gangs have led to 64 deaths. These clashes have led to 300 prisoners escaping.

This rising violence in Ecuador has put Lasso in a tough position. He was praised by organizations for boosting an economic recovery with a $1 billion COVID-19 vaccination program and his fiscal measures have reduced the high deficit. However, his achievements have been overshadowed by high levels of violence and fervent opposition in the National Assembly to his economic investment and security proposals.

Similarly, gang violence and political instability in Haiti have plagued institutions and brought the economy to the brink. Haiti's political and economic condition has been in disrepair ever since the assassination of President Jovenel Moïse in July 2021. Additionally, gang violence has risen by 300 percent in the last few months as gangs force schools, businesses and hospitals to close as they raid new neighborhoods and kidnap victims daily. This ongoing violence and instability has forced hundreds of thousands of Haitians to flee their country to the neighboring Dominican Republic, Cuba and the U.S.

Political repression continues to persist in Nicaragua, as the newly re-elected president Daniel Ortega continues to crack down on civil society groups and opposition figures. More than 130 nongovernmental organisations have been shut down, including 12 universities, because of dissent against the Ortega administration. On May 9, a new law was initiated further restricting the functioning of civil societies by requiring them to seek approval for their activities, and imposing new reporting constraints, including detailing sources of funding, financial statements and activities.

The crackdowns are an attack on any types of dissidence. Since the election, 50 opposition politicians, journalists and business leaders have been arrested. Most, who have been arrested and tried, have been found guilty, with some being sentenced to 13 years in prison. On March 22, Cristiana Chamorro, one of the seven political opposition leaders arrested before the election, was given an eight-year sentence. She was seen as the best hope for defeating President Ortega before being arrested. Sanctions imposed by the U.S. through the Reinforcing Nicaragua's Adherence to Conditions for Electoral Reform Act have been ineffective on Ortega's family and allies. Additionally, the EU has targeted the parties responsible for serious human rights violations and repression of civil society by issuing travel bans and imposing asset freezes. These socio-political events have led to tens of thousands of people fleeing towards the U.S. and asylum-stretched Costa Rica. Around 3 percent of Costa Rica's population consists of Nicaraguan refugees and asylum seekers.

The Central American migrant crisis has been exacerbated due to the aforementioned instability, political violence and natural disasters in the Northern Triangle countries — El Salvador, Guatemala, Honduras and Nicaragua — and waves of migration are expected to increase in 2022. This is one of the key causes of the immigration crisis at the U.S. border. U.S. Customs and Border Protection officials encountered a record-high 234,000 individuals at the U.S. southern border in April 2022. The Biden administration has proposed allocating $4 billion to Central America over four years, with $880 million being implemented in the current fiscal year and $990 million in the next one. Simultaneously, shelters in Mexico have been overwhelmed, and many migrants get stuck along Mexico's southern or northern borders. The Red Cross have reported 100,000 people missing in Mexico with numbers rising in the Northern Triangle and Nicaragua.

The ninth Summit of the Americas occurred from June 6 to 10. The conference was sparked with poor attendance as the U.S. did not invite Cuba, Venezuela and Nicaragua to the summit as these countries are accused of having undemocratically elected leaders. Washington's exclusion of these nations led to Andrés Manuel López Obrador, the President of Mexico; Xiomara Castro, the President of Honduras; Luis Arce, the President of Bolivia; Nayib Bukele, the President of El Salvador; and Ralph Gonsalves, the Prime Minister of Saint Vincent and the Grenadines, boycotting the summit. Instead, the foreign ministers of these nations attended the conference. Furthermore, Alejandro Giammattei, the President of Guatemala, stated he would not attend the summit after the U.S. criticized his government's reappointment of Consuelo Porras as Attorney General, who had been accused of undermining corruption investigations.

# 3



Washington has long considered Latin America as its backyard, but as evidenced by the recent boycott orchestrated by leaders of some Latin American nations, it seems as if the U.S. is losing some of its influence in the region. In particular, the absentees from Mexico and the Northern Triangle and the non-invitation of Cuba, Nicaragua and Venezuela are awkward for the migration declaration, as it does not bear the signatures of the leaders of countries behind the largest upsurge in illegal border crossings in two decades. Furthermore, the U.S. is losing influence to China in the region.

Over the past 15 years, China has invested $137 billion into Latin America, and its companies have made $83 billion of acquisitions in the region. China has always put deals first, turning a blind eye to corruption and transparency. Recently, the nation has increased its efforts to remove Taiwan from the equation by refusing diplomatic relations with countries that recognize Taiwan's sovereignty.

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Leftist Gustavo Petro, a former member of the guerrilla movement M-19 and former mayor of Bogota, won Colombia's presidency on June 19 and is the first left progressive leader to take over. He unexpectedly beat construction magnate Rodolfo Hernández by 797,973 votes. Petro vows profound social and economic change. He plans to fight the rampant inequality (Colombia is Latin America's most unequal nation), reduce oil dependency, raise taxes on the 4,000 wealthiest families, remove some corporate tax benefits, raise some import tariffs, and instigate plans to expand social programs. Petro has also pledged to fully implement the 2016 peace deal with the country's largest rebel group, the Revolutionary Armed Forces of Colombia, or FARC, and to slow the destruction of the Colombian Amazon, where deforestation has risen to new highs in recent years. This campaign was his third presidential bid and his victory adds the Andean nation to a mushrooming list of Latin American countries that have elected left-wing leaders in recent years.

In Brazil this October, former leader Luiz Inácio Lula da Silva beat incumbent Jair Bolsonaro in the presidential election. Lula's manifesto included a new fuel pricing policy, removing a cap on government spending and dramatically reining in deforestation.

A new growing "pink tide" is gaining pace in the region as angry voters, pinched by the economic impact of the COVID-19 pandemic and rampant inflation fanned by Russia's invasion of Ukraine, have ditched mainstream parties and been lured by promises of bigger government and social spending. Colombia and potentially Brazil will join Mexico, Argentina, Chile and Peru in a growing left-wing bloc.

Extreme polarization is another source of political risks in Latin America. A potential consequence of extreme polarization is an increased public tolerance to democratic backsliding, that often gives rise to authoritarian or totalitarian regimes. At the very least, polarization leads to political gridlock and undermined governance. Additionally, extreme polarization increases risks of civil conflict via damaged social cohesion, mistrust in institutions and increasingly antagonist societies.

# The Middle East & North Africa (MENA)

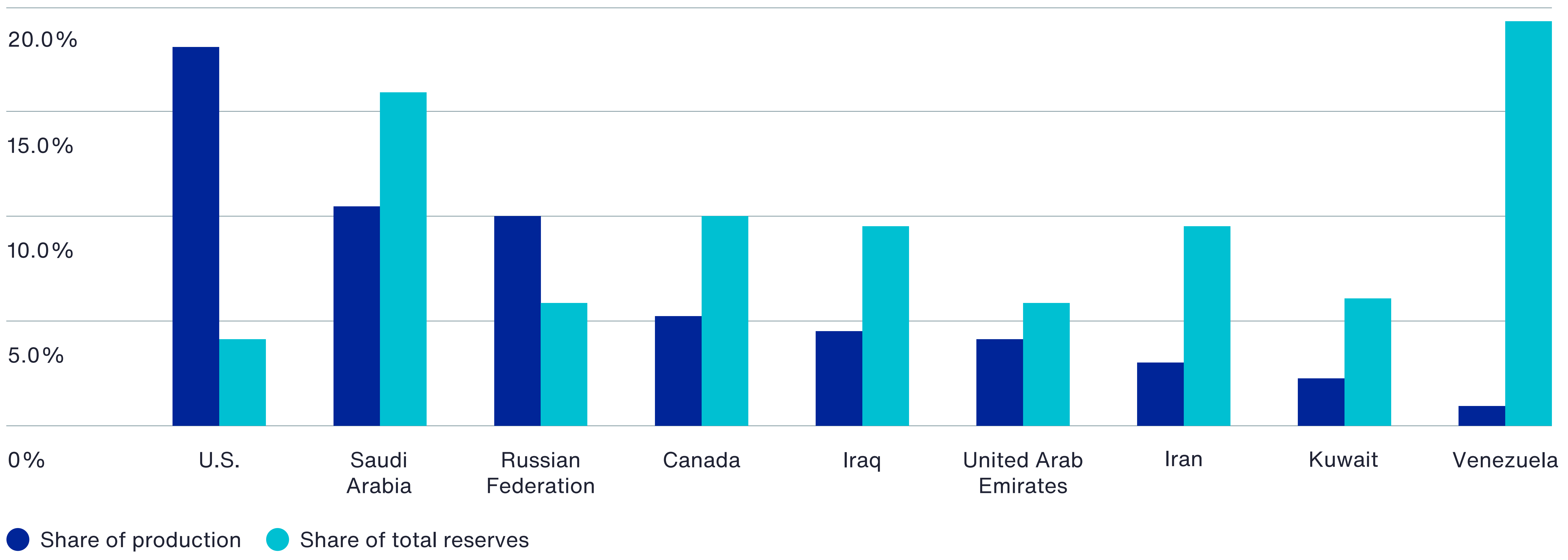


### The Middle East and North Africa (MENA)

The next few years should be bountiful for MENA countries, as underinvestment in new supply in the past few years keeps oil and commodity prices elevated and as the aftermath of the Ukraine war sees consumers switching away from Russia. Indeed, a tailwind can be seen through this decade, as the energy transition adjusts to having a longer life for oil and then gas.

However, Saudi Arabia and the United Arab Emirates (UAE) are adapting more quickly to the long-term challenges of the energy transition than Iraq or Iran, which desperately need foreign investment to avoid the adverse impact once peak oil demand kicks in during the 2030s. The shift from oil to gas also means that Qatar and Iran will have more power in the region in the long run.

**Figure 1: Oil Production and Proven Reserves**
(% of global total, 2020 data)




Source: BP

## Navigating the Energy Transition

MENA countries have been navigating energy market challenges over the past two years, with oil price stabilization in 2020 helped by OPEC+ production cutbacks during the COVID-19 crisis and then in 2022 helping to redirecting oil to Europe due to the Ukraine war and the EU's seaborne oil ban on Russia. The spirit of cooperation has helped, but can this also help in the multiyear and multidecade global energy transition to renewables?

## For now the energy transition strategy has been at a country level, including:

### Upstream diversification

Some countries are seeing opportunities in exporting refined products, and large new capacity is coming on stream into 2023 at Jazan in Saudi Arabia and Al Zour in Kuwait, which will relieve some of the pressure in the global diesel market. GCC countries are also interested in capturing more profit margin via a bigger share in petrochemical production.

### Cleaner energy production/ circular carbon economy

Saudi Arabia has made a big push toward decarbonizing production and reducing unnecessary gas flaring, in contrast to, say, Iraq where wasteful gas flaring remains rife. Additionally, Saudi Arabia and the UAE are keen on carbon capture and storage projects, as part of a concept to a circular carbon economy that avoids climate change spill-over from fossil fuels. The final element is goals in some countries to rapidly increase solar energy to meet domestic electricity production (e.g., Saudi Arabia), while others have a much slower path despite renewable resources (e.g., Iraq, which has hydro and wind potential as well as solar).

### Hydrogen

Long-term the energy transition is expected to involve green hydrogen (from renewable energy once domestic demand is met) to power ships and planes, and Saudi Arabia is trying to position itself as the lowest cost producer and widen its exports of energy products. However, large-scale adoption is not expected until the 2030s for green hydrogen.

3

A number of these strategies can help MENA countries through until 2030, but these are supplementary to the core oil and gas export capabilities. However, Saudi Arabia's and the UAE's balance sheet strength means that they are ahead of Iraq and Iran, which really require large-scale foreign investment — where political stability and green credentials are important preconditions. Additionally, attempts at major diversification away from energy products have not been successful in recent decades. Saudi Arabia's Vision 2030 will have some success given the sums being committed from the government balance sheet, but the real test comes when these businesses are established and have to compete with the U.S., Europe, China and Asia.

One key question for MENA countries is whether energy importers will accelerate the shift away from imported oil and gas in their countries. Solar, wind and hydro plans are being accelerated in many advanced economies, but also emerging markets will increase investment to help reduce energy costs and foster domestic energy security. The circular carbon economy is also expensive, and global renewable investment is more cost-effective at producing electricity. Even so, through until 2030 or 2035 energy usage is projected to surge in EM countries, and this growth will likely require sustained demand for oil for transport and petrochemicals and gas for power generation, given that new nuclear capacity takes at least 10 years. China and India have resorted to increasing coal production, as gas was proving somewhat costly. The growth of renewables production of electricity may merely meet the growth in global energy demand driven by EM countries. This trend can help MENA countries for the remainder of the 2020s.

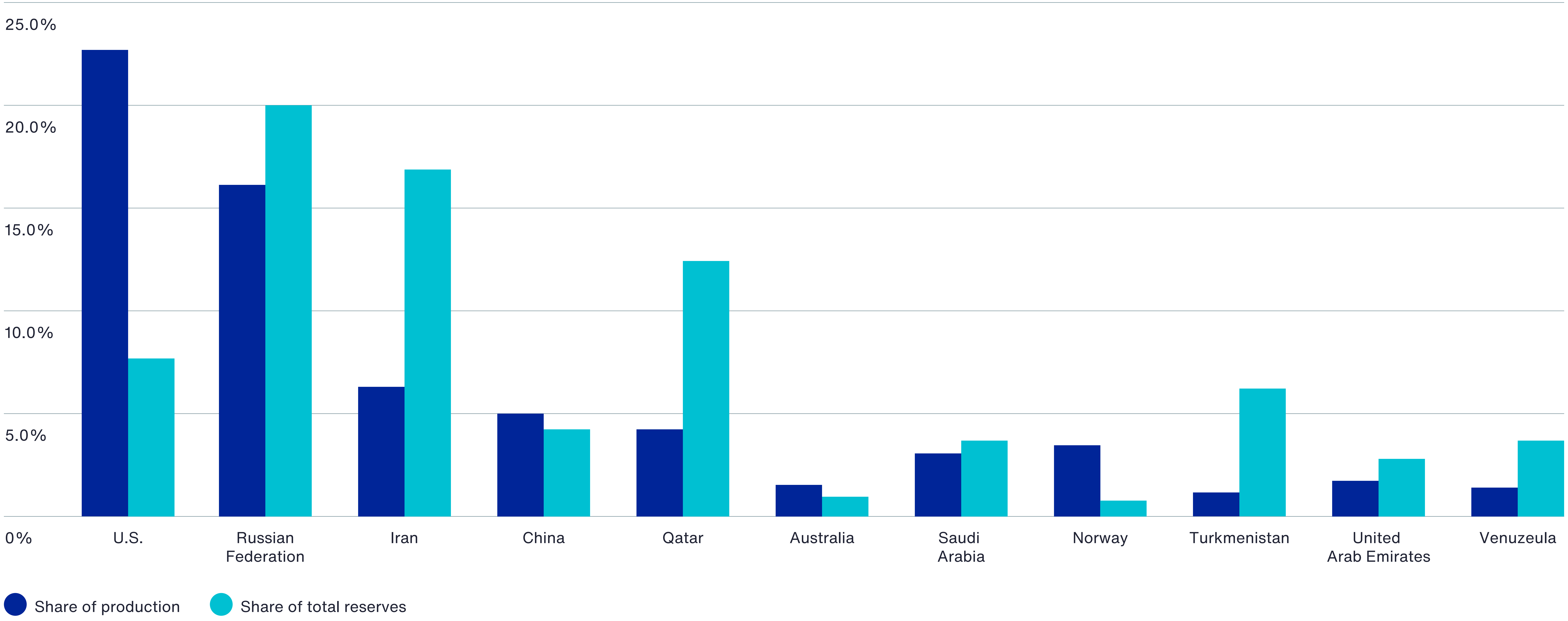
MENA countries remain low-cost oil producers and have ample reserves (Figure 1), especially when the U.S. runs down reserves in the 2030s. Some new crude oil capacity is planned in Saudi Arabia as the profit margins mean short payback on investment that outweighs the risk of peak oil demand causing a price war in the 2030s and beyond. However, other countries will be reluctant to substantively increase capacity, given longer paybacks and the risk of stranded new oil assets in the 2040s.

Saudi Arabia, the UAE and Oman are also aggressively trying to ramp up gas production, which will likely remain a transitional energy source through the 2030s and certainly later than oil. With Australia, Norway and the U.S. expected to exhaust proven reserves in the 2030s, MENA countries can fill the gap. However, unlike oil this will be dominated by Qatar and Iran (Figure 2), with Iran having scope for a major export ramp-up if a peace deal could be reached with a future U.S. president (present opinion polls suggest the prospect of a Republican president in 2024, but uncertainty is high this far out) and foreign investment is unlocked. This will likely alter the balance of power in the Middle East.

This hybrid strategy for MENA countries can still sustain growth momentum and existing government expenditure to GDP ratios for Gulf Cooperation Council (GCC) countries if that is the political choice. However, this is not a real diversification strategy for life once peak oil demand arrives at some stage during the 2030s, as then the political risks increase dramatically. Hard choices will then need to be made over cutting back expenditure or raising taxes to make up for the reduction in oil-related revenues.

## Figure 2: Gas Production and Proven Reserves

(% of global total 2020 data)




Source: BP

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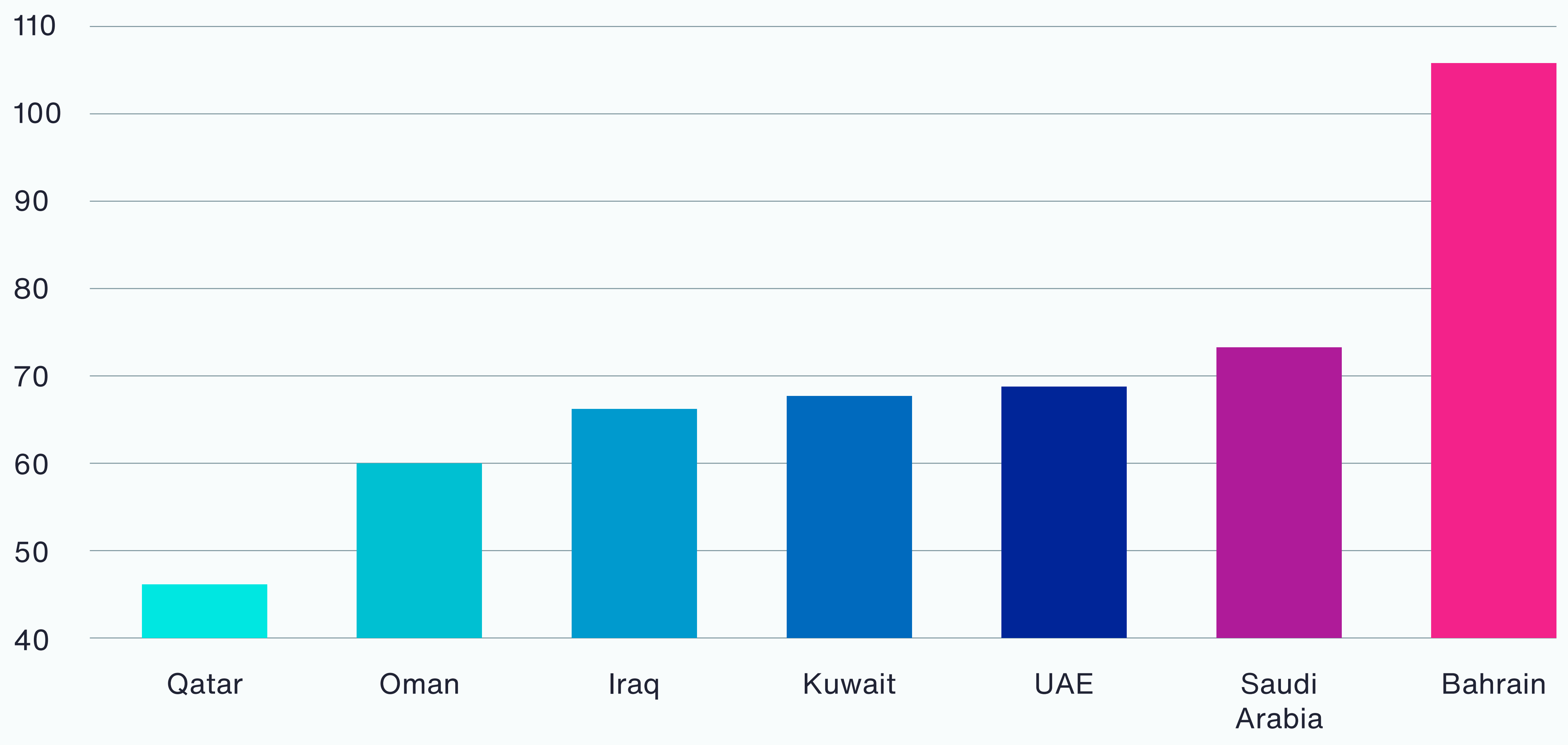
## Long-Term Challenges

One way of monitoring these long-term tensions is to look at the fiscal breakeven in U.S. dollar per barrel (Figure 3), where high government expenditure needs a higher oil price — Iran is not on Figure 3, but is $389. In reality, MENA countries with strong balance sheets plus reasonable medium-term inflation can run a fiscal deficit and accumulate government debt.

An alternative measure of fitness is the current account breakeven oil prices (Figure 4) for a zero current account. Such a target is tough, as a modest current account deficit can be run for better economies but is more challenging for weak economies or those with high inflation. Taking the two measures together, Bahrain is in a vulnerable long-term position; Saudi Arabia needs to do more work to ensure resilience (e.g. broader tax base and controlling government spending); and Qatar is better placed.

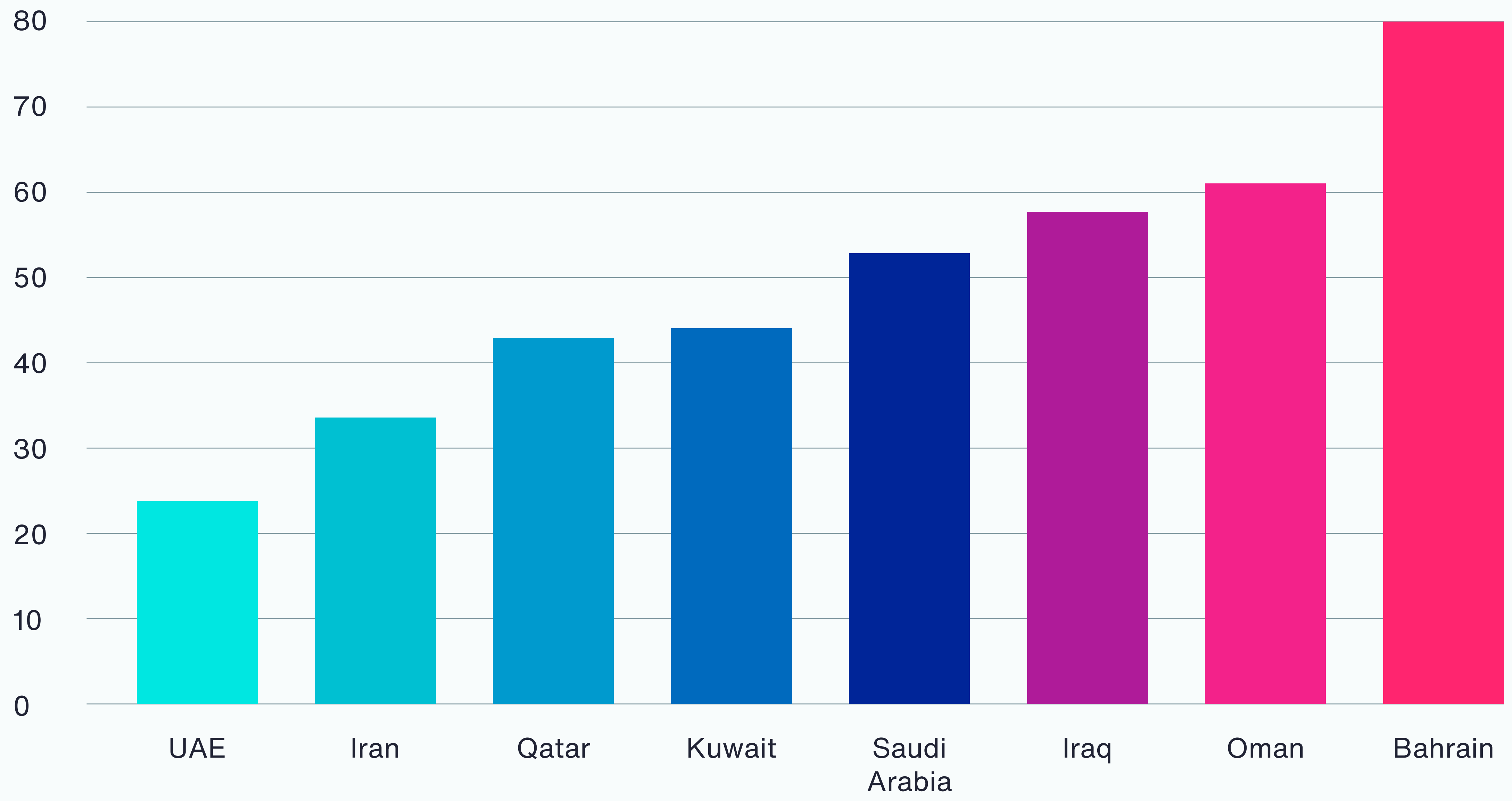
### Figure 3: Fiscal Breakeven for Zero Fiscal Balance

($ per barrel)




### Figure 4: Fiscal Breakeven for Zero Current Account Balance

($ per barrel)

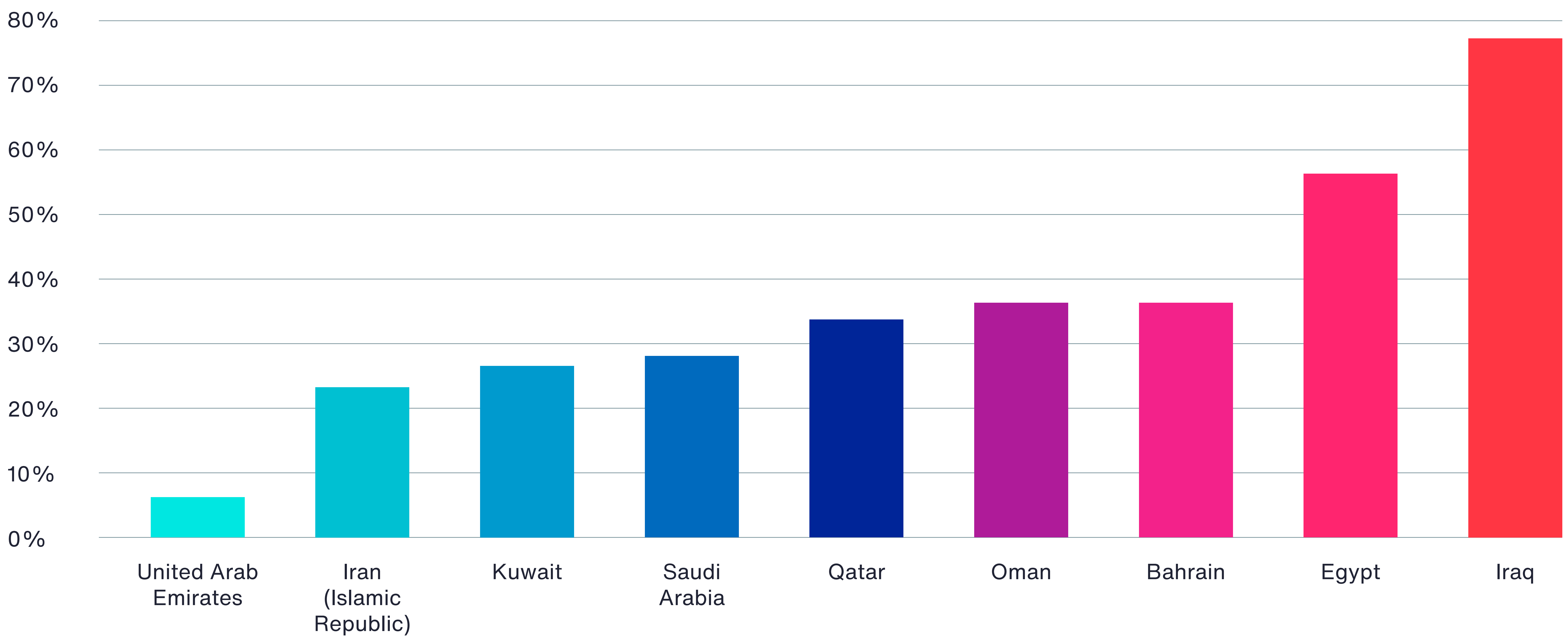



Source: IMF (Figure 3 & 4)

Additionally, food price inflation globally also has long-term implications for the region, as do current tensions caused by the Ukraine war and restricted exports of wheat. A growing and younger population can push for change, which can cause political tensions (Figure 5). The problem depends on scale as well, with projected population totals in Egypt and Iraq jumping by tens of millions.

The political tension does not exist just for food, but also for government services and job creation, and this all has echoes of the 2010-13 Arab Spring. This will be a challenge for governments in Iran and Iraq, which will likely result in social unrest and repression.

## Figure 5: 2050 Population vs. 2020 (%)




Source: UN 2019 estimates

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One final measure to track long-term health of MENA economies is Continuum Economics' Country Insights ranking (for methodology see here). As well as a huge granular array of measures for each country, we provide aggregate measures for country strength, sovereign risk and investment attractiveness. The UAE and Qatar are well-placed by global standards, Saudi Arabia has room to improve and Iran, Egypt and Iraq need to make substantive improvements if they want to attract large-scale foreign investment. These rankings are updated every quarter.

## Figure 6: Country Insights Rankings

| | **Country Strength Index** (Avg Pillar I-IV) | **Investment Attractiveness Index** (Avg Pillar I-III) | **Sovereign Risk Index** (Avg Pillar I-II) |
|---|---|---|---|
| United Arab Emirates | 9 | 21 | 52 |
| Kuwait | 11 | 13 | 21 |
| Qatar | 23 | 57 | 79 |
| Saudi Arabia | 37 | 55 | 75 |
| Oman | 59 | 127 | 151 |
| Iran | 97 | 104 | 106 |
| Egypt | 114 | 131 | 136 |
| Iraq | 148 | 146 | 124 |
| Libya | 152 | 160 | 161 |
| Yemen | 165 | 161 | 162 |

Source: Continuum Economics

# 3 Sub-Saharan Africa



### Sub-Saharan Africa

In Sub-Saharan Africa, two countries have seen a change in their overall risk rating, namely Lesotho and Eswatini (formerly known as Swaziland), both for the worst. In reality, the whole region is in the throes of a major crisis, as it deals with the consequences of Russia's war in Ukraine. In the previous quarter, we looked at the impact of the war and its beneficial impact for Nigeria or Algeria as oil and gas substitutes for Russia in terms of European fossil fuel demand, but we highlighted that most African countries would experience heavy costs from the higher food and fertilizer prices resulting from the blockage by Russia of Black Sea ports, which hold grain containers, but also from the downright absence of food supply, as Africa accounts for 34 percent of Ukrainian/Russian food exports.

With every day that goes by, the list of negative consequences of the conflict for Africa grow. For instance, even if the supply of food to Africa were to be restored, the ban on Swift for Russian banks makes it highly challenging for African countries to pay for their grain and fertilizer from Russian sources.

No wonder a non-negligible number of African leaders have held back from supporting the EU's position on Russia in the Ukraine war, Senegal's president, Macky Sall, being the latest to complain about the Swift ban. Many more will follow, if the West fails to make up for the lack of Russian supply, in order to lower the economic and humanitarian impact of the port blockage. In that sense, Africa has an important position, currently representing the "non-aligned" states but increasingly veering towards the China/Russia bloc, as it fails to see how the West is representing its interests.

**34%**

Africa accounts for 34 percent of Ukrainian/ Russian food exports.

Lesotho's overall risk level has increased to medium-high from medium, due to a rise in sovereign non-payment risk, exchange transfer risk and inability of government to provide stimulus. Persistently high public expenditures are due to gaps in public financial management and a reliance on large and volatile transfers from the Southern African Customs Union. Expenditure pressures in the run-up to the September 2022 general election have driven up financing needs. Spending is being supported through growing domestic and external loans, arrears, and a drawdown of government deposits. Recently, the authorities have found it harder to balance upfront consolidation with recovery, yet it is indispensable to prevent the external position from deteriorating further. While the war in Ukraine has raised commodity prices, thereby benefiting diamond mining, there is limited scope for nominal exchange rate adjustment, which means that fiscal and structural policies must drive external adjustment. The exchange rate peg poses policy constraints, especially for an economy with a large foreign-owned banking sector.

Swaziland (now Eswatini) has seen a rise in its overall risk level to high from medium-high, purely on the basis of rounding effects. A year ago, the country, which is the only absolute monarchy in Africa, saw a major army crackdown on pro-democracy protests, in the most violent demonstrations against King Mswati in years. Political parties are banned. South Africa attempted to create a national dialogue forum with the King in November 2021 to introduce political reforms in Eswatini but the forum has not been established. Economically, Eswatini is in the top 10 of most unequal countries in the world, based on the Oxfam Inequality Report. The exchange rate is pegged to the South African rand, which means that the central bank has to maintain the policy rate broadly in line with the South African Reserve Bank's rate, although high inflation has occasionally led the central bank to raise the policy rate above South Africa's. The fiscal deficit will remain large, and public debt will remain above 60 percent of GDP over the medium term up from 33.9 percent in 2018, further reducing international reserves. Indeed, the government is using fuel subsidies to cushion the impact of a fuel price increase which has risen for the fourth month in a row, partly as a result of higher oil prices but also due to the depreciation of the lilangeni, as it is particularly vulnerable to Fed tightening as a frontier market with debt sustainability issues. Eswatini has faced compounding shocks, starting with El Nino in 2015-16, followed by drought in 2018-19, COVID in 2020 and the Ukraine war in 2022, which has resulted in current account, reserves, fiscal and inflation pressures. Each of these compound shocks depletes budgetary resources and draws civil servants' time and attention from service delivery toward crisis response. Revenue from the Southern Africa Customs Union makes up nearly half of the government's revenue, hence shocks both increase expenditure and reduce revenue, the ingredients of a fiscal crisis. To push the poverty rate lower than the current 28 percent, Eswatini has started strengthening financial resilience through a risk-layering strategy for frequent shocks and severe shocks.

Somalia has seen the inability of government to provide stimulus fall to medium-high from high, as grant financing has finally be liberated for increased public spending following the resolution of a protracted election process, and the fiscal deficit is expected to narrow to 0.5 percent of GDP, as revenues and budget grants recover. Somalia has lacked an effective central government since 1991 and had no legitimate national authority between February and June due to a clash between the President and Prime Minister, prompting a conflict between rival factions. Very recently, an election based on a restricted vote by 328 members of parliament has resulted in former leader President Hassan Sheikh Mohamud's returning to office. Terrorist group as Al-Shabaab wants to overthrow the government, having made gains in the semi-autonomous central state of Galmudug for the first time in a decade and controlling large swaths of southern and central Somalia. The government has lost some military capacity. In this context, U.S. President Joe Biden has reversed former President Donald Trump's withdrawal from the country, although he is only sending less than 500 U.S. soldiers. Yet he has pledged to keep a persistence presence in Somalia.

# 4

# Contacts

# 4 Contacts



**Aon Crisis Managment:**

**Sarah Taylor**
Head of Political Risks and Structured Credit
sarah.taylor@aon.co.uk

**Mairtin O'Griofa**
Broker, Political Risk and Structured Credit
mairtin.ogriofa@aon.co.uk

**Continuum Economics:**

**Orhan Kaya**
Economist, EMEA
orhan.kaya@continuumeconomics.com

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