

# Political Risk Quarterly Newsletter

Q2 2016

*Complementing the annual Political Risk Map, Aon's political risk newsletter is developed in partnership with Roubini Global Economics, an independent, global research firm originally founded in 2004 by renowned economist Nouriel Roubini. The newsletter is released on a quarterly basis and provides insight into levels and types of Political Risk in non-EU and -OECD countries.*

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## Summary

This quarter, two countries experienced improvement in their overall country risk ratings and just one saw deterioration, continuing the trend of improvement in recent quarters.

**Argentina** has been upgraded to medium-high from high. This upgrade was driven by reductions in the risk of political violence and of sovereign non-payment. The latter reflects the Mauricio Macri government's settlement with the country's outstanding bond holders allowing Argentina to regain access to global capital markets.

**Guinea Conakry** saw its overall country risk rating improve to high from very high. This shift was driven by improvements in the risk of political interference, sovereign non-payment and banking sector vulnerability.

**Comoros** saw its overall country risk rating deteriorate, moving to high from medium-high. This is due to increases in exchange transfer risk, banking sector vulnerability and a lessening in the government's ability to provide stimulus in the event of recession. These changes were partially offset by an improvement in supply chain disruption risk.

**Mauritius** experienced significant improvement in three individual risk areas – exchange transfer, banking sector vulnerability and the government's ability to provide stimulus. These changes, however, were not large enough to trigger an overall rating change from medium-low.

**Belarus** and **Tajikistan** showed some deterioration, with the former receiving lower scores for political interference and the risk of doing business, and the latter seeing its exchange transfer risk increase.

# Regional overview of political risks

## Asia

The overall political risk ratings of Asian countries have been modestly improving in terms of domestic economic and social policy. However, we have placed several countries in Southeast Asia on watch (Indonesia, Malaysia, Philippines and Taiwan). This is due to growing populist sentiment, delays to structural reforms and an increased risk of weak growth, all of these have the potential to adversely impact business conditions.

Increased military spending and nationalist sentiment in East and Southeast Asia should be monitored as both factors could disrupt trade. Recent elections in the Philippines add uncertainty to the country's domestic and foreign policy given the incoming Rodrigo Duterte government's focus on criminal justice and a change in its relations with China (including the possibility of direct talks on the two countries' maritime disputes). We anticipate little change in economic policy.

In China, the government has enacted policies to increase financial leverage in the economy in an effort to support growth and roll over existing domestic debt. Although this policy is not sustainable in the long-term, it reflects the government's desire to avoid passing on losses from historic investments at the present time. Political consolidation continues to increase uncertainty in policy making, while key financial markets onshore are subject to greater government intervention.

India's fiscal and economic reform process seems to have stalled under pressure from vested interests in the agricultural sector. The recent decision to replace the governor of the central bank will increase both the uncertainty in financial markets and the likelihood of stimulus measures.

Chinese policy is generally positive for regional growth for 2016-17; however, we would watch the balance-sheet effects of any further increase in oil prices as most Asian economies are net importers.



## Eastern Europe and CIS

Although the conflict in Eastern Ukraine continues, political risks in many of the CIS and Caucasus countries have stabilised, albeit at a high level. Meanwhile, economic and social conditions in Russia have remained stable as the country focuses on domestic economic policy and managing inflation.

Russia continues to present significant hurdles for foreign investors as it endeavours to reduce its reliance on foreign capital and imports. The country's economic recession weighs heavily on the income of CIS countries (such as Armenia, Kazakhstan, Kyrgyzstan, Turkmenistan and Uzbekistan) where remittances have reduced. This has exacerbated the risk of exchange transfer and sovereign non-payment and will lead some of these countries to seek financial assistance from multilateral development banks. Such economic pressures can also increase political tensions; the recent escalation in security risk in the Nagorno-Karabakh region, for example, which is threatening the fragile peace agreement between Armenia and Azerbaijan. Despite inflation falling in Russia, facilitating cuts in interest rates, it is becoming unsustainable elsewhere in the region, adding to the potential for increased political risks.

Although Ukraine's government has passed several reforms that lower the risk of doing business, there is a growing nationalist tilt, which raises questions about implementation of further policy improvements. Implementation of the Minsk II agreement has been very slow, meaning EU sanctions on Russia are likely to continue for the coming quarters, undermining investment in the banking and energy sectors.



# Regional overview of political risks cont.

## Latin America

As we note in this quarter's special feature, political risk in Latin America and the Caribbean is showing signs of improvement, notably in Brazil and Argentina.

Political risk in Brazil will remain high even if, as expected, President Dilma Rousseff's departure is made permanent. The Michel Temer-led caretaker government will be in a much better position to implement badly needed structural and fiscal reforms than its predecessor, but Congress will continue to be fragmented and the Petrobras corruption investigations could undermine the new regime. We expect labour markets to continue to deteriorate this year and the environment for investment will remain weak.

A recovery in economic growth in 2017 is possible, but will largely depend on a new government's capacity to implement key reforms. Brazil could well emerge stronger from the crisis, which has revealed a largely independent judicial system and a population less tolerant of corruption in the future.

As we signalled last quarter, Argentina's country risk rating has continued to improve as the government implements policy improvements in the areas of currency management, trade and debt. Other structural policies might continue these trends, including measures to attract foreign direct investment and reduce government intervention in the economy. However, there is significant implementation risk around the steep monetary and fiscal adjustment that will occur in 2016.

In Venezuela, political violence remains high and is rising as the country faces shortages of basic goods. The fight between the opposition-led legislative and the executive and judicial branches will continue. This will limit the scope for significant change until the country has more clarity on the kind of policies and economic model it wants for the future.

## Middle East and North Africa

The MENA region continues to contain some of the highest-risk countries in the world, and this quarter sees few changes in country risk rating. Weak oil revenues and continued regional conflicts have challenged the resilience of key economies and political systems. Despite the recent rebound, we think the general trend towards higher political risk will persist.

The internationalisation of the Syrian conflict and the fight against ISIS suggests a greater risk of adverse repercussions elsewhere, such as the recent sanctions pressure between Turkey and Russia. The ongoing conflicts in Syria, Iraq and Yemen will heighten the focus on military and security spending despite lower government revenues.

Despite the recent rebound, oil prices remain below fiscal breakeven costs for many producers. This will continue to place pressure on economies and government budgets throughout the region. The richer Gulf Cooperation Council countries will be better able to cope with this continued pressure than others; countries like Iraq and Libya, for example, which continue to struggle with significant internal conflict, or Algeria, which has few foreign assets and significant exchange transfer risks.

We expect greater pressure to employ nationals in Saudi Arabia and Oman and note that both are experiencing weakness across several risk icons, such as political violence and exchange transfer risk. Moreover, government interference in the economy and banking system may increase, and difficulties in implementing reforms suggest policy uncertainty in Saudi Arabia.

Energy importers generally have stable, although high, country risk ratings, but will suffer from a general tightening of regional financial conditions. Egypt, which is highly reliant on external funding, stands out as vulnerable, even as the pound's devaluation and the easing of capital controls dampen exchange transfer risk to some extent.

## Sub-Saharan Africa

There is a mixed picture across this region. As in the MENA region, low oil revenues continue to challenge national balance sheets, reinforcing the high levels of country risk. Oil and metal producers, such as Ghana, Mozambique, Nigeria, Uganda and Zambia, have seen some country risk factors deteriorate, including legal and regulatory risk and exchange transfer risk.

In Nigeria, the belated currency devaluation is a key step towards economic stabilization. However, strict capital controls may keep credit conditions tight and domestic demand weak. Mozambique (where the political environment remains volatile), Uganda and Angola have all seen government arrears to the private sector increase. Meanwhile, Uganda and Tanzania could suffer from further delays in developing their oil and gas resources given the global energy-sector investment cuts.

By contrast, oil-importing nations in East Africa have experienced a modest reduction in risk, notably Ethiopia and Kenya, where some recent regulatory reforms and reduced levels of political violence have improved the outlook, politically and economically.



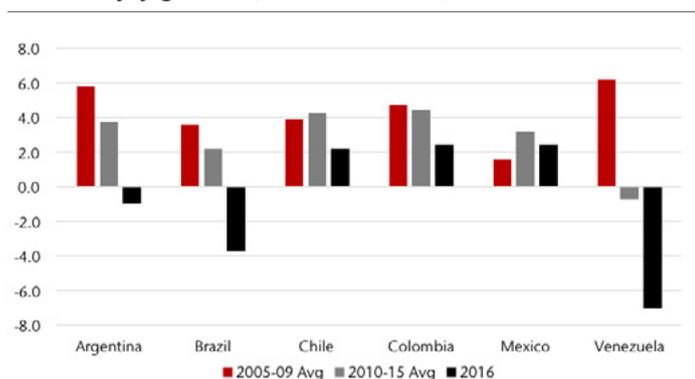
# In the spotlight

## The end of the populist axis in Latin America?

Latin America has had a few tough years, adjusting to the end of the commodity super-cycle, changes to China's growth path and tighter global financial conditions. The resulting steep terms-of-trade shock (a sharp decrease in the price of exports relative to imports) has had significant effects on fiscal and external balances across the continent, increasing economic risks and affecting growth. We noted these economic strains in 2014 and 2015 as country risk ratings generally deteriorated.

This pressure exposed a divide in the region. On the one hand, countries with sound policies and lower political risk (such as Chile, Mexico and Colombia) have been, despite a slowdown in their growth, more resilient to shocks. On the other hand, countries that had rapidly taken on more debt and increased government interference in the economy (such as Argentina, Brazil, Ecuador and Venezuela) were more vulnerable. Accumulated imbalances left them more exposed to external shocks and as they lack the policy options to offset the effects of the downturn.

### Real GDP y/y growth (Roubini forecast)



There are signs that some of the populism that plagued this second group is now starting to reverse, improving the outlook for country risk and investors in these nations. In particular, rule of law is improving as a result of corruption investigations and there are signs that the level of political interference is declining in certain economies. This could have a big effect on the region's overall investment and growth outlook, even if weak commodity prices and falling Chinese demand continue for some time.

The populist axis has suffered two impressive setbacks over the past few months. In Argentina, President Cristina Fernandez's chosen successor lost the presidential elections to the centre-right candidate, Mauricio Macri, who has rapidly advanced with an ambitious reform agenda. In Venezuela, the "Chavistas" lost a legislative election for the first time since the late Hugo Chavez came to power in 1998, with the opposition achieving a two-thirds super majority. Although they may not be able to prompt a change in the policy mix, due to the ability of President Nicolas Maduro and the judiciary to block major legislative changes, the continuation of unsustainable policies are making regime change more likely.

In Brazil, President Dilma Rousseff has been replaced (at least temporarily) by her Vice President Michel Temer, who has already announced some more fiscally sustainable measures. Even if a major policy shift does not take place immediately, Brazilians are unlikely to vote for continuity at the next presidential election, and a more market-friendly reformist candidate is therefore expected to win. The power exercised by the courts during the recent set of scandals has resulted in some improvement in the rule of law and exposed the huge amount of corruption.

In Ecuador and Bolivia, Presidents Rafael Correa and Evo Morales, respectively, have suffered some setbacks to their plans to extend their grips on power. We are yet to see meaningful reforms that would improve the business environment in Bolivia, but we would watch for measures that might reduce government intervention in the future. Ecuador's debt dynamics remain concerning, suggesting some further fiscal adjustment is likely.

## Country risk rating overviews

### Improvement to country risk rating

**Argentina** (high) saw a decrease in the risk of political violence and sovereign non-payment.

**Guinea Conakry** (high) saw improvements to the risk of political interference, sovereign non-payment and banking sector vulnerability.

### Deterioration in country risk rating

**Comoros** (high) deteriorated due to slight increases in exchange transfer risk, banking sector vulnerability and the inability of the government to provide stimulus in the event of recession

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**To view the online map or to download the App, click on the link below:**

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## About Roubini Global Economics

RGE was founded in 2004 by Dr Nouriel Roubini. Using his national balance-sheet approach to analysing economies, RGE's aim is to produce macro analysis which goes beyond the consensus view to influence investment decisions around the world. In 2016, the subscription business of RGE merged with 4CAST, adding shorter-term market and data analysis to its portfolio of services. RGE works with clients in different ways, from its macro-strategy subscription product, to bespoke work and the licensing of its systematic country risk analysis tool. For further information on Roubini Global Economics, please visit [www.roubini.com](http://www.roubini.com).

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