

Political Risk Quarterly Update

JANUARY 2021

Complementing the annual Political Risk Map, Aon's political risk newsletter is developed in partnership with Continuum Economics, providing insight into political risk in non-EU and -OECD countries.

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SUMMARY

While there have been some silver linings for emerging/frontier markets (EM/FM) within the COVID crisis, not least the fact that their younger populations and typically warmer temperatures have limited the spread of the disease compared to developed markets (DMs), they could nonetheless be dealing with the economic aftershock of the crisis for longer than their DM counterparts. First, it will take longer for them to receive the COVID-19 vaccine despite the COVAX initiative, and its distribution will be more targeted to vulnerable groups within the population, implying a longer period of stop-start restrictions and the lack of a sizable consumption rebound. Second, economic scarring will be greater 1) in EMs with the most vulnerable economic structure – one which is heavily based on tourism and remittances, where the labour market is the most rigid, and where the limits to fiscal support are the highest; 2) in EMs with the largest declines in 2020 GDP growth; 3) in EMs with the lowest 2020 consumer confidence.

How does this translate into risk? Two of the greatest impacts will be on increased sovereign non-payment risk and increased political violence. Until private creditors participate in IMF-led debt restructuring initiatives and China shows more enthusiasm towards them, FMs' risk of sovereign non-payment will be significant. As for political violence, it will follow from economic scarring. Indeed, the rise in unemployment caused by COVID-19 will be more significant in FMs, with a higher share of informal jobs and a smaller part of the population able to work from home. The result will be an aggravation

of inequality of income, and for that matter inequality of opportunity, with poor households also unable to switch to online education. In turn, heightened inequality will lead to an increase in protests. While a recent [IMF paper actually provides evidence of a link between pandemics and social unrest, as measured by the civil disorder score from International Country Risk Guide](#), the effect of inequality on social unrest is stronger when income inequality is initially high. Indeed, an increase in the net Gini coefficient, which is a measure of inequality, is associated with more social unrest when the initial level of the net Gini is above 0.4.

This quarter, we saw a change in the overall risk rating of eight countries. Iran, Kyrgyzstan and Macedonia saw their overall risk score decline this quarter, while Macau, Montenegro, Swaziland and Zambia's level increased. Of the increases, Zambia's is the most significant, in that it is the first African country to default on its debt since COVID-19. This may have a domino effect on the rest of the region, which could result in a jump in sovereign non-payment risk across the region.

In terms of the decreases, Iran's is the most critical, in that the expiry of the UN arms embargo on Iran and prospects for a U.S.-Iran détente under a U.S. Joe Biden Presidency could fundamentally alter Middle Eastern relations with the West, foreshadowing a more sustainable easing of risk. Changes in the other countries' risk ratings have more to do with their idiosyncratic politics.

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UNDER THE SPOTLIGHT DIGITAL SERVICES: THE POST-COVID ERA'S NEW OIL

As large swathes of Europe are in lockdown and working from home has become the new normal, one area of global trade has accelerated during the COVID-19 pandemic as others collapsed: trade in digital services, from remote

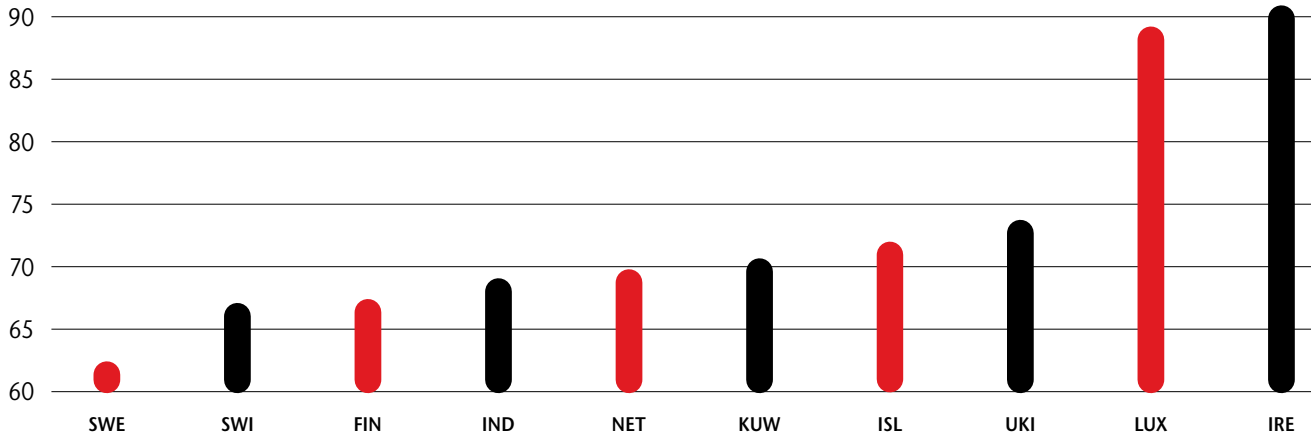
learning to remote health services. If there is one comparative advantage that would be helpful for countries to have right now, especially as the transition to a green economy has barely started, it would be in the production of digital services.

They have become a much-coveted endowment, just like oil has been until recently. Which countries dominate the digital services sector?

Ireland, Luxemburg and the UK are the outperformers in terms of digitally-deliverable services exports to total services exports. Within the EM universe, the outperformers are Israel, Kuwait and India. However, we have seen a tightening in this

sector with a freeze in the liberalisation of trade restrictions since 2015. Especially within EM authoritarian states, which see digital services as potential for the expression of dissent, we are seeing a limitation of foreign providers' access to infrastructure/connectivity. Despite COVID-19 presenting a natural opportunity for growth in digitally-deliverable exports, it has intensified a protectionist backlash in many governments, threatening this development.

Figure 1: Top 10 Country Ratios of Digitally-Deliverable Services Exports to Total Services Exports, %



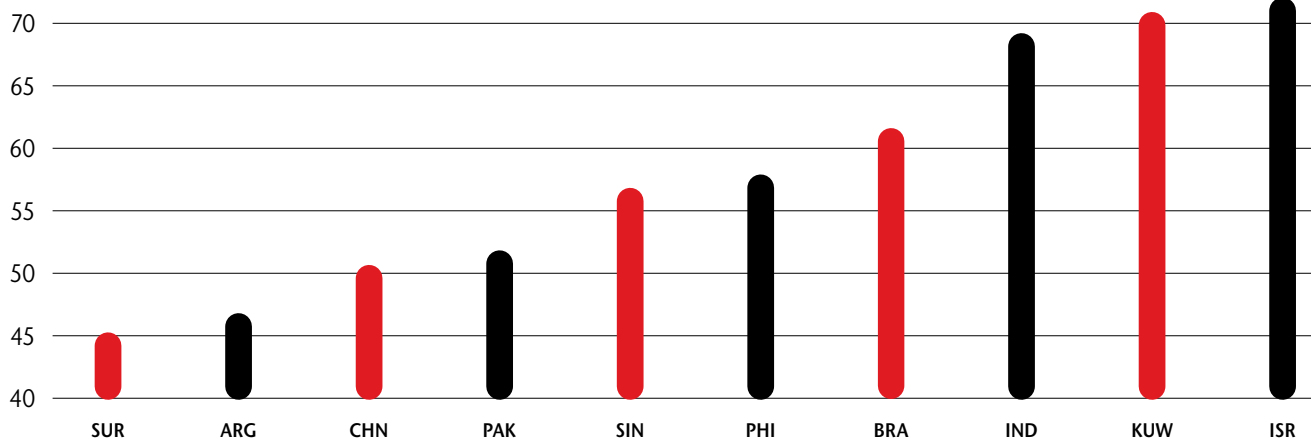
Source: Continuum Economics, UNCTAD

With telecoms and computer services becoming more easily available and affordable, more services are increasingly tradable and remotely deliverable. This has given rise to an expansion of the outsourcing and offshoring of a range of business services, such as marketing and management consulting, and has lowered barriers and entry costs for businesses in EMs to produce and export such services. Digitally delivered or Information and Communication Technology (ICT)-enabled services are defined as services delivered remotely over ICT networks. While they are often difficult to measure, the UN Conference On Trade And Development (UNCTAD) estimates the value of exports of those services that could potentially be delivered digitally, hereafter 'digitally deliverable services'. They include insurance and pension services, financial services, charges for the use of intellectual property, telecommunications, computer and information services, other business services, and audiovisual and related services. [Based on UNCTADStat.](#)

[Figures 1 and 2 provide respectively a global and an EM-specific ranking of countries with the top 10 digitally-deliverable services exports to services exports ratios.](#) Hence what is being measured is not the weight of the digital/ICT sector per se, but the digitally-enabled sectors, which span a wider range of services. These services, which now account for 50% of global services exports, have grown annually by 7% over the past decade and are worth five times more than ICT services alone.

Globally, Ireland, Luxemburg and the UK top the ranking of digitally-deliverable service exports to services exports ratios. But EMs, including Israel, Kuwait and India were all in the global top 10 of digitally-deliverable service exports to services exports, with Israel coming 4th overall. For all three EMs, more than 65% of their services exports could be traded digitally in 2019.

Figure 2: Top 10 EM Ratios of Digitally-Deliverable Services Exports to Total Services Exports



Source: Continuum Economics, UNCTAD

In EMs, telecoms, computer and information services constitute the largest share of digitally deliverable service exports at 30%, as opposed to DMs, where financial services, audiovisual and related services, and charges for the use of intellectual property constituted 80-90% of exports of such services. Israel leads the EM pack, unsurprisingly given that financial-technology, cybersecurity and digital health startups have been flooded with private funding in recent years.

In Kuwait, under the impetus of the Vision 2035 long-term development strategy, digital banking and fintech have become a key focus. In September 2018, the central bank mandated that all service providers register on its e-payments system and develop plans for a digital version of the Kuwaiti dinar by FY 2020/21. Commercial banks are launching digital wallets that can process payments through point-of-sale devices and Whatsapp.

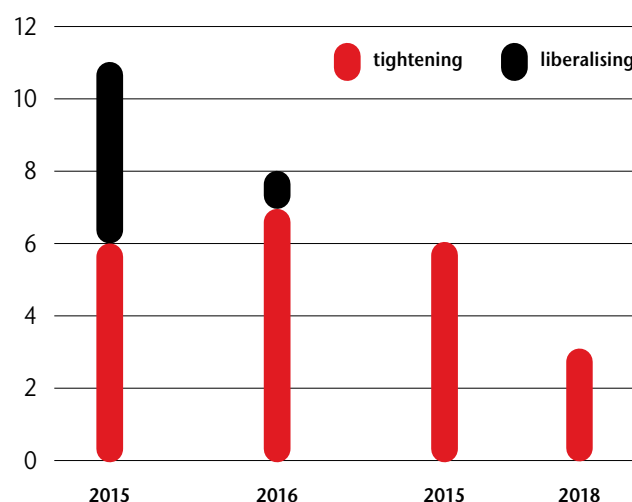
As for India, the ratio of value added by digital services to total exports is the third highest in the world. Computer programming, consultancy and telecoms accounted for 88% of the total value added by digital services to total exports of India, implying a narrow focus.

Notably, China comes 8th highest in the ranking of digitally-deliverable services exports to total services exports, but that is only because actual digital service exports, as opposed to potentially digital service exports make up most of its services exports. After all, China is home to the world's second largest ICT sector and accounts for nearly 50% of all patent applications for technology families relating to blockchains.

In terms of the sector's growth, the highest growth region for digitally-deliverable services over 2005-2018 has been South-East Asia, with 12% average annual growth followed by East Asia and South Asia, while digitally deliverable services grew the least in West Asia, Latin America and Africa (7%).

However, while the pandemic has turned digitally-deliverable services into a lifeline, before COVID-19, trade barriers were starting to threaten the potential growth of the services sector at large. In 2019, the level of services trade restrictions was 30% higher than the year before based on the OECD's Services Trade Restrictiveness Index (STRIs). These barriers particularly affected the service sectors that underpin digital trade, including telecoms, computer services and audio-visual services. They included limiting foreign providers' access to infrastructure and connectivity and hindering electronic transactions/international payments. In a classic case of EM politics negating economic potential, these limits were often placed by EM authoritarian governments to control dissent, thereby presenting a challenge to the growth of digitally-deliverable services exports to EMs.

Figure 3: Policy Changes Affecting Trade in Digitally-Deliverable Services (2015-2018)



Source: Continuum Economics, OECD

In 2018 and 2019, Russia introduced a limitation on foreigners providing electronic means of payment to resident customers. Moreover, a commercial presence is required to provide cross-border money transfer services to individuals and transfers should use the Russian payment infrastructure. In India, all payment system operators are now required to ensure that data related to payment systems operated by them are stored only inside the country. Since July 2019, Turkey requires that domestic communication traffic be exchanged through domestic internet exchange points. Online media service providers must obtain a new licence for online broadcasting and are required to establish in Turkey in accordance with the provisions of the Turkish Commercial Code. Finally, China is increasingly restricting cross-border data flows and introducing data localisation requirements, filtering the web extensively and blocking legitimate sites, restricting cloud computing and requiring partnerships with a Chinese firm to enter the market, with transfer of technology and intellectual property to the partner.

These trends are likely to accelerate post-COVID-19, as many countries pursue a self-reliance agenda which is typically implemented via the non-tariff barriers that are central to import substitution industrialisation in this sector. In that sense, COVID-19 presents a natural opportunity for growth in digitally-deliverable exports, but following the pandemic, many governments have intensified a protectionist backlash that threatens this opportunity. Even beyond EMs, limits are now increasingly being imposed by DM governments, with the U.S. a case in point. In EM, based on a Turkish regulation stipulating that social media companies store the data of their Turkish subscribers in Turkey to enable direct access to the subscriber data and content by a 2 November 2020 deadline, Turkey fined Facebook, Instagram, Twitter, YouTube and TikTok TRY 10 million each for non-compliance. Turkey has also threatened bandwidth throttling if necessary, starting in April and May at 50% and rising to 90%. Any platform facing this would be rendered unusable in Turkey.

REGIONAL OVERVIEW OF POLITICAL RISKS

Asia

Asia/Pacific countries have an edge over the Western world not just on the management of the pandemic in 2020, but also in terms of political risk. Although pockets of risks are seen in various countries, peace should generally be maintained at a regional level. Military continues to dominate politics in many countries such as Myanmar, Pakistan, Thailand etc.

Myanmar's recent elections have been contested by the military-backed opposition party. Aung San Suu Kyi's ruling party saw a landslide victory in these elections, but her administration has been criticised for continuing to commit genocide against Rohingya Muslims in breach of orders by the UN's top court. In the medium to long term, ethnic conflicts will remain a major political risk clouding Myanmar's outlook and stability.

Pakistan's corruption scandals, social unrest, security issues and uneasy relations with neighbouring countries such as India and Afghanistan keep the political system fragile. The opposition party, led by former Prime Minister Nawaz Sharif is holding protests to overthrow Imran Khan's government and restore "real" democracy. Tensions with India on Kashmir border issues also continue and may also interfere in the peace talks with Afghanistan.

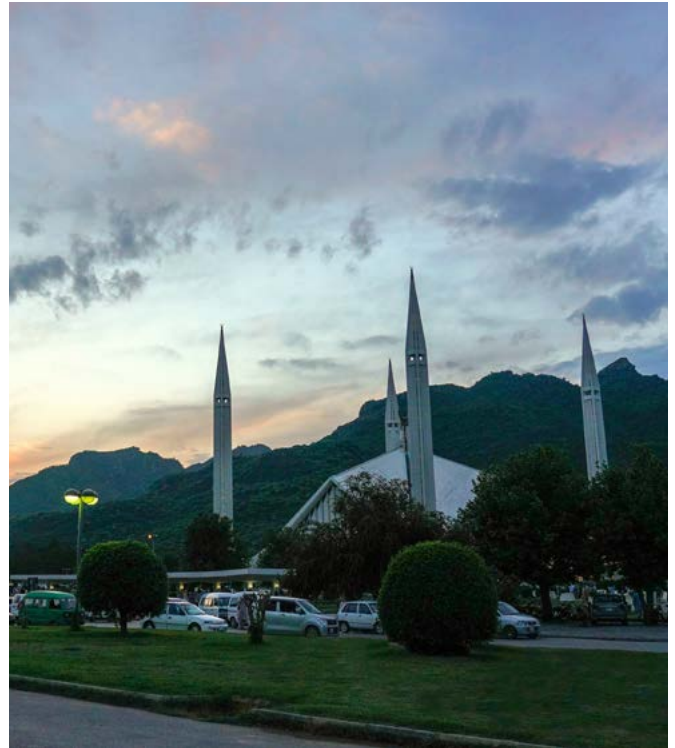
North Korea may be looking to test some missiles to welcome the Biden administration and ensure North Korea remains at the top of his foreign policy agenda, risking fresh sanctions.

Thailand continues to see protests for the resignation of Prime Minister Prayut Chan-o-cha, revision of the constitution to allow for greater democratic participation, and reform of the monarchy to subject it to legal, political, and fiscal oversight. Although these have generally been peaceful so far, risk of escalation remains. We may also see the return of political risk in some countries as they get a grip on the COVID-19 pandemic, which is taking centre stage for now.

Hong Kong's disruptive, violent protests have strained its relationship with mainland China over the last two years, and protests may re-emerge as China continues to tighten its grip. India's Citizenship Amendment Act triggered protests beginning in December 2019, and may regain attention as the COVID-19 pandemic comes under control.

In detail

Myanmar sees high political risk as the military continues to dominate politics. Parliamentary elections held on 8 November 2020 saw Aung San Suu Kyi's ruling party National League for Democracy (NLD) stay in majority. However, Myanmar's international image has been tarnished due to ethnic tensions and the Rohingya crisis which resulted in economic and political sanctions from the EU, the United States, the United Kingdom and Australia. The military-backed opposition party Union Solidarity and Development Party (USDP) is contesting the result on account of alleged fraud. Although political stability may be expected, the



constitutional minority of 25% parliamentary seats reserved for the army continues to weaken the democratic system. In the medium to long term, ethnic conflicts will remain a major political risk clouding Myanmar's outlook and stability. While restoring peace to the ethnic areas was a major goal for Aung San Suu Kyi in 2015, ethnic conflicts have intensified against the army over recent years. The management of the Rohingya refugees – in theory 700,000 people to be repatriated from Bangladesh – remains an embarrassment for the government. Activists say Myanmar is continuing to commit genocide against Rohingya Muslims in breach of orders by the UN's top court, although officials continue to deny this. Rights groups have also condemned the almost absolute exclusion of Rohingya from voting in November's election. Concerns of escalation remain because Myanmar has done nothing to address the root causes of discrimination. Risk of renewed U.S. and EU sanctions also cannot be ruled out.

Pakistan continues to face substantial domestic and regional security risks. Corruption scandals, social unrest, security issues and uneasy relations with neighbouring countries such as India and Afghanistan keep the political system fragile. The opposition party Pakistan Democratic Movement (PDM) has held a series of mass demonstrations since 16 October, in a bid to overthrow the current government. These protests are representative of the long battle between the politicians and the military, with Prime Minister Imran Khan seen by his opponents as an appendage of the latter. The PDM claims it wants to restore "real" democracy in Pakistan's perpetual civil-military conflict, with a return of ex-Prime Minister Nawaz Sharif to politics. The opposition rallies have also thrown a direct challenge to the heads of the army and the Inter-Services Intelligence (ISI), and risk of the return of a military rule remains. Meanwhile, tensions with India over the disputed state of Kashmir continue and daily firings over the border area have become a norm. Tensions with Afghanistan seen to be reducing, with the recent meeting

between Pakistan Prime Minister Imran Khan and President of Afghanistan Ashraf Ghani in Kabul. The two leaders explored ways not just to deepen bilateral ties and regional economic development, but also the need for a peace process. However, Pakistan has to compete with India to grow its influence in Afghanistan and ensure durable peace.

North Korea's nuclear capabilities have steadily improved in the last four years. After a working relationship with President Trump over the last few years, North Korea will be looking to signal to the new Biden administration that North Korea is not to be trifled with and it should remain a key foreign policy focus for Washington. This means some more missile testing remains likely as has generally been the welcome message from North Korea for previous U.S. presidents. The primary concerns for the Biden administration will be the coronavirus and the domestic economy, but Pyongyang has a way of forcing the U.S. to pay attention to North Korea. The Biden administration has signaled more room for negotiations, saying in a policy paper that it wants to "jump start" a campaign with U.S. allies and others for denuclearisation. At the second presidential debate in October 2020, Biden called the North Korean leader Kim Jong Un a "thug" but said he could meet him if he made moves to reduce his nuclear arsenal. While a nuclear detonation would definitely catapult North Korea to the top of the Biden administration's list of foreign policy priorities, it also raises the risk of fresh UN sanctions that may cripple the North Korean economy which is already facing the headwinds from the COVID-19 pandemic.

Thailand continues to see protests for the resignation of Prime Minister Prayut Chan-o-cha, revision of the constitution to allow for greater democratic participation, and reform of the monarchy to subject it to legal, political, and fiscal oversight. Protestor demands have also expanded to issues like changes

in the crown property laws and the recognition of same-sex marriage, to aim for a more equal society. The protest situation continues to escalate and may lead to more conflict and violence, as pro-royalist supporters have also become increasingly militant in their response to calls for monarchical reform. Although chances are slim, we cannot ignore the possibility of the military staging a coup against Prayut, the former army commander-in-chief who staged the last coup. If the movement is just allowed to die down instead, that will mean a delay of the conflict between the youth looking for a change in Thailand's political institutions and the military.

Eastern Europe and CIS

Three countries in Eastern Europe and CIS saw their overall risk rating change this quarter: they are Kyrgyzstan, North Macedonia and Montenegro. The region is gradually becoming less and less of a Russian sphere of influence, but is still caught up in the hesitations of EU members, which are reluctant to welcome Eastern European/CIS countries into the fold of the EU.

The attempt by two Eastern European members of the EU, Hungary and Poland, to hold back the disbursement of the EU Recovery Fund on account of their disapproval of rule of law conditionality, has deepened the Western-Eastern Europe fault line within the EU. To some extent, the stand-off between Hungary/Poland and Western Europe over rule of law conditionality has a negative impact on the accession process of EU hopefuls such as North Macedonia or Montenegro. Conversely, the relationship of Eastern Europe/CIS with Russia is also changing: many countries in the region have seen democratic protests, which have not resulted in Russian intervention, highlighting a more hands-off approach on the part of Russia than has been the case historically.





In Kyrgyzstan, which is the only CIS country with a history of political competition and scrappy but democratic elections, widespread protests have taken place. Unlike in Belarus last quarter, they have resulted in the ouster of President Sooronbai Jeenbekov, without Russian intervention. Yet in Russia itself, the pandemic has provided an ideal excuse for the regime to tighten its autocratic tendencies, and this quarter, the government's decision to designate individuals involved in political activities and receiving financial support from abroad as 'foreign agents' is a step up in authoritarian rule.

With an overall risk level decreasing to medium, North Macedonia's score is driven by a medium risk of political violence. After widespread protests in early summer 2020, on 15 July, parliamentary elections led to the formation of a coalition of the ruling centre-left SDSM and the largest ethnic Albanian party DUI. However, protests by the opposition resumed in the autumn, as the opposition accuses the SDSM leader of being too conciliatory to Bulgaria, which blocked North Macedonia's EU Accession plans this quarter. Indeed, Bulgaria rejects the concept of a 'Macedonian minority' in Bulgaria, the concept of a separate Macedonian ethnic identity and language, and the country name of North Macedonia. Progress on accession will be subject to North Macedonia addressing these points of friction, which is likely to take some time.

In Montenegro, the overall risk level has increased to medium-high, largely on account of exchange transfer risk rising to medium-high. The country is highly dependent on tourism, which has been decimated by COVID. Politically, we believe that Bulgaria's recent veto on North Macedonia's EU accession, while for idiosyncratic ethnic and nationalistic reasons, may still spill over to Montenegro's process. EU members' rising reluctance to progress with accession talks has been evident since France put its first veto on North Macedonia and Albania in 2019. Even beyond political

objections to accession, the necessary economic conditions of convergence have also deteriorated, with debt to GDP likely to reach 90% of GDP in 2020, on the back of debt incurred for the construction of a Chinese-built and financed highway and COVID-19.

In Kyrgyzstan, the overall risk level has fallen to medium-high, largely on account of the inability of government to provide stimulus falling to medium. Kyrgyzstan secured a Paris Club agreement to suspend the servicing of USD 11 million worth of debt until mid-2021. Still, most of its debt is owed to China, which has lent a deaf ear to requests for debt service suspension. Meanwhile, the autumn 2020's political protests resulted in the ouster of President Jeenbekov, giving way to a Presidential election this month. Up to this point, there has been a power vacuum as various political forces position themselves to take advantage of the situation.

In Moldova, where the overall risk level remains high, the recent landslide victory of the Party of Action and Solidarity's Maia Sandu in the Presidential elections holds the potential for a shakeup of the justice system to root out endemic corruption, a commitment to the full implementation of the EU Association Agreement followed by more advanced integration with the EU, whilst also maintaining a cooperative relationship with Russia. This balancing act is essential, as Moldova depends on Russia for energy and there is a significant number of Moldovans in Transnistria. Early signs of judicial reforms have already resulted in legal and regulatory risks falling to high from very-high.

Finally, Armenia's overall level of risk remains medium-high as the country continues to suffer from a moderately high risk of political violence, despite this quarter's ceasefire agreement in the Nagorno-Karabakh conflict with Azerbaijan. Russian peacekeepers have been deployed in a land corridor linking Nagorno Karabakh to Armenia. Given that the outcome of the conflict was a major military victory for Azerbaijan, it raises questions about the future of the enclave, especially given the extent of Turkey's support for Azerbaijan. The conflict has also eroded Armenians' trust in their government after multiple Armenian towns fell under Azeri control, which increases the risk of domestic political instability. Exchange transfer risk and the inability of government to provide stimulus have both risen to medium as a side effect of the conflict with Azerbaijan.

Latin America

Latin America is in a state of relative social and political calm after a wave of anti-government protests across many countries in the region in 2019, including Bolivia, Chile, Ecuador and Colombia. The roots of these protests were idiosyncratic to each country, ranging from accusations of political fraud in Bolivia to discontent over economic policies in Ecuador and Colombia and social injustice in Chile. However, we think there is a common characteristic: they happened in a context of low tolerance, which is in turn explained by an enlarged, better educated middle class that has been long fighting not to fall into poverty in a decade of slowing GDP growth in the region.

The social environment became calmer in 2020, in part because of social distancing restrictions to contain the pandemic. But the state reached is not more than an uneasy calm. We have a sense that social turmoil may pick up steam in the not-too-distant future, especially after vaccines rollout reduces the need to maintain social distance and it becomes evident that the scars in income and poverty levels from the pandemic will not go away soon, if ever. Indeed, the recent resurgence of protests in Colombia and Bolivia supports that social tension persists.

In Bolivia, the Movement Toward Socialism (MAS) returned to power with Luis Arce's victory in October 2020, almost one year after its member and long-standing president Evo Morales was ousted over accusations of fraud in the October 2019 elections. Conservative Jeanine Áñez was interim president from late 2019 to October 2020, but amid the blow from the pandemic, she failed to obtain the electoral support for a conservative party to stay in power after the elections. If some hoped that Morales' oust would lead to a change in leadership towards the right, Arce's landslide victory definitely helped clarify the picture. But dealing with an impoverished and highly polarised country will likely prove difficult, and we would not be surprised if the year-long protests extend further.

In Colombia and Ecuador, the protests that initially started to reject government's economic policies and reforms quickly turned into anti-government movements fueled by the government's response to the unrest. These protests eased during most of 2020 but seem to have been gaining strength of late and setbacks may trigger a large response in terms of social unrest. In both countries these events may result in a switch to left-wing governments, starting with Ecuador's general election in February, followed by Colombia's congressional and presidential elections scheduled for a little over one year from now. But similar to Bolivia's case and most of LatAm lately, there is a high degree of polarisation, thus social unrest will likely continue after the election.

In Peru, after Congress ousted ex-president Martin Vizcarra and social protests against this action forced Vizcarra's successor out, the way towards the April general election may be smoother with Francisco Sagasti assuming as interim president in mid-November. However, political stability is fragile and we cannot rule out renewed tension—Peru's politics have been characterised by accusations of corruption scandals and criminal activity during the last couple of decades. With this political fragility comes the risk of renewed social turmoil, as shown a few months back.

After a year of protests and social pressure, in October, Chile voted on a new constitution written by 100% popularly elected delegates. This historic process, we believe, will result in the government representing a larger portion of the economy compared to the current situation. In particular, we believe the new text will look to guarantee a handful of economic and social rights, including education, health and social security, meaning the judiciary will look after their enforcement. This will effectively, albeit gradually, translate into the government having a larger role in the economy. For the state to guarantee that these rights are covered for everyone, it would probably need to increase taxes eventually. Otherwise, these legal guarantees will either change little in reality or increase social benefits in parallel to government debt. In other words, Chile could end up following the path of countries like Germany or France, where these promised rights are fulfilled, or the path of its regional peers, whose constitutions also list these rights as guarantees, but that has not been reflected in higher welfare levels.

The process will kick off with the April constitutional delegates' election, but it will not finish until well into 2022 with the "final plebiscite" to ratify the text of the new constitution. In the meantime, there will be general elections in November, where we believe a resident to the left of Sebastian Piñera on the political spectrum will be elected. While the social unrest has eased significantly since the government agreed on having a constitutional referendum,



the social climate has not completely been appeased—some protests still take place often to continue pressuring for a change to happen, especially when government-imposed social distancing restrictions allow. The packed political calendar, together with reduced social welfare levels due to the pandemic, may be a good recipe for an unrest re-emergence in the coming few years.

Whether we would see another “pink tide” in the region is a question that naturally arises, especially considering that countries that troubled Colombia, Chile and Ecuador are under right-wing governments. The return of the MAS political party in Bolivia, are also sometimes considered as possible signals that the left is gaining strength in the region. While the economic fallout of the pandemic does put the issue of high inequality in the spotlight, which could support leftist governments, there is more to that. Mexican President Andres Manuel Lopez Obrador and Brazilian President Jair Bolsonaro, the two at opposing sides of the political spectrum, are the two presidents who have emerged relatively unscathed from the harshness of the past two years; this supports the notion that political ideology is not at the core this time. What is clear, however, is that the marked polarisation, recently exacerbated by the pandemic, will keep the risk of renewed political and social turmoil present in the coming years.

The Middle East and North Africa (MENA)

One country has seen a reduction in risk rating in the shape of Iran, with a reduction in banking sector vulnerabilities, less inability of government to provide stimulus and decline in exchange transfer issues. Elsewhere, the inability of government to provide stimulus also improved for Iraq, Jordan and Bahrain, though without any change in overall country risk score. The further rebound in oil prices has helped. For countries in the region three key issues exist: U.S./Iran relations under a Biden administration; Saudi Arabia’s role in the region and dealing with the economic fallout of COVID-19.

Iran wants to get back on track with the 2015 agreement, which is likely to be the long-term desire of an incoming Biden administration. However, the Democrats differ on whether the scope of the relationship with Iran should be wider and also encompass Iran ballistic missile capacity in the region. This would be a hurdle for Iran. Additionally, with the Biden administration focused on domestic issues (COVID-19; racial inequality and climate change investment), progress will be slow and the first step will likely be a call for greater compliance by Iran. The U.S. will likely also back E3 demands that Iran does accelerate uranium enrichment capacity and limit UN inspector visits. If compliance is seen then it could open the door to negotiations on an interim deal, as a stepping stone to eventually fully recommitting to the 2015 agreement. Such a step process would be important to the region, as it would reduce Iran isolation and also provide the prospect of oil export waivers from the U.S. or access to EU trade finance. However, the U.S. will have to be



more balanced and ensure that GCC security concerns are incorporated into the discussions. Overall do not expect quick progress.

Saudi Arabia is already anticipating a shift in the attitude towards the Middle East with the incoming Biden administration. Saudi Arabia is trying to resolve the dispute with Qatar and reported to be holding exploratory talks with Israel. This is all part of ensuring alliances are built against Iran isolation becoming less intense and perhaps also seeking to improve long-term relationships in the region. However, a formal establishment of relations with Israel like the UAE remains difficult, as Saudi Arabia is more conservative on the potential adverse diplomatic and reputational consequences of such a move.

Qatar optimism also needs to be cautious, given that talks to resolve the three-year dispute are only starting and are multi-country rather than bilateral. The UAE is concerned that Turkey has too much influence in Qatar, but Qatar is reluctant to undermine its close and supportive relationship with Turkey. Progress on a genuine end to the dispute will likely be slow.

The economic fallout from the COVID-19 crisis will linger for countries in the Middle East. Though oil prices are rebounding, a recovery to 2019 levels will be difficult as oil demand takes time to recovery. Secondly, momentum towards climate change investment is accelerating in the wake of the COVID-19 crisis, while the Biden administration is expected to quickly rejoin the Paris accord and seek to green the U.S. economy. Finally, OPEC+ discipline will reduce as the economic recovery broadens this year and this points the way to further reduction in the production cuts and restraint on the rebound in oil prices.

Libya and Iraq will likely see the largest deterioration in current account deficits in 2020, but Kuwait and Saudi Arabia are also projected to see a swing from healthy surpluses to current deficits of -6.8% and -2.5% of GDP respectively. Saudi Arabia’s current account deficit is now projected to remain through 2025.

This causes long-term political risk issues, as oil revenue is insufficient to support government expenditure, leading to hard choices between increasing taxation or reducing bloated public sector wage bills. Additionally, persistent current account deficits also point to a rundown of excess overseas assets held by central banks and sovereign wealth funds and it is worth noting that Saudi Arabia's public investment fund is to accelerate repatriations of foreign funds from USD 15 billion per annum to USD 40 billion to help fund government investment projects.

The main instability risks in the region are Iraq, Syria and Yemen - all remain at the very high risk level. The situation in Iraq is deteriorating and concerns are growing about domestic unrest and violence increasing this year. Political, economic and security crises are the cause, with some being a consequence of the Trump administration using Iraq in its moves against Iran. Yemen is expected to improve with the Biden administration likely to pressure Saudi Arabia and Iran into engendering an improvement. Syria will not likely change, with the Assad regime having the upper hand domestically but little priority of a new Biden administration to get involved.

Egypt's overall risk rating remains high, held up by the political violence rating remaining very high. In 2021 with COVID-19 pressures likely to eventually ease, domestic protests against suppression will likely be evident. The government will not be quick to back down, partially as international players such as France are still supportive of Egypt's buffer role in the region, partly overlooking domestic issues surrounding human rights.

Finally, Libya's overall risk score remains very high, with six out of the nine categories being very high, including political violence. Tensions remain between the Turkey-based Government of National Accord (GNA) and General Haftar in Sirte and eastern Libya (supported by Egypt, Russia and the UAE). An improvement in oil production in recent months is at least some progress, but the situation remains tense. The new Biden administration is also unlikely to get engaged in trying to broker a peace deal, as the U.S. started distancing itself from Libya under Obama and Biden.

Sub-Saharan Africa

In sub-Saharan African, two countries have seen a change in their overall risk rating: Zambia and Swaziland. One silver lining for the region is that the health impact of COVID-19 has been much lower in Sub-Saharan Africa than it has been in developed markets. Rather, the greatest impact of COVID-19 on the region is occurring via changes in Sub-Saharan African governments' inability to provide stimulus across twenty countries. So far, sovereign non-payment risk per se has only increased in two countries, namely Zambia and Ghana. We would expect further increases next quarter, although talk of a debt tsunami strikes us as excessive.

Zambia has become the first African country to default on multiple dollar bonds during COVID. We believe that Angola, Ghana and Congo-Brazzaville are the most at risk next, given particularly high levels of debt to China and still limited signs that China is willing to restructure their debt— Angola has registered an 80% increase in its debt to China since 2015 and now owes 43% of its external debt to China.



A secondary problem that applies across Sub-Saharan Africa is that bondholders and western creditors do not want to offer concessions on their own for fear that the released resources will be transferred to China; this was also the case with Zambia. The extension of the G-20's debt service suspension initiative until mid-2021 has a limited impact on the sustainability of Sub-Saharan African debt. For all the IMF's rhetoric on the inclusion of private creditors in debt restructuring discussions, they are still blatantly absent in practice and they hold the key to preventing more defaults.

Zambia's overall risk level has risen to medium-high, with increases in both the inability of government to provide stimulus and sovereign non-repayment risk. The country missed a USD 42.5 million coupon payment on its dollar bonds in October and November, causing it to default. While Zambia owed 1.8% of GDP in debt service alone in 2020, even before COVID-19, the latter tipped it into default. Still today, the government is debating a budget that would see less money spent on healthcare and more on servicing debt repayments. Zambia asked private-sector creditors for a six-month deferment until April. But banks and asset managers refused to engage with Zambia, as they wanted to see more transparency over the current USD 3.4 billion in debt to China, which amounts to 29% of its external debt, and is more than double the amount Zambia owed to China in 2015. They feared that Zambia was prioritising servicing its ballooning debt to China, but the latter's confidentiality agreements prevented such transparency. Just before the default was announced, Zambia reached an agreement with the China Development Bank, a major Chinese lender, to defer debt payments, yet that failed to convince private creditors.

The overall risk level of the absolute monarchy of Swaziland has risen to high, driven by a rise in legal and regulatory risk to high. The kingdom has been labelled 'not free' by Freedom House. King Mswati controls the mainstream media and also controls local governance through his influence over traditional chiefs. Political parties are barred from taking part in elections and groups advocating for democracy are outlawed under the Suppression of Terrorism Act. News websites that call for human rights reforms have been launched, with their editors in exile in neighboring South Africa. In the context of COVID, this quarter, the King's daughter put forward a bill that would see people jailed for up to ten years for reporting fake news, including through social media. The new law would even allow the courts to prosecute Swazi nationals who live outside of Swaziland in some circumstances.

Mali remains a high risk country, with political interference risk rising to high, while exchange transfer risk and inability of government to provide stimulus have fallen to medium-high. Arguably the biggest risk introduced by COVID into the Sahel is that the declining incomes caused by COVID aggravate the jihadi insurgency, as the young opt for terrorism and join militant group Jama'at Nasr al-Islam wal Muslimin in search of an exit from misery. Anxiety in Western Europe about terrorism and a wave of refugees from West Africa has likely resulted in EU countries responding to France's call for increased troop deployments in Mali and in the UK sending three hundred troops to the UN peacekeeping force. Political interference risk has risen after a military junta deposed President Ibrahim Boubacar Keita in a coup in August, resulting in a transitional government, which is expected to hand over power to a fully civilian government after fresh elections at end-2021. The transition is not straightforward given the strong military footprint in the leadership and securing peace will remain crucial to the country's future prosperity.

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