Political Risk Outlook

2016

6 January 2016

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Introduction

Verisk Maplecroft's 2016 Political Risk Outlook enables clients to understand some of the most significant issues facing their global operations, investments and supply chains over the next 12 months. Drawing on the expertise of our regional and country specialists, as well our global risk analytics and mapping capabilities, the report provides regional and global political risk forecasts. It covers some of the world's key economies and analyses the political risk issues that have the potential to impact market stability.

A key takeaway from the report is that there is likely to be little respite from the political instability, civil unrest, economic volatility, security crises and geopolitical rivalries that defined the last 12 months, and that the global turbulence of 2015 looks set to continue.

The outlook highlights low commodity prices as one of the primary catalysts of political risk for investors in major oil, gas and metals producing countries across Africa and Latin America. The increasing international threat posed by the Islamic State and rising tensions between Iran and Saudi Arabia are also flagged among the foremost geopolitical risk multipliers.

More in-depth analysis on the key political, geopolitical, security, regulatory, economic, human rights-related, and environmental risks for all markets are available through our Country Risk Reports. For more information contact us on: info@maplecroft.com

Sub-Saharan Africa

Low commodity prices will strain labour relations

Investors will face an increasing likelihood of civil unrest in sub-Saharan African in 2016 as the prolonged downturn in commodity prices sparks social turmoil. Expected job losses in the extractive sector – the mainstay of many African economies – are likely to provoke industrial action. For instance, a two-month-long strike paralysed iron ore production in Mauritania in early 2015. The potential for business disruption is highlighted by Verisk Maplecroft's Civil Unrest Index 2016, in which 31 of sub-Saharan Africa's 49 countries are classified as 'high' or 'extreme' risk.

Weather extremes could aggravate economic grievances

The risk of rising living costs provoking civil unrest will be compounded by a strong El Niño event extending into early 2016. Verisk Maplecroft's Food Security Index 2016 shows that all but five African countries are considered 'high' or 'extreme' risk. Most regions will experience significantly lower rainfall and even droughts, although parts of East Africa are set for much higher rainfall than usual, likely resulting in flooding and thus damage to crops and infrastructure.

Poor weather conditions will therefore exacerbate food stress, raise prices and increase the risk of food riots – a major source of unrest across the continent in 2007-08 (see *Map 1*). The chance of civil disorder is especially pronounced in rapidly urbanising countries such as Nigeria, where transporting affordable food to cities will become progressively more challenging over the long term. The growing rate of urbanisation and associated pressures in Nigeria's south is reflected in *Map 2*.

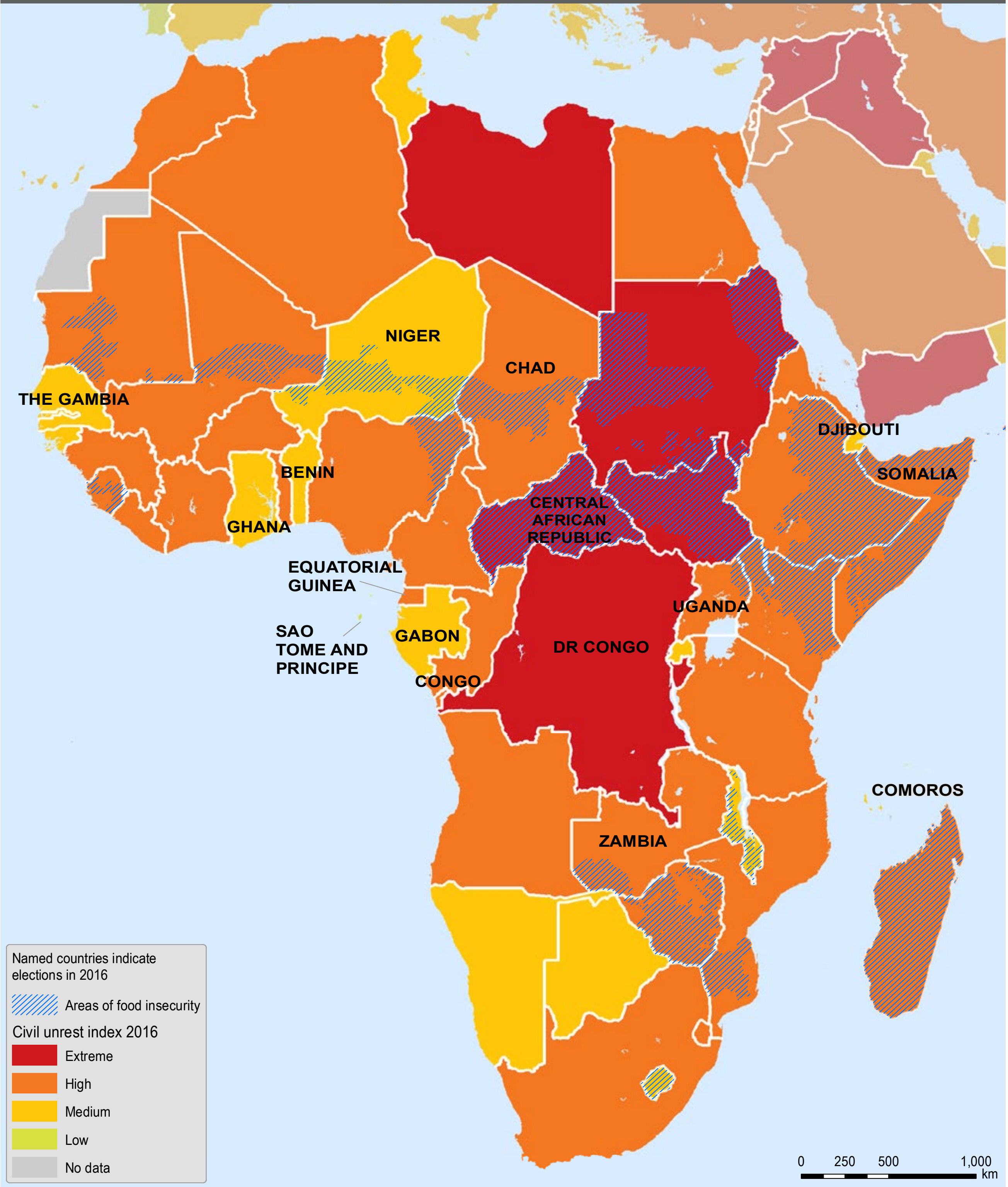
Key elections could provoke unrest and yield change

Social and economic turmoil in sub-Saharan Africa will also be linked to political developments in 2016. Both Congo and DR Congo are scheduled to hold presidential elections in which the incumbent will seek to secure a third term in office contrary to pre-existing constitutional limits. DR Congo's President Joseph Kabila could attempt to postpone the polls for up to four years, claiming the country is not ready for elections in 2016. This would almost certainly be resisted by much of the political establishment, and mining production in the southern Katanga province could be disrupted if local leaders defy Kabila and assert autonomy.

Meanwhile, Congo's Denis Sassou-Nguesso has brought forward the presidential election to early 2016 in a bid to out manoeuvre the political opposition. Though Sassou-Nguesso has already amended the constitution to allow him to stand for a third consecutive term, his re-election would most likely ignite violent protests in Brazzaville and Pointe Noire, the country's oil and gas hub.

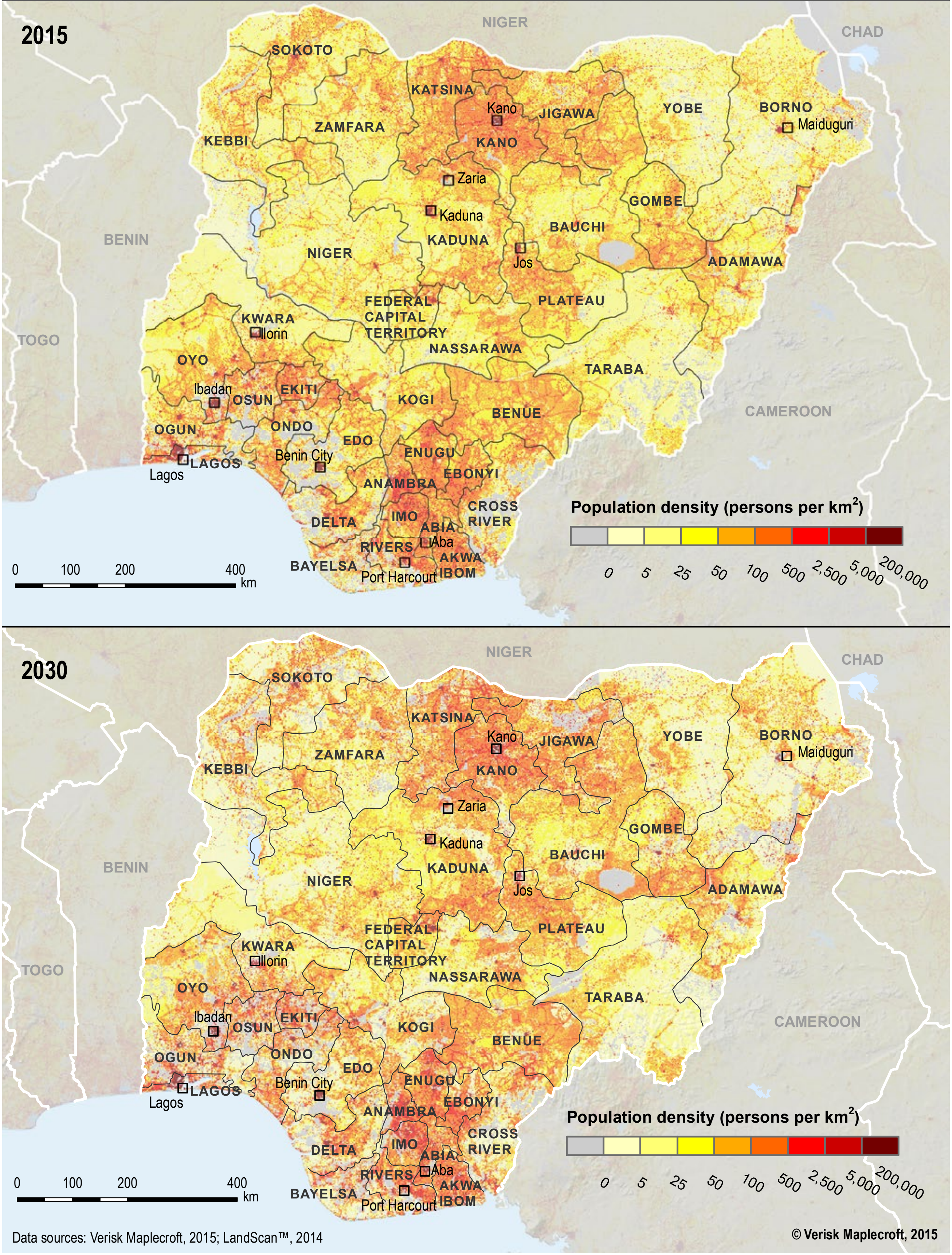
Elsewhere, Zambia and Ghana face crucial elections against a bleak economic backdrop. Incumbent presidents in both countries are vulnerable given their extremely narrow victories at the previous elections and their countries' ongoing economic turmoil. Ghana's main opposition party, the New Patriotic Party (NPP), has a real opportunity to regain power, largely thanks to the growing public perception that the present government is incapable of tackling the country's mounting socioeconomic problems. Zambia's opposition is even better placed to form a new government and promises to render the business environment more favourable for investors.

Map 1: Risk of food insecurity and civil unrest in sub-Saharan Africa



Data sources: Verisk Maplecroft, 2015; Natural Earth, 2012, FEWS 2015.

Map 2: Projected demographic shift in Nigeria between 2015 – 2030



South Africa's politics will meanwhile remain volatile. President Jacob Zuma's decision-making is increasingly erratic and the ruling ANC is heavily divided. Zuma's failed attempt to install a close ally as finance minister in December 2015 highlighted the party's ability to restrain the president's excesses. However, a strong opposition performance in the 2016 municipal elections could compound divisions within the ANC and further undermine investor confidence in the government's ability to run the economy.

Terrorism remains a threat amid evolving security landscapes

The risk of major terror incidents will remain elevated in key hotspots throughout Africa. The staging of attacks in 2015 in national capitals previously thought to be secure, such as Bamako and N'Djamena, reflects the heightened threat of terrorism across the continent. The growing appeal of Islamic State, whose affiliates stretch across the Sahara/Sahel region and down into West Africa, will undoubtedly be of paramount concern to businesses operating in Africa.

In Nigeria, Boko Haram's growing reliance on suicide bombing attacks will most likely extend into 2016 owing to the group's limited ability to repel strengthening Nigerian and regional forces. This change in tactic has enabled Boko Haram to continue its insurgency, despite the loss of most of its territory during 2015.

The Middle East and North Africa (MENA)

Saudi-Iranian rivalry to intensify and play out in the region

The struggle between Tehran and Riyadh for regional power and influence is set to intensify in 2016 following the signing of a nuclear agreement between Iran and world powers in July 2015. With the removal of nuclear-related sanctions likely in the second quarter of 2016, Iran will be able to assert itself even more strongly in MENA. The likelihood of a more confrontational Iranian foreign policy is also heightened by the need to appease hard-line elements opposed to the nuclear agreement.

Heightened tensions following the execution of Shi'ite cleric Nimr-al Nimr in Saudi Arabia in early January have exacerbated geopolitical risks in the Gulf region and beyond. The decision by the Saudi authorities to cut diplomatic ties in response to Iran's vociferous condemnation of the execution has put relations on the worst possible footing at the outset of 2016.

The complete breakdown in relations will also make it even more difficult for foreign companies considering an entry into the Iranian market to navigate a host of political and operational challenges once nuclear-related sanctions have been lifted. Despite substantial commercial opportunities in a range of sectors, investors will have to contend with a significant compliance burden, high levels of political interference, weak corporate governance and a cumbersome and inefficient bureaucracy.

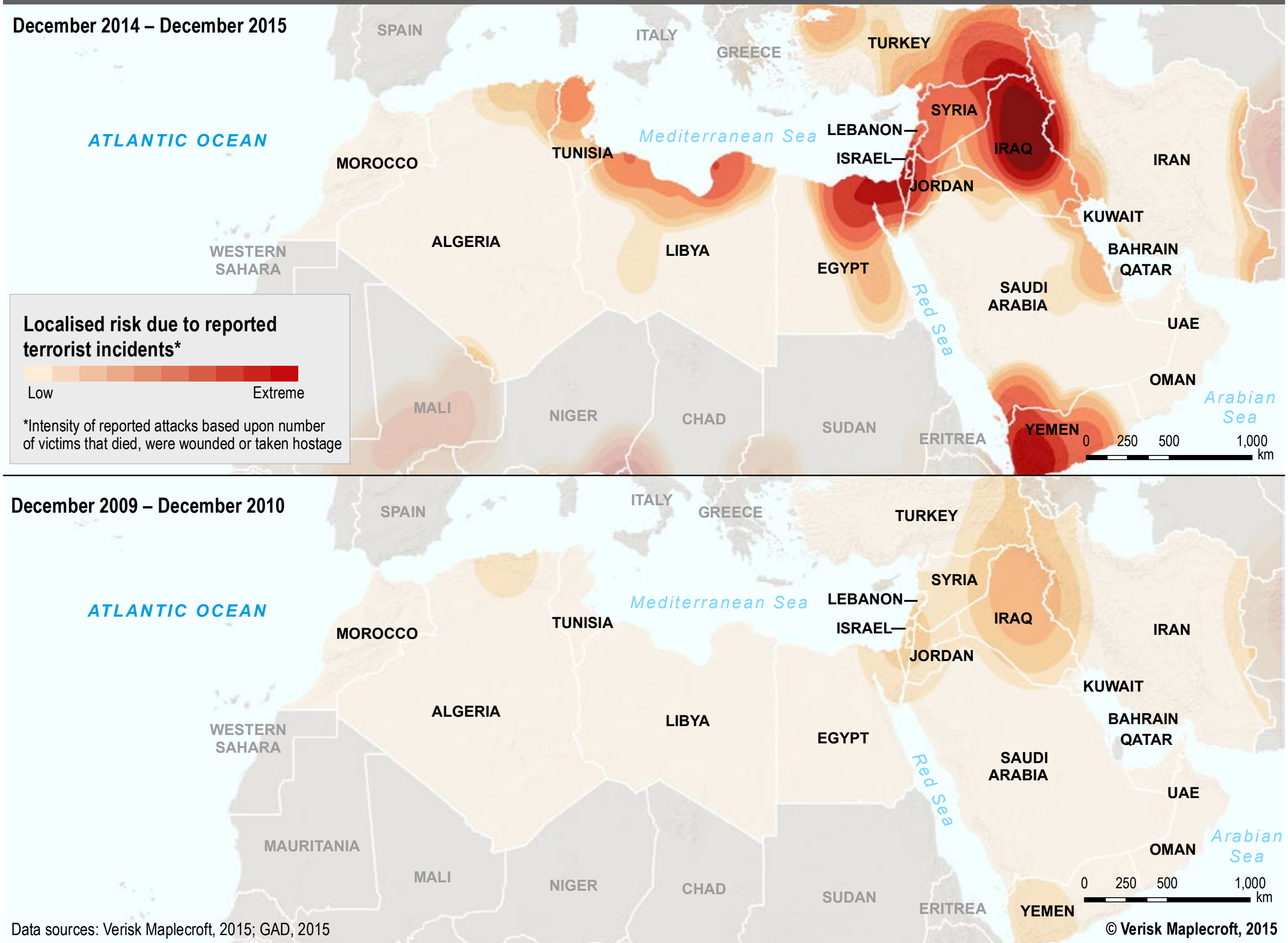
Opposition to Islamic State aside, the absence of common ground between Iran and Riyadh will complicate efforts to find a solution to a host of conflicts in the region – most importantly in Syria, Yemen and Iraq. Rivalry between Saudi Arabia and Iran will also continue to impact the fiscal balance of oil producers throughout the region as the Saudi authorities have shown little appetite to cut production. While protecting market share has been the main driver of Saudi oil policy, Riyadh's desire to squeeze the Iranian economy will also continue to factor into the House of Saud's decision-making.

Islamic State the chief security risk in MENA

The resilience of Islamic State in both Syria and Iraq will increase the risk posed by terrorism throughout MENA in 2016. While the threat posed by the group varies considerably by country, there are few states that are beyond the group's reach. Among the states bordering Syria and / or Iraq, only Iran and Jordan have yet to experience Islamic State attacks on their soil. Figures from Verisk Maplecroft's Global Alerts Dashboard show that, excluding Syria and Iraq, at least 1,269 people were killed by Islamic State in the MENA region in 2015.

Islamic State's reach will continue to extend across the region in large part due to the strong foothold established by local entities that have pledged allegiance to the group in northern Sinai and Libya. The negative trend is reflected in Verisk Maplecroft's Terrorism Risk Index 2016, in which Egypt, the country with the largest population in the Arab world, has been moved into the 'extreme' risk category. Over the course of 2016, an increasing number of countries are likely to follow a similar trajectory. As highlighted by *Map 3*, the intensity and frequency of terrorist attacks in MENA have increased markedly over the last five years.

Map 3: Terrorism trends in the MENA region



Despite the multitude of local and international actors actively engaged in military operations against Islamic State, a credible and viable strategy to defeat the group looks set to remain elusive. Most importantly, the international coalition against Islamic State is unlikely to establish an effective on-the-ground Sunni fighting force. Current efforts to cut the group's revenue streams will not prove decisive in the absence of a coordinated and sustained ground offensive to roll back the group's territorial gains. Islamic State may have made as much as US$600 million from taxation, extortion and confiscations in 2015, underscoring the shortcomings of a strategy that relies primarily on airstrikes.

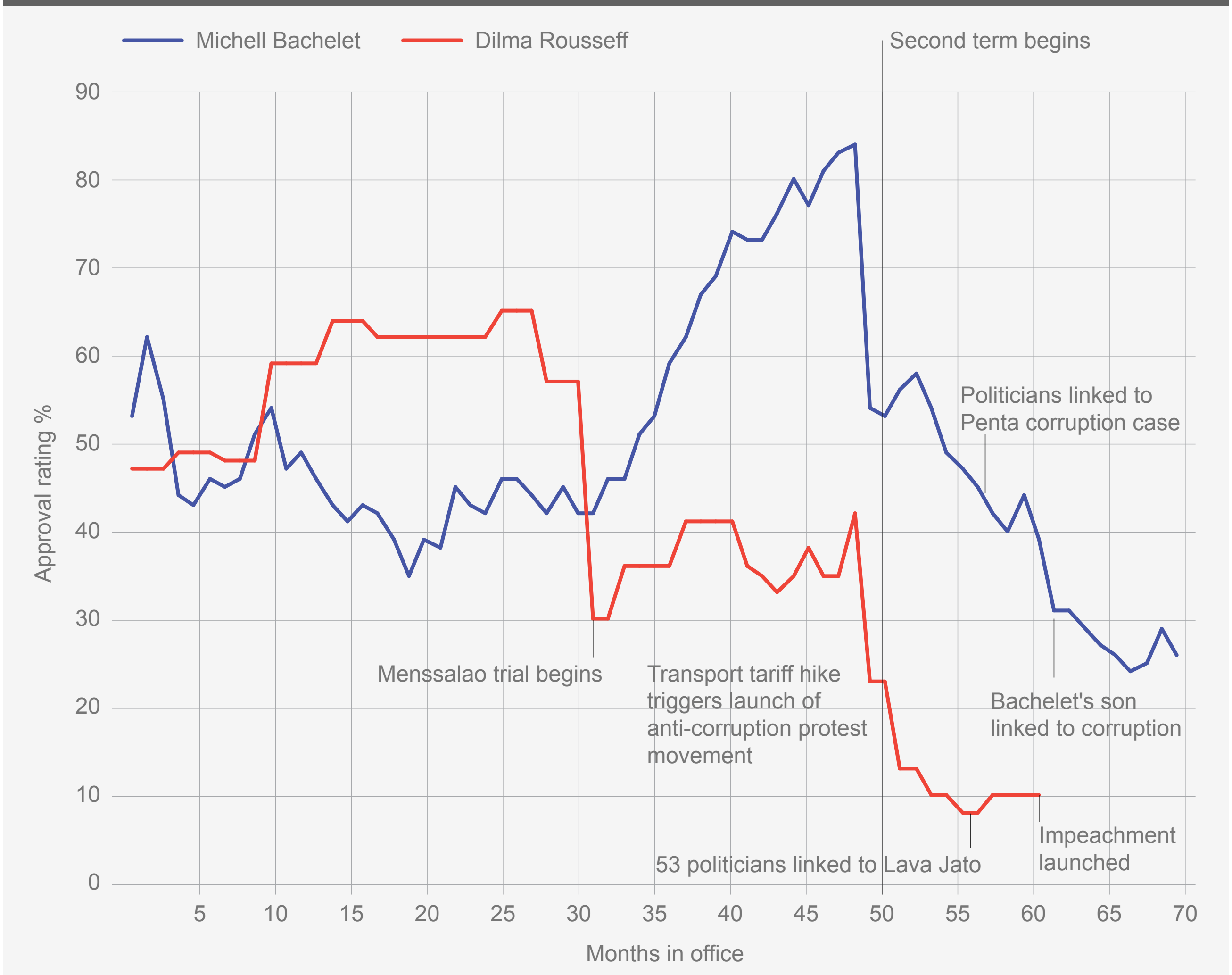
The Americas

Corruption to undermine political stability in 2016

In several major Latin American countries, high-profile corruption cases will continue to erode public support for incumbent governments. Brazil's President Dilma Rousseff faces impeachment proceedings for violating a key fiscal responsibility law and corrupt practices. Although the government's majority in the Senate means that Rousseff is unlikely to be impeached, heightened opposition to the president in the lower house will seriously curtail her ability to push through new legislation in 2016.

In Chile, meanwhile, allegations of influence-peddling involving the son of President Michelle Bachelet led the president's approval ratings to plummet to historic lows during 2015 (see *Figure 1*). A separate corruption case involving one of the country's largest business conglomerates and numerous politicians has left public confidence in the country's traditional political class in tatters.

Figure 1: Brazil and Chile – presidential approval plummets amid corruption allegations



Source: Adimark; Datafolha

Faced with low copper prices and a complex political landscape, Bachelet will lack the financial resources and political capital to deliver on some of her key campaign promises. Concerns over mismanagement and corruption will therefore fuel further discontent and increase the risk of operational disruption to companies as a result of demonstrations. Unlike Argentina, Brazil, Colombia, Ecuador, Peru and Venezuela, Chile is not a 'high' or 'extreme' risk country in Verisk Maplecroft's Corruption Risk Index 2016.

Economic weakness will exacerbate popular frustration with the political establishments in Latin America, contributing to increased levels of social unrest in 2016. This is particularly true for the large South American resource producers such as Colombia, Argentina and Venezuela, which failed to save their windfalls from the decade-long commodity price boom beginning in the mid-2000s. These economies now face a prolonged period of lacklustre growth. By contrast, GDP growth should continue to accelerate in Mexico as productivity-enhancing structural reforms begin to take effect and firmer demand from the US boosts domestic manufacturing output.

Elections in Venezuela and Argentina in late 2015 have raised hopes of a shift towards more orthodox policies and greater macroeconomic stability. However, both countries desperately need to introduce fiscal tightening measures which will squeeze living standards and could fuel protest movements during 2016. Not only will these pressures reduce the scope for a rebound in inbound FDI over the year ahead, locally based companies with operations in and around Venezuela's and Argentina's major cities will also face an increased threat of disruption to their activities.

US presidential election to provoke major policy shift?

In the United States, the looming November presidential election will dominate political risk considerations in 2016. After eight years of Democratic Party control of the White House, low approval ratings for both President Barack Obama and likely nominee Hillary Clinton could see a major shift to the right in American politics. However, the ongoing popularity in the Republican primary of a number of candidates on the hard right of the party may still jeopardise the Republicans' opportunity to seize power in 2016.

A whole swathe of major policy implications – both domestic and international – rests on the outcome of the election. The course set by President Obama on the lifting of nuclear-related sanctions against Iran, relations with Cuba and energy/environmental/trade policy would be profoundly altered if Clinton fails to emerge victorious in the election.

Whether there is a return to a more muscular foreign policy trajectory will depend on whom the Republicans nominate and whether that person succeeds in defeating Hillary Clinton. Current frontrunners Senator Ted Cruz and property magnate Donald Trump favour a hawkish foreign policy, but one which is limited in scope. However, Florida Senator Marco Rubio – the favourite to win the nomination – backs a highly interventionist foreign policy with clear echoes from the George W. Bush administration.

Asia

Reform agendas in India and Indonesia risk losing momentum

Prime Minister Narendra Modi of India and President Joko Widodo of Indonesia struggled to implement their respective economic reform agendas in 2015, and the year ahead is likely to prove challenging given the ongoing political constraints faced by the two leaders.

Lacking a majority in the upper house of parliament and facing an obstinate opposition, Prime Minister Modi has so far failed to pass key pieces of his legislative programme. Unless Modi is able to win support from political opponents, significant components of the prime minister's policy agenda for 2016 look set to be stymied by an ongoing stalemate in parliament. State governments represent another potent obstacle to Modi's pro-business reforms. To maintain momentum, the prime minister's Bharatiya Janata Party (BJP) will need to bounce back from defeats in Delhi and Bihar last year and return to its winning ways at the subnational level in 2016 and beyond.

As a political outsider, President Joko Widodo has struggled to navigate the murky world of elite politics in Indonesia. The president's reform agenda faces an uphill battle in 2016 unless he can stamp his authority on a self-serving oligarchy and vested interests. In particular, Widodo must reverse a lingering trend towards protectionism and economic nationalism to avoid an erosion of investor confidence. Factors such as a decentralised governance framework, an unwieldy ruling coalition and an ineffectual parliament are all likely to act as a brake on reforms in South-East Asia's largest economy over the coming months.

Modi and Widodo share a common vision: that improving the business environment and incentivising overseas investors to set up shop locally will transform their countries into global manufacturing hubs, unlocking their economic growth potential. While there have been some encouraging signs of progress towards this goal over recent months, the need for sweeping structural reform in the two countries is clear (see *Figure 2*). Neither leader can afford to be complacent in the year ahead.

Figure 2: Key Verisk Maplecroft business indices for India, Indonesia and China

Risk Index	Score	Rank	Low risk	Medium risk	High risk	Extreme risk
Regulatory Framework						
India	3.26	26				
Indonesia	3.92	43				
China	4.55	73				
Corruption Risk						
India	2.40	70				
Indonesia	1.77	48				
China	2.60	76				
Judicial Effectiveness						
India	1.40	29				
Indonesia	3.27	67				
China	0.60	13				

Score: out of 10, where 0 indicates highest risk. Rank: world ranking out of 198 countries, where 1 indicates highest risk.

Source: Verisk Maplecroft 2016 Risk Indices

Election risks undermining cross-strait relations

Based on current opinion polls, the opposition Democratic Progressive Party (DPP) is expected to sweep legislative elections and see its candidate, Tsai Ing-wen, win the presidency on 16 January. This could spell the end of a golden era of cross-strait relations and undermine ties with Beijing in the months and years ahead.

Economic links with mainland China have blossomed under the leadership of President Ma Ying-jeou and his ruling Kuomintang (KMT) party, while historically tense diplomatic relations also improved significantly. The DPP traditionally leans towards asserting the island's independence and is much more sceptical of Beijing's intentions than the current government.

Tsai has been critical of a perceived economic overdependence on the mainland and has called for the development of closer ties with the US, Japan and other like-minded democracies.The possible stalling of economic integration with mainland China under a Tsai presidency risks undermining investor sentiment. Foreign firms often invest in the island as a gateway to the mainland market.

Although Tsai has said she will seek to maintain stable relations with Beijing, her expected victory is likely to bring to an end the current period of cross-strait rapprochement. While a serious deterioration in diplomatic ties is by no means inevitable, its consequence could be far reaching and adversely impact US-China relations; Washington has a long-standing commitment to provide Taipei with the means to defend itself.

With regional tensions set to remain high throughout 2016 thanks to multiple disputes in both the East and South China seas, the potential for another geopolitical flashpoint to re-emerge is an unwelcome but conceivable scenario.

Europe and Central Asia

Disunion in EU to continue and deepen

Faced with a multitude of serious interlinked challenges, 2016 promises to be a decisive year, if not a turning point, for the EU. The UK referendum on EU membership is likely to take place, and a negative vote would fundamentally change Europe's political landscape. Business would face months of extreme uncertainty while the UK and EU negotiate the 'divorce' settlement, including terms for Britain's continued access to the single market. Public opinion in the UK is divided, and a neck-and-neck race is highly likely.

The flow of migrants into Europe from Syria, Iraq, Afghanistan, the Maghreb and further afield, combined with the uneven pace of economic recovery, has and will continue to sustain the rise of populist parties across the continent (see *Map 4*). Staunch opposition from right-wing and populist governments in Central Europe severely diminishes the chances of a coordinated Europe-wide solution to the refugee crisis. Such resistance could also exacerbate tensions between member states in other key policy areas, such as EU energy and infrastructure policy.

Greece's future in the eurozone remains uncertain as the left-right government struggles to implement painful structural reforms agreed with international lenders. Similarly, competing visions for the eurozone are expected to test the EU's unity even further. More expansionary fiscal measures advocated by France and Italy contrast starkly with Germany's emphasis on fiscal prudence.

Putin regime under increasing pressure

Russia is entering 2016 embroiled in multiple diplomatic and military conflicts abroad and with the economy in a deep recession. The collapse in oil prices has opened a hole in the state budget which is projected to exhaust Russia's cash reserves by 2017 at the latest. Reflecting growing popular dissatisfaction with the state of Russia's economy, the introduction of a new haulage tax in November – and the commercial involvement of a close Putin ally in the payment system – sparked a series of protests by truck drivers across Russia.

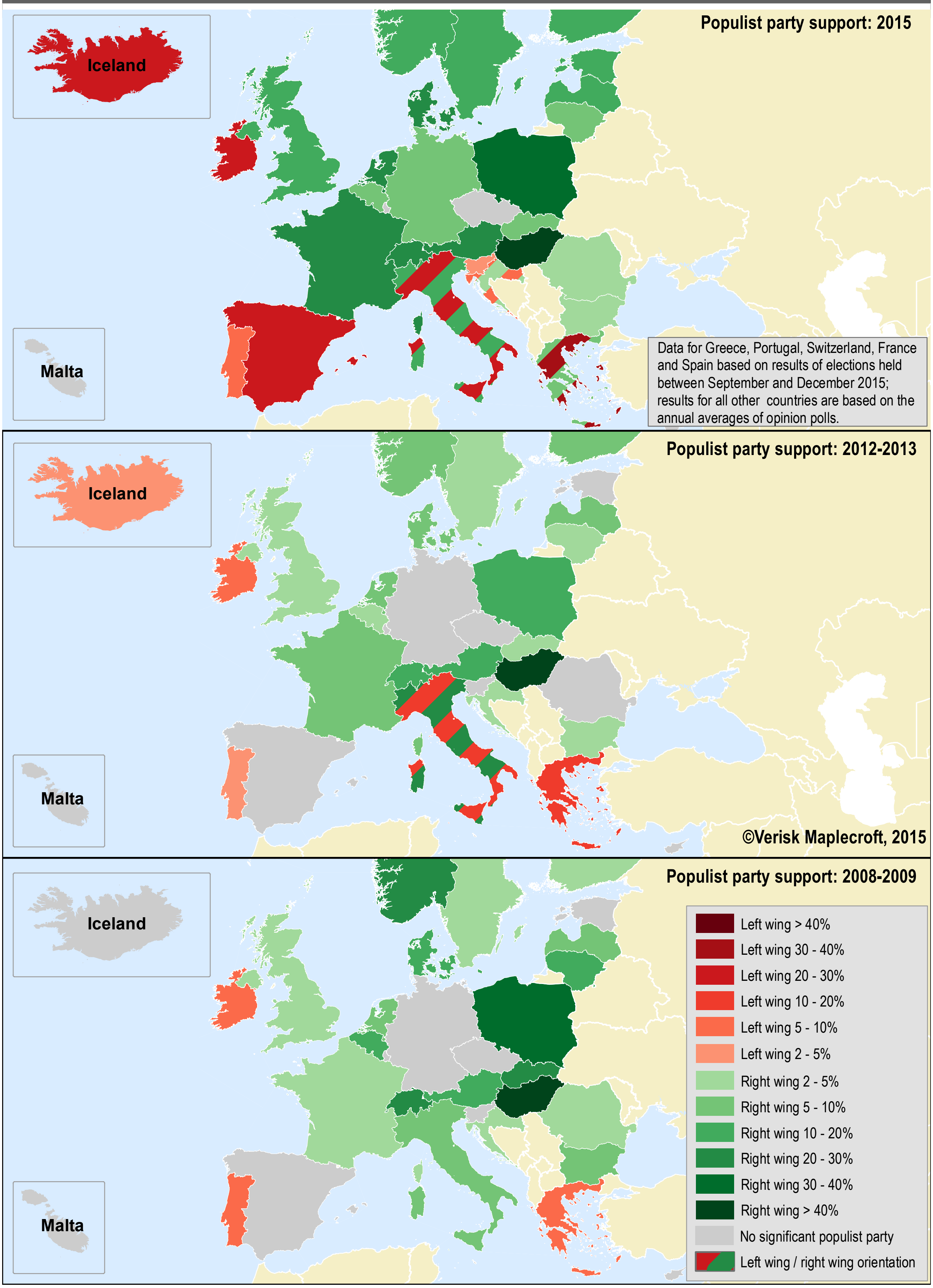
The September 2016 Duma elections may be a key test of support for Putin's regime. If the economy continues to deteriorate and social discontent rises further, the elite as a whole may move against Putin, compelling him to not contest the 2018 presidential election and begin the process of naming a successor. The possible extension of Western sanctions into 2017 may convince members of the elite that Putin has become a hindrance to rapprochement with the West.

Irrespective of Putin's fate, corruption will remain an integral part of political management in Russia over the years to come. Verisk Maplecroft's Corruption Risk Index 2016 classifies Russia as 'extreme risk', ranking 10th out of 198 countries (where 1st denotes the highest level of risk).

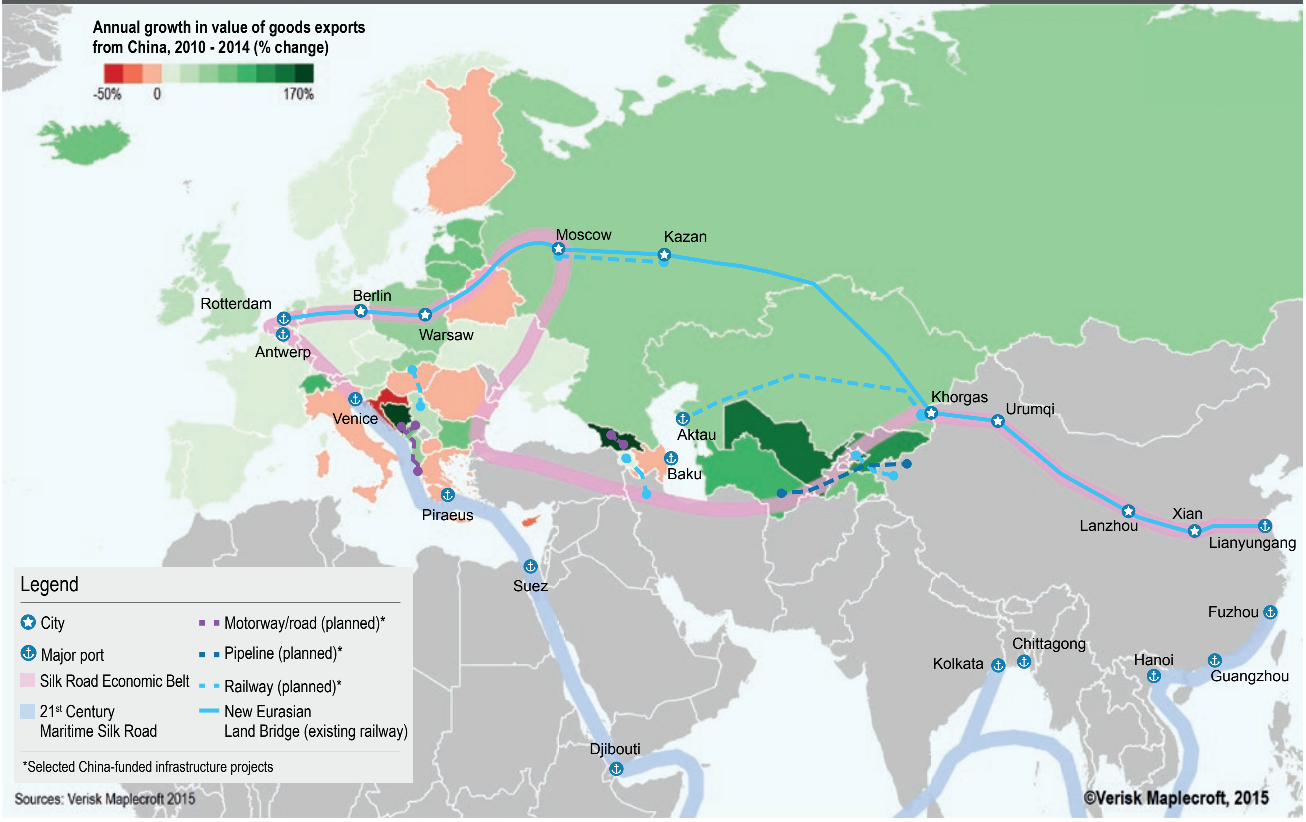
China advancing along 'Silk Road'

As the Chinese economy slows, Beijing is expected to offload some excess industrial capacity by way of targeted infrastructure development projects abroad. The One Belt, One Road (OBOR) policy will play a crucial role in strategically directing investment towards Central Asia and Central and Eastern Europe. It will also advance China's economic and geopolitical interests in these regions (see *Map 5*). In the longer term, the implementation of OBOR will reduce transit costs and provide Chinese exports greater access to key European markets.

Map 4: The rise in support for populist parties across Europe



Map 5: China's One Belt, One Road policy



However, Chinese infrastructure investments often come as loan deals, locking receiving countries into purchasing agreements with Chinese companies, thus crowding out domestic enterprise and limiting opportunities for other foreign investors. Besides growing political and financial dependency on China, many countries in Central Asia, Central Europe and Eastern Europe have insufficient administrative and absorption capacity for large-scale investments. This has the potential to compound existing deficiencies in the areas of transparency and governance.

The global economy

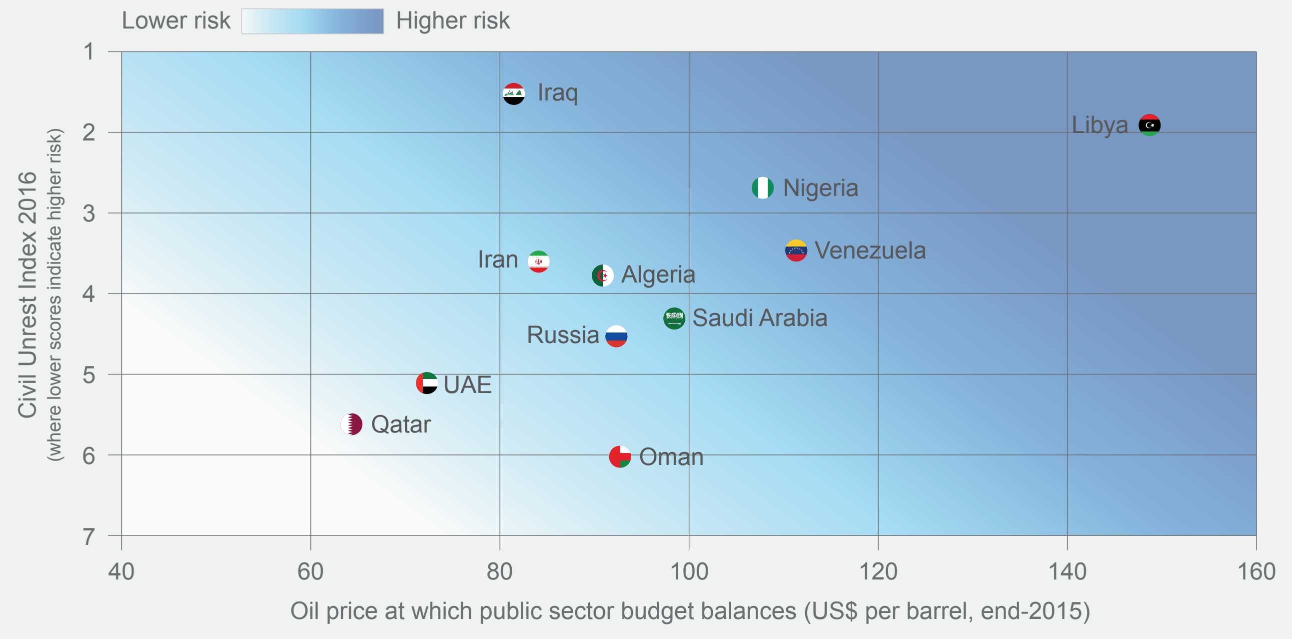
End of commodity boom drives up threat of societal unrest

The public finances of major commodity-producing countries are set to remain under intense strain in 2016, in many cases forcing unpopular fiscal tightening measures which will increase the risk of societal unrest (as detailed in the sub-Sahara Africa section). In several of the world's largest oil producers, autocratic regimes have maintained their grip on power via a mixture of populist spending and repression.

Yet with global oil prices likely to stay below US$60 per barrel in 2016, it will become increasingly hard for the authorities to maintain this balancing act. Countries which failed to run a surplus and amass hard currency savings during the recent period of high energy prices will have little choice but to pare back spending in 2016.

As public spending cuts squeeze living standards and stoke popular dissatisfaction, companies with operations in exposed commodity exporting countries will face a heightened threat of disruption as a result of demonstrations and mass mobilisation. *Figure 3* identifies the countries where the risk of frustrations boiling over is greatest. The chart plots the oil price at which the budget balances against Verisk Maplecroft's Civil Unrest Index 2016 (a measure of the latent risk of protest and conflict). Disregarding countries that have recently been embroiled in a major civil war (namely Iraq and Libya), our analysis suggests that the potential for societal unrest is highest in Venezuela and Nigeria.

Figure 3: Oil price at which budgets balance and risk of unrest



Source: Verisk Maplecroft, Various

Debt overhang to delay economic recovery in emerging markets

One of the most striking features of the past decade in emerging markets has been the unprecedented build-up in private sector debt, with some estimates putting this aggregate figure at more than 100% of GDP. Financial intermediaries across the developing world – from China to Brazil to Turkey – have unleashed a flood of financing to domestic consumers and businesses. Yet with the balance sheets of households and firms now stretched, and growth and employment prospects weak, loan arrears are poised to pick up in 2016. This will have an adverse impact on the health of local banks and their willingness to extend new loans, contributing to a double whammy of subdued domestic demand and tightening credit conditions for locally based firms.

Furthermore, although most of the last decade's lending binge was extended in local currencies, a small subset of countries has accumulated high concentrations of dollar debt which now warrants attention. Most notable in this regard are the large commodity producers in Africa and Latin America that took advantage of favourable external financing conditions to borrow in the greenback. These include Brazil, South Africa and Ghana.

In such places, borrowers will be forced to default as rising US interest rates and weaker exchange rates raise the local currency costs of servicing dollar debt. All of this is likely to result in weakening business confidence and rising external borrowing costs for firms, depressing capital investment and leading to slower rates of economic activity over the short to medium term.

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