

Geopolitical Threats for the Year Ahead: Marsh's Political Risk Map 2016



INTRODUCTION

In the last decade, multinational organizations have undertaken unprecedented international expansion, leaving them exposed to global credit and political risks like never before. And those risks — including terrorism and political violence, armed conflicts, increasingly powerful anti-establishment political movements, and persistently low commodity prices — continue to grow. Multinational risk professionals must now be prepared for virtually any type of political or economic risk threat in both developed and emerging markets.

Drawing on data and insight from BMI Research, a leading source of independent political, macroeconomic, financial, and industry risk analysis, Marsh's Political Risk Map 2016 presents a global view of issues facing multinational organizations and investors. Accounting for in-country political, economic, and operational risks, the map presents overall country risk scores for more than 200 countries and territories, helping businesses and investors make smarter decisions about where and how to deploy financial resources — including risk capital — globally in 2016 and beyond.

The following are key findings from BMI and Marsh regarding the major political risks that organizations and investors will face in the coming year. We also invite you to explore an [interactive version of our Political Risk Map 2016 on marsh.com](#).

TERRORISM

Attacks in 2015 have led to a renewed focus by world powers on combating terrorism. Of greatest concern is the Islamic State, which remains powerful in Iraq and Syria and is expanding its presence throughout the Middle East and North Africa. The “war on terror,” which began in earnest after the September 11, 2001, attacks in the United States, is likely to continue for at least another decade, according to BMI.

“The United States and Russia have learned lessons in the past about the difficulty of fighting ground wars for extended periods of time in the Middle East and Afghanistan, and neither country appears willing to risk repeating

those earlier experiences,” said Yoel Sano, BMI’s head of Global Political and Security Risk. “That means the most likely response from these and other governments will be an air campaign, which may not be enough to defeat the Islamic State.”

In addition to their role in prolonging instability in the Middle East, the risk of terrorist attacks will persist in North American, European, and Asian countries, even as they introduce stronger security measures. The threat of terrorism has also increased concerns in Western countries about immigration policy, and has proven to be a boon for right-wing political parties in Europe.

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CONFLICTS IN THE MIDDLE EAST AND NORTH AFRICA

The November 13, 2015, terrorist attacks in Paris have prompted Western countries to intensify airstrikes against Islamic State targets in Syria. France, for example, deployed its flagship aircraft carrier to the region to participate in the airstrikes. However, the Syrian civil war, which began in early 2011 amid the larger Arab Spring movement, continues in 2016. It has essentially become a proxy war between global and regional powers, with Russia and Iran fighting on the side of the Syrian government, and the United States, United Kingdom, France, Turkey, and Saudi Arabia among the leading supporters of the opposition. The influx of hundreds of thousands of refugees into neighboring Jordan, Lebanon, and Turkey has put severe strains on government services in these countries and has jeopardized their security.

Meanwhile, although Iraqi forces recaptured the city of Ramadi from the Islamic State at the end of 2015, the bigger challenge will be to regain Iraq’s second-largest city, Mosul, from the group. Even if that happens, however, much of Iraq’s Sunni minority is likely to remain highly distrustful of the Shi’a-dominated Iraqi government. Prime Minister Haider al-Abadi’s control over paramilitary forces also remains limited by strong political opposition to his anti-corruption campaign and other policies. Elsewhere in the region, deteriorating relations between Iran and Saudi Arabia — which severed diplomatic ties at the start of 2016 — will exacerbate Shi’a-Sunni divisions in the Middle East.

EMERGING ECONOMIES STRUGGLE

China continues to struggle as the country's economy shifts its focus from investment to consumption. In the third quarter of 2015, real GDP growth in China fell to 6.9% year over year, the slowest growth since the first quarter of 2009. Economic reforms, a weak real estate market, over-leveraging of corporate entities, and rising wages — which will eliminate a significant competitive advantage for Chinese manufacturers — will likely continue to limit growth in the next several years. In 2016, BMI forecasts real GDP growth of 6.3% (see Figure 1).

China's slowdown is emblematic of the broader struggles of emerging markets globally. In Brazil,

fixed investment and household consumption remain weak, driven by rising job losses, high inflation and interest rates, and a prolonged investigation into alleged corruption at Petrobras; BMI forecasts GDP contraction of 4.4% in 2016.

Meanwhile, investment growth in Russia has been minimal since 2012, and the deep recession in 2015 only exacerbated the problem for the Russian economy. Consumption will likely recover slowly in 2016, but inflation will stay high and nominal wage growth will remain subdued. BMI forecasts real GDP growth of 0.5% in 2016.

A bright spot among emerging economies is India, for which BMI forecasts real GDP growth of 7.2% in 2016. Prime Minister

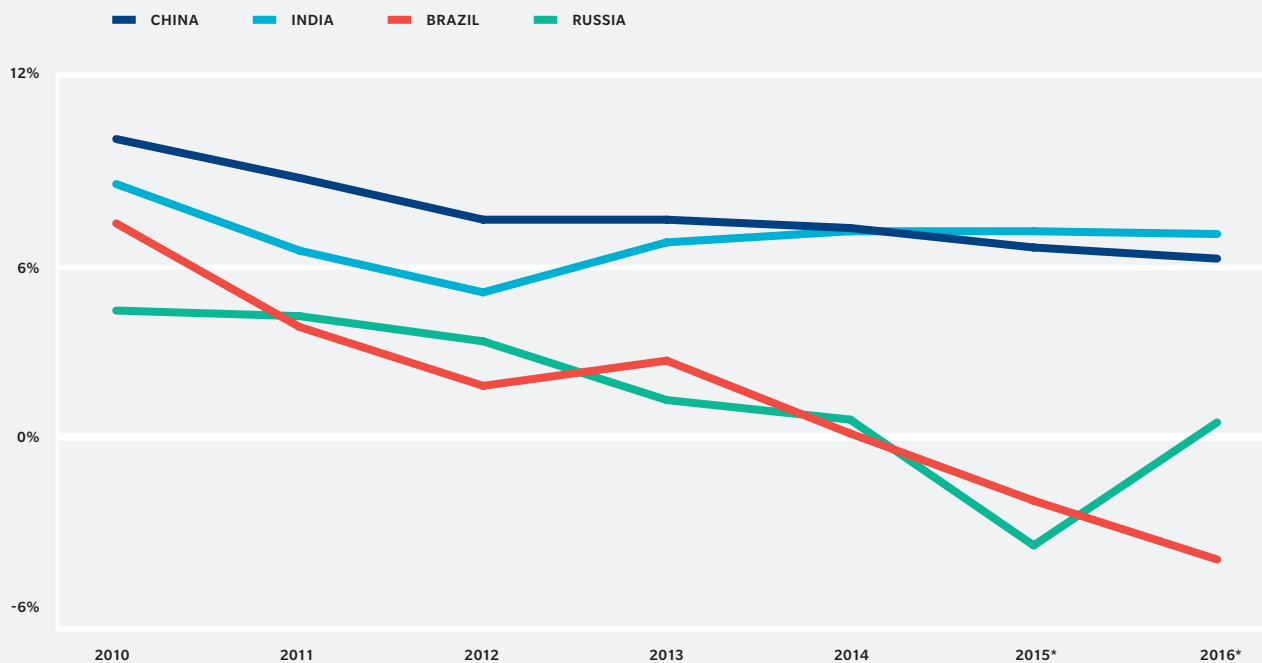
Narendra Modi's business-friendly government has launched several initiatives designed to boost economic investment, including by foreign entities, and to stabilize the Indian rupee. Industrial production is also expected to increase as many companies have announced plans to build factories in India in 2016.

2016 US PRESIDENTIAL ELECTION

Although foreign relations and defense policy were already areas of focus in the run-up to the US presidential election, the recent terrorist attacks in Paris and San Bernardino, California, intensified political rhetoric and brought these topics to the forefront. With polls showing national security to be a

FIGURE 1 GDP Growth in Brazil, Russia, India, and China, 2010 to 2016

Source: BMI Research



*PROJECTED

major concern for voters, foreign policy will remain a key theme on the campaign trail in 2016 — and will be top of mind for the next presidential administration.

“Presidential candidates in both major political parties have criticized what they regard as the Obama administration’s ‘aloof’ approach to foreign policy, which they see as contributing to China’s assertive stance in the East and South China Seas, Russia’s intervention in Ukraine, and Islamic State’s growth in Iraq and Syria,” Mr. Sano said. “Regardless of the election outcome, the next president is likely to take a more interventionist approach following the 2016 election.”

ANTI-ESTABLISHMENT PARTIES IN EUROPE

Terrorism, the migrant crisis, austerity measures, and other economic factors have contributed to the rise of anti-establishment parties in Denmark, France, Germany, Greece, Spain, the United Kingdom, and other countries. In most cases, these parties do not appear likely to win power through elections, but they could influence rhetoric and public policy as members of ruling coalitions with other parties. Many anti-establishment parties — particularly on the far right — have espoused tougher stances on immigration and defense amid the migrant crisis and following the attacks in Paris. Their growing power is likely to continue to test the European Union’s principle allowing for the free movement of workers.

Economic reforms, a weak real estate market, over-leveraging of corporate entities, and rising wages will likely continue to limit growth in China in the next several years.



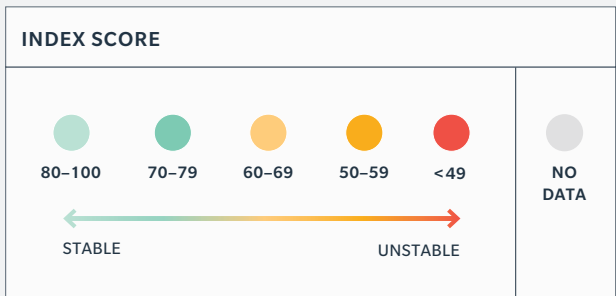
CRITICAL TESTS FOR THE EUROPEAN UNION

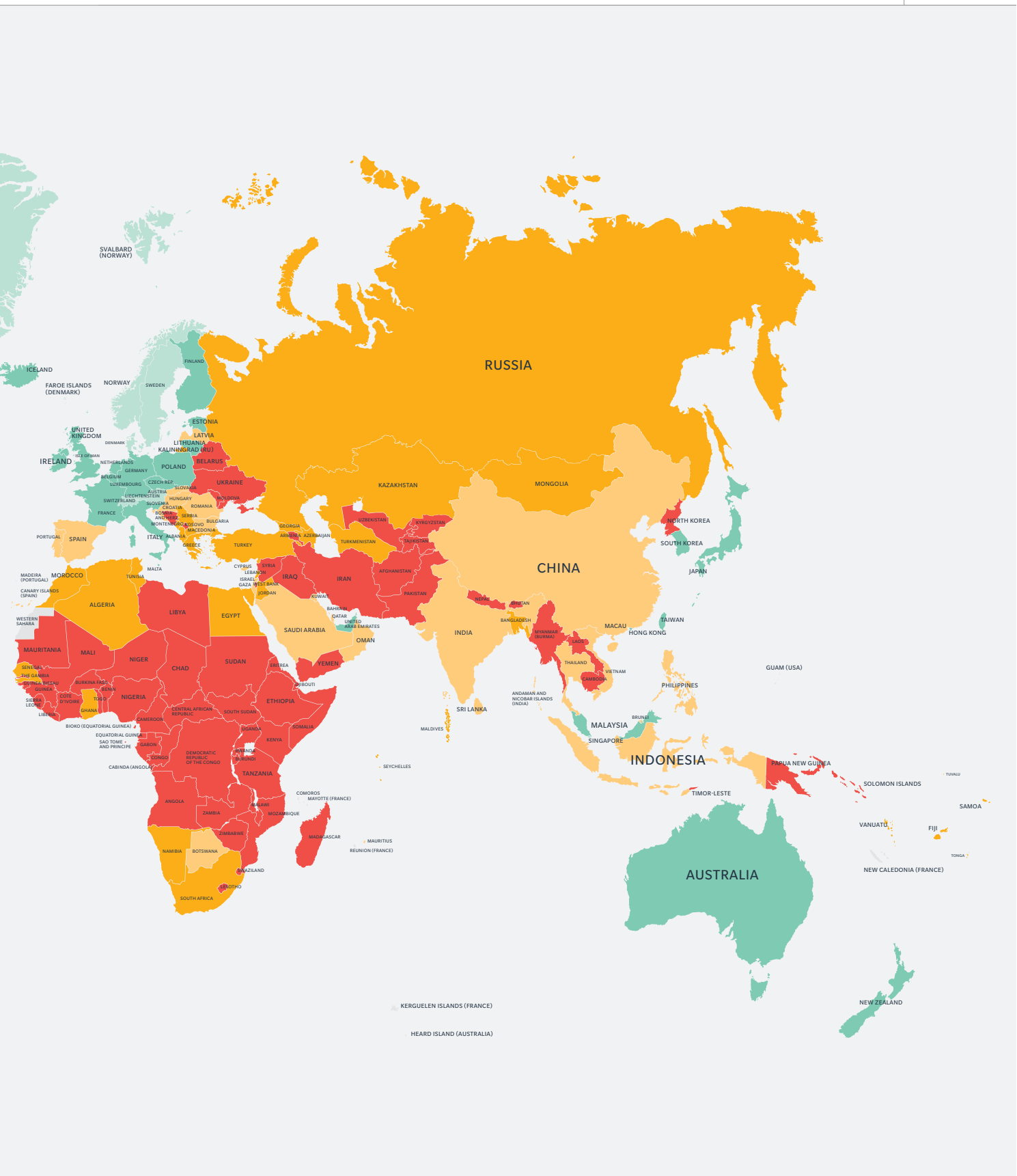
The ongoing migrant crisis — stemming from conflicts and poor living conditions in Syria, Iraq, Eritrea, Afghanistan, Libya, and elsewhere — will be a major test for the European Union. Under the Schengen Agreement, which took effect in 1995, free movement — without border checks — is legal across the vast majority of the EU. All but two EU members — the UK and Ireland — participate in the Schengen Agreement or are obliged to do so in the future; non-EU members Iceland, Norway, and Switzerland also participate. But as several countries have struggled with the rapid entry of migrants into their territories, the future of the Schengen Area is now in question. In 2015, passport checks were introduced along the borders between Austria and Germany, Sweden and Denmark, and Sweden and Germany. As public anti-immigration sentiment grows in many EU nations, more divisions between member states are likely to develop in 2016, unless there is a coordinated EU-wide response.

Meanwhile, questions about the future of the EU itself have been raised as the referendum on the UK’s EU membership approaches. The so-called “Brexit” (British exit) referendum is expected to occur in 2016; BMI estimates the likelihood of the UK exiting the EU at 35%, although this could change. To date, the UK’s Conservative government has remained neutral on the issue as it negotiates with the EU on several matters, most notably limiting immigration into the UK and curtailing benefits for EU nationals working in the UK. The outcome of these negotiations could determine whether the government campaigns in favor of or against a UK exit, which would significantly affect the referendum results. A presidential election in France and federal elections in Germany — both scheduled for 2017 — could also help shape the future of the EU.

POLITICAL RISK IN 2016

Drawing on data and insight from BMI Research, Marsh’s Political Risk Map 2016 provides country risk scores for more than 200 countries and territories. The overall risk scores are based on three categories of risk — political, economic, and operational — and reflect both short- and long-term threats to stability. For more detail on individual country results, [explore our interactive Political Risk Map 2016 on marsh.com](#).





FALLING COMMODITY PRICES

Oil prices dropped precipitously in the second half of 2014. Although prices rebounded somewhat in the first half of 2015, they have since fallen even lower. From a recent high of USD 112 per barrel in June 2014, prices for Brent crude oil fell to USD 38 per barrel in December 2015, the lowest price since July 2004, according to the US Energy Information Administration (see Figure 2).

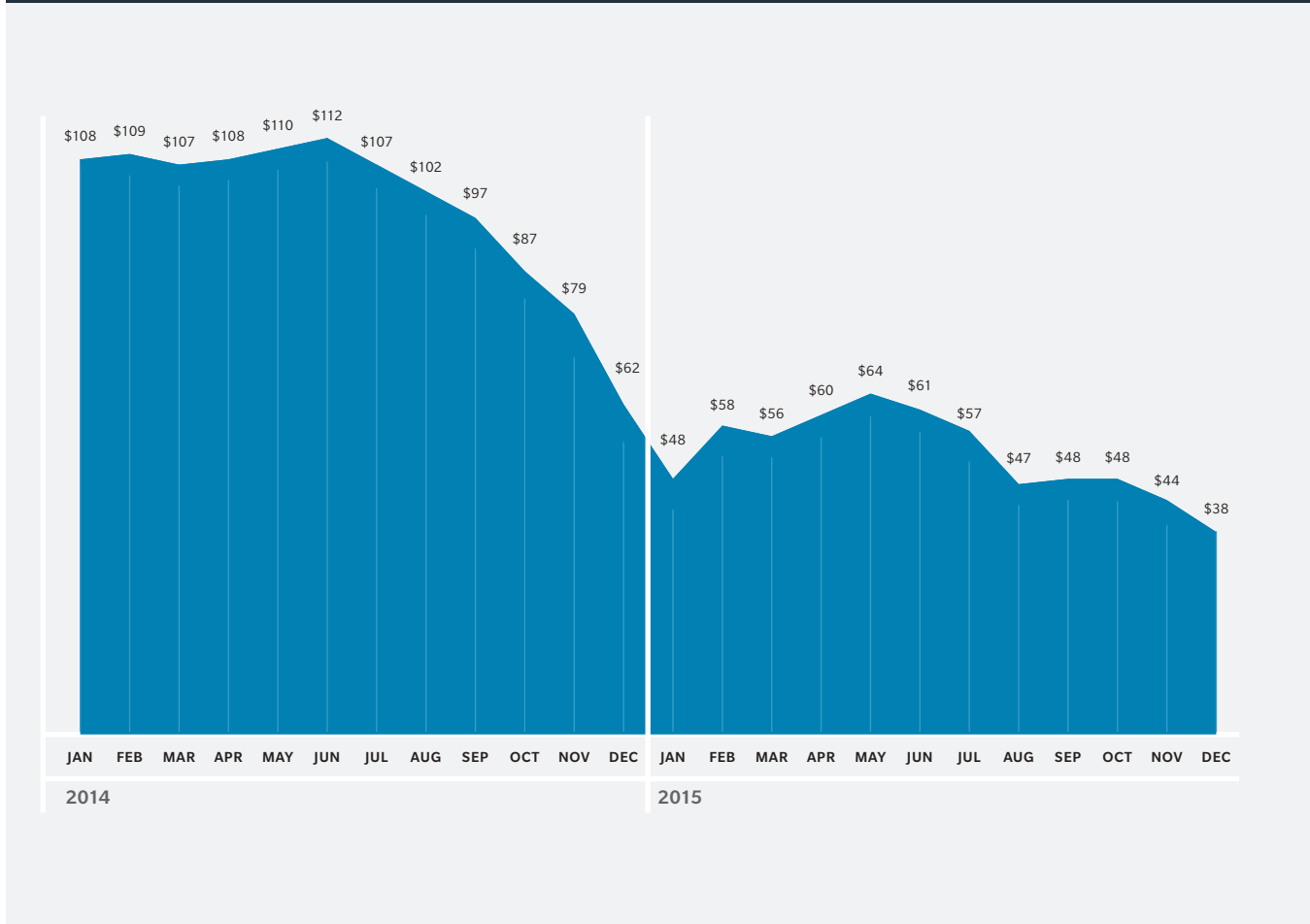
BMI forecasts an average price for Brent crude oil of USD 42.50

per barrel in 2016, which will continue to have negative effects on the economies of oil-exporting countries, adding to their political risks. Those at highest risk include Angola, Congo-Brazzaville, Equatorial Guinea, Iran, Iraq, Nigeria, and Venezuela. Low oil prices could also increase political risk in Russia.

“Many net oil exporters already faced significant political risks before the drop in oil prices, which could be exacerbated if

prices remain low,” Mr. Sano said. “In Venezuela, for example, voter dissatisfaction with the poor economy and high inflation contributed to the opposition party’s victory in December’s legislative elections. That could lead to a move away from the statist system in the long run, but the near-term impact is greater political risk stemming from internal political clashes. Low oil prices and economic sanctions could keep the Russian economy weak, although political change

FIGURE 2 Brent Crude Oil Spot Prices 2014 to 2015 (USD per Barrel)
 Source: US Energy Information Administration



is unlikely as President Putin remains a popular figure.”

Beyond oil, prices for a number of other agricultural commodities, livestock, and precious and industrial metals have fallen since early 2014. For example:

- ▶ Prices for cotton, which had sold for more than USD 90 per pound in March 2014, fell to below USD 65 per pound in December 2015.
- ▶ Gold, which had sold for more than USD 1,300 per ounce in June 2014, fell to below USD 1,100 per ounce in December 2015.
- ▶ Copper prices fell from more than USD 3.20 per pound in June 2014 to just over USD 2 per pound in December 2015.

The global decline in many commodity prices has been attributed in part to the economic slowdown in China, which no longer has the same voracious appetite for materials imported from Latin America, Africa, and elsewhere. Coupled with rising interest rates and the slump of currencies against the US dollar, these falling prices portend an increase in political risk in many emerging markets whose economies rely on commodities exports, such as Brazil. The drop in prices could also have lasting economic effects on resource-rich developed economies, including Canada and Australia.

SUCCESSION RISKS

According to BMI, more than 20 countries have aging, longstanding leaders but no clear plans or frameworks for the transition of power. When such leaders have

died or resigned in the past — for example, in Indonesia, Iraq, Libya, Yugoslavia, and Zaire — the result has often been civil war or substantial political unrest and violence. Among the countries that could experience similar turmoil in the next few years are Angola, Cameroon, Cuba, Equatorial Guinea, Iran, Kazakhstan, Oman, Saudi Arabia, Thailand, Uzbekistan, and Zimbabwe.

CENTRALIZATION VS. FEDERALIZATION

The 2014 referendum on Scottish independence and subsequent pledge by the UK's ruling Conservative party to grant new powers to the Scottish Parliament is one example of the pressures that governments across the world face to devolve more power to their regions. Similar pressures have been seen in:

- ▶ The separatist conflict in Eastern Ukraine.
- ▶ India, where a popular movement led to the division of Andhra Pradesh into two separate states (Andhra Pradesh and Telangana) in 2014.
- ▶ The Houthi rebellion and Southern separatism in Yemen.
- ▶ A referendum on the independence of Catalonia, which was blocked by the Spanish government.
- ▶ Hong Kong, where political protesters have sought greater autonomy from the Chinese government.

As falling oil prices and other factors continue to put pressure on several countries' economies, it's critical for businesses to be prepared for the possibility that political violence, unrest, or other large-scale crises will quickly develop in virtually any part of the world — including those countries that were historically seen as safe or stable.

“We expect the debate between centralization and federalization to continue, although we do not expect to see many new sovereign states formed in the next five years,” Mr. Sano said. “Rather than seeking outright independence, many separatists are likely to settle for greater autonomy, as appears to be the case in Scotland.”

RIVALRIES AMONG “GREAT POWERS”

In 2016, we will likely see continuing tensions among the world’s three “great powers” – the United States, Russia, and China – and between these countries and various regional powers. In 2016, tensions could continue to build between:

- ▶ China and Japan in the East China Sea, and China and the US in the South China Sea, stemming from China’s assertion of territorial rights and construction of artificial islands and airstrips.
- ▶ North Korea and South Korea, especially after the North’s announcement in early January of a successful nuclear bomb test. Should a conflict develop between the two countries, it could easily draw in the US, China, and Japan, all of which have strong interests in the security and stability of the Korean Peninsula.
- ▶ Russia and the North Atlantic Treaty Organization in the Baltic states or Eastern Mediterranean, as NATO extends membership invitations to more countries (the most recent being Montenegro).
- ▶ Russia and Turkey, exacerbated by the latter’s downing of a Russian military jet in November 2015 near Syria’s border with Turkey.

“Both China and Russia appear intent on flexing their muscles and playing a greater role in the politics of many regions, as evidenced by China’s plan to build a military base in Djibouti, in the Horn of Africa,” Mr. Sano said. “We expect that rivalries between both the great powers and regional powers like Turkey will continue to develop, including some direct confrontations and proxy wars in the coming years.”

MANAGING POLITICAL RISK

As we were reminded by recent events in Paris and elsewhere, terrorist and politically motivated attacks often occur without warning. And as falling oil prices and other factors continue to put pressure on several countries’ economies, it’s critical for businesses to be prepared for the possibility that political violence, unrest, or other large-scale crises will quickly develop in virtually any part of the world – including those countries that were historically seen as safe or stable.

Businesses can prepare for these risks in several ways:

- ▶ **Build resilient supply chains.** Before a crisis develops, an organization should understand how a crisis in one country can disrupt its global supply chain. Businesses should also have response plans in place to allow for the use of alternative suppliers and/or ports, and to communicate with customers and suppliers as needed.
- ▶ **Protect people.** Developing and testing crisis plans in advance can help ensure effective communication during and immediately following a crisis.
- ▶ **Protect assets through insurance.** Credit and political risk insurance can protect against a variety of risks, including expropriation, political violence, currency inconvertibility, non-payment, and contract frustration.
- ▶ **Manage credit risk.** When a government collapses or descends into crisis, it often loses its ability to honor financial obligations. This can create a chain reaction of default that spreads into the private sector. Businesses should review their credit risks and credit-control policies and procedures, and evaluate the potential impact of political risk on the countries in which they, their customers, and suppliers operate.



About BMI Research

Specializing in emerging and frontier markets, [BMI Research \(BMI\)](#) covers macroeconomics, financial markets, political risk, and 24 industry verticals across 200 global markets. For more than 30 years, our unique approach and insights have been used by multinationals, governments, and financial institutions to guide their strategic, tactical, and investment decisions. BMI clients span more than 160 countries and include more than half the Global Fortune 500 companies. With offices in London, New York, Singapore, Hong Kong, Dubai, and South Africa, BMI is part of [Fitch Group](#), a global leader in financial information services.

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