Marsh

Political risk report 2023

Navigating through volatility

March 2023

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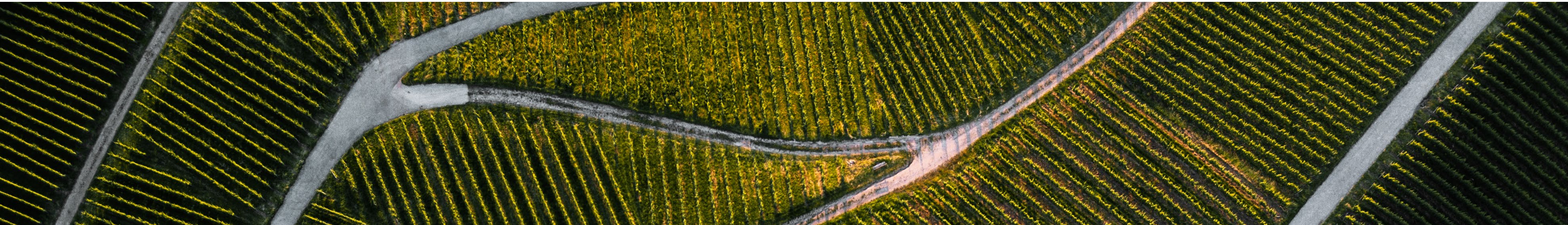
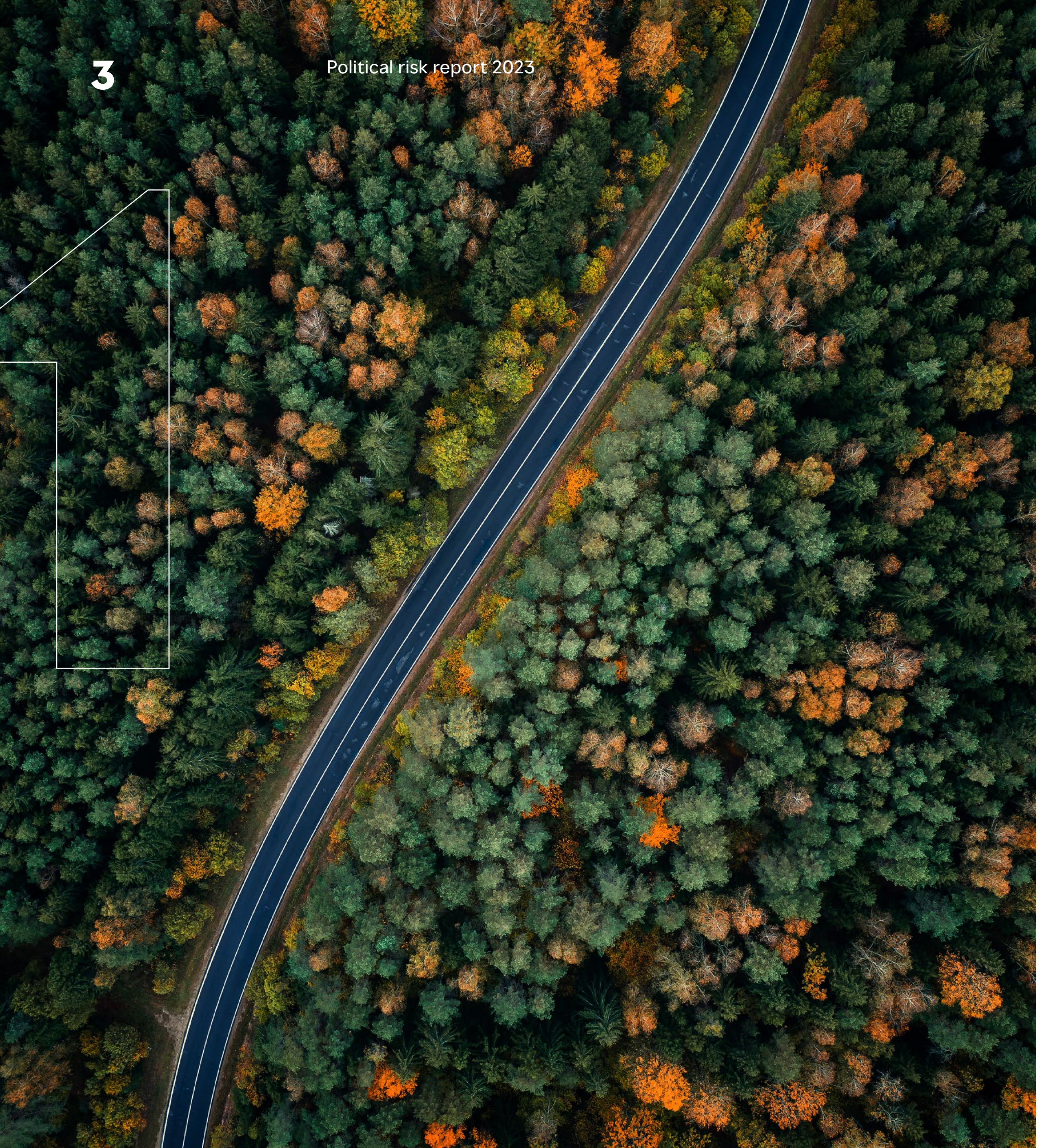




Introduction

The global political and economic environment is likely to remain fragile in 2023 as a number of factors work in concert to compound the impact of various risks. Marsh's *Political Risk Report 2023* examines four areas where increasing political, performance, and credit risk threaten global trading, security, and investment environments:

Persistent political instability, especially when compounded by the impact of inflation, threatens the economic and investment environment and, in some cases, the social fabric of emerging markets. Various countries will soon hold, or have recently held, elections that could further fuel social instability and political polarization.

Economic retrenchment is a dominant trend as governments worldwide focus on their self-interests in national economic security, often at the expense of free trade, further fragmenting international alliances. In 2022, every region felt the impact of the slowing global economy, although some were better insulated than others. Decisions by key economic powers on issues from fertilizers to microchips to the energy transition will continue to have global repercussions.

Competition for strategic resources is intensifying as a result of the Russia-Ukraine conflict and the ever-increasing demand for raw materials used in modern technologies. While countries that hold these resources are seeing opportunities for growth, the competition between governments in many places contributes to geopolitical instability.

Supply chain diversification brings new risks, with companies seeking solutions to mitigate against soaring material prices, fluctuating exchange rates, increased shipping costs, and government intervention. While supply chain resilience trends — including reshoring and supply chain simplification — may disrupt many economies and businesses for years to come, they also present opportunities for nimble competitors.

In line with the four trends identified, Marsh's *Political Risk Report 2023* highlights a continuing increase in economic risk across most regions, driven principally by high inflation, which adds to long-simmering geopolitical tensions (see Figure 1). However, our analysis shows that some countries stand to benefit from a diversified supply chain and a pivot towards critical minerals.

The compounding effect of related global risks is what the World Economic Forum (WEF) *Global Risks Report 2023* calls "polycrises" that will test resiliency at the global, country, and business levels.

The WEF report, created in partnership with Marsh McLennan and others, warns that these polycrises have turned the focus of nations inward and that the emerging outlook for international cooperation is deteriorating. A better balance between national preparedness and global cooperation is needed to build collective resilience to the next global shock or shocks, whatever form they may take.

A particularly unusual and positive feature of the current elevated risk environment is the concurrent existence of at least four substantial and overriding global economic growth drivers.

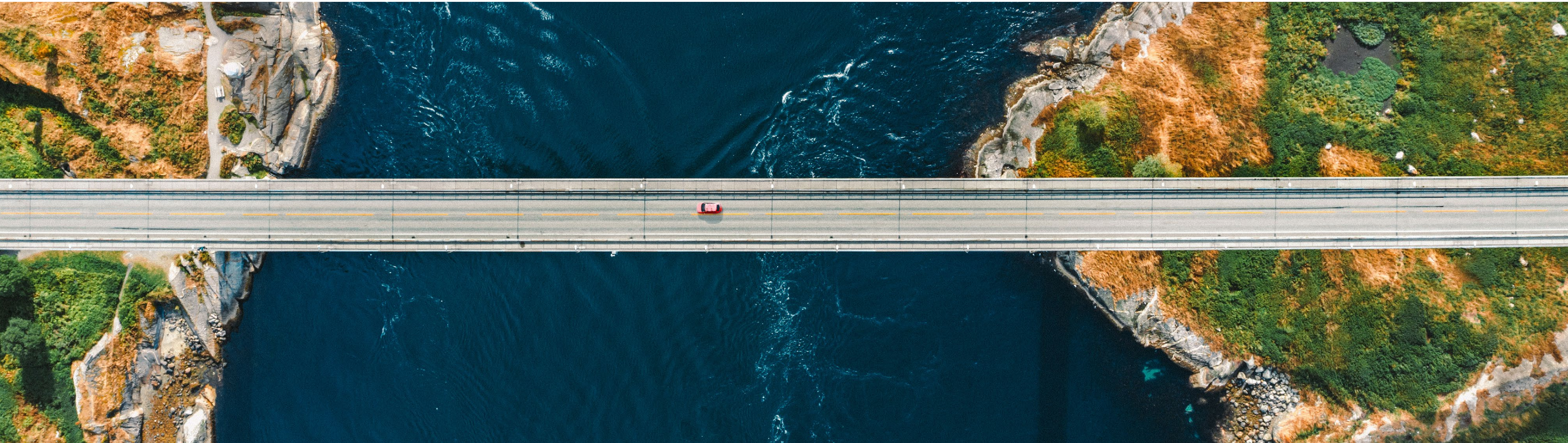
They include:

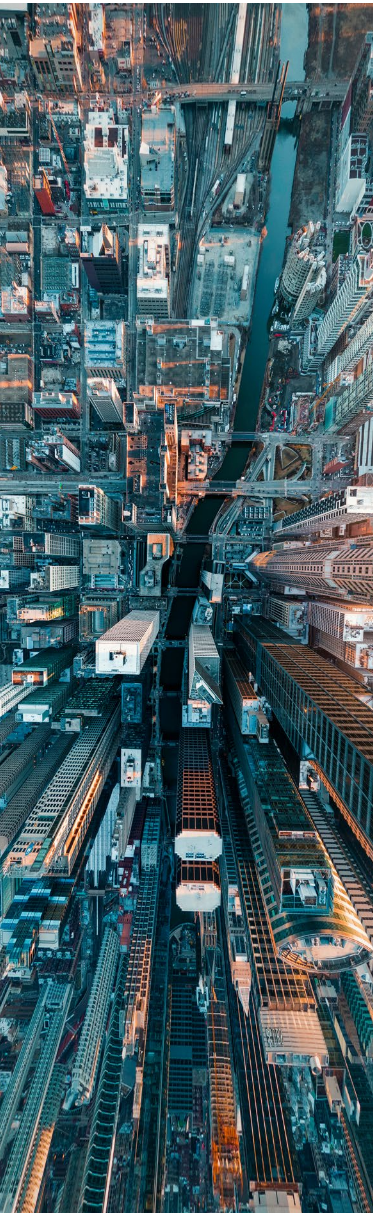
1. The backlog of core infrastructure investment.
2. The need to rapidly increase energy transition investments to meet the 2030 Paris Agreement climate and sustainability goals.
3. Energy and food security.
4. Defense investment.

Changing economic or political circumstances may impact these four growth drivers, but they are global imperatives that will affect almost every step of every supply chain for many years to come.

This presents public and private corporations, in every region of the world, with substantial investment and trade opportunities.

Combining today's complex, volatile risks with substantial growth opportunities provides an environment in which credit, performance, and political risk management and mitigation is critical, not only to protect capital, but also to enable growth of existing assets and new investments.





01| Political risk ratings for 2022 saw a universal deterioration in the trading environment driven by changes in both sovereign credit risk and country economic risk

Region	Security environment			Trading environment			Investment environment		
	Strikes, riots, & civil commotion	Terrorism	War & civil war	Country economic risk	Currency inconvertibility & transfer risk	Sovereign credit risk	Expropriation	Contractual agreement repudiation	Legal & regulatory risk
North America	5.2	3.9	2.5	3.5	2.2	1.9	2.2	4.8	3.4
South America	5.2	2.3	2.5	4.9	4.3	6.2	4.0	5.1	5.0
Asia Pacific	4.1	2.9	2.8	4.8	4.3	4.8	3.4	4.4	4.9
Europe	4.0	2.7	2.1	4.1	2.5	3.1	2.2	3.8	3.3
Eastern Europe and Central Asia	5.2	3.6	4.7	6.0	5.8	6.5	6.4	6.0	5.8
Middle East and North Africa	5.5	5.5	4.5	5.1	4.9	5.6	4.9	5.7	5.7
Sub-Saharan Africa	5.5	4.3	3.9	5.8	5.8	6.9	5.3	5.8	6.1
World average	4.9	3.4	3.1	5.0	4.4	5.3	4.0	5.0	5.0

Region	Averages and changes					
	Average of security perils	3-Year deterioration (2023-2020)	Average of trading perils	3-Year deterioration (2023-2020)	Average of investment perils	3-Year deterioration (2023-2020)
North America	3.9	5.4%	2.5	9.2%	3.5	4.8%
South America	3.3	1.2%	5.1	4.6%	4.7	0.1%
Asia Pacific	3.3	3.4%	4.6	12.1%	4.2	1.2%
Europe	2.9	5.0%	3.2	10.2%	3.1	5.7%
Eastern Europe and Central Asia	4.5	11.8%	6.1	13.7%	6.1	6.2%
Middle East and North Africa	5.2	-1.7%	5.2	4.5%	5.4	-0.9%
Sub-Saharan Africa	4.6	3.2%	6.2	5.9%	5.7	-0.1%
World average	3.8	2.8%	4.9	7.9%	4.7	1.2%

Marsh's risk ratings are generated monthly by a proprietary, algorithm-based modelling system incorporating over 200 international indices across 197 countries. For each peril, countries are scored on a scale from 0.1 to 10.0, with intervals of one decimal; 0.1 represents the lowest risk score, 10.0 the highest. Five risk bands are identified within the scale, correspond to distinct risk environments.

HIGH RISK				LOW RISK
8.1–10.0	6.1–8.0	4.1–6.0	2.1–4.0	0.1–2.0

Source: Marsh

Ratings current as of February 2023.

Persistent political instability in emerging markets

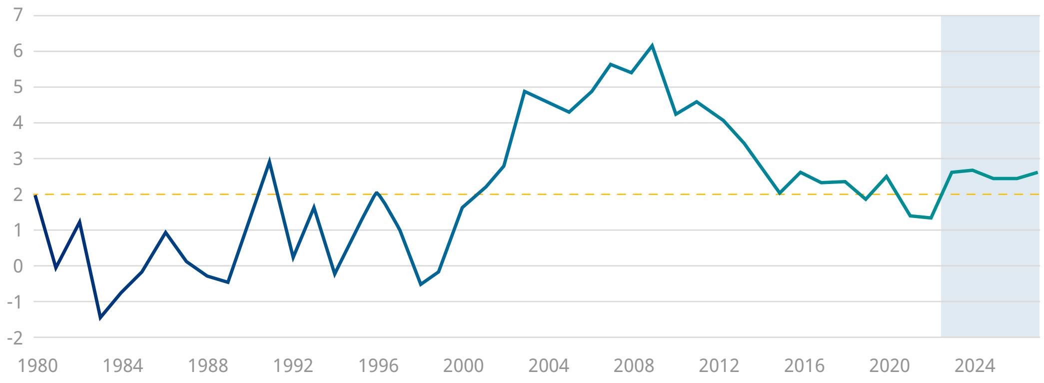
Despite a recent rebound of foreign direct investment (FDI), ongoing political instability could derail economic growth and threaten investment returns in emerging markets. This country risk confronts policymakers and investors with difficult decisions.

Political stability encourages investor confidence and attracts FDI inflows. After the removal of COVID-19 restrictions and a slowdown in global inflation, FDI inflows into emerging markets recovered, bringing economic opportunities to many regions (see Figure 2). Yet the continued ability to attract substantial volumes of FDI and use it effectively depends heavily on political stability – the likelihood of which remains precarious.

According to Marsh's risk ratings, the incidence and risk of war, civil war, and terrorism in several regions — including Sub-Saharan Africa, Latin America, and parts of Asia — remains high and could threaten investment returns.

Global inflationary pressures are forecast to ease in 2023, although the trend may not hold for emerging economies, which tend to be less socially resilient and institutionally effective. To avoid inflationary pressures from mounting further, decision-makers face a choice between supporting weak growth and maintaining restrictive monetary policies to lower inflationary expectations.

02| **FDI flows to emerging market assets surged post-pandemic**



Source: *International Monetary Fund, Haver Analytics* Average EM - DM Forecast

Cost of living crisis a key risk

The cost of living crisis is ranked by respondents to the 2022-2023 Global Risks Perception Survey as the most severe risk over the next two years, according to *The Global Risks Report (GRR) 2023.* Even in the absence of geopolitically fuelled shocks or constraints, continued price pressures on food, water, and energy have resulted in an elongated cost-of-living crisis in selected markets, ushering in wage strikes, violent protests, and state instability, the report says. Facing actual or perceived shortages, states continue to quickly and regularly exercise control over key resources to protect their own population, which will fracture alliances, deepen conditions of scarcity, and result in escalating trade tensions that restrict the flow of climate technologies.

If policymakers opt for the latter course of action, they are likely to lower interest rates only cautiously in 2023. Higher external borrowing costs could see governments make increased use of central bank funding, leading to large fiscal deficits and fueling inflation and social unrest. High sovereign credit risk scores for Sub-Saharan Africa and Latin America in the World Risk Review indicate the difficult choices facing policymakers.

AFRICA

Several African economies have higher than average risk scores across all nine perils within the three World Risk Review environments — security, trading, and investment (see Figure 3).

03| Risk ratings for several countries in Sub-Saharan Africa

Country	Security environment			Trading environment			Investment environment			Averages		
	Strikes, riots, & civil commotion	Terrorism	War & civil war	Country economic risk	Currency inconvertibility & transfer risk	Sovereign credit risk	Expropriation	Contractual agreement repudiation	Legal & regulatory risk	Average of security perils	Average of trading perils	Average of investment perils
Angola	5.7	3.5	4.1	5.6	5.8	6.7	4.5	5.4	6.3	4.4	6.0	5.4
DR Congo	6.6	7.7	6.6	5.6	7.2	6.7	6.6	7.4	7.9	7.0	6.5	7.3
Côte d'Ivoire	5.2	5.3	3.7	4.8	5.2	5.7	4.4	5.2	5.5	4.7	5.2	5.0
Ghana	5.8	3.7	2.5	5.9	5.2	8.7	4.0	5.9	4.9	4.0	6.6	4.9
Nigeria	6.9	8.3	5.9	6.0	7.0	6.7	5.9	6.0	6.5	7.0	6.6	6.1
South Africa	7.5	3.1	2.7	5.1	3.9	5.1	3.7	4.8	4.6	4.4	4.7	4.4
World average	4.9	3.4	3.1	5.0	4.4	5.3	4.0	5.0	5.0	3.8	5.9	4.7

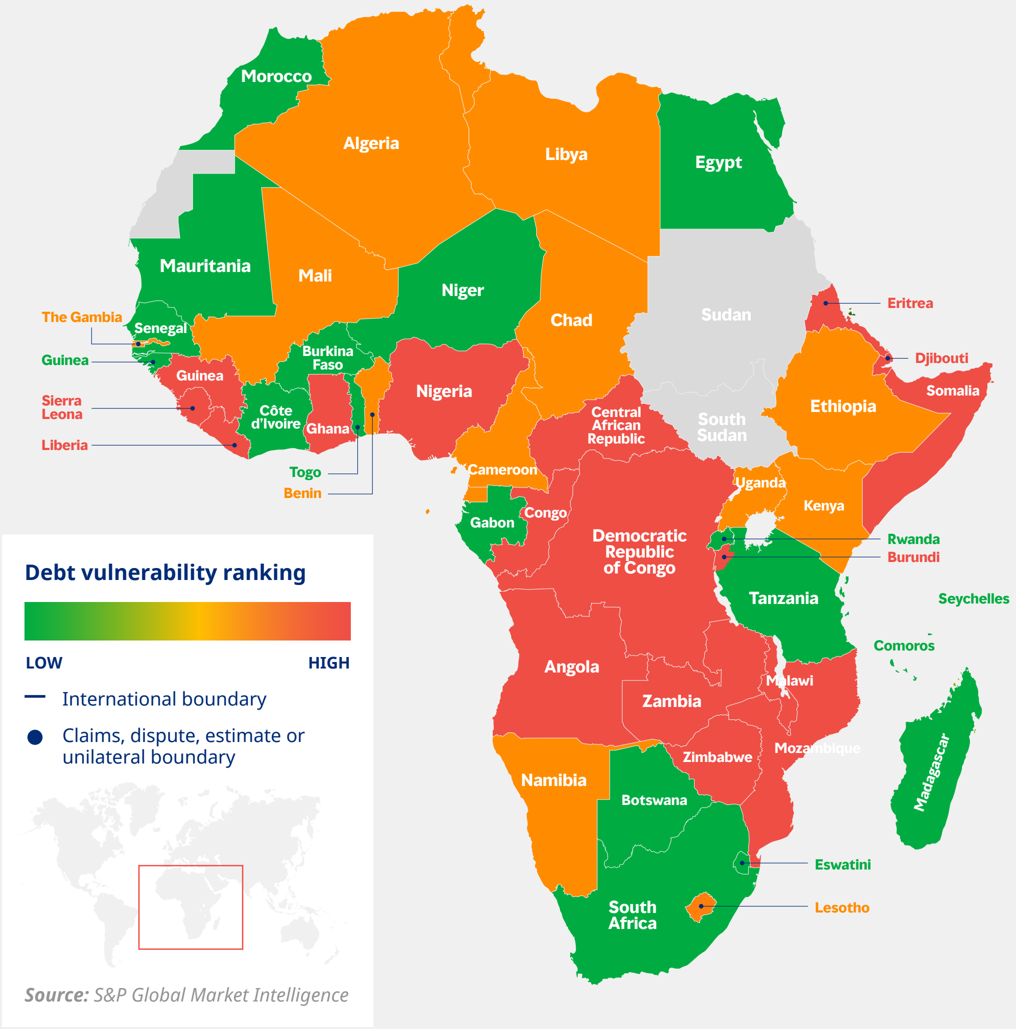
HIGH RISK — LOW RISK

8.1–10.0	6.1–8.0	4.1–6.0	2.1–4.0	0.1–2.0

Source: Marsh

Ratings current as of February 2023.

04| Ranking of African countries' debt vulnerability impacting the sovereign credit ratings



Source: S&P Global Market Intelligence

In West Africa, Ghana faces severe economic and financial challenges, indicated by 20-year high inflationary trends, local currency depreciation, dwindling foreign reserves, and rising debt vulnerabilities (see Figure 4). These factors raise the prospect of political instability in the country.

Elsewhere, Nigeria's new president, Bola Tinubu, will face urgent challenges amid economic hardship, record unemployment and inflation, increasing social inequality, and diminishing oil revenues. These issues highlight the country's precarious future and could lead to violence and security challenges unless addressed. Nigeria's security environment is compounded by the risk of terrorism, which has a high score of 8.3, according to the World Risk Review — a result surpassed only by a handful of territories globally.

The potential spillover of terrorism into West African countries poses a serious threat to the region's political stability, particularly in Benin and Togo, but also in Côte d'Ivoire and Ghana, where jihadist groups are increasingly taking advantage of instability in Mali and Burkina Faso. While it has been reported that Burkina Faso is likely to engage Russia-backed Wagner private security contractors, it is doubtful this alliance will prevent jihadists from establishing greater de facto control of national territory.

Southern Africa is also likely to see continued social unrest. A growing protest movement in Angola — led mostly by young people, among whom unemployment is nearly 70% — aims to apply pressure on the recently re-elected People's Movement for the Liberation of Angola (MPLA) government to hold municipal elections. The MPLA may continue to delay these elections, given the steep decline in support for the ruling party in national voting in August 2022. Elsewhere, amid an already fragile fundamentalist landscape, the restarting of gas infrastructure projects in Mozambique and international oil companies' (IOCs) commitment to the country, could continue to be instability drivers.

In South Africa, hundreds of people took to the streets of Johannesburg in 2022 to protest a prolonged energy crisis that has caused record power cuts in the country. Scheduled blackouts, known as "load shedding," have burdened South Africa for years as the state-owned energy firm Eskom, often the target of criminal gangs and corruption, has struggled to keep pace with growing demand and maintenance requirements of its ageing infrastructure. The outages reached new extremes in the past year and it is expected that they will continue to be a flashpoint.

The prosecution of former president Jacob Zuma and others implicated in the Zondo Commission Inquiry into Allegations of State Capture is another source of tension that may lead to occasional incidents of violent protest. Significant military deployments may prevent large-scale attacks on retail stores, yet the risk of disruptions to critical infrastructure — including ports, railways, and electricity grids — remains elevated. South Africa's 7.5 rating for strikes, riots, and civil commotion in the World Risk Review indicates the prevalence of social instability that could undermine the country's economic potential.

MIDDLE EAST

Prior to the onset of the COVID-19 pandemic in 2020, the Egyptian economy expanded rapidly, supported by the successful implementation of fundamental macroeconomic reforms under two International Monetary Fund (IMF)-supported programs, increased exports and investment, and improved public finances. Despite sizeable reforms, substantial economic and systemic challenges remain, and efforts to address inclusion gaps have yet to lead to broader economic opportunities.

Egypt faces multiple economic challenges, with high inflation inflicting hardship on households that could lead to rising anger among the population. Egypt's sovereign credit risk rating remains elevated at 6.1, having received a further downgrade early in February 2023. Although trade flows are improving, they are exposed to the 6.9 risk rating for terrorism (see Figure 5). Replenishing Egypt's export portfolio to pre-pandemic levels is contingent on FDI, which is likely to fare better with a decrease in the terrorism risk. Furthermore, financial markets continue to attribute elevated default risk to Egyptian debt.

The latest IMF Staff Report on Egypt, relating to a recent US$3 billion extended fund facility (EFF), calls for the country to move to a flexible exchange rate, tighten its fiscal position, and reduce the role of the state and the military in the country's economy. Given the acute financing situation Egypt faces, it is likely the government will follow some of the IMF's recommendations. Yet the resulting adjustments are unlikely to represent a fundamental shift towards a fully competitive private sector. The investment environment and FDI are expected to remain compromised in the first half of 2023.

In Türkiye, several factors have contributed to persistently high risk scores assigned to the country's sovereign and banking sectors since the mid-2010s. These factors include the current account deficit, increasing government interference in the banking sector, state control over central bank policymaking decisions, and banks' elevated reliance on foreign funding. Indicative of these underlying vulnerabilities, the lira has been one of the worst-performing currencies globally since the beginning of 2021. In recent years, foreign currency reserves have been consistently negative on a net basis and inflation has risen sharply.

World Risk Review ratings are elevated for Türkiye across all three perils of the investment environment (see Figure 5).

05| Security, trading, and investment risks are above the world average in Egypt and Türkiye

Country	Security environment			Trading environment			Investment environment			Averages		
	Strikes, riots, & civil commotion	Terrorism	War & civil war	Country economic risk	Currency inconvertibility & transfer risk	Sovereign credit risk	Expropriation	Contractual agreement repudiation	Legal & regulatory risk	Average of security perils	Average of trading perils	Average of investment perils
Egypt	4.6	6.9	4.7	5.5	5.7	6.1	4.6	5.1	6.1	5.4	5.8	5.3
Türkiye	5.4	6.0	5.3	6.3	6.4	6.8	4.6	6.1	4.8	5.6	6.5	5.2
World average	4.9	3.4	3.1	5.0	4.4	5.3	4.0	5.0	5.0	3.8	6.1	4.7

HIGH RISK — LOW RISK

8.1–10.0	6.1–8.0	4.1–6.0	2.1–4.0	0.1–2.0

Source: Marsh

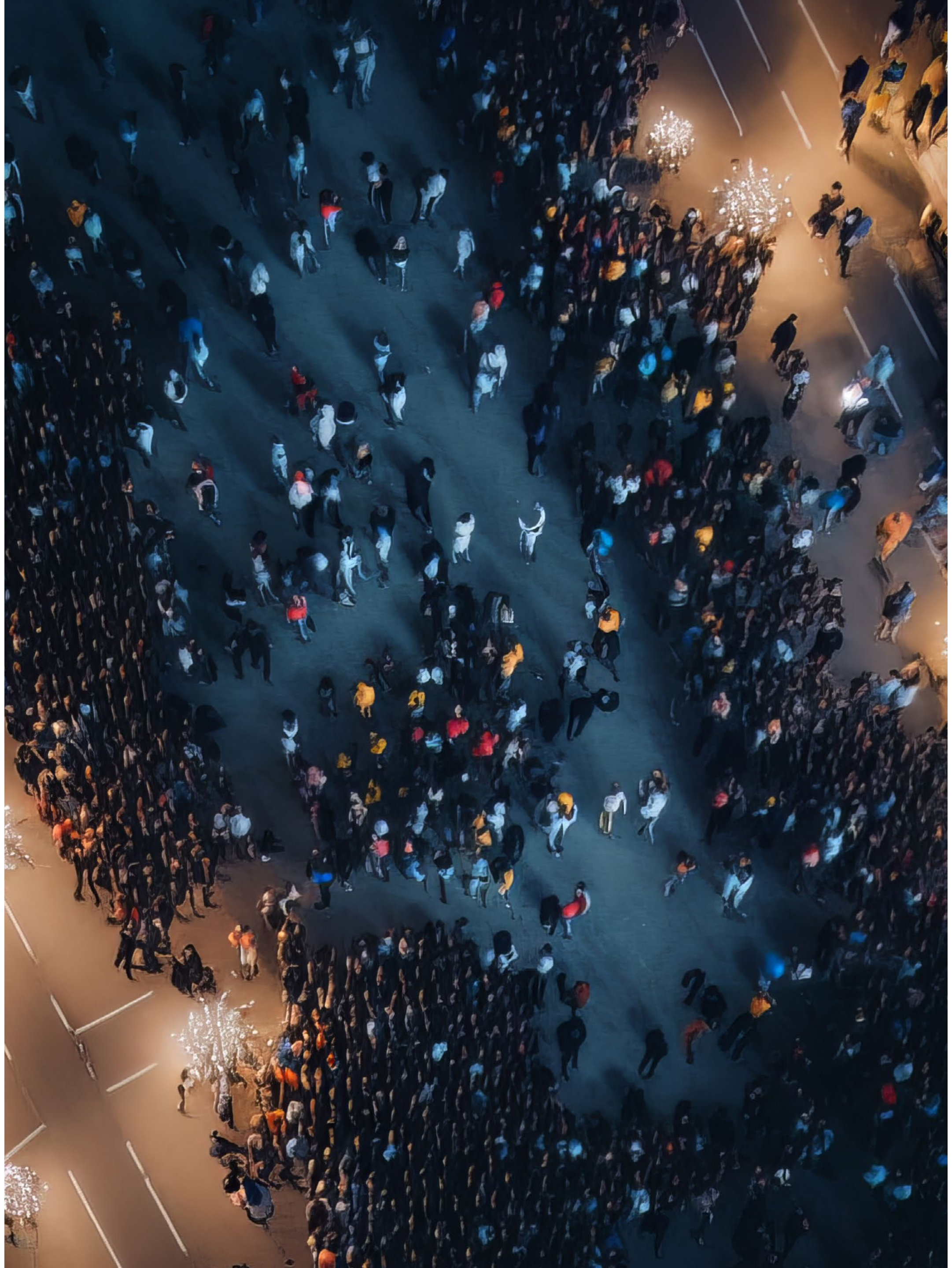
Ratings current as of February 2023.

With security, trading, and investment environment risk ratings higher than the world average, Türkiye will need to remedy the stresses across its economic profile, especially from a sovereign standpoint, in order to keep attracting foreign investment.

The devastating earthquake of February 2023 will compound Türkiye's economic headwinds, contributing to lost economic activity and reduced agricultural output as the region affected generates almost 10% of Türkiye's GDP and 9% of its exports. However, the value added of construction and government services will grow sharply, mitigating some of the lost output in industry and agriculture.

As Türkiye heads into an election this year, pressure on the country's banking sector to support economic growth and keep lending rates low is projected to continue. A revival of foreign capital inflows would help to keep credit growth at a robust pace, the effects of which would likely continue to lower the non-performing loan ratio. Vulnerabilities related to banks' foreign currency lending remain a constant source of risk.

Despite relatively elevated levels of country risk, Türkiye looks to benefit from the Middle Corridor (see Section 5), a hub for export and energy connections between China and Europe, which offers many opportunities for foreign infrastructure investment.



LATIN AMERICA AND THE CARIBBEAN (LAC)

Widespread social disenchantment, reflected in the high risk ratings for strikes, riots, and civil commotion in the LAC region, is expected to be a consistent theme throughout 2023 (see Figure 6).

Ahead of general elections later in 2023, the Argentine government is implementing a deal signed with the IMF in March 2022 to reduce fiscal spending, while trying not to alienate supporters of the government of President Alberto Fernandez. Protests and strikes in 2022 sought to pressure the government to do more to counter high inflation, poverty, and unemployment.

In Colombia, the number of urban protests declined in 2022, but they could increase in 2023 if food and electricity costs continue to rise. Meanwhile, President Gustavo Petro's criticism of the environmental impact of extractive industries may encourage protests that disrupt mining oil production.

Chile also could see potentially violent protests if the country's new constitution is delayed. However, a repeat of the social unrest of 2019 against high living costs and inequality is currently considered unlikely given the government's attempt to address the issues.

Elsewhere, the resurgence of protests in Ecuador by indigenous and social groups in 2022 disrupted the oil and transport sectors. Mexico, too, saw protestors disrupt traffic and cargo transport.

06| Risk ratings for strikes, riots, and civil commotion in LAC are high

Country	Security environment			Trading environment			Investment environment			Averages		
	Strikes, riots, & civil commotion	Terrorism	War & civil war	Country economic risk	Currency inconvertibility & transfer risk	Sovereign credit risk	Expropriation	Contractual agreement repudiation	Legal & regulatory risk	Average of security perils	Average of trading perils	Average of investment perils
Argentina	7.2	2.9	1.9	7.0	7.9	8.1	5.5	5.3	5.5	4.0	7.7	5.4
Bolivia	7.1	2.7	3.3	5.0	6.5	6.3	6.6	6.4	6.5	4.4	5.9	6.5
Brazil	6.3	2.1	2.6	4.8	4.0	5.1	3.2	5.4	5.0	3.7	4.6	4.5
Chile	6.1	4.7	2.6	4.4	3.2	2.8	2.7	4.2	2.9	4.5	3.5	3.3
Colombia	6.2	6.5	5.2	4.7	4.0	4.4	3.8	5.4	5.1	6.0	4.4	4.8
Mexico	6.1	3.5	2.5	3.8	3.6	3.6	4.3	6.7	5.3	4.0	3.7	5.4
Peru	5.9	3.6	2.7	4.0	3.4	3.5	4.7	5.4	5.2	4.1	3.6	5.1
World average	4.9	3.4	3.1	5.0	4.4	5.3	4.0	5.0	5.0	3.8	6.1	4.7

HIGH RISK LOW RISK

8.1–10.0	6.1–8.0	4.1–6.0	2.1–4.0	0.1–2.0

Source: *Marsh*

Ratings current as of February 2023.

Peru saw the worst deterioration in the three risk environments among LAC countries from 2019-2022. Intensified political instability limits Peru's ability to execute timely economic policies to support robust economic growth. The weakening of Peru's governance institutions and the political instability that followed the impeachment of former president Pedro Castillo threatens the country's 2023 economic outlook. Social conflict is leading to low business confidence and regulatory risks that constrain and deter private investment. According to the Peruvian government, social unrest in 2022 cost US$625 million in lost production, in addition to the damage caused to infrastructure, warehouses, mines, and farms.

Latin America is likely to face another challenging year politically, which could complicate the region's ability to attract FDI. Given rising interest rates and lower deposit growth, some banking sectors in the region are already experiencing significant declines in liquidity. For example, between 2020 and mid-2022 in Peru and Colombia, banks managed to gather a significant pool of liquid assets, which they are now using to finance new loans as deposits have declined. This trend is expected to continue through 2023, with banks likely to place greater reliance on foreign funding or deleveraging to preserve their liquidity ratios.

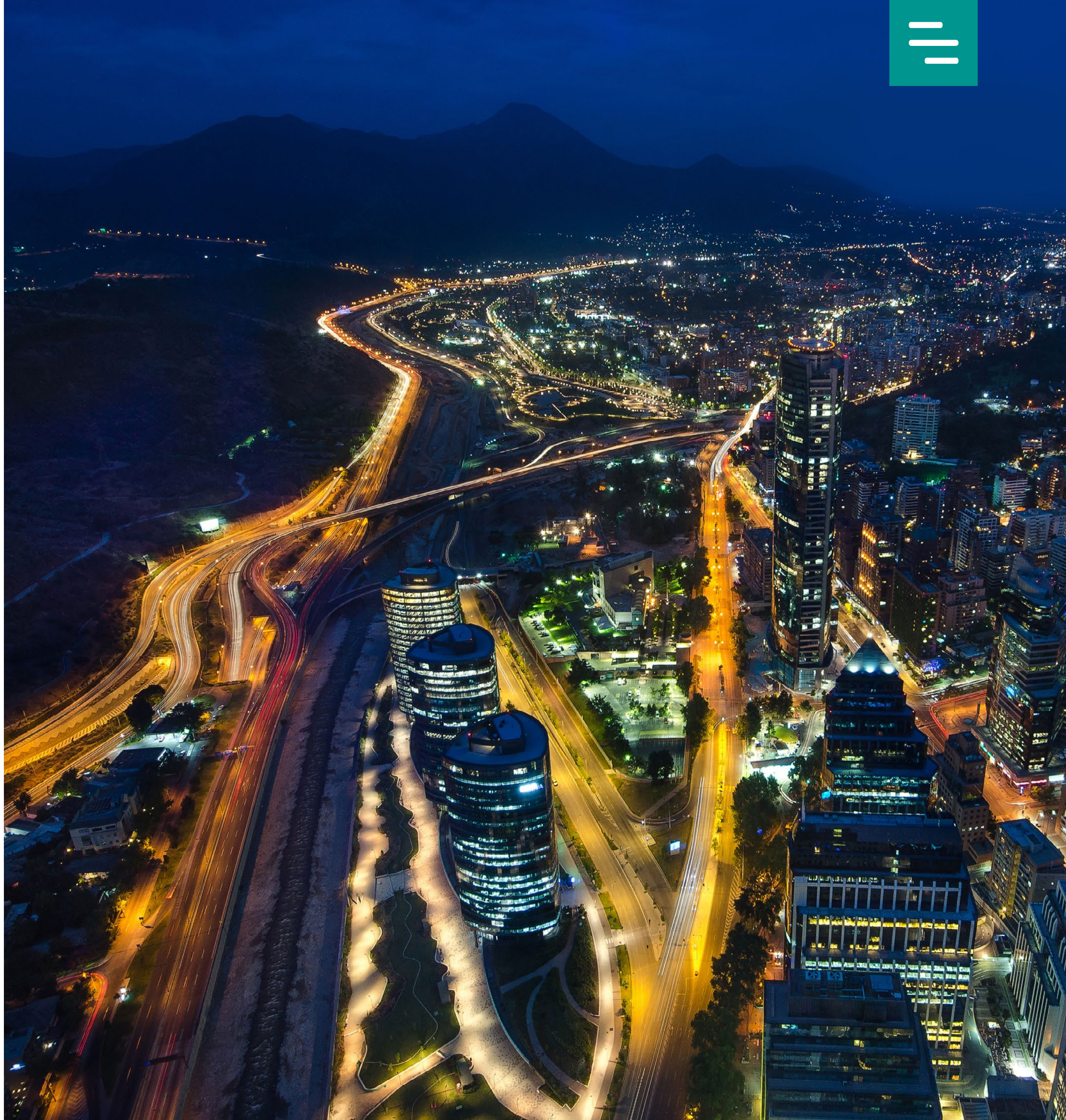
Geopolitical instability benefits some countries, such as Guyana. The country's oil exports doubled in 2022, boosted by European countries seeking alternative energy suppliers. The composition of Guyana's economy will continue to transform rapidly as the government and foreign investors pursue aggressive development timelines for the oil and gas sector. Guyana's political and economic stability will depend on effective absorption, management, and utilization of incoming oil revenues.

Emerging markets offer investors the potential for high rates of return. However, political and economic instability may continue throughout 2023, threatening to dampen returns on capital and the security of existing assets. A review of each country's resilience and industry-specific risk exposures can help investors understand the medium- and long-term prognoses.

Private credit and political risk insurance can create tangible financial benefits for investors by protecting emerging market returns and enhancing project internal rate of return (IRR). A joint 2022 study by Marsh and S&P Global Ratings shows that the potential benefits of political risk insurance (PRI) include:

- Reducing the country risk premium.
- Reducing the discount rate applicable to project cash flow.
- Enhancing net present value and asset valuations.
- Increasing an investment's internal rate of return.

The study aimed to quantify the benefits of procuring PRI on overseas assets. Previously, decisions on using political risk insurance were based on intuition instead of any rigorous framework, which led to inconsistent outcomes. S&P Global built new tools, to add to their existing "Country Risk Investment Model", focusing on the incremental investment returns required by investors in risky countries (the "Country Risk Premium"). S&P Global could draw a direct equivalence between the coverages provided in PRI policies and certain key factors in their model that explain the Country Risk Premium.



Economic retrenchment

Continued geopolitical volatility and supply chain disruption has encouraged many governments to focus on national economic security at the expense of free trade and international alliances, leading to fragmentation of the international system.

The lines between national and economic security are increasingly blurred, with many governments taking offensive and defensive actions to shore up their own economies, such as building protectionist barriers, which may threaten the economic, energy, and food security of other nations. As economies adjust to these changing dynamics, new global winners and losers will emerge. The impact of economic retrenchment may be especially strong in countries that rely on importing food and fertilizers, contributing to food scarcity and higher food prices.

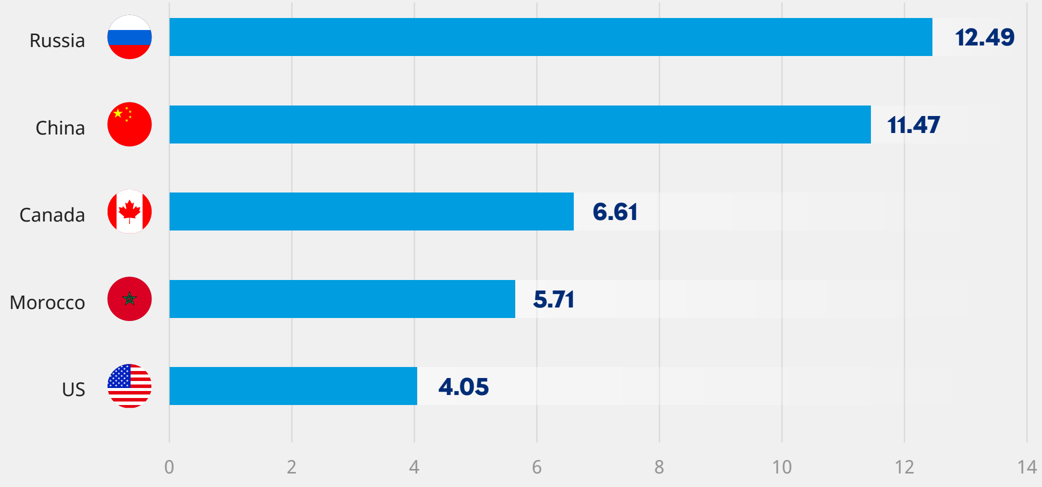
The trend shows no signs of abating with the EU joining the US in adopting protectionist policies that are expected to exacerbate geopolitical tensions.

Fertilizer decisions in China, elsewhere impact global food security

In 2021, China banned all exports of phosphate, a major component of commercial fertilizer, to protect supplies in the domestic market. China's retrenchment combined with Russian fertilizers coming off the market in 2022, has severely reduced the amount of fertilizer in the global system (see Figure 7).

07| Fertilizers export value worldwide 2021, by leading country

Leading fertilizer exporting countries worldwide in 2021, based on value (US$bn)



Source: *Statista*

Geoeconomic confrontation a key risk in short and long term

Geopolitical fragmentation will drive geoeconomic warfare and heighten the risk of multi-domain conflicts, according to the GRR 2023. Geoeconomic confrontation is ranked by respondents in the 2022-2023 Global Risks Perception Survey as the third most severe risk over two years, and the ninth over the next 10 years. In a complex risks outlook, there must be a better balance between national preparedness and global cooperation, the report says.

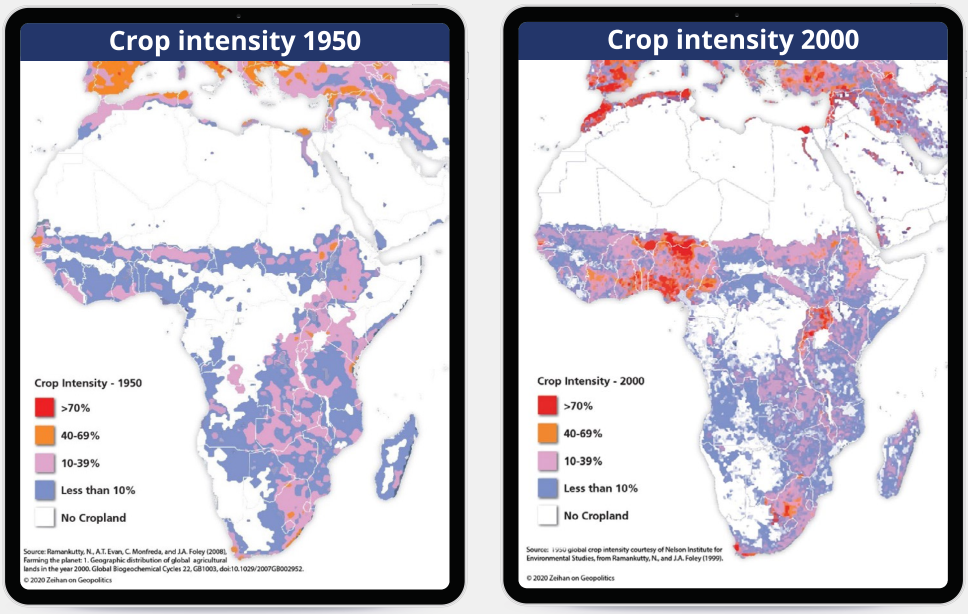
Restrictions on the availability of fertilizer will impact food prices in emerging economies, helping to drive the cost of living crisis. High fertilizer prices are also a major concern for agricultural producers, and higher interest rates could further increase production costs and affect planted acreage.

For example, fertilizer availability and price has been identified as one of the Brazilian government's most pressing concerns for 2023. The country relies on imports for more than 80% of its fertilizer requirements, so reduced availability threatens to lower crop yields.

Changing global dynamics could also dampen agribusiness potential in Africa. For decades, the continent has benefited substantially from importing fertilizer to increase crop yields (see Figure 8).

Use of fertilizers by most smallholder farmers in Africa is severely limited by a lack of access to savings or credit, even during times of lower prices. Higher prices combined with currency devaluation in many countries will make fertilizer unaffordable for many.

08| Africa's agribusiness has gained significantly from value-added inputs



***Source:** Zeihan on Geopolitics*

As the cost passes to consumers, elevated food prices will likely affect supply and demand, which would also negatively impact the incomes and savings of African farmers.

The impacts of high fertilizer prices on countries' national economies depends on the importance of agriculture in the economy, major crops grown, climate, and reliance on fertilizer imports. Fertilizer manufacturing countries, such as the US, China, and India, can gain from higher export prices and/or impose export tariffs to reduce domestic prices, an option unavailable to fertilizer importing countries, which face increased costs.

Unless governments subsidize fertilizers, their use is likely to fall, reducing food and export crop production. The result would be increased food import bills and reduced export earnings. High food prices, likely food shortages, and low export crop production are expected to have damaging effects on welfare, balance of payments, and economic growth in some countries. The decrease in fertilizer exports from China, Russia, Ukraine, and elsewhere, and other issues, could increase the risk of famine.

The race for advanced semiconductor domination

The semiconductor industry is strategically important for energy, national, and technology security. From computers and communications to car manufacturing, defense, and renewable energy, semiconductors are embedded in almost every device we use today (see Figure 9). With the majority of semiconductors currently produced in Taiwan, semiconductor shortages have become a critical vulnerability for major economies.

For years, China has encouraged investment in domestic semiconductor production and in 2022 announced a US$143 billion support package for its semiconductor industry. The US, in an effort to prioritize the achievement of semiconductor technology superiority, has imposed export controls on technology products and passed legislation and trade incentives to encourage onshore production.

In response to US export controls, China has filed a complaint with the World Trade Organization (WTO) over unfair trade practices. The potential for higher value chain costs does not phase the US, which is countering with promises of accelerated innovation.

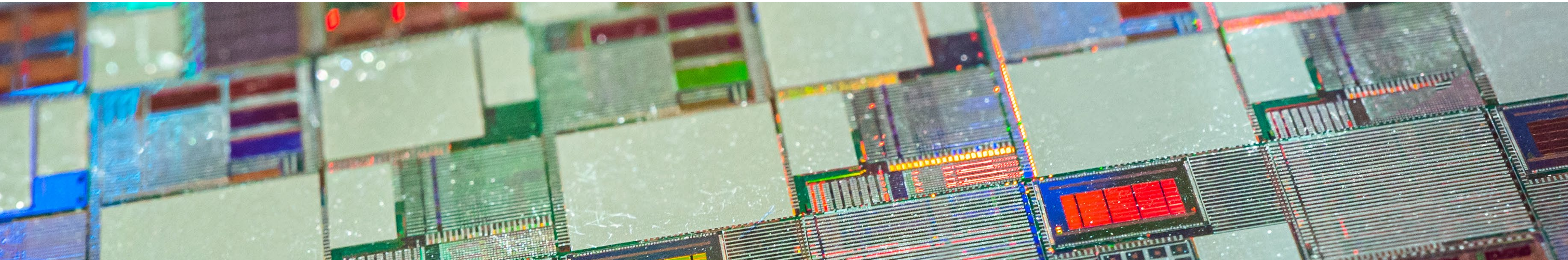
Through careful diplomacy and economic incentives, such as the CHIPS and Science Act, the US is set to allocate US$52 billion of government investments for domestic chip manufacturing. This has attracted several companies to invest in building chip plants in the US, including the Taiwan Semiconductor Manufacturing Company (TSMC), which is building a US$12 billion chip fabrication plant in Arizona (see Figure 10). The US is also working with Canada and Mexico to coordinate investment and manufacturing efforts for semiconductors, with Mexico expected to profit from supporting broader elements of the semiconductor supply chain.

09| The importance of semiconductors to the US economy continues to grow

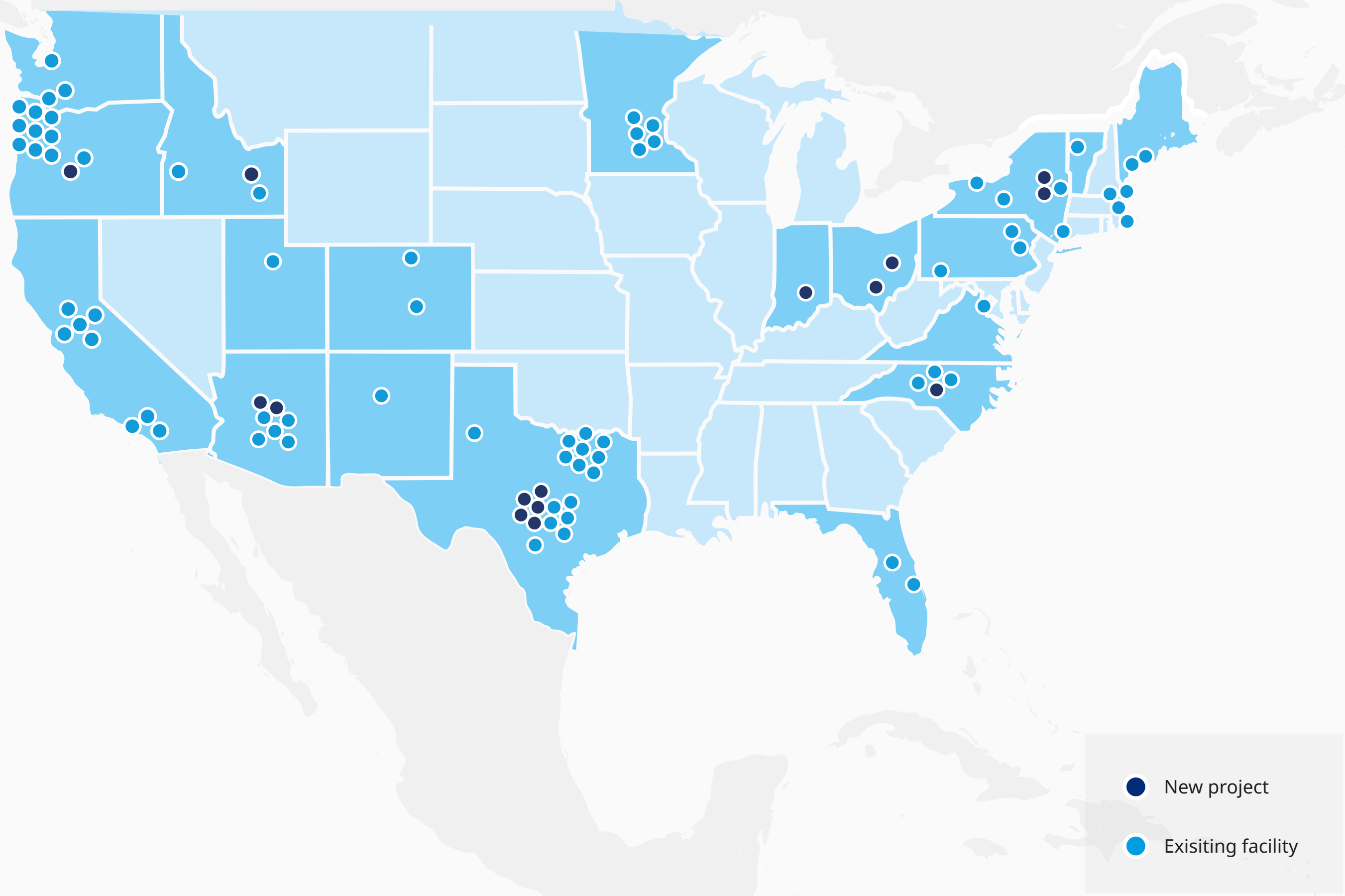
2021 US demand by end-use

End of year category	Computer	Communication	Automotive	Consumer	Industrial	Government
Annual growth	23.1	24	37.9	28.9	26.6	26.4
Total value (US$bn)	175	170.6	69.1	68.4	66.9	5.8

Source: *Semiconductor Industry Association*



10| **New semiconductor projects include the construction of 15 new fabrication facilities and the expansion of nine factories across 12 US states**



Source: *Semiconductor Industry Association*

THE US PUSH TO LEAD ON GREEN ENERGY TECHNOLOGY

Perhaps the most high-profile example of both geoeconomic rivalry and economic retrenchment is the US Inflation Reduction Act (IRA), which was approved in 2022. Viewed by some as an offensive tactic by the US to gain a competitive edge over Europe in the race to develop green technology, the IRA will channel US$370 billion of federal spending — mainly in the form of tax credits, loan guarantees, and grants — to create green jobs and promote domestic manufacturing. While sending a positive message on climate action, the concern among European governments is that the IRA puts Europe's industrial base for clean technologies at a disadvantage.

Competition for strategic resources

The Russia-Ukraine conflict will undoubtedly transform the global energy landscape for years to come, weighing on long-term energy demand and accelerating the shift to renewables and low-carbon power.

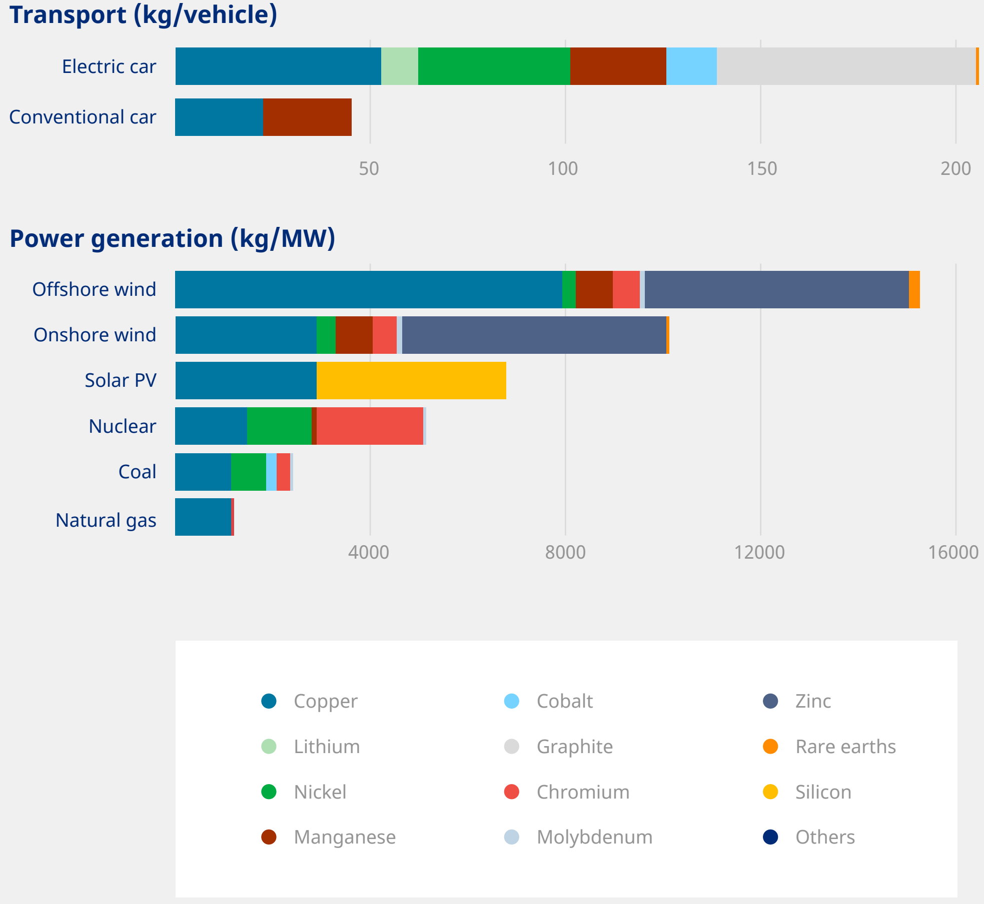
The Russia-Ukraine conflict has compounded global supply chain challenges and increased commodity prices, resulting in an acute crisis for economies that are net energy importers, including countries in Europe. Longer term, the invasion may alter the strategic resource landscape and accelerate a greener future.

Clean energy transitions offer opportunities

As the push towards clean energy technologies accelerates, demand for certain minerals and metals is rising (see Figure 11). In 2021, global demand for rare earths was 125,000 metric tons; by 2030 it is forecast to reach 315,000 tons. This creates enormous pressure on global production, but if managed correctly, the search for rare earth elements offers emerging and advanced economies opportunities for growth.

Latin America's mining profile is shifting towards minerals that are critical for the energy transition, including lithium, nickel, cobalt, manganese, and copper. Mexico currently stands to benefit due to its significant nearshoring potential.

11| Relative importance of metals and minerals for green energy production and cars



Source: *IEA 2022; The Role of Critical Minerals in Clean Energy Transitions, License: CC BY 4.0.*

Countries such as Argentina and Brazil also stand to gain from a drive towards more integrated supply chains, as indicated by Chinese firm Gotion High-tech announcing a US$12 million investment for a lithium battery manufacturing facility in Argentina.

Scaling up exploration is crucial for enabling Africa to further identify and extract rare earth elements. Already, rich deposits of critical minerals have been found, leading several international companies to pursue investment. A Canadian exploration firm announced that its rare earths mine in Malawi will commence production in 2025, and an Australian firm has acquired a 42% stake in Namibia Critical Metals, which owns a majority stake in the Lofdal heavy rare earths project. The mine produces 2,000 tons of rare earth oxides per year and has rich deposits of two of the most valuable heavy rare earth metals — dysprosium and terbium. South Africa also has rich deposits, for instance the Steenkampskraal Mine possesses 15 elements and 86,900 tons of rare earth oxides.

Mineral wealth is not a guarantor of positive outcomes. Despite high prices and strong demand for critical minerals, many mineral-rich countries have elevated political risk, which can deter foreign direct investment (see Section 2).

Resource-rich countries could find themselves at the crossroads of geopolitical competition between China and Western countries. As of 2022, China accounts for more than 60% of the world's rare earth mining, and it has made significant investments in power companies across the world.

In an effort to catch up, the US and others are using a number of restrictive policies and initiatives to counter China's leading position on the global supply chain. For example, the Minerals Security Partnership, launched in June 2022, is an alliance formed by the US to secure supply chains of critical minerals. Using countries' mineral wealth as a battleground for geoeconomic rivalry could create conditions for further instability.

AUSTRALIA

Expanding Australia's critical minerals sector by increasing output and developing downstream capabilities is a major focus for the new government that came to power in 2022 (see Figure 12). The country's critical minerals strategy aims to position Australia "at the center of meeting the growing demand for critical minerals" and the government has pledged AU$50.5 million (US$35 million) in state funding to establish the Critical Minerals Research and Development Hub to help meet this ambition.

The government has signaled its intent to promote cleaner energy exports by indicating that it will prioritize federal support for mining projects that increase output for minerals critical to renewable and low-emission technologies, such as copper and lithium. This aligns with the government's plans to develop a domestic renewables and low-carbon emitting technologies industry.

Australia is likely to increase cooperation with international partners to secure its critical minerals supply chain.

Multilateral and bilateral partnership agreements, for instance with Japan, set out commercial frameworks for increased coordination on critical minerals. By increasing supply chain resilience and diversifying trade among its international partners, Australia is showing how collaboration is key for governments wishing to prioritize mutually relevant critical minerals.

The cost of inaction

The energy transition presents unique challenges to the mining industry. While the industry has impacted the environment, it is also a provider of many of the materials required for the energy transition. The sector remains strategically important, and as competition for mining resources intensifies, it is likely to be accompanied by geopolitical volatility.

As the adoption of clean energy technologies gathers momentum, particularly following commencement of the Russia-Ukraine conflict, a robust private credit and political risk insurance market is critical to de-risk the development of, and investment in, green energy. The insurance market also plays a vital role in the decommissioning of fossil fuels or brown energy projects.

In economic terms, it has been projected that approximately US$125 trillion in investments is required by 2050 to meet the emission reduction goals. The cost burden is huge and will require private and public insurance markets to play a role in the syndication of risk. However, if the cost burden is not responsibly shared, the disposal of climate-polluting assets is expected to exacerbate environmental, social, and governance (ESG) issues.

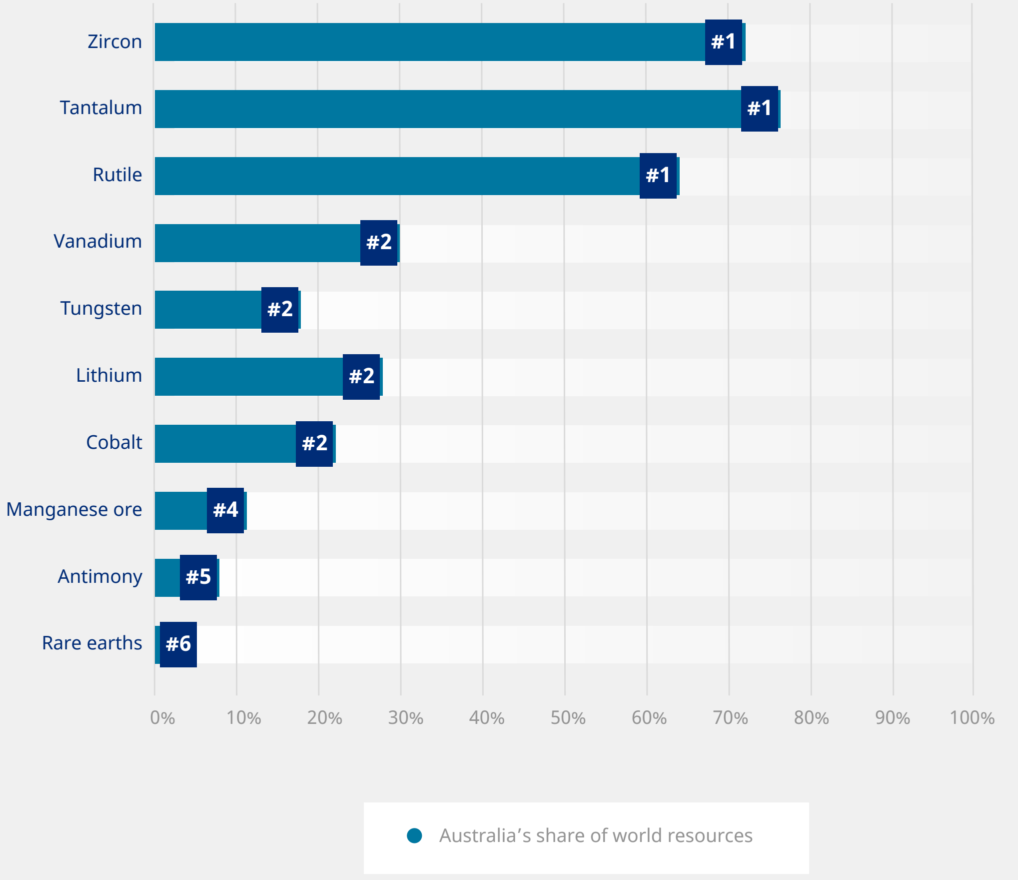
For example, the risk of a brown asset folding can have widespread implications, such as leaving high numbers of people unemployed and the decommissioning bill falling to taxpayers. As an industry we have an opportunity and responsibility to derisk the energy transition across metals, mining, minerals, and other related sectors.

Political risk can affect energy and power companies in terms of infrastructure, operations, profitability, and access to capital. Yet as the number of renewable energy projects increases, political risk insurance solutions can offer an option to help secure infrastructure, protect contracts for the supply of goods or services, and open up opportunities to attract capital that may otherwise be restricted due to country risk concerns. One example is counterparty risk under a power purchase agreement (PPA), which specifies how much energy will be bought, sold, and generated by an asset. In the event that the PPA is disputed or defaulted on, arbitration award default coverage can offer financial protection.

Resource nationalism a new trend

Critical metals and minerals are a potential area of geopolitical confrontation due to their geographic concentration, according to the *GRR 2023*, and one of the key themes of Marsh's *Political Risk Map 2021*. In their search for resource security, countries are building and favoring domestic and trusted supply chains, with resource nationalism also becoming a trend.

12| Australia's share of critical minerals



Source: *S&P Global Market Intelligence. Data compiled Dec. 06, 2022. Estimated Economic Demonstrated Resources (EDR)*
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Supply chain diversification

Building supply chain resilience will increasingly become a source of competitive advantage for companies able to capitalize on the ongoing disruption and global realignment.

Risk events have firmly put global supply chains in the spotlight, from trade disputes to pandemic-led delays, natural disasters, inflationary pressures, cyberattacks, and more. A recent survey of procurement leaders shows that more than 80% of participants have developed multiple supply sources. Over half of the leaders canvassed said they dual-source the raw materials they buy.

Meanwhile, between 25% and 33% of companies are developing backup production capabilities. "Just-in-time" remains a priority, but the "just-in-case" model of inventory management is now evident in procurement practices. The strength of the US dollar and rising shipping costs have also led many companies to look to onshore or reshore part of their production to mitigate the increasing costs of materials and transport.

Supply chain diversification will likely impact many economies and businesses for years to come, with some businesses now facing oversupply and challenges to store and warehouse goods.

Yet changes also present opportunities for those who can proactively build resilience into their supply chain strategies, thereby gaining a competitive advantage.

Critical shortages affecting pharmaceuticals

The pharmaceutical industry's success is highly dependent on a well-functioning supply chain. Globally, the pharmaceutical supply chain contains inefficiencies and fragmentation, with multiple stakeholders and interests. The industry is subject to a complex regulatory environment throughout the value chain, from research and development through to sales and distribution. A disruption at any point in the supply chain can stall the entire process.

The fragility of global supply chains is exacerbated by weak forecasting systems, for example, the availability and supply of antimicrobials is under constant threat. It is estimated that 5.7 million deaths globally could be prevented by antibiotics each year.

While shortages are most acute in low-income and middle-income countries, shortages of amoxicillin have been reported in the US and Canada, while the EU has reported scarce supplies of some antibiotics. To address its medicine shortage, in 2022, Greece — which is a gateway for many drugs, especially generic medication — limited the export of medicines in short supply.

The EU is also preparing to introduce legislation to manage the risk of supply chain disruption.

As the pharmaceutical industry evolves, the risks posed to its supply chain are becoming increasingly complex. While some countries respond by boosting domestic manufacturing capabilities, others focus on supplier diversification, showing the many forms of supply chain resilience.

The rise of government intervention in supply chains may increase as countries look to retrench to protect their own populations and strategic industries.

India and the growth in the refinement of petroleum products

India has been one of the main beneficiaries of shifting supply routes resulting from the price caps and sanctions imposed on Russia following its invasion of Ukraine in February 2022. By May 2022, Russian crude oil imports into the EU fell by 18%. This reduction was taken up by India, the United Arab Emirates, and other countries leading to no net change in Russia's crude oil export volumes. With a large refining industry that can import cheap Russian crude and, in most circumstances, sell the refined products at world market prices, India became a significant importer of Russian crude oil in 2022, buying 18% of the country's exports. A significant share of the crude oil is re-exported as refined oil products, including to the US and Europe.

Diversification of supply chains has positively impacted India's economy, with the US and EU the country's two largest export markets. Foreign direct investment has been a key driver of India's economic growth and a significant non-debt financial resource for the country's economic development.

Although there are robust upsides to India's outlook, the relatively high risks in the security environment, driven principally by strikes, riots, and civil commotion, could dampen the country's economic profile (see Figure 13). The government has recently made substantial efforts to attract continued FDI, including relaxing industry regulations. With the help of significant dealings in the technology and health sectors, multinational companies have pursued strategic collaborations with pre-eminent domestic business groups, stimulating an increase in cross-border mergers and acquisitions valued at US$27 billion in 2022.

To further boost resilience, India, Australia, and Japan announced their intention to collaborate in the Indo-Pacific region with the Supply Chain Resilience Initiative (SCRI), which focuses on strengthening the industrial supply chain in the region.

13| India has solid ratings across the trading environment with steady inflows of FDI

Country	Security environment			Trading environment			Investment environment			Averages		
	Strikes, riots, & civil commotion	Terrorism	War & civil war	Country economic risk	Currency inconvertibility & transfer risk	Sovereign credit risk	Expropriation	Contractual agreement repudiation	Legal & regulatory risk	Average of security perils	Average of trading perils	Average of investment perils
India	6.5	6.3	4.6	3.9	3.9	4.0	2.6	4.9	5.4	5.8	3.9	4.3
World average	4.9	3.4	3.1	5.0	4.4	5.3	4.0	5.0	5.0	3.8	4.2	4.7

HIGH RISK — LOW RISK

8.1–10.0	6.1–8.0	4.1–6.0	2.1–4.0	0.1–2.0

Source: Marsh

Ratings current as of February 2023.

Amid so many disruptions, improving supply chain resilience is a strategic priority for many industries, including pharmaceuticals and petroleum refining.

A number of credit, performance, and political risk solutions are available to help companies mitigate and manage supply chain risk by reducing uncertainty and volatility in areas such as:

- Export license cancellation.
- Contracts or stock confiscation.
- Collateral requirements, for example, payment guarantees for taxes and customs.
- Non-payment by buyers.
- Trade disruption, protecting against loss of earnings for political perils.
- Loss of pre-payments from sellers following non-delivery.
- Access to liquidity via receivables and/or supply chain finance.

The rise of the Eurasian Middle Corridor

The Russia-Ukraine conflict has caused global supply chain disruption, generated food shortages, and sent commodity prices soaring. Despite the turmoil, geoeconomic forces continue to pull Europe and Asia together to realign supply chains. An alternative "middle corridor" is gaining traction, running from China through Kazakhstan, Kyrgyzstan, and Turkmenistan, across the Caspian Sea, and through Azerbaijan and Georgia before connecting to Europe via Turkish railways and ports (see Figure 14).

The Middle Corridor, as it has become known, provides the shortest overland route from Asia to Europe. The growing transport demand along this route is positive: cargo volumes increased six-fold in 2022.

Türkiye stands at the geographic nexus of Europe, Russia, Central Asia, and the Middle East. It is generally in Türkiye's interests to align with wider geopolitical trends, seizing opportunities as they come, for example, integration with China's Belt and Road Initiative.

14| Routes from China to Europe

Source: *The German Institute for International and Security Affairs (SWP)*

In 2015, Türkiye and China agreed to harmonize their infrastructure developments, leading to several megaprojects including the Baku-Tbilisi-Kars railway, which opened in 2017. This track complements the earlier Trans-Kazakhstan railway, reducing the East-West transit route by 1,000 kilometers. The Middle Corridor has become the shortest cross-Eurasian rail link, bolstering Türkiye's plan to become a hub for containerized freight between China and the EU.

At the strategic level, Türkiye seeks to make itself indispensable to both China and Europe. Until recently, the Middle Corridor was considered a footnote to Eurasian geoeconomics. Its multi-modal combination of sea and rail transport was seen as inefficient compared to the straightforward rail line of Russia's Northern Corridor.

Moreover, some Central Asian states, such as Kazakhstan, were concerned that undermining Russian influence could result in repercussions.

As a result, there was little progress along the Middle Corridor. However, following sanctions against Russia in response to the annexation of Crimea, Central Asia has begun to reorient away from Russia, increasing the importance of this route.

For China, the Middle Corridor allows for trade route diversification. China's political and economic stability depends on international trade, but its overland route through Russia and its maritime route through Malacca are exposed to higher elements of risk. The Middle Corridor bypasses high risk areas such as Iran, Afghanistan, and Russia, and also choke points such as Malacca, Sunda, and Lombok. The corridor is therefore considered crucial to China's objective to diversify its geoeconomic portfolio.

Companies from Denmark, Finland, The Netherlands, France, Azerbaijan, and China have leveraged the Middle Corridor. The Russia-Ukraine conflict accelerated this trend. Almost all trade flows between Russia and Europe have been affected by the conflict, with shipments along the Northern Corridor down 40% in 2022 compared to the previous year.

Beyond the unprecedented sanctions affecting Russia's European trade, its actions in Ukraine have resulted in many nations considering it an unreliable partner. Since February 2022, the Middle Corridor has absorbed a third of the Northern Corridor's trade, with volume amounting to [3.2 million tons of cargo.](#)

In Kazakhstan, the Russia-Ukraine conflict has increased supply-side inflation, while budget spending and rapid credit expansion have increased pressures on the demand side. Sanctions against Russia are impacting Uzbekistan's privatization of public assets and the realization of infrastructure projects, reflected in the elevated risks affixed with the investment environment (Figure 15). Several Russian businesses and businesspeople that the Uzbek government had previously anticipated would invest in privatizations and infrastructure projects may no longer be considered due to the sanctions, suggesting that the pace of privatization will be slower.

Looking ahead, Central Asian states will likely play an important role in the EU's energy transition. With land and maritime transport increasing between the continents, the ability to assess and mitigate political risks will be crucial for these countries. This will be fundamental to their ability to attract a diversified portfolio of foreign direct investment — insurance continues to have a critical role to play to enable risk minimization and transfer.

However, the elevated risk of expropriation in many crucial states of the Middle Corridor could serve to deter foreign investment in key sectors for energy extraction and transportation. Indeed, all Central Asian states integral to the Middle Corridor possess a higher-than-average risk rating in the investment environment, except for Azerbaijan (see Figure 15).

HIGH RISK — LOW RISK

8.1–10.0	6.1–8.0	4.1–6.0	2.1–4.0	0.1–2.0

Source: *Marsh*

Ratings current as of February 2023.

15| Security, trading, and investment risks are elevated across countries in Central Asia

Country	Security environment			Trading environment			Investment environment			Averages		
	Strikes, riots, & civil commotion	Terrorism	War & civil war	Country economic risk	Currency inconvertibility & transfer risk	Sovereign credit risk	Expropriation	Contractual agreement repudiation	Legal & regulatory risk	Average of security perils	Average of trading perils	Average of investment perils
Azerbaijan	4.6	3.9	5.5	4.4	5.4	4.7	4.3	4.1	5.5	4.7	4.8	4.6
Kazakhstan	5.6	3.6	2.7	5.1	5.3	4.4	4.3	5.2	5.1	4.0	4.9	4.9
Kyrgyzstan	6.7	3.6	4.7	5.8	4.7	7.1	8.4	7.6	6.3	5.0	5.9	7.4
Turkmenistan	4.8	3.2	2.8	5.8	7.6	5.9	8.1	6.1	7.2	3.6	6.4	7.1
Uzbekistan	4.7	4.0	3.4	5.9	4.9	5.8	7.6	5.7	6.2	4.0	5.5	6.5
World average	4.9	3.4	3.1	5.0	4.4	5.3	4.0	5.0	5.0	3.8	5.5	4.7

Conclusion

According to our World Risk Review ratings, almost all regions have experienced a deterioration in the trading, security, and investment environment since 2019 due to the convergence of unprecedented events.

These interconnected crises, or polycrises, are expected to continue to reverberate across the world in 2023, highlighting that the need to mitigate credit, performance, and political risk has never been more critical. To ride out this volatility, companies are advised to deploy tools to manage credit, performance, and political risk, from both public and private sources.

The four major shifts outlined in this report are expected to continue throughout 2023 and beyond.

- The effects of political volatility are likely to become more prominent, particularly in emerging economies, raising the prospect of political and civil unrest over the coming year. Countries such as Angola and Peru have already experienced instability, whereas countries such as Chile, Colombia, and South Africa may face challenges in the year ahead.
- To counteract this volatility, governments are expected to continue to focus on national economic security, the impacts of which could include advancing a retreat from international alliances and open markets and precipitating a slide into protectionism and global fragmentation. Tensions over the US Inflation Reduction Act have already begun to raise concern in some countries, and suggests that the actions governments take independently to mitigate climate change have the potential to become a geopolitical flashpoint.
- The risks of greater strategic resource competition have been compounded by the Russia-Ukraine conflict. The crisis has amplified existing inflationary pressures and elevated concerns over food and energy security, although in the nearer term, this concern is expected to accelerate the energy transition.
- Finally, the geopolitical and trade tensions outlined above have put a spotlight on the vulnerability of global supply chains. Indeed, geoeconomic confrontation ranks among the top three perceived risks, according to this year's *Global Risks Report.* A new balance between efficiency and resiliency could result in supply chains that shift from dependency to diversification.

SEEING OPPORTUNITY AMID THE VOLATILITY

A key question for investors and our clients is whether this global friction, polarization, and retrenchment will further exacerbate persistent and emerging risks. Our analysis supports the view that four areas in particular will override this volatility and remain robust to sustain growth in the coming years.

- Globally, the lockdown backlog of infrastructure investment bodes well for future activity and expansion.
- The need to rapidly increase investment in the net-zero transition to reduce total emissions through 2030, in line with the goals of the Paris Agreement.
- Food and energy security will continue to attract opportunities to diversify supply chains and secure supplies.
- Government defense spending is rising substantially worldwide to support allies, counter threats, and accelerate the sector's modernization.

What's needed at a time of major economic headwinds and increased geopolitical instability is an informed view of the political and credit risk landscape, and how it impacts your business. Marsh advisors are available to support your business's efforts to build resilience, face operational challenges, and enable future opportunities.

To find out how we can help your business, email us at **creditspecialties@marsh.com** or contact your Marsh representative for a confidential discussion.

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