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Rising political risks cloud outlook for Asian economies

Political risks in Asia have increased, according to Coface's Political Risk Model. Asia currently ranks above the world average in terms of political risk, behind the Middle East and North Africa (MENA), Sub-Saharan Africa and Latin America. Although political risks in Asia have remained broadly stable relative to other parts of the world, some exceptions are notable. These risks could cloud the outlook for some economies going forward. Much of the systemic sources of political risk are related to the continent's dynamic growth and existing social fragilities. It appears that most of the increases in recent years have been due to rising political fragilities, associated with a proliferation of less democratic styles of governance.

In terms of geographic differences¹, South Asia features the highest political risk score, followed by Southeast Asia. East Asia featured the fastest pace of political risk increases since 2007, led by increases in China. Our model also attaches a terrorism "penalty", in countries where there is a high number of conflicts and terrorist attacks. South and Southeast Asia feature high levels of ethnic, religious, and linguistic fractionalisation, resulting in tensions between the different groups. Noteworthy examples of this can be seen in India, Pakistan, Myanmar and the Philippines.

Measuring political risk in the Asia-Pacific region

Political risks are often associated with endogenous sources of fragility, both political and social, which increase the likelihood of risk events taking place, often with ominous costs for citizens and the economy itself. Examples of such events include the Rohingya crisis in Myanmar, where the plight of hundreds of thousands of refugees prompted the European Union and other international observers to impose sanctions in June 2018. Kashmir, where formal borders are yet to be defined, remains a point of contention between India and Pakistan. More recently, protests erupted in the territory over claims that India would cancel Article 35A, which grants special rights to permanent residents of

Jammu and Kashmir. Elsewhere, the Korean peninsula is a looming source of political risk – for example, in early 2018 financial markets reacted to global fears of a war with North Korea, draining billions in liquidity out of Asian economies.

Economic growth and political risk are interconnected. Deteriorating economic conditions are likely to result in higher political risk, and vice versa. For example, a rise in unemployment, inflation or income inequality can exacerbate social discontent. But more importantly, increased political risk can adversely affect economic activity. The impact of political risk on growth primarily involves two transmission channels. First of all, outflows from an economy may lead to falling equity markets and rising bond yields, which worsens financing conditions, making it costlier for agents in

1 - East Asia (China, Japan, Mongolia, South Korea); South Asia (Bangladesh, India, Nepal, Pakistan, Sri Lanka); Southeast Asia (Cambodia, Hong Kong, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam); Oceania (Australia, New Zealand).