

Thursday, August 4, 2022

## Geopolitics: Inflation Fuels Instability, Policy Shifts

*Economic pressures are heightening aboveground risks for the energy industry, from political unrest and sovereign debt defaults to windfall taxes and protectionist measures. Pressures will mount heading into winter as markets tighten and new European sanctions kick in.*

- **Economic and inflation pressures — particularly food and fuel prices — are elevating political risk.** We see rising pressures — exacerbated by the Ukraine war — manifesting in multiple ways, creating direct (operational) and indirect challenges for the energy business. Higher food and fuel prices are eroding government and personal budgets, prompting policy shifts and political change. Rising US interest rates and an investor flight to safety are prompting an outflow of capital and currency depreciation in other countries. Debt servicing is becoming more expensive, further straining government budgets and raising risks of unpopular spending cuts, sovereign debt defaults or even all-out currency crises. China's economy is slowing down. Pressures are particularly acute in Europe — which is trying to rapidly move away from Russian gas and oil imports — and developing countries, which were already facing macroeconomic stress or are major food/fuel importers.
- **Global stability is under strain.** In extreme cases, mass dissatisfaction with economic conditions has played a role in the removal of leaders in Pakistan and Sri Lanka. In Latin America, voter anger is fueling anti-incumbent sentiment, generating protests and populist electoral victories in Chile, Peru and Colombia. Protests have broken out in sub-Saharan Africa from Ghana to South Africa, and in Lebanon and Iran in the Mideast. The economy is straining government coalitions in Europe. Declines in real wages are spurring labor unrest, from Norway to Congo (Brazzaville).
- **New policies are creating curveballs.** Governments are rolling out new policies to shield citizens from inflationary impacts or boost energy security and government take. Windfall taxes on energy producers are proliferating, with measures announced or proposed in the UK, Italy, Spain, India, Argentina and others. Other fiscal terms are likely to be adjusted. Proposed US legislation would raise corporate taxes and oil and gas royalties, and introduce new penalties on methane emissions. Price caps are being instituted in some countries, and market liberalization/fuel pricing reforms rolled back (e.g. Ecuador). Protectionist export policies are creeping into the energy space, with bans or reductions of coal, gas or oil product exports in Kazakhstan, Hungary and China.
- **Developing world risks are likely to increase.** We see food and fuel pressures largely remaining even with any settlement in Ukraine, given the disruption to agriculture and energy. We are watching, in particular, pivotal Brazilian elections in October, where former leftist President Luiz Inacio Lula da Silva has a clear lead. A Lula win could undermine the oil and gas investment climate, including potential changes in taxes, local content or fuel pricing policies. In Turkey, inflation (80% in July) is harming President Recep Tayyip Erdogan ahead of elections next year. An Erdogan loss would have major geopolitical implications, given Turkey's influence in Libya, the Caucasus, Syria, Iraq and Eastern Mediterranean. Heavily indebted governments will increasingly turn to unpopular IMF bailouts or sovereign debt defaults. Many have become highly indebted to China in recent years, and Beijing may be less likely to forgive or restructure loans given its own slowdown. Other risks include countries restricting energy exports to support their domestic market.
- **In the West, Europe will be hit hardest.** Political pressures in Europe will rise as winter approaches, particularly if a Russian gas cut-off leads to further price spikes and/or rationing. A potential increase in migration from Africa/South Asia, triggered by economic conditions, would intensify these pressures. The crisis has so far hit Europe's most unstable governing coalitions (Italy, Bulgaria), but we see pressures from Ukraine policies and economic strains rising across the continent. In the US — where energy prices are much lower — high inflation will weigh on Democratic party prospects in November midterms, threatening control of Congress. We will also be watching US-EU Ukraine policy: While a formal, major rollback of Russian sanctions is unlikely, economic pressures could (1) undermine appetite for new sanctions; (2) limit additional economic and military support; and (3) erode enforcement of existing measures. Other sanctioned oil producers could benefit as the US approves waivers for oil operations (Venezuela) and re-enters nuclear talks (Iran).

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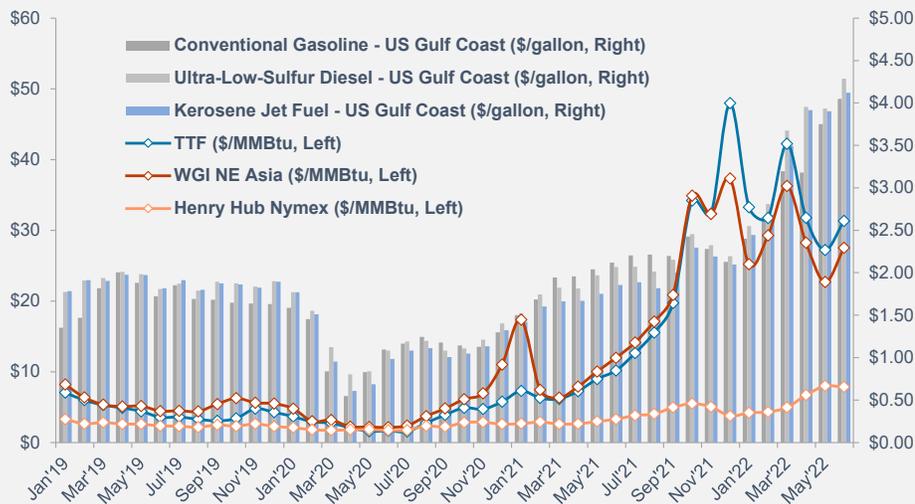
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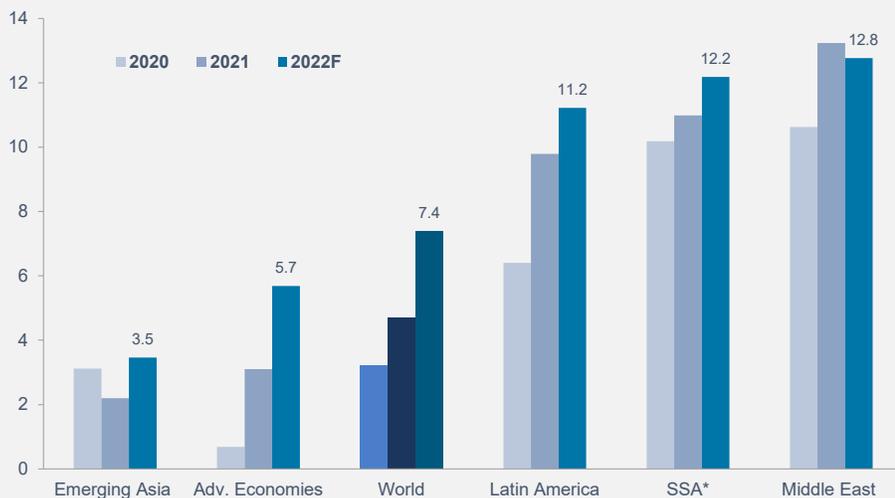
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**Energy Prices: Refined Product and Natural Gas Prices**



Source: Energy Intelligence, EIA

**Global Economy: Inflation on the Rise**  
(%Chg., average consumer prices)



Note: F = forecast \*Sub-Saharan Africa. Source: IMF

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**Inflation's Impact on Aboveground Risk**

Risk Factor	Potential Impacts
Political Volatility Fiscal Terms	<ul style="list-style-type: none"> <li>• Inflation-linked protests and backlash at the polls are growing worldwide.</li> <li>• Increasing consumer discontent is driving a new round of windfall profit taxes even in jurisdictions that have long been viewed as more investor friendly.</li> </ul>
Monetization and Export Challenges	<ul style="list-style-type: none"> <li>• Inflation and scarcity concerns are prompting a wave of populist, protectionist export policies.</li> <li>• Agriculture has been hit harder than the energy sector, but risks are rising.</li> <li>• Likewise, rising fuel and food prices increase the likelihood of price caps.</li> </ul>
Energy Strategy and Stability	<ul style="list-style-type: none"> <li>• Global voter discontent is driving major electoral changes, risking large swings in energy governance and direction.</li> <li>• Even without a government change, protests and public opinion concerns are driving large regulatory and policy shifts.</li> </ul>
Labor Market Conditions	<ul style="list-style-type: none"> <li>• Inflation is likely to lead to greater labor disputes over wage increases.</li> </ul>

Source: Energy Intelligence