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## **Demand for political risk insurance increases as sharp fall in foreign exchange reserves raises spectre of governments failing to pay foreign suppliers**

- 50 countries saw their foreign reserves fall by 10% or more
- Even UK saw a 13.7% fall in its foreign reserves

64% (91 out of 142) of countries have seen their foreign exchange reserves fall in the last year\*, with 35% (50) seeing their reserves fall by more than 10% according to a study of 142 by global specialty(re) insurance group Chaucer\*.

Of the 142 countries covered by the research foreign exchange reserves of USD dropped from \$12.23tn to \$11.16tn in the past year. Over the last year even the UK's saw its foreign reserves fall sharply by 13.7%. A sharp fall in foreign exchange reserves, often caused by economic instability, can limit a country's ability to pay debts that they owe in foreign currency and to pay for imports.

When governments are struggling to pay their bills, this can increase the risk that corporates can find their public sector contracts suddenly cancelled or go unpaid. Corporates have increasingly been insuring against governments failing to pay their bills by buying Political Risk Insurance (PRI).

Jonathan Bint, Senior Analyst & Underwriter at Chaucer explains: "When governments are short of foreign exchange then contracts with foreign suppliers can be a tempting target for cost-cutting. When the global economy stutters, cancelled government contracts and disputes over payments rise and they are by no means limited to emerging markets."

"In a period of rising global economic uncertainty, businesses that ignore the risk of contract cancellation, or an increase in renegeing on bills, could be opening themselves up to significant financial loss."

Sri Lanka's foreign reserves dropped to unsustainable levels in 2022 as it battled rising import and debt servicing costs. This resulted in the country defaulting on its debts, inflation rising to around 50% and widespread civil unrest.

More than half of countries depleting their reserves over the past year is an indication of growing pressure on global economies and suggests a rising number of countries are now less capable of managing their obligations.

Foreign reserves usually comprise of US dollars or, to a lesser extent, Euros and are controlled by central banks.

Some sectors are at greater risk of than others of having their contracts cut by cash-strapped governments.

Says Jonathan Bint: “Businesses in the infrastructure and construction sectors are especially at risk of suffering losses from governments renegeing on bills especially given the high value of the projects they typically undertake on behalf of national governments.”

Jonathan Bint says that whilst emerging markets present great opportunities for multinational corporations to grow, they often present greater risks. However, insurance firms are also seeing increased demand for political risk insurance in places that had previously been ‘safe’ investment destinations such as the UK and the EU.

Bolivia, New Zealand, and the Republic of Congo saw their foreign reserves fall the fastest in the past year, with Bolivia seeing reserves fall by more than half (51.7%) or \$881m of its reserves.

*\*Year-end December 31<sup>st</sup>*

*\*\*Analysis of Reserve Foreign Exchange Holdings (\$m)*

**End**

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## **About Chaucer**

Chaucer are a leading specialty (re)insurance group working with brokers, coverholders and clients to protect and support business activities around the world. Our services are accessed both through Lloyd's of London and the company markets.

We are defined by an enterprising, bespoke approach to (re)insurance, enabled by the individual character, experience and imagination of our expert teams.

Chaucer is a member of the China Re Group and backed by their financial and operational resources. China Re is one of the world's largest reinsurance companies whose outstanding and comprehensive strength is rated A (excellent) by AM Best and A (strong) by S&P Global Rating.

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