

Journal of Risk Management in Financial Institutions

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Book review

Managing Country Risk in an Age of Globalization: A Practical Guide to Overcoming Challenges in a Complex World

By **Michel Henry Bouchet, Charles A. Fishkin, Amaury Goguel**

Palgrave Macmillan; 2018;
Ebook: ISBN 978-3-319-89752-3;
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527 pp

One might worry about the title. ‘An age of globalization?’ These days most of the noise is about the opposite (populism, nationalism, trade wars). But fear not: the book feels up-to-date and features extensive coverage of hot topics such as country risk in advanced economies. Indeed, the book includes not one but, in effect, two chapters on risks in the troubled Eurozone.

There is also a good reason for the ‘globalization’ title: the authors emphasise international contagion as a source of country risk. Anti-globalisation backlash or no, contagion is with us as ever, as the gyrations of emerging markets equities over the past few years have demonstrated (gyrations that have had little apparent relationship to the performance of the real economies in most of the affected countries).

This substantial volume (over 500 pages) aims to be a comprehensive guide to the economics of country risk analysis. The first chapters offer definitions, a reasonably well-structured review of relevant research, and a guide to the many sources of country risk information, both public and private. At times in these introductory chapters, the authors appear to be going through the motions as they seek to cover everything a beginning analyst must know. Still, some provocative notions are introduced — for

instance, a review of Benoit Mandelbrot’s prescient contributions to the mathematics of risk, and the contention that country risk can be a domestic as well as a cross-border phenomenon. (An idea that, one hopes, does not catch on with regulators.) There is also a good discussion of model risk.

The next few chapters cover contagion, how to analyse the balance of payments, how to analyse debt sustainability, and the special topic of the Eurozone and fixed exchange regimes. In these chapters, the authors hit their stride. These are well-presented and comprehensive, starting with a bit of economic theory and surveys of recent research — but always focused on what a practitioner needs to know. There are also two chapters on the political risk element of country risk (on which, more later). In general, the authors provide balanced surveys of well-chosen and relevant material.

The volume concludes with two chapters on early warning signals (including one piece of original research on capital flight). These chapters argue, not inaccurately, that financial indicators do not work as mechanical early warning signals and therefore much falls to the analyst’s judgment. The final two chapters in the book are a short survey of country risk mitigation strategies, focusing on financial products, and a glossary of country risk terms. I was sad to see two of my favourite country risk terms of recent years, the bank-sovereign ‘doom loop’, and ‘contingent liabilities’, missing from the glossary list (although these topics are certainly covered earlier in the volume).

In any comprehensive volume, there will be a few omissions. The book focuses on the economics of country risk. Hence there is little discussion of the organisation of the country risk function. New big data and analytics approaches to country risk analysis are mentioned, but not in any detail. There is little discussion of the role of regulatory requirements in country risk assessment. Speaking of things that regulators love, there is little coverage of scenarios or stress testing (although there are

other volumes on such topics from the same publisher). The review of private-sector providers of country risk information leaves out one of the largest, IHS Markit, as well as the wonderful sovereign and country risk models of Oxford Economics, where (full disclosure) I worked for some years. I would have liked to have seen a bit more on the risks associated with deflation.

There are, inevitably in such a lengthy text, a few editorial errors. It is Aon not AON. The global financial crisis emerged from the US East Coast, not the West Coast. It is Cape Verde (or Cabo Verde) not Cap Verde. But overall, the standard of editing is high for a book of this type. Tables and figures are plentiful and there are lots of well-chosen callout boxes. Many of the graphs are insightful, an inspiration to country risk analysts as they produce reports for management, it is hoped. There is good cross-chapter referencing.

I have a few minor differences of opinion with the authors. The perspective on nudge theory seems odd to me — I do not think central bank waffle qualifies as a ‘nudge’ (overall, there is little coverage of behavioural economics). Political risk is defined as the viability of institutions and governance, which seems to leave out quite a lot, including what the authors call ‘Trump-driven volatility’.

(As an American, I could not possibly comment on that topic.) To be fair, there is a purpose to this restrictive definition: the authors wish to argue that the best way to measure political risk is to focus on institutional strength. I do not entirely disagree, although I would have liked to see more coverage of areas such as social movements, political violence and the topic of the moment, populism — on all of these, social science has provided insights that are relevant for country analysis.

Some interesting themes run through the book. One is the importance of economic inequality in driving country risk. Another is the limits of quantitative models and weaknesses of sovereign ratings. Yet another theme, already mentioned, is the importance of contagion effects. Overall, this book succeeds better than any other I know in being a comprehensive and practical guide to the economics of country risk analysis. Financial institutions would do well to have a copy in the library. For beginning country risk analysts, it is a must-read.

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