



The Changing Nature of Country Risk in the Age of Globalisation and Donald Trump

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In today's global economy, the concept of Country Risk has been evolving. In this article, the author elaborates on the changing nature of country risk, recent events to be considered, and how socio-political stability is a must for market-based capitalism to achieve sustainability.

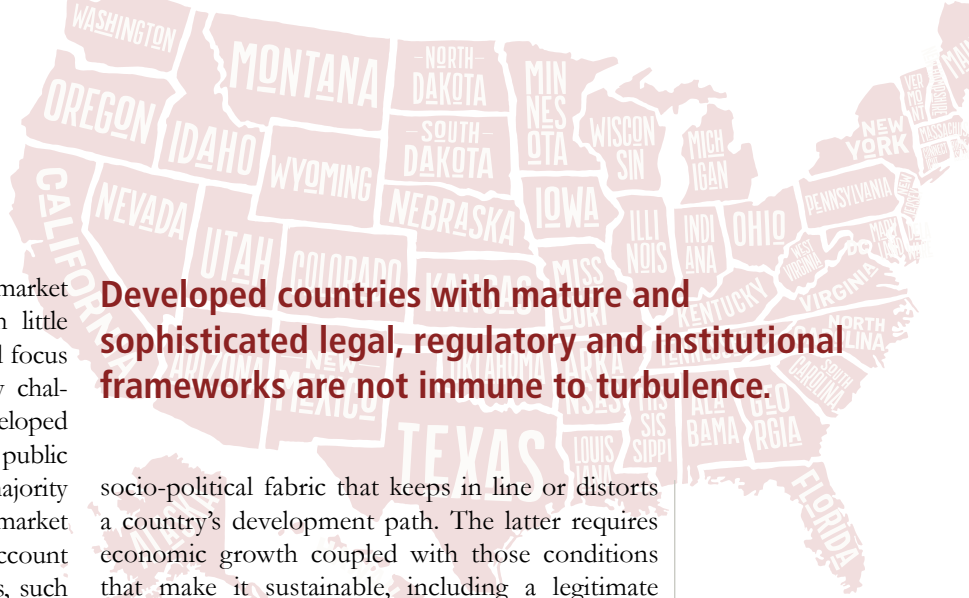
1 A Changing and Multi-faceted Concept. Country Risk stems from a set of interdependent economic, financial and socio-political factors specific to a particular country in the global economy; these factors

can affect both domestic and foreign economic agents in terms of savings, investment and credit transactions. But Country Risk is no longer what it used to be. Since the late 1990s and more recently in the wake of the Global Financial Crisis, there have been profound changes in the nature and consequences of Country Risk. Donald Trump's presidency is about to accelerate these changes, contributing to greater uncertainty and more risk. We can identify six radically new dimensions.

First, country risk managers are used to focussing on country-specific risk

features, such as balance of payments deficits, exchange rate, indebtedness ratios and political fragility. But the globalised market economy has added a new component of country risk, namely spill-over effect and crisis contamination. Indeed, the full scope and range of the risks economic agents face in the global economy is precisely that this economy is global. This "echo chamber" that propagates and accentuates imbalances is bound to breed volatility and crises. Worldwide income inequalities within and among countries impede the conditions for stable, sustained growth, feeding instead social disorder, migrations, and political upheaval. Many investors and domestic residents, often in rich countries with poor populations, are plagued by failed states. These changing conditions mean that country risk managers have only done part of their job when they analyse the socio-economic and political situation of a specific country.

Second, the traditional divide between developed/emerging countries is at best obsolete, and at worst, a source of errors in country risk assessment. This divide adds a conceptual myopia to the complexity of economic, financial and



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socio-political risk assessment. Emerging market countries with large external debt and with little export diversification have been the traditional focus of Country Risk. But liquidity and solvency challenges have shifted north-west, towards developed countries. On average, the solvency ratios (i.e. public debt to GDP) are near or above 100% for the majority of developed countries, while many emerging market countries have boasted substantial current account surpluses since the late 1990s. In recent years, such concerns have led rating agencies to shift the risk focus from emerging to developed markets, with a much larger number of downgrades for the latter.

Third, for long developing countries with weak socio-political institutions have held the monopoly of political volatility. This is no longer true. Developed countries with mature and sophisticated legal, regulatory and institutional frameworks are not immune to turbulence. Drastic adjustment measures in advanced economies have contributed to socio-political turmoil, notably in the EU. Greece, Spain, Portugal and to a lesser extent Italy and France, have witnessed the emergence of radical political parties as a response to the growing discredit of traditional channels of popular mobilisation. The downgrading of developed countries since the inception of the global crisis has, in many cases, been rooted in political risk. When S&Ps lowered the US long-term sovereign rating in August 2011, the agency spotlighted the political uncertainty of American policymaking. Widening wealth gaps, terrorism threats and immigration-driven political radicalism nurtures social volatility in industrialised nations.

Fourth, country risk managers can no longer rely on traditional yardsticks of risk rating and ranking. Volatility, herd instinct and complexity make quantitative assessment of Country Risk at best biased tools and at worst recipes for simplistic outlooks. Rating agencies almost systematically failed to predict crises over the last three decades. Exchange rate depreciation, falling commodity export revenues, deteriorating creditworthiness, and socio-political upheavals have been followed rather than preceded by rating signals. Country Risk in the age of globalisation thus requires managers to be more agile, broad-minded and innovative than in the past. Only an array of converging analytical approaches can lead to a more rigorous examination of the economic, institutional and

socio-political fabric that keeps in line or distorts a country's development path. The latter requires economic growth coupled with those conditions that make it sustainable, including a legitimate political power base, social mobilisation, sound institutions and robust infrastructures.

Fifth, Country Risk has become the by-product of complex intertwining between the public and private sectors. Financial sector weaknesses constitute a new channel of Country Risk due to large sovereign claims that are held by financial institutions which would suffer from bond value declines, including in supposedly more regulated markets such as Japan, the Eurozone, and the United States. As the IMF has warned: "Sovereign risks have been transformed in a number of important ways as a direct consequence of the crisis and major fault lines in the financial sector. As the public sector intervened to support financial institutions, distinctions between sovereign and non-sovereign and private liabilities have been blurred, and public exposure to private risks has increased."¹

2 The Domestic Dimension of Country Risk. The sixth and last change in Country Risk is probably the most important. For too long the definition of country risk analysis has been restricted to the assessment of a foreign entity's ability and willingness to meet its external obligations in full and on time. This narrow definition concerns only the cross-border claims of foreign economic agents while excluding domestic residents. The exclusive focus on a foreign country's uncertainty has proved elusive and in many ways risky. How can we explain the massive private capital outflows of residents of Venezuela who strive to mitigate the risk of an abrupt drop in purchasing power and mounting political turmoil? How can we account for the so-called brain drain in Spain in the aftermath of 2008, when thousands of young engineers, architects, and economists fled to work in Germany, Canada or the United States, to escape massive unemployment and shrinking job opportunities?



How should we analyse the 15% drop in the pound exchange rate in the wake of the narrow victory of Brexit in June of 2016, feeding inflation and hurting the competitiveness of British industry?

Each of these examples shows that Country Risk is not the monopoly of foreign creditors, exporters, or investors. Domestic residents also face Country Risk from their own country's socio-economic and political turmoil. A country's government can take arbitrary decisions that will alter residents' economic and social prosperity. Private corporations, banks and insurance companies, as well as households, all face the risk of rising uncertainty and a destabilising business environment that will affect profit, investment and revenue opportunities. The man in the street is faced with Country Risk in times of corruption, volatile tax regulations, heavy bureaucracy, inflation, devaluation and negative real interest rates. The range of risk mitigation tools commonly available is rather limited. Risk hedging policies for those whose real value of savings is at stake include cutting consumption, holding gold and shifting liquid assets abroad. A country's government can become hostile to its own population. In addition, a deterioration in the perception of risk by capital markets and rating agencies will feed back into domestic residents' environment and well-being.

3 Country Risk in the Age of Donald Trump's Presidency. In the United States, domestic sources of Country Risk have been increasing since the turbulent election of Donald Trump in November of 2016. One can distinguish three main sources of Trump-driven volatility, namely, direct, indirect, and collateral sources of Country Risk:

One source of volatility came from the rising uncertainty of financial investment in the US stock market during the tough election campaign of late 2016 between Clinton and Trump. As noted by an

Direct "Hard Risks"	<ul style="list-style-type: none"> • Risk materialisation directly hurts US business: outbreak of a military conflict between North Korea and the United States; sharp rise in interest rates and fall in bond prices; stock market crash; sharp weakening of USD; protracted renegotiation of NAFTA; mounting trade and geopolitical tensions with China.
Indirect "Surrounding Risks"	<ul style="list-style-type: none"> • Risk materialisation stems from a more hostile environment: protracted stalemate between White House and Congress regarding budgetary policy; ongoing saber-rattling with North Korea; trade retaliation by Mexico and Canada; regional crisis in the Western Hemisphere.
Collateral "Soft Risks"	<ul style="list-style-type: none"> • Risk materialisation as by-product of unfavourable interactions between power groups: Impeachment of Donald Trump; global protectionism, fiscal uncertainty, mounting wealth gap, pressure groups and hostile NGOs.



investment bank's report to its clients: "Trump's election means that financial markets will have to digest additional monetary uncertainty. He has been saying for some time now that interest rates have been too low for too long and that he does not wish to reappoint Janet Yellen."² Another cause of volatility could stem from the US Congress' failure to raise the debt ceiling in the Fall of 2017, triggering a chain reaction of higher bond yields, with dramatic consequences for banks, insurance companies and investors globally. As noted by Aon's political risk experts: "Although the scope and scale of President Trump's policies are as yet unclear, proposed policies include trade and investment restrictions, greater government spending and lower taxes, resulting in wider fiscal deficits (and greater debt levels) and restrictions on immigration, which may impact remittances."³ Another cause of uncertainty is the populist, trade protectionist and anti-globalisation stance of Donald Trump that has created widespread anxiety in US companies with stakes in export and import markets in Mexico and Canada. Brookings data show that "the United States trades as much with Canada and Mexico as it does with Japan, Korea, and the BRICS combined. Millions of jobs in US states depend on exports to Canada and Mexico."⁴ In addition, many companies rely on supply chains with suppliers in Canada and Mexico to import intermediate inputs for the domestic US market or for re-exporting. At stake is the global competitiveness of US manufacturing whose reliance on a much weaker dollar would make imports more expensive without boosting


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trade markets. Trump's harsh anti-globalisation rhetoric and his "Buy American" slogan have led governors and mayors to promote investment pledges aimed at reassuring foreign companies whose supply chains nurture employment. Needless to say, the US dependence on oil supplies from both Canada and Mexico could of course not be offset by a diversification of energy resources from the Middle East and still less from Venezuela. Last but not least, an additional cause of uncertainty is Trump's deregulation objectives that are applauded by free-market fundamentalists while encouraging the financial sector to take excessive risk.

Perhaps still more dangerous is a deeply-rooted split that is emerging between two forces in the United States' socio-political arena: on the one hand, the traditional institutional set up, including political parties, "mainstream" media, the federal agencies, academia, and the unions; and on the other, a popular base that claims that these institutional actors are discredited and represent a secretive class of globalist bureaucrats. A so-called "deep state" is accused of constituting a disloyal force and powerful inertia in Washington that defends the interests of globalised business against those of the man in the street. Consequently, the strength of traditional media channels is challenged by alternative conservative media groups (such as Breitbart, Infowars, Sinclair Broadcast Group, and to some extent FoxNews).⁵ Donald Trump's repeated accusations that the mainstream media are dishonest, coupled with dwindling readership, tend to discredit mass channels of public opinion while substituting the direct thrust of presidential tweets and biased news from his most vocal supporters in conservative-leaning digital networks. As noted by Zingales: "Inquisitive, daring and influential media outlets willing to take a strong stand against economic power are essential in a capitalist society. They are our defense against crony capitalism."⁶

4 Conclusion: To reach sustainability, market-based capitalism requires a minimum level of socio-political stability to preserve democratic rights and economic inclusiveness. Today, its two main threats come from widening wealth gaps and radical populism whose fertile ground combines global terrorism, corruption, discredited elites and migration flows. When traditional channels of the

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public voice such as parties, unions and media are bypassed or prove to be ineffective, a crisis of social mediation is not far from the horizon. Frustration and social demands find shortcuts that result in "the age of brutality". Civil society's ability to challenge power is an essential component of modernisation. Today, competitive capitalism has become inherently unstable due to mounting scepticism regarding the fair distribution of its benefits and its stubborn myopia concerning the natural environment. Donald Trump in the White House could not be further from representing an impartial arbiter setting fair rules for the game and enforcing them to help level the playing field. Under his "fire and fury" presidency, uncertainty, volatility and hence Country Risk will continue to rise both in the United States and globally. 



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