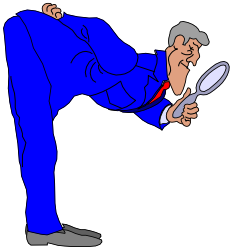




**Joint Master in Global Economic Governance & Public Affairs**

## **Country Risk Management & Governance**

**CIFE Seminar Roma-Berlin-Nice**



# **Case study: Solvencia 2023**

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NICE BERLIN BRUXELLES ISTANBUL



**CONFIDENTIAL**

CIFE Master in Global Governance (Roma-Berlin-Nice 2021-22)

## **Governance and Country risk Analysis**

**Michel-Henry BOUCHET**



### **Republic of Solvencia©'s Eurobond Request**

*Governance and Global Capital Markets in a post-pandemic world*



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## Republic of Solvencia's upcoming Bond issue and Casino Bank

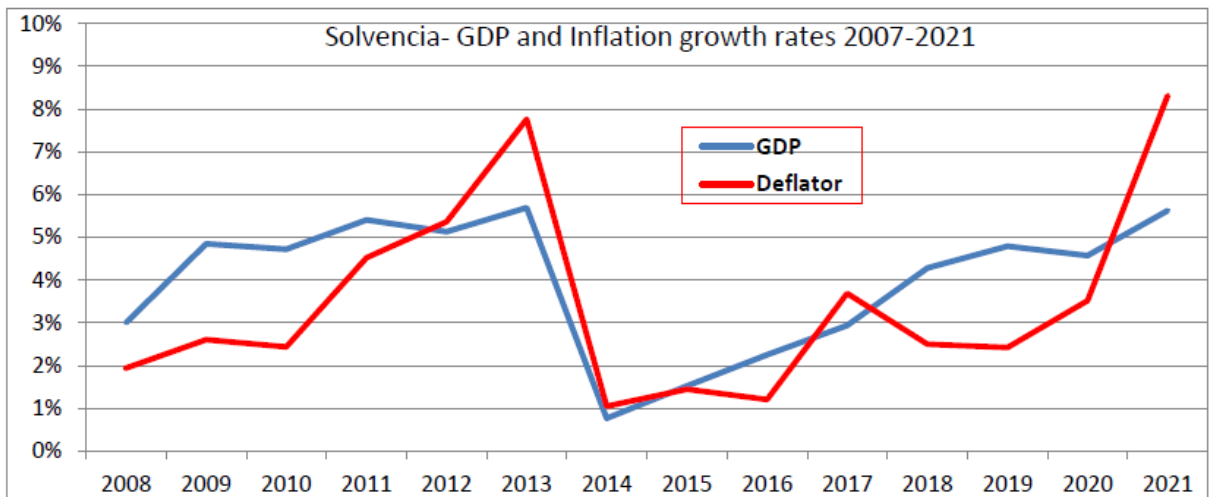
1. It was 9 o'clock yesterday morning, when you got an important message from Solvencia's Finance Minister, requesting meeting you next week in Monaco.
2. Solvencia plans to launch €500/800 million Eurobond on international capital markets, taking advantage of (still) ultra-low rates of interest currently!
3. Mr. Solvent, the finance minister, wants to get your assessment regarding market conditions for the bond floating.
4. The global pandemic crisis, though abating, makes the request a formidable challenge due to a host of headwinds, including risk aversion in the global financial markets and market nervousness regarding developing countries' mounting debt, hence higher yields. Not mentioning loose governance, stubborn corruption, and unabated capital flight...

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## A stop & go economy!

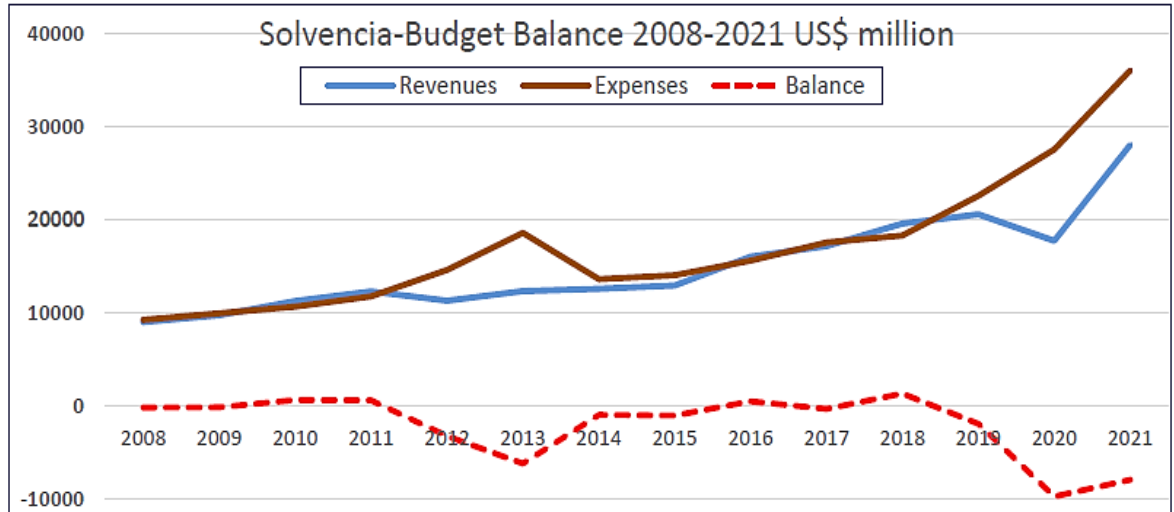


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# Ongoing budget deficits: living beyond its means!

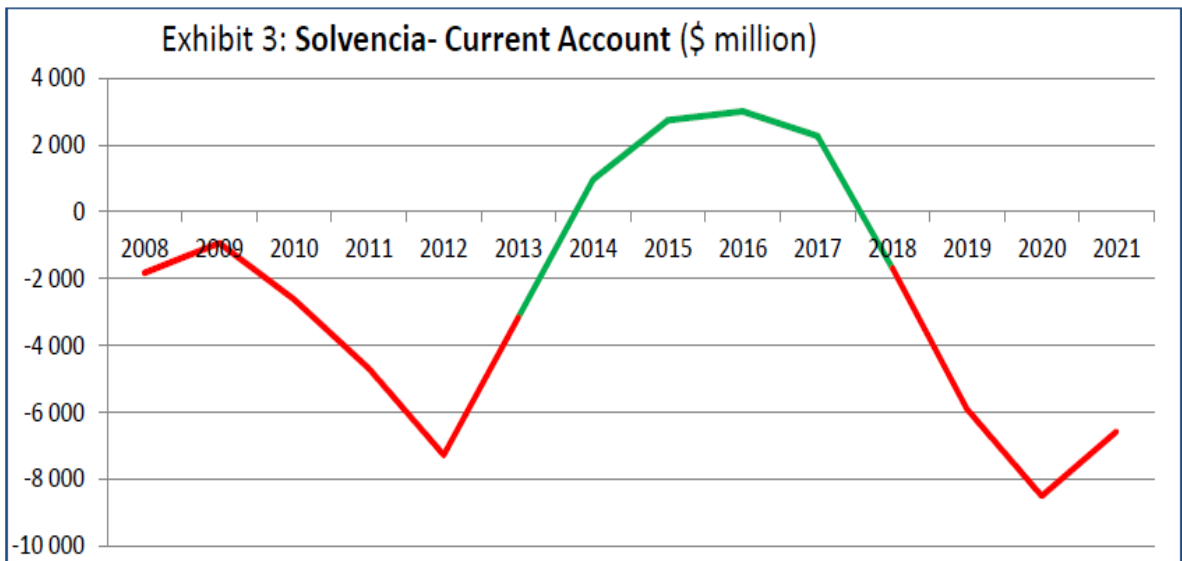


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# Large BOP deficits! Looming debt crisis?

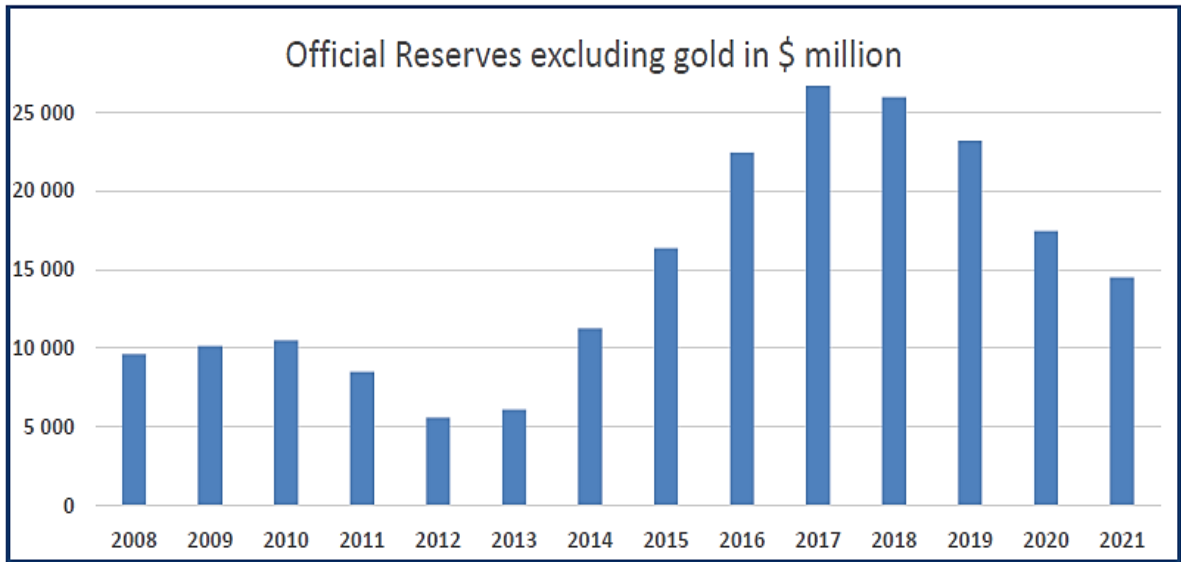


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## Declining reserve trend... liquidity or solvency crisis?



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## Solvencia: data base

FALL 2021-WINTER 2022		Source: Solvencia National Statistics Agency SNSA - 2021													
COUNTRY RISK ANALYSIS		SOLVENCIA													
															(proj.)
A	DOMESTIC ECONOMY	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
	DOMESTIC ECONOMY ( constant prices )														
	Nominal GDP ( local currency billion )	51 125	55 000	59 000	65 000	72 000	82 000	83 500	86 000	89 000	95 000	101 550	109 000	118 000	135 000
	Nominal GDP % change	5,00%	7,58%	7,27%	10,17%	10,77%	13,89%	1,83%	2,99%	3,49%	6,74%	6,89%	7,34%	8,26%	14,41%
	Real GDP ( local currency billion )	5 055	5 300	5 550	5 850	6 150	6 500	6 550	6 650	6 800	7 000	7 300	7 650	8 000	8 450
	Real GDP growth rate %	3,00%	4,85%	4,72%	5,41%	5,13%	5,69%	0,77%	1,53%	2,26%	2,94%	4,29%	4,79%	4,58%	5,63%
	Real GDP Index	103	104,85	104,72	105,41	105,13	105,69	100,77	101,53	102,26	102,94	104,29	104,79	104,58	105,63
	Nominal GDP Index	105	107,58	107,27	110,17	110,77	113,89	101,83	102,99	103,49	106,74	106,89	107,34	108,26	114,41
	GDP deflator	101,94	102,61	102,44	104,52	105,37	107,76	101,05	101,45	101,21	103,69	102,50	102,43	103,52	108,31
	GDP deflator % change	1,94%	2,61%	2,44%	4,52%	5,37%	7,76%	1,05%	1,45%	1,21%	3,69%	2,50%	2,43%	3,52%	8,31%
	Exchange Rate	1 000	1 025	1 035	1 065	1 100	1 175	1 350	1 650	1 950	2020	2040	2070	2125	2250
	Rate of ER depreciation	5,3%	2,5%	1,0%	2,9%	3,3%	6,8%	14,9%	22,2%	18,2%	3,6%	1,0%	1,5%	2,7%	5,9%
	Nominal GDP ( \$ billion )	51,13	53,66	57,00	61,03	65,45	69,79	61,85	52,12	45,64	47,03	49,78	52,66	55,53	60,00
	Nominal GDP per capita \$	5 113	5 250	5 468	5 740	6 035	6 308	5 492	4 546	3 911	3 958	4 120	4 285	4 443	4 721

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## Balance of payments: deficits!

BALANCE of PAYMENTS (\$ million)	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Trade Balance	-1 130	-411	-1 577	-2 494	-4 000	-1 050	1 040	2 000	2 300	1 500	-1 500	-4 000	-5 500	-5 000
Merchandise exports	4 882	6 151	7 910	8 061	9 000	10 500	11 000	12 000	13 800	14 000	13 500	12 000	12 000	13 000
Merchandise imports	-6 012	-6 562	-9 487	-10 555	-13 000	-11 550	-9 960	-10 000	-11 500	-12 500	-15 000	-16 000	-17 500	-18 000
Balance on Services, Income & Transfers	-699	-529	-1 044	-2 201	-3 281	-2 107	-75	738	703	765	-184	-1 901	-3 010	-1 574
Services & income receipts	824	1 008	1 464	1 652	1 447	1 629	2 251	2 594	2 730	2 590	2 769	2 244	2 150	2 750
Exports of services	697	879	1 130	1 152	1 286	1 500	1 571	1 714	1 800	1 750	1 929	1 714	1 500	1 850
Interest receipts	124	120	317	486	146	70	650	850	900	800	800	500	600	850
Other services & income receipts	2	9	17	15	15	59	30	30	30	40	40	30	50	50
Services & income payments	-1 737	-1 832	-3 133	-4 448	-5 197	-4 352	-3 077	-2 686	-2 907	-2 525	-3 452	-4 546	-5 385	-5 224
Imports of services	-902	-984	-1 423	-1 583	-1 950	-1 733	-1 494	-1 500	-1 725	-1 875	-2 250	-2 400	-2 625	-2 700
Interest payments	-831	-835	-1 681	-2 831	-3 197	-2 460	-1 433	-1 006	-992	-450	-802	-1 646	-2 235	-1 973
Other services & income payments	-4	-12	-29	-33	-50	-160	-150	-180	-190	-200	-400	-500	-525	-551
Transfers, net	214	295	625	594	469	616	750	830	880	700	500	400	225	900
Private transfers, net	103	182	320	394	269	565	600	630	630	450	400	300	125	650
Official transfers, net	111	113	305	200	200	51	150	200	250	250	100	100	100	250
<b>Current Account</b>	<b>-1 829</b>	<b>-940</b>	<b>-2 621</b>	<b>-4 695</b>	<b>-7 281</b>	<b>-3 157</b>	<b>965</b>	<b>2 738</b>	<b>3 003</b>	<b>2 265</b>	<b>-1 684</b>	<b>-5 901</b>	<b>-8 510</b>	<b>-6 574</b>

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## Financing the deficit!

Foreign investment, net	14	416	396	600	642	1 960	1 480	1 600	3 650	1 800	470	470	250	1 400
Foreign Direct Investment (disbursed, net)	87	341	417	600	500	1 900	1 400	1 500	3 500	1 650	350	350	300	1 250
Portfolio equity investment, net	-73	75	-21	0	142	60	80	100	150	150	120	120	-50	150
International financial institutions	137	434	-7	-236	-450	2 150	2 000	500	25	25	-150	-175	30	1 250
IMF	0	216	-315	-356	-500	850	850	250	-75	-75	-75	-100	-150	850
World Bank Group	0	100	100	0	0	650	500	50	0	0	-50	-50	150	250
Other multilateral creditors	137	118	208	120	50	650	650	200	100	100	-25	-25	30	150
Paris Club and other bilateral creditors	85	69	348	132	-128	-68	-50	-56	-56	-65	100	150	200	150
London Club	95	651	277	726	1 639	-1 254	-210	-297	-300	-300	350	1 050	1 400	380
Credit flows	70	601	222	641	139	-254	-210	-347	-350	-350	200	200	100	200
Interest arrears	0	0	0	0	0	0	0	0	0	0	0	0	50	80
Short-term credits	25	50	55	85	1 500	-1 000	0	50	50	50	150	850	1 250	100
Private creditors (bond markets)	-4	10	1 000	1 500	200	-378	-860	-143	-143	-250	-200	-150	-150	-250
Resident lending abroad, net	541	-683	430	-19	481	450	929	975	975	850	825	825	-20	-50
Errors and omissions, net	152	93	-150	-250	-350	500	100	100	100	0	-250	-350	-500	500
Gold reserve variation	50	420	606	179	825	1 311	786	-367	-1 242	-150	-300	450	330	168
Reserves excluding gold (- = increase)	734	-520	-334	1 979	2 922	-514	-5 140	-5 101	-6 062	-4 225	689	2 781	5 720	2 926

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EXTERNAL DEBT (\$ million)	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Total External Debt</b>	25 485	26 104	27 111	28 314	31 377	32 798	34 116	33 540	33 069	32 586	32 086	32 911	34 391	35 871
Medium/Long term debt	25 235	25 804	26 756	27 874	29 437	31 858	33 176	32 550	32 029	31 496	30 846	30 821	31 001	32 351
Short term debt	250	300	355	440	1 940	940	940	990	1 040	1 090	1 240	2 090	3 340	3 440
Interest arrears	0	0	0	0	0	0	0	0	0	0	0	0	50	80
<b>Breakdown by creditor :</b>														
International financial institutions	18 550	18 984	18 977	18 741	18 291	20 441	22 441	22 941	22 966	22 991	22 841	22 666	22 696	23 946
IMF	3 500	3 716	3 401	3 045	2 545	3 395	4 245	4 495	4 420	4 345	4 270	4 170	4 020	4 870
World Bank Group	8 500	8 600	8 700	8 700	8 700	9 350	9 850	9 900	9 900	9 900	9 850	9 800	9 950	10 200
Other multilateral creditors	6 550	6 668	6 876	6 996	7 046	7 696	8 346	8 546	8 646	8 746	8 721	8 696	8 726	8 876
Paris Club and other bilateral creditors	4 585	4 654	5 002	5 134	5 006	4 938	4 888	4 832	4 776	4 711	4 811	4 961	5 161	5 311
London Club	1 500	1 620	2 276	2 583	4 724	3 863	3 609	3 449	3 152	2 852	2 652	3 702	5 052	5 352
Medium/long term	1 250	1 320	1 921	2 143	2 784	2 923	2 669	2 459	2 112	1 762	1 412	1 612	1 712	1 912
Short term	250	300	355	440	1 940	940	940	990	1 040	1 090	1 240	2 090	3 340	3 440
Other private & institutional creditors	850	846	856	1 856	3 356	3 556	3 178	2 318	2 175	2 032	1 782	1 582	1 432	1 182
<b>EXTERNAL ASSETS (\$ million)</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>
Official Reserves excluding gold	9 634	10 154	10 488	8 509	5 587	6 102	11 241	16 342	22 404	26 629	25 940	23 159	17 439	14 512
	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Residents' Deposits in International Banks	250	200	300	500	850	1 200	600	500	350	350	625	625	700	850
Gold Reserves (in million ounces)	2,40	2,60	2,70	2,80	3,00	3,22	3,50	3,00	3,00	3,00	3,00	3,00	2,40	2,40
Gold Reserve assets (\$ million)	1 231	1 651	2 257	2 436	3 261	4 572	5 359	4 992	3 750	3 600	3 300	3 750	4 080	4 248

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DEBT SERVICE PAYMENT (\$ million)	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Total debt servicing obligations</b>	1680,8	1835,3	2880,9	4381,4	6147,3	5127,9	3899,9	2861,2	2492,1	2296,1	2652,2	3895,6	4435,4	5422,9
Interest payments due	831	835	1681	2831	3197	2460	1433	1006	992	896	802	1646	2235	1973
Amortization paid or due	850	1000	1200	1550	2950	2668	2467	1855	1500	1400	1850	2250	2200	3450
<b>AMORTIZATION PAYMENTS DUE</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2023</b>	<b>2024</b>	<b>2025</b>	<b>2026</b>	<b>2027</b>	<b>2028</b>	<b>2029</b>
<b>Total principal repayments due</b>	2668	2467	1855	1500	1400	1850	2250	2200	3450	3350	3450	1150	1125	1075
IMF	0	0	124	200	200	250	300	300	450	200	250	250	250	300
World Bank Group	118	100	162	191	193	250	400	400	500	500	500	250	50	100
Other multilateral creditors	400	450	280	150	172	260	250	300	350	300	300	250	250	250
Paris Club	500	500	250	150	185	190	300	400	850	850	850	300	350	300
London Club	950	700	565	459	500	650	750	600	800	950	950	0	0	0
Other private creditors (bonds)	700	717	474	350	150	250	250	200	500	550	600	100	225	125
<b>GLOBAL ECONOMIC DATA</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>
\$ LIBOR (six-month, average)	1,26%	1,20%	3,20%	6,00%	4,19%	2,50%	1,20%	1,00%	1,00%	0,75%	0,50%	1,00%	1,50%	0,50%
Gold Price (US\$/ounce)	513	635	836	870	1087	1420	1531	1664	1250	1200	1100	1250	1700	1770
Oil Price (Brent) in \$/barrel	30	62	56	111	113	108	95	52	44	54	70	64	42	75
<b>GOVERNMENT BUDGET</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>
(in LC billion)														
Government Revenues	8950	9700	11200	12250	11255	12300	12525	12900	16000	17125	19550	20550	17700	28000
Government Expenditures	9202,5	9900	10620	11700	14550	18550	13550	14000	15550	17500	18279	22550	27500	36000
<b>BUDGET BALANCE</b>	-253	-200	580	550	-3295	-6250	-1025	-1100	450	-375	1271	-2000	-9800	-8000
<b>INFLATION</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>
Consumer price % change average	4,00%	4,80%	5,00%	6,50%	7,00%	9,00%	2,20%	2,65%	2,75%	6,00%	6,50%	8,00%	8,00%	9,50%

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## We advise

MHB staff engage in discussions with various groups—including government and central bank officials, legislators, business leaders, labor unions, and civil society—to better evaluate each country's economic policies and outlook.

## What do do, now?

1. Looking at the trends to assess economic prospects beyond 2021
2. Is the trajectory comforting, negative, promising? Is stabilization in sight?
3. Is there a risk of rising debt with declining liquidity and solvency prospects? Reserve trends? Debt ratios?
4. Will a substantial bond issue today meet the needs of Solvencia to boost economic growth?
5. At which conditions? Project lending, specific purpose financing or filling the black hole of the balance of payments deficit?
6. Under which specific conditions, if any, it makes sense to lend \$0,5 billion to Solvencia? How to improve governance and sustainability?

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## First, filling the blank cells!

Risk Indicators	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
GDP (in US\$ billion)														
Real GDP Growth rate (in Local Currency)														
GDP Growth rate (in US\$)														
GDP per capita (US\$)														
GDP per capita /day														
Rate of currency depreciation														
Trade Balance (US\$ million)														
External competitiveness														
Trade openness ratio (X+M/GDP)														
Budget Deficit-Surplus /GDP%														
Current account/GDP %														

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## Filling the blank cells!

RATIOS	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Solvency														
Debt/Exports														
Debt/GDP														
Reserves/External Debt														
Short-term Debt/Total Debt														
Liquidity														
Principal Amortization/Exports %														
Net Capital Flows														
Debt servicing Ratio %														
Interest/Exports %														
Reserves/Imports GS in %														
Reserves/Imports in Months Coverage														
Average external interest rate in %														
Cash-flow ratio														
Numerator:														
+ Official reserves assets including Gold+XG&S														
+Undisbursed bank credits + Net transfers )														
Denominator (debt service + MG&S + ST debt)														
Cash flow ratio														

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### Example?

**Key market-based economic policy** measures to preserve healthy growth dynamism in the 2020-2022 period

1. Adopting market-based economic policies promoting competitiveness and trade openness
2. Cutting inefficient public expenditures and stimulating privatization-driven revenues to balance the budget
3. Focusing on tourism sector, more security and better services
4. Keeping cost-push inflation pressures at bay while maintaining a competitive real effective exchange rate with a floating exchange rate system, aimed at supporting a liberalization of the capital account, attracting further FDI and stimulating productivity growth.
5. Improving the current account balance by encouraging the return of capital flight, and boosting exports of goods and services.

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### Example?

Key **structural and institutional** challenges Solvencia must tackle to restore sustainable development path:

1. Addressing financial sector weaknesses, liberalizing the capital account, improving the regulatory framework and tackling labour market rigidities
2. Modernizing the industrial sector
3. Continuing the privatization program given that the state retains a large presence throughout the economy, including in the state-owned banks.
4. Increasing trade openness and diversifying the export base regarding products and markets;
5. Enhancing free trade with the EU and the USA
6. Improving living standards and creating jobs for the young generation
7. Articulating a strategy to accelerate the structural transformation of the economy towards more skill-intensive sectors.
8. Implementing social and institutional reforms while improving governance

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### Example?

Overall conclusion regarding Solvencia's request for launching a US\$800 million Eurobond issue

1. Solvencia's return to market access is premature given lack of market-based economic policy commitment and weak governance
2. Market appetite might be tested with smaller bond (US\$200-350 million) maturing after the bunching of upcoming debt repayments
3. Enhancing features will facilitate the success of the bond issue: equity conversion option, recapture clause, extended grace period, gold collateral, on-going monitoring of the IMF, cross-default clause...

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## The strategy adviser's conclusion and recommendation!

### **IX- Conclusion and recommendation to Casino Bank's Risk Committee**

In conclusion, **we recommend the Board of Directors not to underwrite Solvencia's Eurobond.** We believe that investment banks will be reluctant to underwrite the US\$500 million bond and that bondholders will show little appetite for a straight bond issue despite its attractive yield.

From our standpoint, however, there might still exist an opportunity to support the Eurobond issue while mitigating the risk for Casino Bank. One can request Government of Solvencia to use the country's gold reserves to guarantee the Eurobond. Gold reserves will be held by an independent party, such as the BIS or an escrow account in a reputed financial institution. With this arrangement, we believe, we can sell the Eurobond of Solvencia in the capital markets with promising fees for our bank, and favorable risk/return ratio for international investors.

1. Solvencia's return to market access is premature given lack of market-based economic policy commitment and weak governance;
2. Market appetite might be tested with smaller bond (US\$200 million) maturing after the bunching of upcoming debt repayments;
3. Enhancing features will facilitate the success of the bond issue: equity conversion option, gold collateral, on-going monitoring of the IMF, cross-default clause...