

POLITICAL RISK ASSESSMENT III

MEASURING POLITICAL RISK



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MEASURING POLITICAL RISK: FIVE MAIN TAKEAWAYS

1. There is no reliable market “canary” for political risk

Traditional indicators (VIX, ratings, bond yields, CDS) react *after* crises erupt. They overshoot ex post and provide little genuine early warning. Gold: barometer of *global* risk, not country-specific political risk.

2. Political risk must be assessed qualitatively before it is quantified

In-depth economic intelligence, power-structure analysis, scenario building, and tools like the PRINCE model and Delphi surveys are essential. Purely numerical approaches miss context, legitimacy, and informal power dynamics.

3. Power structures and legitimacy matter more than formal institutions

Political stability depends on how power is rooted (ideological, military, religious, economic, ethnic, patron-client). Rapid socio-economic change without institutional strengthening increases political disorder, especially in emerging markets.

4. Country risk ratings are useful—but deeply flawed

Ratings simplify complex realities and enable comparisons, but they are reductionist, procyclical, herd-driven, and often biased. They tend to bury early warning signals and can become self-fulfilling prophecies.

5. Rating agencies are poor early-warning systems

Major crises (Asia 1997–98, Enron, Tunisia post-2011) show that agencies downgrade *after* instability becomes obvious. Their track record highlights limited predictability, conflicts of interest, and conformity bias rather than foresight.

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IN SEARCH OF EARLY WARNING SIGNALS OF POLITICAL RISK RISE?



Wall Street 'fear gauge' leaps as traders take fright
Vix volatility index (intraday high)



No Canari in the Coal Mine:
 Vix, rating agencies, bond yields, CDS...
 All react and overshoot EX POST
 Gold is a reliable risk barometer, though for Global Risk turmoil!

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Source: LSEG via markets.ft.com



HOW TO ASSESS & MEASURE POLITICAL RISK?

1. Economic intelligence: in-depth socio-political analysis (Huntington)
2. Checklist approach & Power structure:
key political forces that affect a country's risk:
3. the **Prince Model**
4. Delphi technique
 - establish surveys
 - collect information and independent opinions
 - analyze results and make predictions
5. Ratings of country's political turmoil
6. Consultants on political risks
7. AI-based assessment models
8. Early warning signals?



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1. INFORMATION SOURCES ON POLITICAL RISK: THE KEY ROLE OF ECONOMIC INTELLIGENCE

- MIGA (IBRD)
- MIG (UK)
- HISCOX
- PLATUS
 - AON
- S&P Global
 - IFRI
 - EIU
- COFACE, US-IDFC/OPIC, EULER
 - Howell International
- Control Risks: www.crg.com
 - WMRC
 - Freedom House
- FGS Global <https://fgsglobal.com/what-we-do>

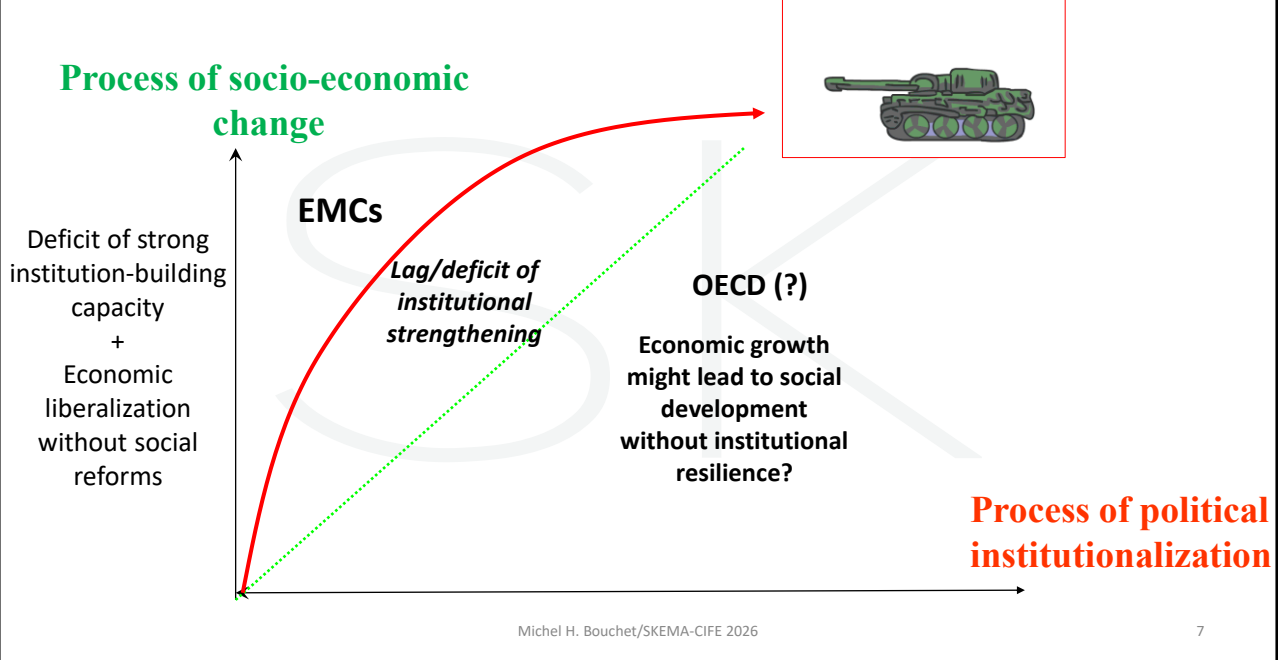
- Frost & Sullivan
- Falcone International
- US State Department + CIA
- Marsh Crisis Consulting
- University of Maryland Center for Conflict Management
- Muir Analytics (Threat Watch)
 - NYA International
 - PRS-ICRG
 - TAC (France)
- DragonFly Intelligence
<https://dragonflyintelligence.com/#content>

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POLITICAL DIS/ORDER IN RAPIDLY CHANGING SOCIETIES



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2. POLITICAL RISK ANALYSIS

Mapping out the **economic and political power roots** and identifying the base of political legitimacy:

- ▶ ideological & repressive (North Korea, Russia, China)
 - ▶ charismatic (Cuba, Venezuela, Nicaragua, Bolivia)
 - ▶ economic/financial (Brunei)
- ▶ authoritarian populism (Thailand, Morocco, Tunisia)
 - ▶ ethnic (Ivory Coast, Ghana)
 - ▶ religious & repressive (Iran)
- ▶ military control (Burma, North Korea, Algeria)
- ▶ patron-client relationships (Togo, Congo, Gabon, RCI)

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3. POLITICAL RISK ANALYSIS: PRINCE MODEL

Frost & Sullivan: William D. Coplin and Michael K. O’Leary of the firm Political Risk Services.

PRINCE = Probe, Interact, Calculate, and Execute

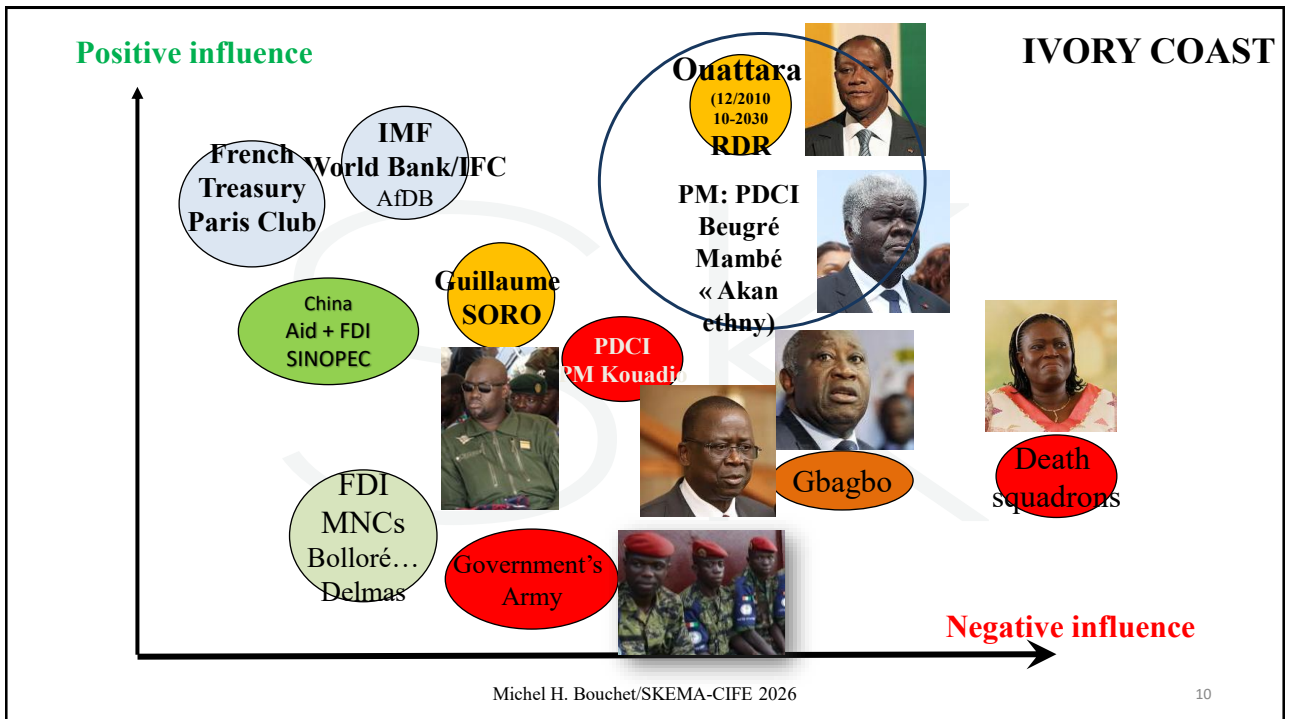
Emphasis on the power structure of a nation by identifying key individuals or groups that can influence a specific risk outcome:
destabilization, nationalisation, expropriation...

Political risk forecasting model to produce probability of loss from political instability by relating relative importance in decision-making and relative political orientation towards radical or incremental change (+/-)

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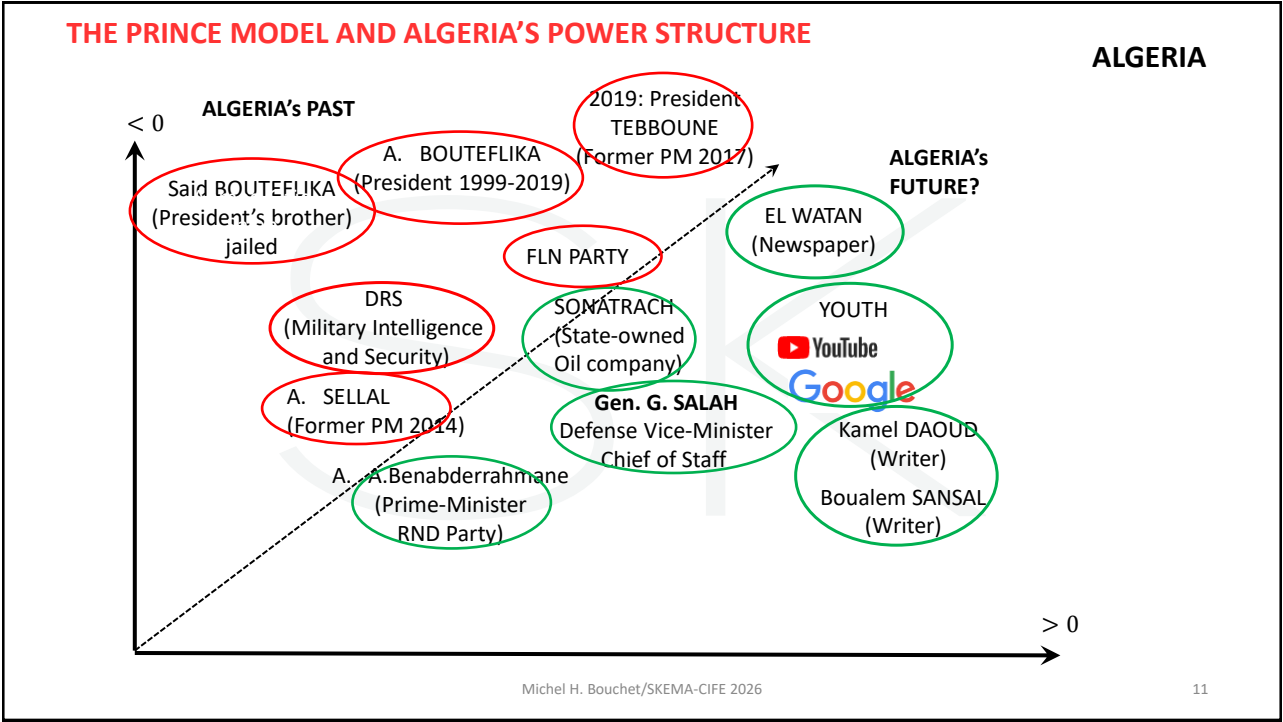
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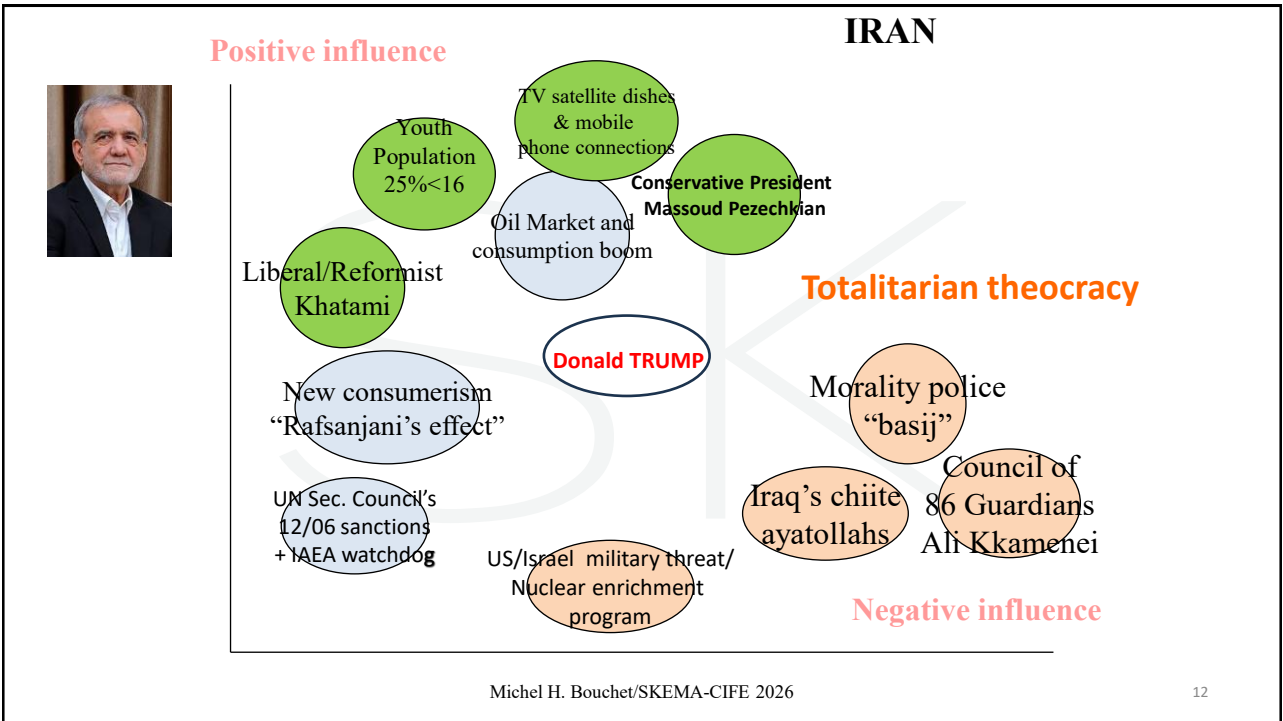


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4. QUANTIFYING COUNTRY RISK

Rating, scoring and Ranking:

- ▶ Can one boil things down to numerical indices, when dealing with culture, politics, and ethnic tensions?
- ▶ *Problem of “usability” of rankings: number fetishism leads astray by focusing on statistical Delphi-based analyses that are often subjectively biased, misleading and overly narrow. Lack of insight and qualitative research? (www.useit.com Jakob Nielsen)*

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QUANTITATIVE APPROACH: RATING

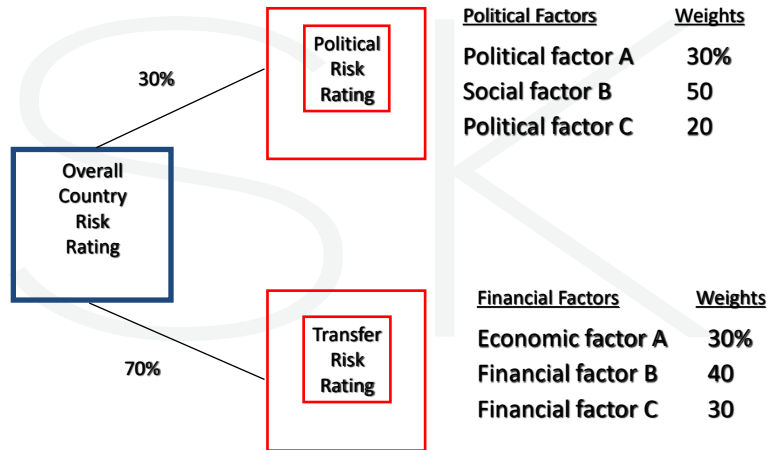
- ▶ Means: Transforming a number of observations (Delphi method, surveys) or quantitative indicators into **one** single number.
- ▶ The various indicators can be weighted regarding their impact on creditworthiness and risk.
- ▶ **End-product:** one single grade to assess past and current country risk situation with cross-country comparisons across time

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QUANTIFYING COUNTRY RISK: RISK WEIGHTING



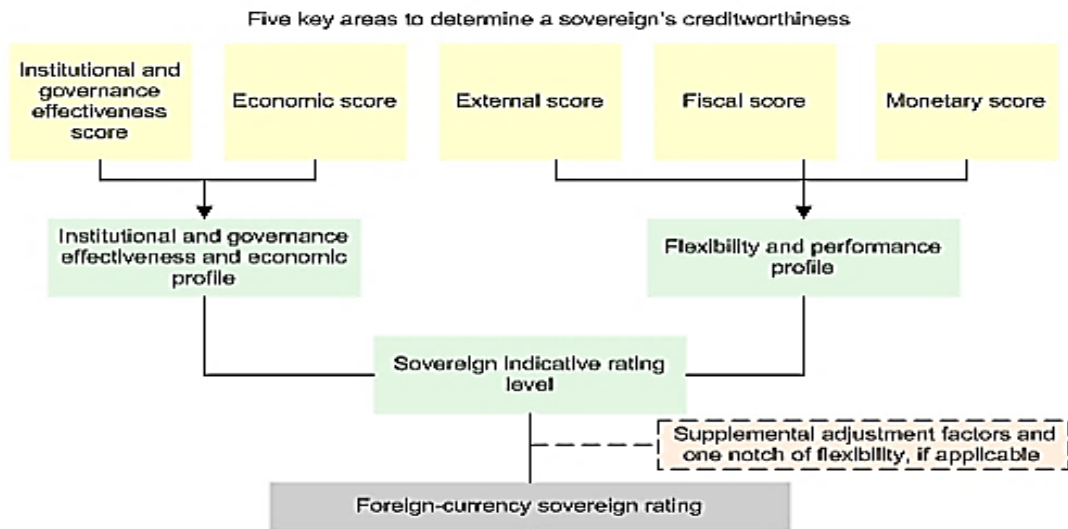
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EX. : S&P'S COUNTRY RISK ASSESSMENT FRAMEWORK

Sovereign Issuer Credit Rating Framework


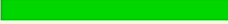



































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DIFFERENT AND DIVERGENT COUNTRY RATINGS REQUIRE IN-DEPTH ANALYSIS OF THE METHODOLOGY

Sovereign Ratings List			
	Moody's ratings [+]	S&P ratings [+]	Fitch ratings [+]
United States [+]	 Aaa	 AA+	 AAA
United Kingdom [+]	 Aa3	 AA	 AA-
Germany [+]	 Aaa	 AAA	 AAA
France [+]	 Aa3	 AA-	 AA-
Japan [+]	 A1	 A+	 A
Spain [+]	 Baa1	 A	 A-
Italy [+]	 Baa3	 BBB+	 BBB
Portugal [+]	 A3	 A-	 BBB+
Greece [+]	 Baa3	 BBB	 BB+
Ireland [+]	 Aa3	 AA	 AA-
Andorra [+]		 A-	 A-
United Arab Emirates	 Aa2	 AA	 AA-

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SHRINKING SELECT CLUB OF TRIPLE-A RATING COUNTRIES	S&P	Moody's	DBRS
	Australia	AAA	Aaa
Canada	AAA	Aaa	AAA
Denmark	AAA	Aaa	AAA
Germany	AAA	Aaa	AAA
Liechtenstein	AAA		
Luxembourg	AAA	Aaa	AAA
Netherlands	AAA	Aaa	AAA
Switzerland	AAA	Aaa	AAA
Norway	AAA	Aaa	AAA
Sweden	AAA	Aaa	AAA
European Union	AA	Aaa	AAA
Singapore	AAA	Aaa	AAA
United States	AA+	Aaa ↓	AAA

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COUNTRY RISK RATING ?

Advantages/ Pros

- ▶ simple
- ▶ shrinks a large number of variables into one single grade
- ▶ cross-country comparison
- ▶ comparison across time
- ▶ reliable for smooth risk evolution
- ▶ useful for statistical and econometric analysis

Shortcomings/Cons

- ▶ “reductionist”
- ▶ simplistic
- ▶ risk of self-fulfilling prophecy
- ▶ little predictive value
- ▶ weighted average tends to bury salient trends
- ▶ gives “market consensus” often made of herd instinct

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SHORTCOMINGS OF RATING AGENCIES?

- Power without accountability + conflict of interest
- Conformity bias and herd behavior
- Sociocultural bias
- Punishment of disobedient firms/countries that do not request a rating
- Procyclical bias, hence following the majority opinion of market participants without any early warning signals nor predictability track record
- Spill-over effect!

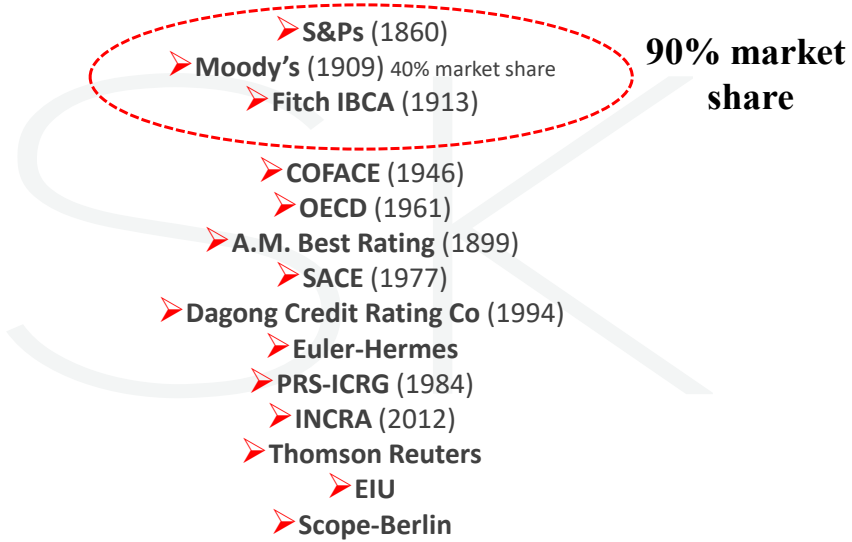


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MAIN COUNTRY RATINGS



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THE **OCDE** IMPLEMENTS A RATING AND RANKING OF COUNTRY RISK FOR PROVIDING A LEVEL PLAYING FIELD TO EXPORT GUARANTEE COMPANIES WITHIN THE GROUP OF 38 DEVELOPED COUNTRIES AND FOR THE PURPOSE OF SETTING **MINIMUM PREMIUM RATES** FOR EXPORT CREDIT TRANSACTIONS

THE COUNTRY RISK ENCOMPASSES:
1. TRANSFER AND CONVERTIBILITY RISK (I.E. THE RISK THAT A GOVERNMENT IMPOSES CAPITAL OR EXCHANGE CONTROLS THAT PREVENT AN ENTITY FROM CONVERTING LOCAL CURRENCY INTO FOREIGN CURRENCY AND/OR TRANSFERRING FUNDS TO CREDITORS LOCATED OUTSIDE THE COUNTRY),
2. CASES OF FORCE MAJEURE (E.G. WAR, EXPROPRIATION, REVOLUTION, CIVIL DISTURBANCE, FLOODS, EARTHQUAKES).

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Country Risk Classifications
of the Participants to the Arrangement on Officially Supported Export Credits
Valid as of: 31 January 2025

nb	Country Code ISO Alpha 3	Country Name ⁽¹⁾	Classification		Notes
			Previous	Current Prevailing	
1	AFG	Afghanistan	7	7	
2	ALB	Albania	5	4	
3	DZA	Algeria	5	5	
4	AND	Andorra	-	-	(8)
5	AGO	Angola	6	6	
6	ATG	Antigua and Barbuda	7	7	
7	ARG	Argentina	7	7	
8	ARM	Armenia	6	6	
9	ABW	Aruba	4	4	
10	AUS	Australia	-	-	(6)
11	AUT	Austria	-	-	(6) (7)
12	AZE	Azerbaijan	4	4	
13	BHS	Bahamas	4	4	
14	BHR	Bahrain	6	6	
15	BGD	Bangladesh	5	5	
16	BRB	Barbados	-	-	(5)
17	BLR	Belarus	7	7	
18	BEL	Belgium	-	-	(6) (7)
19	BLZ	Belize	-	-	(5)
20	BEN	Benin	6	6	
21	BTN	Bhutan	6	6	
22	BOL	Bolivia	7	7	
23	BIH	Bosnia and Herzegovina	6	6	
24	BWA	Botswana	3	3	
25	BRA	Brazil	4	4	
26	BRN	Brunei Darussalam	-	-	(5)
27	BGR	Bulgaria	3	2	

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DAGONG (SET UP IN 1994)

**LACK OF INDEPENDENCE
AND GEOPOLITICAL BIAS**

- Japan A-
- Spain BBB+
- Italy BBB-
- Greece CC
- Chile AA-
- China AAA
- France A+
- Brazil A6
- Germany AA+
- Russia A stable
- USA A- and BBB+ 2018

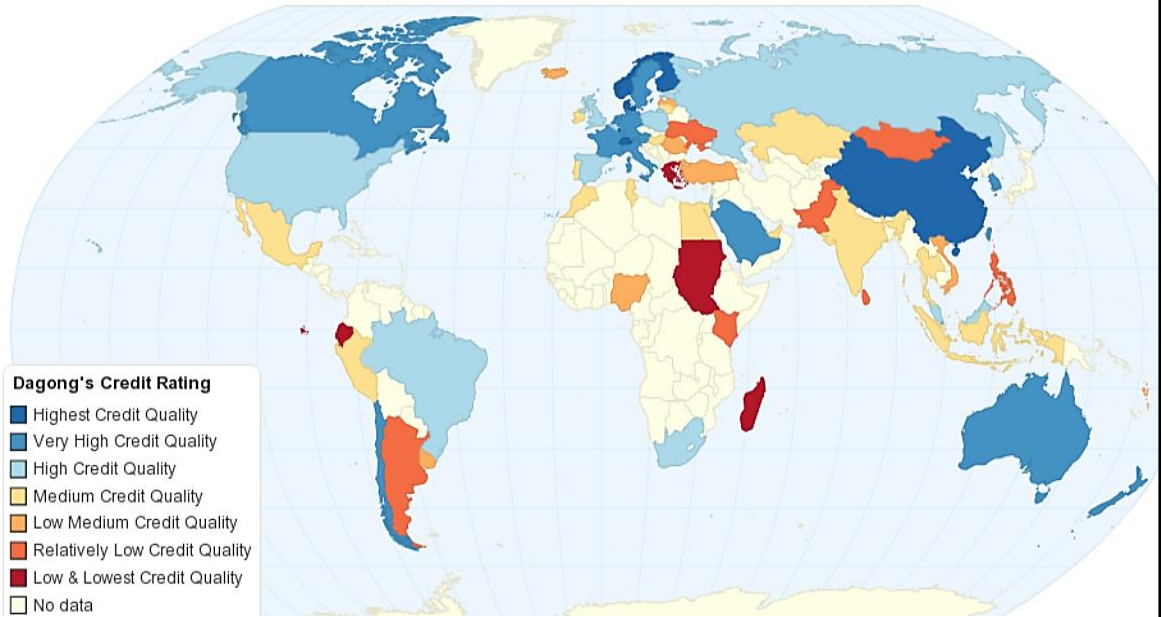
- Argentina CC-
- Nigeria BB+
- Venezuela BB-
- Turkey BB-
- Ecuador B-
- Malaysia A+
- Thailand BBB-
- Vietnam B+
- Morocco BBB-
- Korea AA-

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Dagong's Credit Rating for each country



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RATING = POOR EARLY WARNING SIGNAL?

1997 Asia risk ? « *It's like growth stocks... sovereign risk has never looked better!* »

- Institutional Investor (March 1997)

▶ South Korea was rated as Italy and Sweden until October of 1997... but was abruptly downgraded to junk bond status!

« *There were no early warnings about Korea from us or, to the best of our knowledge, from other market participants, and our customers should expect a better job from us!* » FITCH IBCA January 14, 1998

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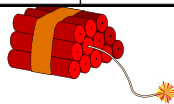
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EUROMONEY'S RISK RATING

THE HIGHER THE SCORE, THE LARGER THE RISK

	1996	1997	1998	1999	2000	2005	2009	2010
Korea	28	30	42	44	29	28	40	25
Thailand	45	51	54	49	65	49	60	45
Philippines	55	57	55	53	78	75	77	58
Malaysia	33	35	56	46	46	46	45	60
Indonesia	45	49	91	98	107	81	76	61



Agencies were blind for too long then hammered the countries with abrupt downgrading!

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WAS THE 1998 ASIAN CRISIS ANTICIPATED BY RATING AGENCIES?

	Credit Ratings			
	<i>Standard & Poor' s</i>		<i>Moody' s</i>	
	June 1996	June 1997	June 1996	June 1997
Indonesia	BBB	BBB	Baa3	Baa3
Korea	AA-	AA-	A1	A1
Malaysia	A+	A+	A1	A1
Philippines	BB	BB+	Ba2	Ba1
Thailand	A	A	A2	A2

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ASIA-1998: LESSONS OF THE CRISIS

- ▶ “Any agency which rated the Republic of Korea at the high investment grade rating of AA- (in the case of Fitch IBCA and S&Ps) or A1 (Moody’s) before the crisis, and which now rates Korea at a speculative grade B-, was clearly either wrong initially or subsequently”

Fitch IBCA January 13, 1998

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RATING = POOR EARLY WARNING SIGNALS?

ENRON's collapse in December 2001

- ▶ The credit agencies were still tipping the energy firm as an investment-grade credit four days before it filed for bankruptcy protection on 12/2/2001.
- ▶ Moody's and S&Ps finally downgraded Enron to junk status on 11/28/01
- ▶ « *The credit raters -despite their unique position to obtain information unavailable to other analyst- were no more astute and no quicker to act than others* »
 - Senator Joe Lieberman

Source: Credit-October 2006, Vol7, Issue 09

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TUNISA 2011- 2026

THE 2011 "JASMIN REVOLUTION": MOODY'S DOWNGRADES TUNISIA'S TO BAA3 NEGATIVE

- ▶ **January 2011:** Moody's Investors Service downgraded to Baa3 from Baa2 the local and foreign currency government bond ratings of the Tunisian government.

Main drivers for the rating action:

- (1) The country's instability due to the unexpected recent regime change, which resulted from the ongoing political crisis that first began as social unrest.
- (2) The significant uncertainties surrounding both the economic and political outcomes.
- (3) The ongoing unrest and the fluidity of the political situation

▶ **May 2013:** new downgrading to Ba2

- **October 2017:** B1 -
- **August 2019:** B2 –
- **May 2022:** Caa1 –
- **May 2025:** Caa1 stable

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