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WHAT IS COUNTRY RISK ALL ABOUT IN AN AGE OF GLOBALIZATION?



CIFE SEMINAR NICE MAY 6-8, 2020
 MICHEL-HENRY BOUCHET

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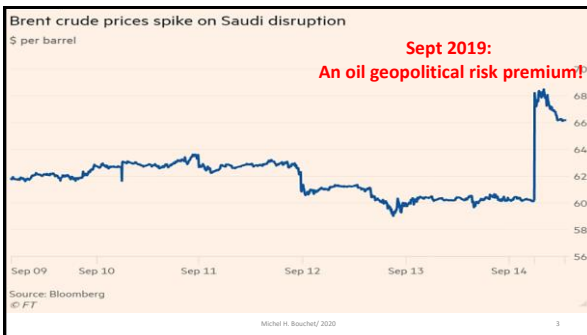
«YESTERDAY'S» COUNTRY RISK

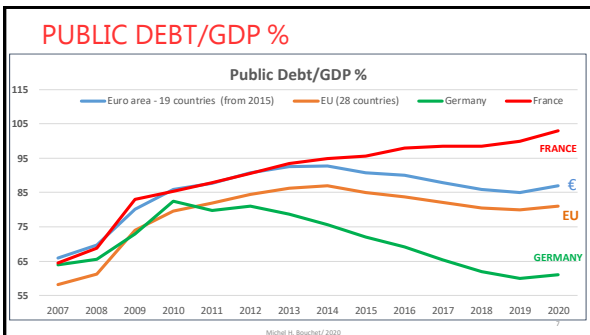
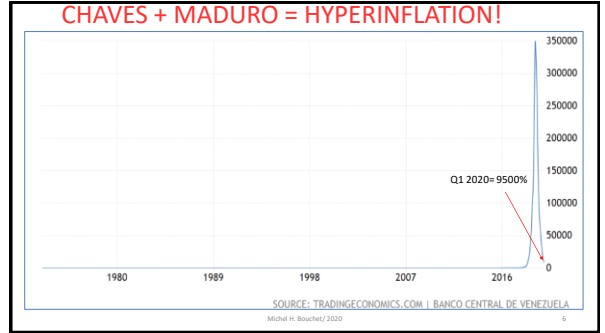
▶ Traditional definition of cross-border risk:
Assessment of a foreign entity's ability and willingness to meet its external obligations in full and on time

Foreign entity? Private firm, debtor country government, bank, investment fund, supplier, client, partner...

Country risk is composed of a complex combination of **political, financial and macro-economic risk**

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« TODAY'S » COUNTRY RISK IN THE AGE OF GLOBALIZATION

Operational definition:
Set of interdependent economic, financial, environmental, sanitary and socio-political factors, specific to a country in the global economy, which can affect both foreign and domestic economic agents

Domestic agents? Private firms, households, banks, merchants, fund managers, exporters and importers, students...

► Country risk is composed of a complex combination of **socio-political, financial, environmental and macroeconomic risks that must be assessed in the globalized system**

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WHAT COUNTRY RISK IS NOT

- Country risk is **not** a monopoly of foreign creditors, exporters, importers, or investors
 - Domestic residents (households, investors, corporate sector) also face country risk from their own country's socio-economic and political situation: the country's government can take **arbitrary** decisions that will affect the residents' well-being
 - The country can be **contaminated** by adverse regional or global forces
- A deterioration in the risk perception by capital markets and rating agencies will **feedback** on domestic residents' environment = downgrading + capital flight!

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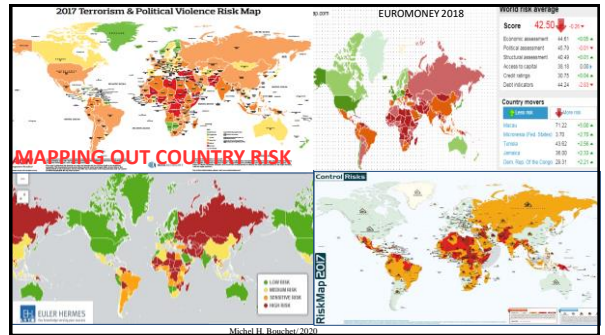



COUNTRY RISK IN THE AGE OF DONALD TRUMP

- Direct «Hard Risks»**
 - Risk materialization directly hurts US business: outbreak of a military conflict US-North Korea; sharp rise in interest rates and fall in bond prices; fall in oil prices; pandemic corona crisis; stock market crash; large weakening of USD; trade retaliation by Mexico, China, and Canada; mounting trade and geopolitical tensions with China and Russia
- Indirect «Surrounding Risks»**
 - Risk materialization stems from a more hostile environment: protracted Corona virus crisis; stalemate between White House and Congress regarding budgetary policy and National Security Strategy; ongoing saber-rattling with North Korea, Iran, and Pakistan; regional crisis in the Western Hemisphere and in the Middle East; protracted failed NAFTA renegotiations
- Collateral «Soft Risks»**
 - Risk materialization as byproduct of unfavorable interactions between power groups: Impeachment of Donald Trump; global protectionism; geopolitical volatility; mounting wealth gap; pressure groups and hostile NGOs; lagged institutional reaction to covid-19 crisis



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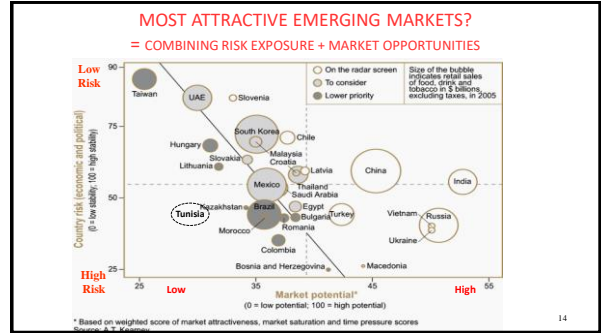


TACKLING COUNTRY RISK

COUNTRY + RISK

- ▶ **Country** = sovereign entity, culture and values, geographical distance, national laws and regulations, socio-political parameters
- ▶ **Risk** = lack of perfect information in real time, spill-over effect, abrupt changes

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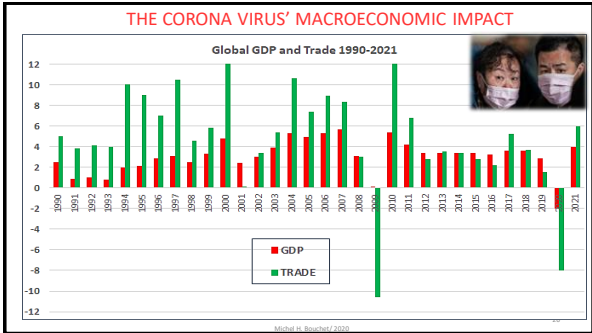
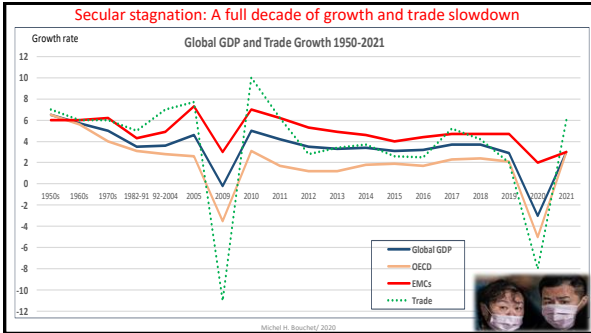
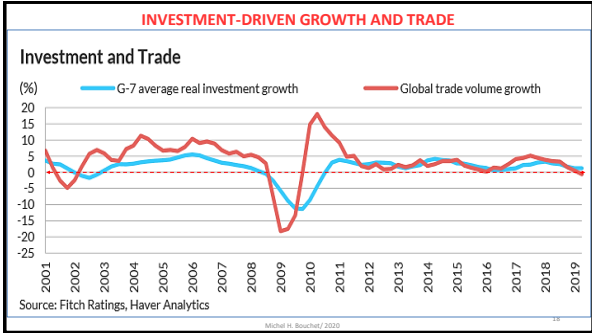
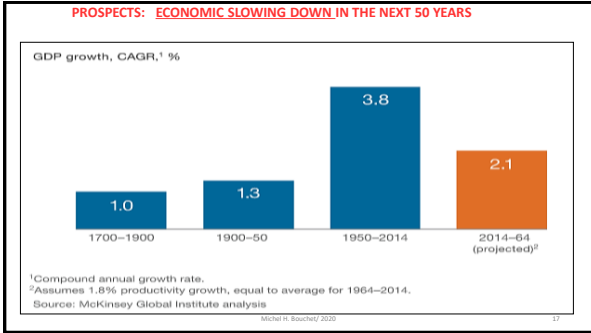


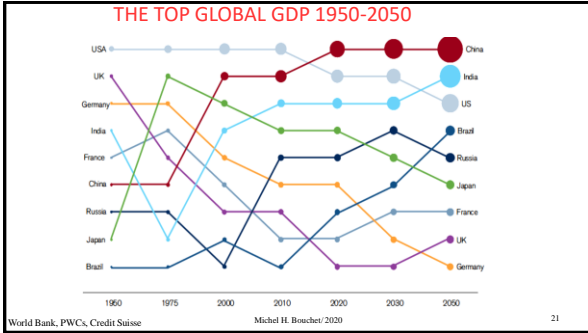
AT KEARNEY FDI CONFIDENCE INDEX GOVERNANCE MATTERS!

Ranking	2017	2018	2019	Country	Score
1	1	1	1	United States	2.31
2	3	2	2	Germany	1.90
5	2	3	3	Canada	1.87
4	4	4	4	United Kingdom	1.85
7	7	5	5	France	1.79
6	6	6	6	Japan	1.78
3	5	7	7	China	1.72
13	10	8	8	Italy	1.67
9	8	9	9	Australia	1.67
10	12	10	10	Singapore	1.65
11	15	11	11	Spain	1.62
14	13	12	12	Netherlands	1.61
12	9	13	13	Switzerland	1.59
-	20	14	14	Denmark	1.58
15	14	15	15	Sweden	1.55
8	11	16	16	India	1.54
18	16	17	17	South Korea	1.54
22	21	18	18	Belgium	1.54
23	15	19	19	New Zealand	1.52
20	19	20	20	Ireland	1.52
24	24	21	21	Austria	1.50
-	-	22	22	Taiwan (China)	1.50
-	-	23	23	Finland	1.50
-	-	24	24	Norway	1.49
17	17	25	25	Mexico	1.49

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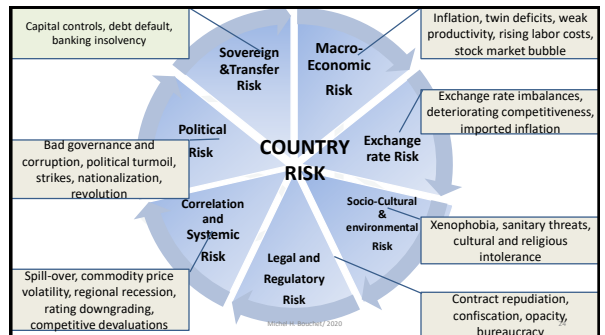


WHAT ABOUT THE KEY COMPONENTS OF COUNTRY RISK?

COUNTRY RISK

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- ### 5 MAIN APPROACHES TO COUNTRY RISK ASSESSMENT
1. **Qualitative « macro » approach:** financial, macroeconomic, legal, regulatory, environmental (inc. Sanitary) and political parameters
 2. **External debt analysis:** Balance of payments + liquidity and solvency
 3. **Quantitative approach :** rating, ranking, and scoring
 4. **Market signals:** yields, spreads, CDS, Vix
 5. **Econometric approach** and modelization
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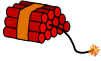


MAIN COMPONENTS OF GLOBAL RISK

- Economic risk
- Financial and transfer risk
- Exchange risk
- Commodity risk
- Sanitary threats
- Political risk
- Cultural environment risk
- Operational risk
- Legal and contractual risk (repudiation, confiscation, bribes...)
- Regional contamination risk (spill-over effect)
- Systemic risk (global crisis)

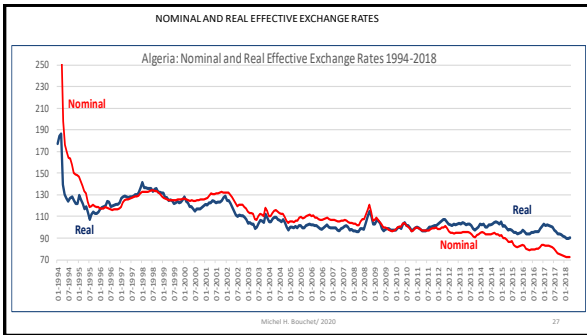
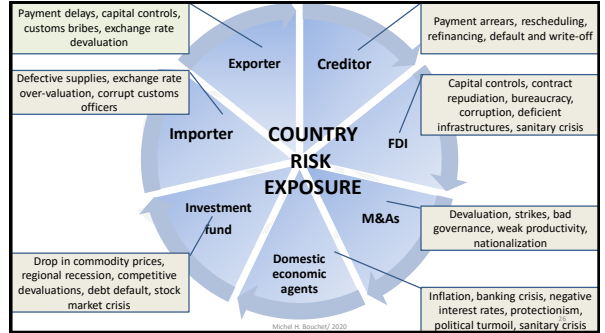
Quantifiable but ultimately judgmental

Subjective, insurable and diversifiable

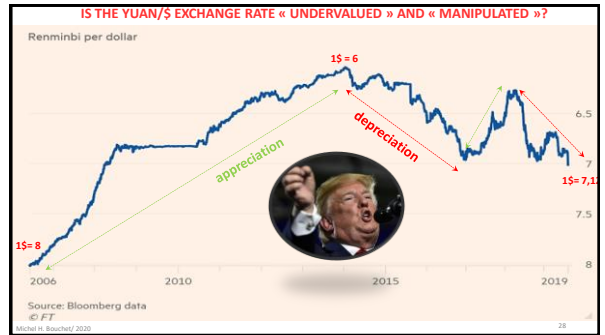


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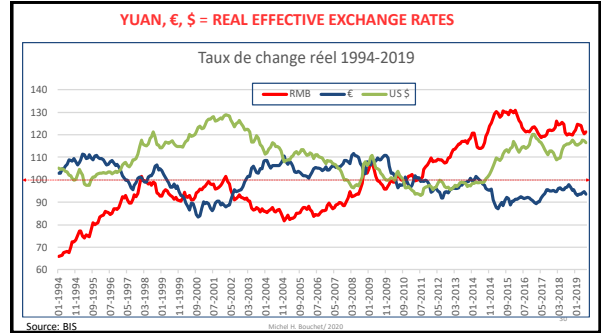
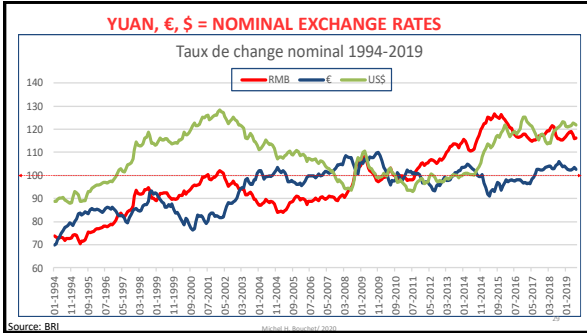
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BETTER OFF IN TUNISIA OR IN ALGERIA?

TUNISIA	ALGERIA
▶ GDP Per capita = \$10500	▶ GDP Per capita=13500
▶ HDI= 97	▶ HDI= 83
▶ Life expectancy f = 78	▶ Life expectancy f= 75
▶ Infant mortality= 13/1000	▶ Infant mortality= 22/1000
▶ Gender inequality: 0,28	▶ Gender inequality: 0,43
▶ Doing Business= 80	▶ Doing Business= 157/190
▶ Corruption = 74	▶ Corruption = 112
▶ Coface = C/B	▶ Coface = C/C

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MOROCCO



- ▶ GDP per capita ppp= \$8000
- ▶ HDI = 123
- ▶ Life expectancy= 76
- ▶ CPI corruption= 81
- ▶ Gender inequality = **0,49**
- ▶ Infant mortality= **23,7/1000**
- ▶ Doing Business = **60**
- ▶ FDI= **Tunisia * 2** (=2,4% GDP)
- ▶ Coface = **A4/A4**

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BOLIVIA

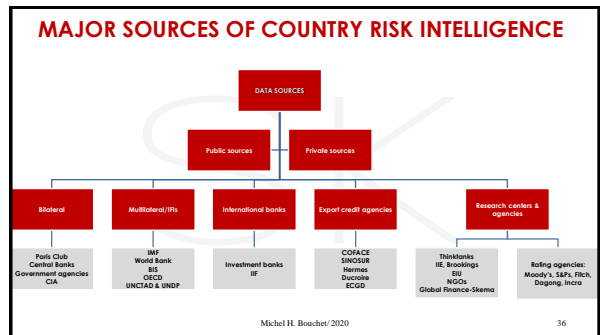


- ▶ GDP per capita ppp= \$7500
- ▶ HDI = 118
- ▶ Life expectancy= 68
- ▶ CPI corruption= 112
- ▶ Gender inequality = **0,49**
- ▶ Infant mortality= **30/1000**
- ▶ Doing Business = **156/190**
- ▶ FDI = **minimal**
- ▶ Coface = **C/B**

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COUNTRY RISK ASSESSMENT

Reliable and updated information
= Economic intelligence
→ **Robust risk analysis**

ANALYSIS AND INFORMATION

IMF, World Bank, IFC & MIGA
UNCTAD & UNDP
Fed Reserve Bk of St Louis
BIS, OECD, EBRD, EIB
Coface, Euler-Hermes
Moody's, S&P, Fitch, Dagong
Euromoney, Institutional Investor
CIA & US State Dept, ICRG
Transparency International
Hiscox, AON, Control Group
DEFI www.developingfinance.org

Country Political Risk
 La globalisation
 Introduction à l'économie de la sécurité mondiale
 Managing Country Risk in an Age of Globalization
 Country Risk Assessment
 AON
 Euler-Hermes
 Coface
 International Monetary Fund
 The World Bank

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