Centre international
de formation européenne

NICE BERLIN BRUXELLES ISTANBUL

SEMINAR INTRODUCTION:

COUNTRY RISK IN AN AGE OF GLOBALIZATION

(AND GLOBAL PANDEMIC CRISIS)

CIFE SEMINAR NICE MAY 6-8, 2020

MICHEL-HENRY BOUCHET

MAY 2020 CIFE SEMINAR

CIFE Master of Global Governance students are provided with 5 academic supports:

1. A 8-session seminar : www.developingfinance.org (16 files) and Webex platform
2. A Case Study: Solvencia & Casino Bank 2020
3. A Book: Bouchet, Fishkin & Goguel: Country Risk in an Age of Globalization, Palgrave-MacMillan, 2018
https://www.amazon.fr/Managing-Country-Risk-Age-Globalization/dp/3319897519
4. A Udemy-based MOOC:
► https://www.udemy.com/course/country-risk-in-the-age-of-global-turbulences/
5. A MOOC tackling the challenges of Globalization:
► https://www.udemy.com/course/globalizationskema/

SEMINAR ORGANIZATION:

15 hours / 2 days/ 8 sessions

1. Intro: What is Risk about in an age of global pandemic crisis?
2. What is country risk and its main components?
3. The key role of the balance of payments
4. Where do financial crises come from?
5. Solvencia Case Study
6. Political risk: Where does socio-political turmoil come from?
7. What about governance? Definition and measures
8. Conclusion: anticipating upheaval and failed states?

- discussions/debates

Web site: www.developingfinance.org

2-PAGE REVIEW OF 1 OUT OF 16 DOCUMENTS TO READ BEFORE THE BEGINNING OF THE SEMINAR

(LIST ALSO PROVIDED IN THE WELCOME LETTER THREE WEEKS BEFORE THE SEMINAR)

1. Aon-Risk-Maps Forecast	05/07/2019 17:28
2. AT Kearney FDI Index Report	28/07/2019 14:05
3. CA Word Growth Scenario 2020	16/04/2019 11:17
4. Council on Foreign Relations March 2019	06/08/2019 14:26
5. Eurasia Group Top Risks Report	07/01/2019 20:49
6. Foreign Affairs 2020- Trump & Global Trade	01/04/2020 10:06
7. FT M WOLF-This pandemic is an ethical challe...	31/03/2020 13:57
8. How The Next Recession Could Be Worse Tha...	02/04/2019 18:29
9. IMF Finance & Inequality 2020	02/04/2020 20:19
10. IMF Policy challenges against the Corona Vi...	02/04/2020 20:20
11. IMF WEO 2020	02/04/2020 20:21
12. Investing in EMCs FT July 2019	12/08/2019 17:36
13. LARRY SUMMERS Secular stagnation	25/06/2017 11:45
14. Poverty and Corruption IMF Sept 2018	31/08/2018 13:39
15. Predictions for Global Geopolitics 2019-2025	15/03/2019 11:23
16. SAXO BANK Strategy Outlook 2020	03/10/2019 08:48

A KEY TAKEAWAY OF THE SEMINAR IS IDENTIFYING CRUCIAL SOURCES OF **ECONOMIC INTELLIGENCE**

Economic Intelligence Sources

www.developingfinance.org
https://www.theglobaleconomy.com/rankings/Nonperforming_loans/
https://www.coface.com/fr/Etudes-economiques-et-risque-pays
https://www.theglobaleconomy.com/
https://www.bis.org/statistics/consstats.htm
https://etudes-economiques.credit-agricole.com/
https://www.fitchratings.com/site/sovereigns/political
https://www.imf.org/en/Publications
https://www.heritage.org/index/
https://www.doingbusiness.org/en/rankings
https://www.weforum.org/reports/how-to-end-a-decade-of-lost-productivity-growth
https://www.transparency.org/cpi2019

ECONOMIC INTELLIGENCE SOURCES

- http://etudes-economiques.credit-agricole.com/
- http://cib.natixis.com/research/economic/publications.aspx?lang=fr
- http://economic-research.bnpparibas.com/
- http://www.societegenerale.com/fr/s-informer-et-nous-suivre/econews
- MarketAxess Daily btdata@marketaxess.com
- Fed St Louis, The Economist, US Treasury, World Bank
- S&Ps GlobalRatings, Fitch Rating https://www.spratings.com/en_US/home
- OCDE: https://stats.oecd.org/
- ECB: https://www.ecb.europa.eu/home/languagepolicy/html/index.fr.html
- IMF: https://www.imf.org/external/french/index.htm

SEMINAR ORGANIZATION

- Preliminary readings of documents
- Succinct summary of 2 key documents
- On-line seminar (Webex)
- Topic presentation & discussion
- Short review of global governance **hot spots** (9 groups of 2/3 students) <10 mns!
- Individual and group research

Sources: EIB, Les Echos, La Tribune, FT, IMF, WSJ, BIS, Huffpost, The Economist, Fitch Rating, Moody's, IIF, IIE, Brookings…

CIFE SEMINAR MAY 6-8, 2020

	Wednesday May 6	Thursday May 7	Friday May 8
9h	Intro		Seminar Intro: Failed States
	Quiz	The root causes of debt crisis	Defining Failed States?
	What is Risk about?	Anticipating debt crisis	Institutional weaknesses
	What is Country Risk?	Debt Restructuring	and political crisis
12h			TI: Assessing Corruption?
13h30		Governance & Political Risk	TAC: Anticipating risk upheaval
	Balance of payments	Political upheaval	*Conclusion: How mitigating*
17h	Solvencia Case Study	Solvencia Case Study	***the impact of state failure?***

SEMINAR PROGRAMME 05 2020 COURSE + MOOC

Home | Biography | Publications | Courses | Research | Corporate Activities | Conferences | Articles | Blog

https://developingfinance.org/

MOOC + CIFE ACADEMIC PLATFORM + DEFI

MH BOUCHET/ (c) CIFE 2020

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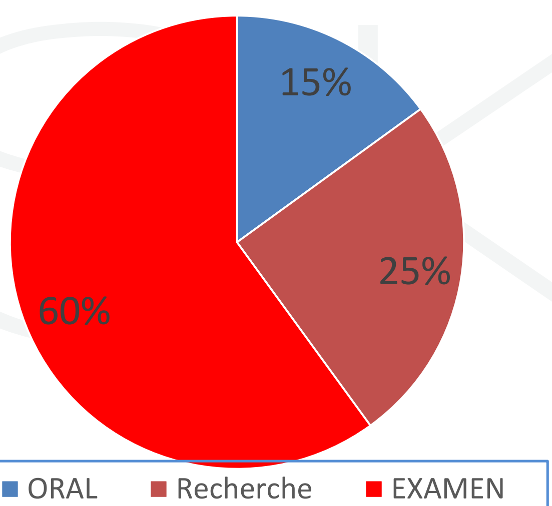
ORAL PRESENTATIONS « GOVERNANCE HOT SPOTS » + GROUP RESEARCH REPORT + FINAL EXAM



MH BOUCHET/ (c) CIFE 2020

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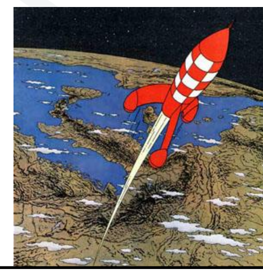
SEMINAR PROGRAMME

D2 S7/S8 = Failed states
Governance crisis
Political risk

D2 S5/S6= The unfolding of
Social, sanitary and financial crises

D1 S3/S4= BOP solvency crisis
IFIs IMF& IBRD

D1 S1/S2= Introduction
Global pandemic crisis &
Market Globalization



QUIZ TIME!

COUNTRY RISK ECONOMIC INTELLIGENCE AND INFORMATION SOURCES

CIFE SEMINAR NICE MAY 6-8, 2020

MICHEL-HENRY BOUCHET

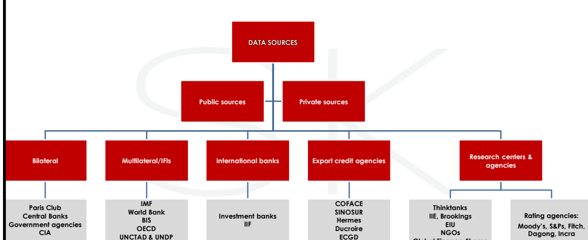
COUNTRY RISK ASSESSMENT

Reliable and updated information

= Economic intelligence

➔Robust risk analysis

MAJOR SOURCES OF COUNTRY RISK INTELLIGENCE



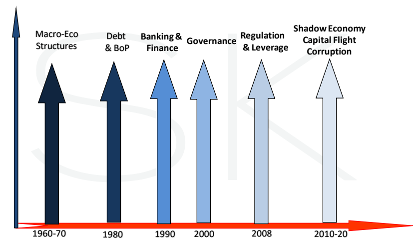
ANALYSIS AND INFORMATION

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

ECONOMIC INTELLIGENCE = THE KEY OF RELIABLE RISK ANALYSIS AND MITIGATION!

- www.developingfinance.org
- https://www.theglobaleconomy.com/rankings/Nonperforming_loans/
- https://www.coface.com/fr/Etudes-economiques-et-risque-pays
- https://www.theglobaleconomy.com/
- https://www.bis.org/statistics/consstats.htm
- https://etudes-economiques.credit-agricole.com/
- https://www.fitchratings.com/site/sovereigns/political
- https://www.imf.org/en/Publications
- https://www.heritage.org/index/
- https://www.doingbusiness.org/en/rankings
- https://www.weforum.org/reports/how-to-end-a-decade-of-lost-productivity-growth
- https://www.transparency.org/cpi2019
- http://etudes-economiques.credit-agricole.com/
- http://cib.natixis.com/research/economic/publications.aspx?lang=fr
- http://economic-research.bnpparibas.com/
- http://www.societegenerale.com/fr/s-informer-et-nous-suivre/econews/
- MarketAxess Daily btdata@marketaxess.com
- Fed St Louis, The Economist, US Treasury, World Bank
- S&Ps GlobalRatings, Fitch Rating https://www.spratings.com/en_US/home
- OCDE: https://stats.oecd.org/
- BCE: https://www.ecb.europa.eu/home/languagepolicy/html/index.fr.html
- FMI: https://www.imf.org/external/french/index.htm

ECONOMIC INTELLIGENCE =
TRANSFORMING INFORMATION INTO RISK STRATEGY



FINANCIAL, MACROECONOMIC AND SOCIO-POLITICAL INFORMATION AND INTELLIGENCE SOURCES

Official sources

1 . Multilateral sources
- IMF
- World Bank
- BIS, OECD
- RDBs

2. **Official bilateral sources**
- Country governments (CBs, CIA)
- ECAs (Coface, Hermes, Eximbank, ECGD, SACE, CESCE)
- Paris Club

Private sources

1. Insurance agencies (Coface, AON OPIC)
2. Research institutes (IIE, IIF, Brookings, Transparency Int.)
3. Thinktanks (Cato, Heritage, Freedom House, Heritage F.)
4. Magazines (Euromoney, Institutional Investor…)
5. Academic centers (CforGD, Global Finance…)
6. Rating agencies (S&Ps, Dagong, Incra)

OFFICIAL **INFORMATION** SOURCES

- 4 IFIs = IMF + World Bank + BIS + OECD
- 4 RDBs= AsDB, AfDB, EBRD, IADB
- 2 UNs= UNCTAD + UNDP
- Export credit agencies (Coface, EFIC, Hermes…)
- Paris Club
- Central Banks
- Governments and Intelligence agencies (https://www.cia.gov/library/publications/the-world-factbook/wfbExt/region_eur.html)

IMF AS SOURCE OF RISK INFORMATION

International Financial Statistics (monthly)

Global tables:

IMF Credits

Official reserves and MS

Exchange rates (nominal and real effective rates)

CPI and interest rates

Trade Flows (M/X)

Commodity prices

Country data

Balance of payments

Government budget

National accounts (GDP/GNP)

International liquidity

Monetary survey (bank credit, money and quasi-money)

Interest rates

Debt ratios

IMF AS SOURCE OF MACRO-ECONOMIC INFORMATION

Table 5. Ecuador: Balance of Payments, 2008–21
(Millions of U.S. dollars, unless otherwise indicated)

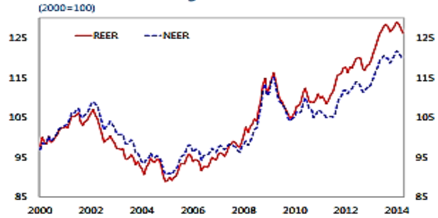
	2008	2009	2010	2011	2012	2013	2014	2015 Est.	2016 Proj.	2017	2018	2019	2020	2021
Current account	1,766	309	-1,586	-403	-166	-968	-567	-2,247	-2,280	-978	-874	-140	596	-834
Trade account	1,549	144	-1,504	-303	50	-493	-53	-1,700	-1,311	538	165	799	1,260	-276
Exports, f.o.b.	19,461	14,412	18,137	23,082	24,569	25,686	26,604	18,998	16,225	18,147	18,666	19,136	19,636	20,025
Oil	11,721	6,965	9,673	12,945	13,792	14,108	13,302	6,610	5,565	6,577	6,891	7,103	7,349	7,553
Non-Oil	7,740	7,447	8,464	10,137	10,777	11,578	13,302	12,389	10,660	11,570	11,775	12,033	12,287	12,472
Imports (f.o.b.)	-17,912	-14,268	-19,641	-23,385	-24,519	-26,178	-26,657	-20,699	-17,536	-17,609	-18,501	-18,337	-18,375	-20,301
Oil	-3,358	-2,338	-4,043	-5,087	-5,441	-5,927	-6,417	-3,950	-2,916	-3,370	-3,798	-3,904	-3,932	-4,258
Non-Oil	-14,554	-11,930	-15,598	-18,298	-19,078	-20,251	-20,240	-16,748	-14,620	-14,239	-14,704	-14,433	-14,443	-16,043
Services (net)	-3,003	-2,556	-2,564	-2,822	-2,696	-2,874	-2,778	-2,625	-3,089	-3,561	-3,429	-3,375	-3,242	-3,290
Transfers (net)	3,221	2,722	2,481	2,722	2,480	2,399	2,264	2,078	2,120	2,045	2,391	2,435	2,578	2,733

China: Selected Economic Indicators

	2012	2013	2014	2015	2016	2017 Projections	2018	2019	2020	2021	2022
NATIONAL ACCOUNTS											
Real GDP (base=2015)	7.9	7.8	7.3	6.9	6.7	6.7	6.4	6.4	6.3	6.0	5.8
Total domestic demand	7.9	8.1	7.2	7.2	7.4	7.0	6.9	6.8	6.6	6.2	5.9
Consumption	8.7	7.2	7.2	8.3	8.4	8.6	8.0	7.4	7.1	6.6	6.2
Investment	7.1	9.1	7.1	6.1	6.3	5.2	5.5	6.0	6.0	5.8	5.6
Fixed	9.0	9.3	6.8	6.7	6.7	5.2	5.6	6.1	6.2	6.0	5.8
Inventories (contribution)	-0.6	0.1	0.2	-0.2	-0.1	0.1	0.0	0.0	0.0	0.0	0.0
Net exports (contribution)	0.3	0.1	0.4	-0.1	-0.5	-0.1	-0.2	-0.2	-0.2	-0.2	-0.1
Total capital formation (percent of GDP)	47.2	47.3	46.8	44.7	44.2	43.7	42.9	42.4	42.0	41.7	41.4
Gross national saving (percent of GDP) 1/	49.7	48.8	49.0	47.5	45.9	45.1	44.3	43.6	42.9	42.3	41.8

THE IMF AS SOURCE OF EXCHANGE RATE AND MONETARY DATA: **CHINA**

Real Effective Exchange Rate
(2000=100)



Sources: IMF, Information Notice System; and IMF staff calculations.

THE IMF'S WEO

World Economic Outlook UPDATE
An update of the key WEO projections

FOR RELEASE
Washington, DC: July 16, 2018, 10:00 a.m. EST

STRICTLY CONFIDENTIAL
UNTIL RELEASED

Less Even Expansion, Rising Trade Tensions

- *Global growth is projected to reach 3.9 percent in 2018 and 2019, in line with the forecast of the April 2018* World Economic Outlook *(WEO), but the expansion is becoming less even, and risks to the outlook are mounting. The rate of expansion appears to have peaked in some major economies and growth has become less synchronized. In the United States, near-term momentum is strengthening in line with the April WEO forecast, and the US dollar has appreciated by around 5 percent in recent weeks. Growth projections have been revised down for the euro area, Japan, and the United Kingdom, reflecting negative surprises to activity in early 2018. Among emerging market and developing economies, growth prospects are also becoming more uneven, amid rising oil prices, higher yields in the United States, escalating trade tensions, and market pressures on the currencies of some economies with weaker fundamentals. Growth projections have been revised down for Argentina, Brazil, and India, while the outlook for some oil exporters has strengthened.*

IMF Managing Director Kristalina Georgieva's Statement Following a G20 Ministerial Call on the Coronavirus Emergency
March 23, 2020

"The human costs of the Coronavirus pandemic are already immeasurable and all countries need to work together to protect people and limit the economic damage. This is a moment for solidarity—which was a major theme of the meeting today of the G20 Finance Ministers and Central Bank Governors."I emphasized three points in particular:
"First, the outlook for global growth: for 2020 it is negative—a recession at least as bad as during the global financial crisis or worse. But we expect recovery in 2021. To get there, it is paramount to prioritize containment and strengthen health systems—everywhere. The economic impact is and will be severe, but the faster the virus stops, the quicker and stronger the recovery will be. "We strongly support the extraordinary fiscal actions many countries have already taken to boost health systems and protect affected workers and firms. We welcome the moves of major central banks to ease monetary policy.
"**Second, advanced economies are generally in a better position to respond to the crisis**, but many emerging markets and low-income countries face significant challenges. They are badly affected by outward capital flows, and domestic activity will be severely impacted as countries respond to the epidemic. Investors have already removed US$83 billion from emerging markets since the beginning of the crisis, the largest capital outflow ever recorded. We are particularly concerned about low-income countries in debt distress—an issue on which we are working closely with the World Bank.
"**Third, what can we, the IMF, do to support our members**? We are concentrating bilateral and multilateral surveillance on this crisis and policy actions to temper its impact. We will massively step up emergency finance—nearly 80 countries are requesting our help—and we are working closely with the other international financial institutions to provide a strong coordinated response. We are replenishing the Catastrophe Containment and Relief Trust to help the poorest countries. We welcome the pledges already made and call on others to join. We stand ready to deploy all our US$1 trillion lending capacity.

WORLD BANK AS SOURCE OF RISK INFORMATION

Global Development Finance (annual)

- Vol. 1 = Global tables

Total debt stock and flows of EMCs broken down by creditors & maturities

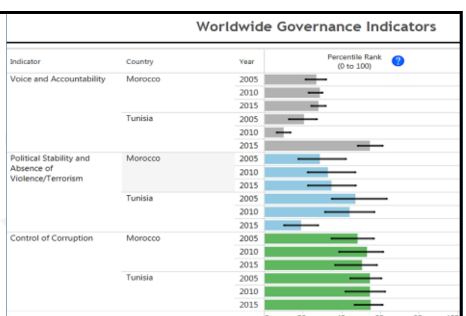
- Vol.2 = country tables

Total debt and debt servicing payments

Country economic reports

- Structural indicators
- Economic policy issues
- WB project lending
- Debt sustainability analysis
- Governance analysis

WORLD BANK: CROSS-COUNTRY COMPARISON OF GOVERNANCE INDICATORS: **TUNISIA VS MOROCCO**



http://info.worldbank.org/governance/wgi/#reportsindicators: **Tunisia vs Morocco**

BIS = KEY SOURCE OF FINANCIAL RISK INFORMATION

Global tables

International Banking statistics (quarterly)
+ Annual BIS report

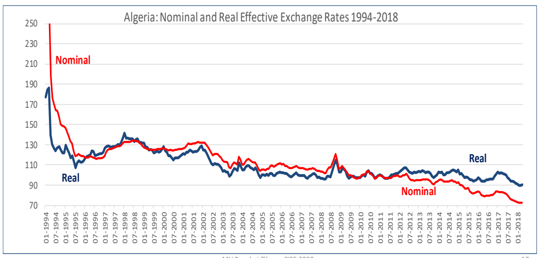
- International banking market
- International debt securities market
- Derivatives market

Country Tables

- External positions of BIS reporting banks: assets (claims) and liabilities (deposits) vis à vis all sectors and the non-bank private sector
- Breakdown by creditor banks and by maturities
- Real effective exchange rates

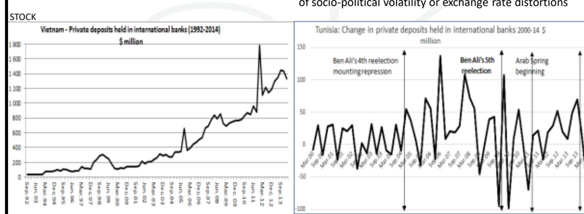
http://stats.bis.org/statx/srs/table/b4

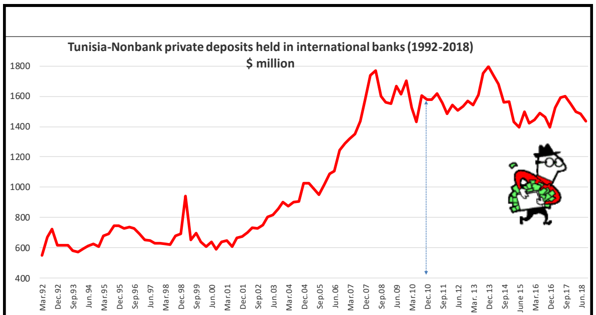
THE BIS: NOMINAL AND REAL EFFECTIVE EXCHANGE RATES



BIS: A SOURCE OF CAPITAL FLIGHT DATA

Private capital outflows in international banks as measure of socio-political volatility or exchange rate distortions





Source: BIS 2020

OECD, CENTRAL BANKS AND TREASURIES

- Ex. FFIEC: US Federal Financial Institution Examination Council

- **US banks' claims on CHILE = US$ 3.22 billion o/w**

1. On banks= $ 903 million
2. On public sector= $320 million
3. On private sector= $1970 million
4. Total ST debt < 1 year loans= 51%

PARIS CLUB = SOURCE OF DEBT-RELATED INFORMATION

- There are no established institutionalized mechanisms for dealing with **private** sector cross-border debt in arrears! This is not the case of **official-source** debt that is renegotiated under the auspices of the Paris Club since 1956! Cf. Argentina's debt crisis
- The Paris Club: A confidential ad-hoc forum of debt negotiations between OECD country creditors and sovereign debtors.
- It only deals with official or officially-guaranteed credits (Coface, Hermes, ECGD, US Eximbank…).
- Consensus-based agreements.

THE PARIS CLUB

- The first meeting with a debtor country was in 1956 when Argentina agreed to meet its public creditors in Paris. Since then, the Paris Club has reached >430 agreements concerning 90 debtor countries. The total amount of debt covered in these agreements has been $583 billion.
- The Paris Club has remained strictly informal. It is the voluntary gathering of creditor countries willing to treat in a co-ordinated way the debt due to them by the developing countries.
- It can be described as a "non institution".

THE PARIS CLUB'S KEY NUMBERS

KEY NUMBERS

Total amount of agreements	433
Total amount of debtor countries	90
Total amount of debt	583 Billion $
Total amount of countries in "Classic Terms"	60
Total amount of countries in "Houston Terms"	21
Total amount of countries in "Naples Terms"	36
Total amount of countries in "Cologne Terms"	33

TOTAL CLAIMS OF PARIS CLUB MEMBERS ON EMERGING MARKET COUNTRIES

Créances du Club de Paris au 31 décembre 2016, hors intérêts de retard (en millions de dollars)

APD : Aide Publique au Développement
NAPD : non consenties aux conditions de l'APD

Pays débiteurs	Créances APD	Créances NAPD	TOTAL
Afghanistan	1	1 250	1 251
Afrique du Sud	766	173	939
Albanie	495	23	517
Algérie	520	2	522
Angola	451	853	1 304
Antigua-et-Barbuda	3	118	121
Arabie Saoudite	-	2 925	2 925
Argentine	661	5 288	5 949
Arménie	452	16	467
Azerbaïdjan	758	34	791
Bangladesh	3 121	431	3 552
Barbade	2	-	2
Belize	-	-	-
Bénin	5	14	19
Biélorussie	26	6 359	6 385
Bolivie	105	2	106
Bosnie-Herzégovine	250	374	624
Botswana	19	-	19
Bulgarie	186	74	260
Burkina Faso	140	0	140
Burundi	-	-	-
Cambodge	915	1 399	2 314
Cameroun	537	24	562
Cap Vert	111	47	158
Chili	90	-	90
Chine	14 710	1 030	15 740

PARIS CLUB DEBT RESTRUCTURING TERMS

Restructuring Terms	**Eligibility**	**Rescheduling term (T/Grace)**	**Debt Reduction Terms** ODA	Non ODA	**Debt Conversion**
Houston 09/90	GDP per capita <$2995 and debt/GDP>50 %	ODA: 20/10 Non ODA: 15/2-3	Rescheduled at an interest rate at least as favourable as the original concessional interest rate applying to these loans	Repayment periods are lengthened	ODA: no limit Non ODA: up to 20% of the outstanding amount or 15-30 million SDR
Toronto 10/88	Poorest countries	ODA: 25/14 Non ODA: 14/8		33,33%	
London, 12/91	23 countries	ODA: 30/12 Non ODA: 23/6		50%	
Naples 12/94	Poorest countries	ODA: 25/14 Non ODA: 14/8		67%	
Lyon 11/96	Poorest countries	ODA: 40/16 Non ODA: 23/6		80%	
Cologne 11/99	41 HIPC	ODA: 40/16 Non ODA: 23/6		90%	

NIGERIA: 10/2005 PARIS CLUB DEBT RESTRUCTURING

- **Total stock of public sector debt= US$ 36.2 billion, o/w US$ 30 billion due to the Paris Club**

- Debt agreement follows the IMF's Policy Support Instrument (PSI) on 17 October 2005, including a debt reduction under Naples terms on eligible debts and a buy back at a market-related discount on the remaining eligible debts after reduction. Two conditonal phases:
- 1. Nigeria undertakes to pay arrears due on all categories of debts and Paris Club creditors grant a 33% cancellation of eligible debts;
- 2. After the first review of the PSI, planned for March 2006, Nigeria will pay amounts due under post-cut off date debt, and Paris Club creditors will grant a further tranche of cancellation of 34%, and Nigeria will buy back the remaining eligible debts.
- Total debt cancellation of **US$ 18 billion** (including moratorium interest) representing an overall cancellation of about 60% of Paris Club debt. Paris Club creditors will be paid an amount of US$ 12.4 billion, representing regularization of arrears.

UNDP AND UNCTAD

UNDP

- **HDI**
- **Social and development indicators**

UNCTAD

- **Trade, FDI and development indicators**
- **Role of MNCs in EMCs**

UNDP HUMAN DEVELOPMENT INDEX

1	Norway	171	Côte d'Ivoire
2	Australia	172	Djibouti
2	Switzerland	173	Gambia
4	Germany	174	Ethiopia
5	Denmark	175	Mali
5	Singapore	176	Congo (Dem R)
7	Netherlands	177	Liberia
8	Ireland	178	Guinea-Bissau
9	Iceland	179	Eritrea
10	Canada	179	Sierra Leone
10	United States	181	Mozambique
12	Hong Kong	181	South Sudan
13	New Zealand	183	Guinea
14	Sweden	184	Burundi
15	Liechtenstein	185	Burkina Faso
16	United Kingdom	186	Chad
17	Japan	187	Niger
18	Korea	188	Central Af Rep

Often rich countries with poor people!

CIA

- The World FactBook
- https://www.cia.gov/library/publications/the-world-factbook/wfbExt/region_eur.html

COUNTRY COMPARISON GDP (PURCHASING POWER PARITY)

GDP (purchasing power parity) compares the gross domestic product (GDP) or value of all final goods and services produced within a nation in a given year. A nation's GDP at purchasing power parity (PPP) exchange rates is the sum value of all goods and services produced in the country valued at prices prevailing in the United States.

DOWNLOAD DATA

RANK	COUNTRY	GDP (PURCHASING POWER PARITY)	DATE OF INFORMATION
1	CHINA	$21,140,000,000,000	2016 EST.
2	EUROPEAN UNION	$19,970,000,000,000	2016 EST.
3	UNITED STATES	$18,560,000,000,000	2016 EST.
4	INDIA	$8,721,000,000,000	2016 EST.
5	JAPAN	$4,932,000,000,000	2016 EST.
6	GERMANY	$3,979,000,000,000	2016 EST.
7	RUSSIA	$3,745,000,000,000	2016 EST.
8	BRAZIL	$3,081,000,000,000	2016 EST.
9	INDONESIA	$3,028,000,000,000	2016 EST.
10	UNITED KINGDOM	$2,788,000,000,000	2016 EST.

SPECIALIZED COUNTRY **RISK ANALYSIS** INSTITUTIONS

- IIF (Washington) The Institute for International Finance
- IIE (Washington), EIU (London), Brookings (D.C.)
- Bond rating agencies: Dun and Bradstreet, Moody's, S&P, FITCH IBCA, Dagong
- BERI (Business Environment Risk Index)
- Institutional Investor, Euromoney
- Frost & Sullivan
- INCRA (Bertelsmann Foundation)
- Transparency International
- Heritage Foundation, Davos-WEF, Cato Institute, IMD, AT Kearney, Global Finance-SKEMA
- ICRG, PRS
- Insurance companies: AON

RATING AGENCIES

- Bond rating: Moody's, Fitch, S&Ps
- DAGONG
- Risk rating: COFACE
- INCRA (non-profit credit-rating agency for sovereign risk)
- Country risk rating: BERI, Euromoney, Institutional Investor
- CountryRisk io

CountryRisk.io A COMMUNITY-BASED COUNTRY RISK RATING PLATFORM

Toward a transparent and independent country and sovereign risk rating models!?
The long-term Sovereign Risk Score measures a country's economic and financial strength, as well as its ability and willingness to honour its foreign debt obligations
The long-term Sovereign Risk Score is a quantitatively-derived index based on a large set of indicators, and assesses a country's economic and financial strength. Available on an annual frequency, with values ranging between 0 and 100.
Higher values indicate higher sovereign risk and weaker economic and financial fundamentals. >140 countries with five-year forecasts

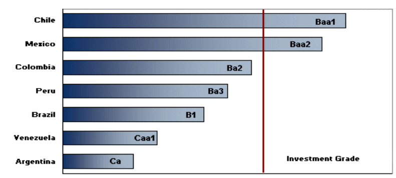
GOVERNMENTS ARE BYPASSED BY MARKET FORCES AND UNDER THE SCRUTINY OF IFIS AND RATING AGENCIES

Rating Distribution of Sovereign Issuers on Selected Dates

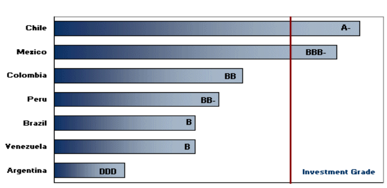
Rating	1983	1990	1995	2000	2005	2010	2011	2012
Aaa	79%	33%	16%	12%	19%	15%	14%	13%
Aa	21%	28%	25%	15%	7%	15%	11%	12%
A	0%	17%	18%	10%	22%	13%	14%	8%
Baa	0%	8%	18%	21%	14%	18%	21%	26%
Ba	0%	8%	16%	19%	15%	16%	15%	16%
B	0%	6%	5%	18%	17%	23%	23%	22%
Caa-C	0%	0%	0%	5%	5%	1%	2%	3%
Investment-grade	100%	86%	78%	59%	63%	61%	59%	59%
Speculative-grade	0%	14%	22%	41%	37%	39%	41%	41%

Moody's-Summer 2013

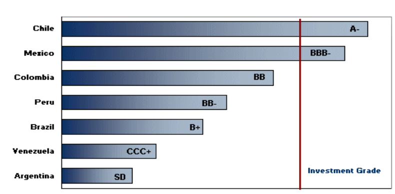
MOODY'S INVESTORS SERVICE LONG-TERM FOREIGN CURRENCY RATINGS



FITCH IBCA, DUFF AND PHELPS LONG-TERM FOREIGN CURRENCY RATINGS



STANDARD AND POOR'S LONG-TERM FOREIGN CURRENCY RATINGS



Information sources: Standard & Poor's: Sovereign risk indicators

Sovereign Risk Indicators: Economic Data

	LT FC rating	Nominal GDP (bil. LC) 2016e	Nominal GDP (bil. US$) 2016e	GDP per capita (US$) 2016e	Real GDP growth (%) 2016e	Real GDP per capita growth (%) 2016e	Real investment growth (%) 2016e	Investment /GDP (%) 2016e	Savings /GDP (%) 2016e	Exports/ GDP (%) 2016e	Unemployment rate (% of work force) 2016e
Abu Dhabi	AA	769	209	71,647	2.0	(2.9)	N/A	N/A	N/A	69.1	3.0
Albania	B+	1,523	12	4,216	3.2	3.4	8.0	27.9	15.6	26.5	17.1
Andorra	BBB-	3	3	36,564	1.0	0.8	N/A	N/A	N/A	N/A	3.7
Angola	B	14,367	95	3,718	1.3	(1.2)	0.4	28.4	16.0	36.9	35.0
Argentina	B-	8,069	547	12,550	(1.8)	(2.8)	(0.3)	17.4	14.6	14.1	8.9
Aruba	BBB+	5	3	24,324	0.4	(0.7)	1.1	22.3	22.6	71.0	7.5
Australia	AAA	1,655	1,205	49,934	2.7	1.3	(3.6)	25.7	21.2	18.8	5.9
Austria	AA+	350	389	45,125	1.4	0.9	2.0	23.4	25.4	53.2	6.2
Azerbaijan	BB+	59	35	3,603	(3.5)	(4.6)	4.5	35.8	33.0	39.1	5.5
Bahamas	BBB-	9	9	22,754	0.3	(1.1)	(7.1)	26.2	10.5	38.6	14.0
Bahrain	BB-	12	31	22,039	2.0	(1.5)	3.0	25.1	19.2	72.9	3.4
Bangladesh	BB-	17,296	220	1,355	7.1	6.3	8.0	29.4	31.1	16.3	3.5
Barbados	B-	9	4	15,791	1.0	0.7	2.1	12.8	5.9	36.8	11.5
Belarus	B-	930,842	45	4,772	(2.7)	(2.7)	(2.3)	32.4	28.6	53.8	1.0
Belgium	AA	420	467	41,416	1.3	0.7	3.5	23.9	25.6	85.3	8.1
Belize	CC	3	2	4,562	(1.6)	(4.1)	(1.6)	20.9	10.5	60.1	11.7
Bermuda	A+	6	6	99,669	2.0	2.1	(13.8)	11.0	23.7	48.3	8.0
Bolivia	BB	248	36	3,296	4.1	2.5	4.1	19.2	13.8	30.9	4.0

THE INSTITUTE OF INTERNATIONAL FINANCE (IIF)

IIF INSTITUTE OF INTERNATIONAL FINANCE

The Institute of International Finance is the global association of the financial industry, with close to 500 members from 70 countries. Its mission is to support the financial industry in the prudent management of risks; to develop sound industry practices; and to advocate for regulatory, financial and economic policies that are in the broad interests of its members and foster global financial stability and sustainable economic growth. IIF members include commercial and investment banks, asset managers, insurance companies, sovereign wealth funds, hedge funds, central banks and development banks.

IIF'S ANALYSIS OF CAPITAL FLOWS

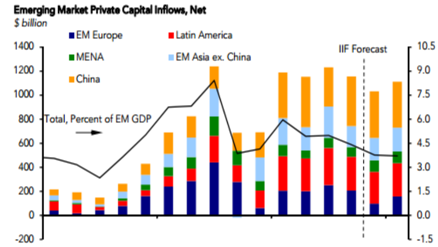
Emerging Market Economies: Capital Flows
$ billion

	2012	2013	2014	2015
Capital Inflows				
Total Inflows, Net:	*1269*	*1188*	*1079*	*1164*
Private Inflows, Net	1232	1156	1032	1112
Equity Investment, Net	668	626	657	675
Direct Investment, Net	545	548	540	560
Portfolio Investment, Net	124	78	117	114
Private Creditors, Net	564	530	375	437
Commercial Banks, Net	118	193	124	151
Nonbanks, Net	446	338	251	287
Official Inflows, Net	37	32	47	53
International Financial Institutions	5	-3	19	27
Bilateral Creditors	31	35	28	25
Capital Outflows				
Total Outflows, Net	*-1299*	*-1360*	*-1348*	*-1339*
Private Outflows, Net	-946	-825	-981	-950
Equity Investment Abroad, Net	-332	-403	-368	-381
Resident Lending/Other, Net	-614	-422	-613	-570
Reserves (- = Increase)	-352	-534	-367	-388
Memo:				
Net Errors and Omissions	*-246*	*-65*	*0*	*0*
Current Account Balance	*276*	*236*	*269*	*174*

Source: IIF

IIF MACRO RESEARCH ON CAPITAL FLOWS

Emerging Market Private Capital Inflows, Net
$ billion



Source: IIF.

COFACE
(COMPAGNIE FRANÇAISE D'ASSURANCE POUR LE COMMERCE EXTÉRIEUR)

- The Coface Group facilitates and secures trade throughout the world. The Group offers a range of solutions spanning rating, protection and services, including country risk data and analysis.
- Country risk analysis is expressed in a rating/ranking format but based on a qualitative analysis aimed at integrating the socio-political and economic specificities of each country.

COFACE

- Coface takes into account several types of country risk around six different analytical modules:

1. political risk;
2. liquidity and non-transfer risk;
3. sovereign risk;
4. market crisis risk;
5. systemic banking crisis;
6. macroeconomic growth risk

- *www.coface.org*

COFACE 2020 GLOBAL RISK MAP

TUNISIE

POPULATION: 11,7 MILLIONS
PIB PAR HABITANT: 3 422 $US

C — EVALUATION DES RISQUES PAYS
B — ENVIRONNEMENT DES AFFAIRES
CHANGER DE PAYS
COMPARER LES PAYS

SYNTHÈSE

Localiser le pays
Imprimer

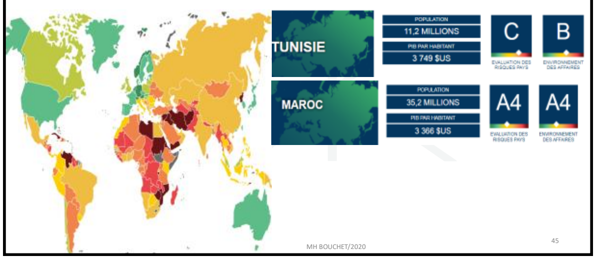
PRINCIPAUX INDICATEURS ÉCONOMIQUES

	2017	2018	2019 (e)	2020 (p)
Croissance PIB (%)	1,8	2,5	1,4	1,9
Inflation (moyenne annuelle, %)	5,3	7,3	6,8	6,1
Solde public / PIB (%)	-6,2	-4,8	-4,4	-3,8
Solde courant / PIB (%)	-10,2	-11,1	-8,7	-8,5
Dette publique / PIB (%)	70,4	77,0	75,7	78,7

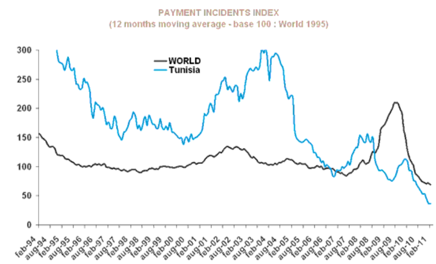
(e) : Estimation. (p) : Prévision.

coface FOR TRADE

CROSS-COUNTRY RISK COMPARISON



TUNISIA 1994-2011 PAYMENT ARREARS INDEX (COFACE)



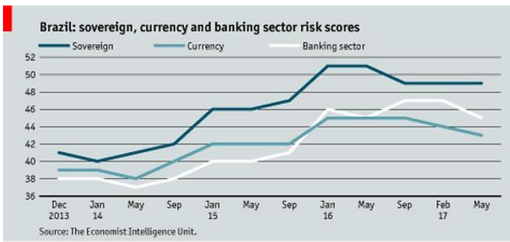
EFIC-AUSTRALIA

- http://www.efic.gov.au/COUNTRY/COUNTRYPROFILES/Pages/countryprofiles.aspx

EIU 5 RISK ANALYSIS SERVICES

- **Country analysis**–Political and economic analysis, business environment analysis, cross-country benchmarking and market-trends tracking.
- **Risk assessment**–Sovereign debt risk assessment and operational risk analysis on 190 countries
- **Market entry and sizing**–Market entry strategies, market sizing, market potential and pricing data.
- **Strategic industry analysis**–Industry benchmarking, strategic trend analysis and global commodities analysis.
- **Economic modelling and forecasting**–Data customisation, demand forecasts and econometric analysis of industry drivers.

EIU ▶London-based Economic Intelligence Unit



EIU
London-based Economic Intelligence Unit

July 31st 2017 Print Share

Overview

Brazil: risk assessment

	Sovereign risk	Currency risk	Banking sector risk	Political risk	Economic structure risk	Country risk
May 2017	BB	BB	BB	BB	BB	BB

Robert Wood (lead analyst); Fiona Mackie (analyst). Published 05 May 2017, 2100 GMT.

These ratings are restated from the Ratings Report indicated above, which was produced outside the European Union, and therefore are not issued by The Economist Intelligence Unit credit rating agency, which is registered in accordance with Regulation (EC) No 1060/2009 of 16 September 2009, on credit rating agencies, as amended. This report and the ratings, therefore, are not issued pursuant to such Regulation and do not fall within its scope.

Download the numbers in Excel

Sovereign risk

The president, Michel Temer, is resisting pressure to resign following corruption allegations made against him in May. Even if he does survive (we now assume that he will), governability will weaken, reducing the likelihood that pension reforms will be approved in Congress. This will set back medium-term fiscal consolidation plans and rekindle lingering concerns about debt sustainability.

Currency risk

The latest political crisis caused a sell-off in the Real, but it has since regained ground (to R3.15:US$1 in late July). Narrowing interest-rate differentials will weaken the Brazilian currency as the Banco Central do Brasil (the central bank) continues to ease monetary policy while US policy rates rise. Brazil has a large reserves cushion.

Business Environment Risk Intelligence BERI provides a Political Risk Index assessing the social and political environment of a country. It is built on the opinion and scores provided by a hundred experts with a diplomatic or political science background. Governance quality is included into political risk analysis along with government effectiveness and social indicators. http://beri.com	**Political Risk Services**[1] The PRS analyses cover a hundred countries and are updated on a quarterly basis. **International Country Risk Guide** measures and tracks corruption perception in government, law and order, expropriation risk, as well as the quality of bureaucracy. These measures stem from the subjective assessment of experts around the world. http://prsgroup.com	Thanks to its unique policy dialogue with more than 180 countries, the **World Bank** has developed a comprehensive database of composite governance indicators, measuring perceptions of voice and accountability, political stability, government effectiveness, regulatory quality, rule of law, and corruption. www.worldbank.org/wbi/governance/
The London-based **Economist Intelligence Unit** (EIU) provides a comprehensive é-year forecasting country risk analysis on some 100 EMCs., on a quarterly basis. The EIU method flows from expert's answers to a series of 77 predetermined qualitative and quantitative questions. http://eiu.com	To look upon governance and corruption, Moody's takes into consideration the structures of social interaction, social and political dynamics, as well as the economic fundamentals. Moody's relies on the judgment of a group of credit risk professionals to weigh the various risk factors as well as the impact of each of these factors upon business prospects. http://moodys.com	**Standard and Poor's** rating approach is both quantitative and qualitative. It is based on a checklist of 10 categories, including governance and political risk. The political risk factors gauge the impact of politics on economic conditions, as well as the quality of governance and the degree of government support in the population. S&P assigns short term and long-term ratings. http://standardandpoors.com
Euromoney publishes ratings of some 180 countries since 1982 on a semi-annual basis. The methodology is built from a blend of quantitative criteria and qualitative factors coming from surveys with about 40 political analysts and economists. Political risk receives a 25% weighting, as much as economic performance. Countries are graded on scale from 0 (worst) to 100 (best). www.euromoney.com	**Institutional Investor**'s ratings are published twice a year since 1979 to assess the creditworthiness of about 150 countries, based on a survey of some 100 international bankers' perception of creditworthiness, including economic, financial and socio-political stability criteria. The resulting score scales from zero (very high chance of default) to 100 (least chance of default). www.institutionalinvestor.com	**Transparency International**, a non-profit non-governmental organization in Berlin, provides an annual survey of corruption practices in nearly 90 countries since 1995. The Corruption Perception Index is based on a wide network of information sources with local NGOs, domestic and foreign corporations, investors, and business contacts. www.transparency.org

Heritage Foundation established since 1985, in partnership with the WSJ, an economic freedom index for some 160 countries, both industrialized and developing. The ranking is based on various socio-political and economic criteria, including political stability, state interference, regulatory framework, institutional strength, and corruption scope. www.heritage.org	PricewaterhouseCoopers's **Opacity Index** measures the lack of clear, accurate, formal and widely accepted practices in a country's business environment. As such, it focuses on the relative state of corrupt business practices, the transparence of the legal system and the regulatory framework. It represents a quantitative approach to measuring opacity and its resulting extra risk premium that stems from the additional business and economic costs. www.opacityindex.com/	The Institute for Management Development's **World Competitiveness Report** analyses 49 industrialized and emerging economies around the world based on a far-reaching survey since 1989. Its analysis of the institutional framework addresses issues such as state efficiency, transparency of government policy, public service's independence from political interference, bureaucracy as well as bribery and corruption. www.imd.ch
Freedom House focuses since 1972 on corruption levels in a number of developing and transition economies around the world. FH publishes an annual assessment of state of freedom in various countries on the base of political rights and civil liberties. Political stability and civil liberties are ranked on a scale of 1 (best) to 7 (worst). www.freedomhouse.org/ratings.index.html	**The Political and Economic Stability** Index of Lehman Brothers and Eurasia measures relative stability in around 20 EMCs by integrating political science theories with financial markets developments. The monthly evaluation uses both quantitative and qualitative criteria, including institutional efficiency, political legitimacy, economic performance, and government effectiveness. www.legsi.com	**Political and Economic Risk Consultancy** (PERC) specializes in strategic business information and analysis in East and Southeast Asia, with emphasis on corruption and business costs. Annual risk reports survey over 1,000 senior expatriates living in to obtain their perceptions of corruption, labor quality, intellectual property rights risks and other systemic shortcomings. www.asiarisk.com

Centre international
de formation européenne

NICE BERLIN BRUXELLES ISTANBUL

A GLANCE AT ACADEMIC APPROACHES TO RISK: FROM KEYNES TO STIGLITZ

CIFE SEMINAR NICE MAY 6-8, 2020

MICHEL-HENRY BOUCHET

1

H Bouchet SKEMA-CIFE 20

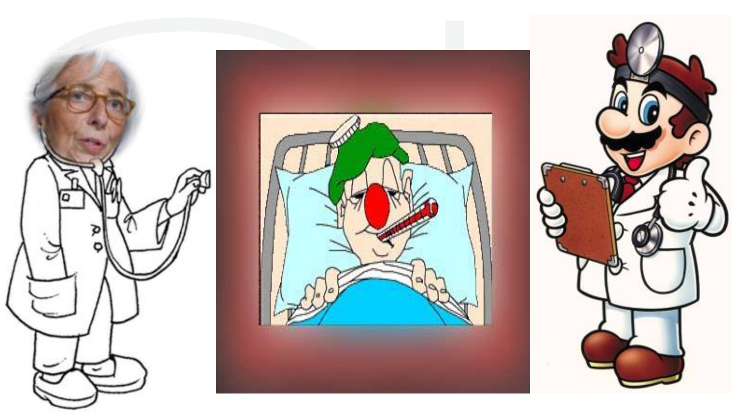
2

GLOBAL RISKS = A POLARIZED DEBATE

	Positive sum game > 0 "win-win"	Distorted growth process Zero-sum game
Neo-classical economists	Adam Smith, David Ricardo, Benjamin Constant, Frédéric Bastiat, Fridriech Hayek	Karl Marx, F. Engels, Lénine, Rosa Luxembourg
Contemporary economists	Kenneth Arrow, Milton Friedman, Walter Rostow, Robert Lucas, Jagdish Bhagwati, Anne Krueger, Stanley Fisher, Rüdiger Dornbusch, Alan Greenspan, Kenneth Rogoff	Paul Prebish, Hans Singer, Paul Baran, Paul Sweezie, Arghiri Emmanuel, Harry Magdoff, Immanuel Wallerstein, Samir Amin, Gunther Franck P. Krugman, J. Sachs, J. Stiglitz, Michel Aglietta, Thomas Piketty, MH. Bouchet, James Galbraith
Social scientists	Martin Wolf, Francis Fukuyama, Kenichi Ohmae, Peter Drucker Ayn Rand (writer)	Pierre Bourdieu, Alain Joxe, Dominique Wolton, Joel Bakan, Susan Strange, M. Foucault, Bernard Stiegler
Academic institutions, thinktanks & NGOs	Heritage Foundation, Cato Institute Freedom House, The Economist, FT	ATTAC, Oxfam, Alternatives Economiques
IFIs	IMF, OECD, IIF, BIS, WTO	UNCTAD, ECLA, UNDP

GLOBAL CRISIS = **CONFLICTING DIAGNOSIS** = **CONFLICTING CRISIS MANAGEMENT STRATEGY** = DIFFERENT POLICY TOOL-KIT !

Too much regulation? Weak liberalization? Central bank independency? Capital controls?



The « founding fathers » of the analysis of risk and uncertainty

- **Frank Knight**: 1921 « Risk, Uncertainty and Profit »: **Risk** stems from **outcomes that are unknown** but can be tackled with probability distribution….
- **Uncertainty** stems from a deficit of information, hence randomness of results

- **J M. Keynes:** Treatise on Probability 1921: role of animal spirits in volatility spill-over and herd behavior.
- Non-linear nature of risks and danger of expecting the future as simple projection of the past

A glance at modern approaches to risk and uncertainty

1. P. Krugman
2. J. Stiglitz
3. Hyman Minski
4. N. Taleb
5. B. Mandelbrot
6. Didier Sornette
7. T. Piketty

The « Modern » are often Neo-Keynesians

- For short hand: « Don't buy the assumptions of Chicago Economics regarding market rationality and self-regulation: ***markets don't get things wrong, but governments do***! »

1. We don't know much about the future and we cannot thus predict and price risk accurately (hence markets crash)
2. Risk of falling back on conventions: the future replicates the past and probabilities are distributed along a bell-shaped curve without « fat tails »
3. No self-correction of markets, hence risk of protracted depression
4. Governments must inject extra spending to provide stimulus and shorten level and duration of crisis (multiplier)
5. Markets need regulation to correct unequal income and wealth distribution and to promote sustainable full employment
6. Financial intermediation must be regulated to provide long-term financing to the real economy

Financial Globalization and Country Risk
TWO SCHOOLS OF THOUGHT


- 1- **Stiglitz, Sachs, Eichengreen, Krugman, Rodrik…**

Financial and capital account liberalization = capital flow volatility + financial crises = capital controls + Tobin taxes + pressure to promote **finance sustainability (**Environmental + social concerns-IFC)

- 2. **Quinn, Edwards, Edison, Greenspan, Fischer, Summers…**

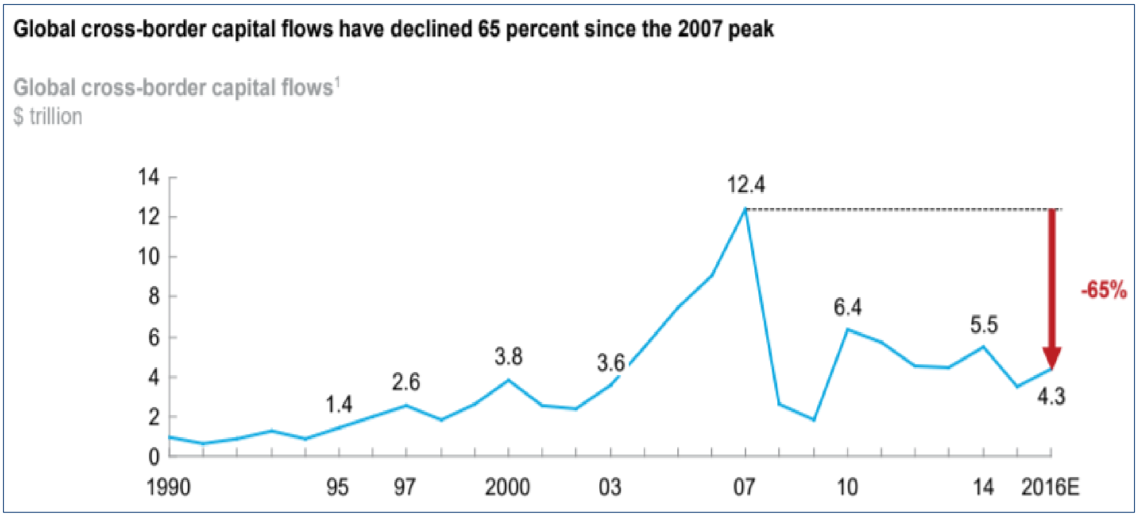
Fruitful openness to global capital flows = higher capital efficiency

Better balance S=I

North-South + technology spillover + financial market liberalization + FDI = △ GDP

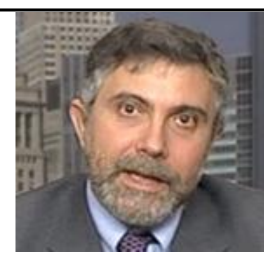
Prasad-Rogoff IMF-Harvard 2006 and IMF: https://www.imf.org/external/pubs/ft/wp/2002/wp02120.pdf

THE VOLATILITY OF GLOBAL CAPITAL FLOWS HAS DEEP CONSEQUENCES ON COUNTRIES' BALANCE OF PAYMENTS AND GROWTH PROSPECTS



Source: McKinsey August 2017 Financial Globalization Report

PAUL KRUGMAN: THE "DARK SIDE" OF GLOBALIZATION



- In the 1980s, openness to trade was widely believed to reduce the likelihood of economic and financial crises.
- Today, growing global integration does predispose the world economy toward more crises because it creates pressures on governments to relax restrictions: **de-regulation + privatization**!
- Economies are doing better in good times but are far more vulnerable to sudden crises due to volatile capital flight. The ride will continue to be very bumpy for many years to come!
- http://www.nytimes.com/2007/05/14/opinion/14krugman.html?_r=1&ref=paulkrugman

PAUL KRUGMAN: THE “WAY FORWARD”? Against Trump!

- **Myth**: Globalization and modern technology displace low-qualified jobs to EMCs, while well-educated workers are clear winners (true in the 1980s !)
- **Facts**: Both high-wage and low-wage employment have grown rapidly, but medium-wage jobs of the middle class have lagged behind. The combination of NTIC and growing international trade in services will further “hollow out” the OECD job market: white collars and college graduates are NOT sheltered!
- **Facts**: EMCs’ low-wage competition is driving down U.S. wages: When the US imports labor-intensive manufactured goods from the third world, the result is reduced demand for less-educated American workers, hence lower wages for these workers. And cheap consumer goods does not compensate for lost jobs!
- The key is not protectionism but labor standards and higher wages in EMCs.

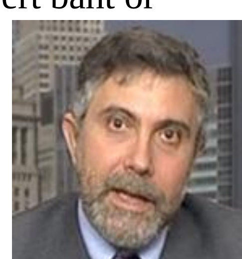
Global growth is possible only if rising economies can expand into new markets.

Krugman’s view on Asia’s 1997-98 economic crisis

- IMF’s shortsighted approach to the crisis:
- The logic of catastrophe was pretty much the same in Thailand, Malaysia, Indonesia and South Korea. In each case investors--mainly, but not entirely, foreign banks who had made short-term loans--all tried to pull their money out at the same time.

The result was a combined crisis:

1. a <u>banking crisis</u> because no bank can convert all its assets into cash on short notice;
2. a <u>currency crisis</u> because panicked investors were trying to convert baht or rupiah into dollars.
3. a <u>governance crisis</u>
4. <u>A growth crisis!</u>



Krugman: CHALLENGING THE IMF’S APPROACH TO CRISIS MANAGEMENT IN ASIA IN 1998

▶ There vas no « fundamental » reason for Asia’s financial calamity

- Budgets were in balance or surplus
- Low inflation
- High private savings rates
- Economies were poised for export growth

- The IMF’s tough macro-economic conditionality for approving financial support led to recessionary monetary policy, capital flight, domino effect and increased panic

Paul Krugman’s view on Asia’s crisis and the role of governance

“Was the crisis a punishment for bad economic management?”

Like most *clichés*, the catchphrase "**crony capitalism**" underlies something real: excessively cozy relationships between government and business lead to bad investments, speculation, corruption, low investment efficiency

The still primitive financial structure of Asian business--too little equity, too much debt and too much of that debt consisting of soft loans from accommodating banks--also made the economies peculiarly vulnerable to a loss of confidence:

Governance is key to promote inclusive growth and sustainable development

MEA CULPA AT THE IMF IN 2016: IS THE **NEOLIBERAL AGENDA** OVERSOLD?

►Neoliberal agenda's 4 key features:

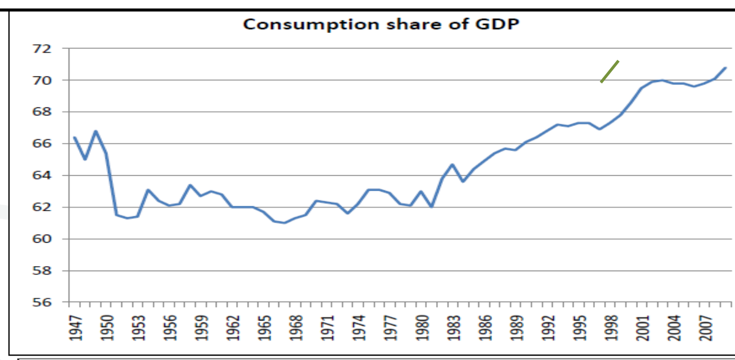
1. Increased competition (opening up of domestic markets)
2. Deregulation (interest and exchange rates)
3. Capital account liberalization
4. Smaller role for the state (privatization and fiscal austerity)

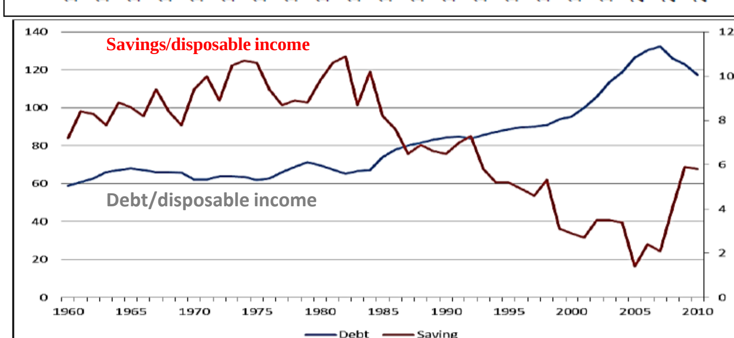
Do austerity, liberalization and competition pay off?

1. Trade off between growth and inequality
2. Wealth gap lowers growth (hurts domestic demand and increases unemployment)
3. Volatility, stop & go, and crisis frequency
4. Decreasing debt does not boost growth!

Source: IM Finance & Development, June 2016

GLOBAL FINANCIAL CRISIS ROOTED IN RISING HOUSEHOLD DEBT TO OFFSET RISING INCOME INEQUALITY!

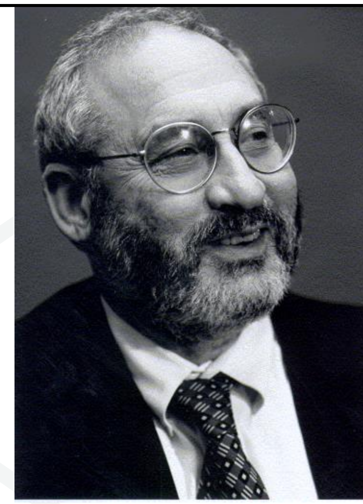




Stiglitz, Rajan, Krugman 2011-12

NIPA, Flow of Funds; authors' calculations

JOSEPH STIGLITZ' view of Global Risk



WHAT IS ASYMMETRY OF INFORMATION?

- It is the difference in information between two economic agents within an economic relation (e.g.: « the worker and his employer, the lender and the borrower, the insurance company and the insured »)
- According to Stiglitz, financial markets cannot regulate themselves because anyone do not have the same information at the same moment. Therefore the aim is to find the best structure to regulate markets (and not to let them work by themselves).
- Deregulation will **not** promote financial development when information is asymmetric and competition inadequate. The economic efficiency is not secured.

It will spur corruption and create an oligarchic elite that opposes the emergence of competitive markets.

ASYMMETRY OF INFORMATION'S CONSEQUENCES

- Mismatch between national regulation/globalized markets lead to weak multilateral governance in finance
- Weak governance = short-sighted behaviour, self interest, speculation and greed
- Wrong incentive structure for excess risk taking and leverage (credit bubbles)
- The partisans of the « Washington consensus » overlook the importance of economic and corporate governance, underestimate the difficulty of building institutions, and forget that many countries lack the sophisticated public administrations needed to ensure adequate competition.

STIGLITZ'S CORE IDEAS

- Global crisis challenges not only the capitalist financial and economic system but also the intellectual edifice of Economics thinking (and teaching!)
- No perfect information nor perfect competition: Markets are not efficient, economic agents are not rational, there is no self-regulation. The « invisible hand » is simply not there!
- Poverty is an « affront to human dignity ». Globalization does not work well as a wealth distribution engine
- G7 governments urge liberalization on developing countries while maintaining trade restrictions and pushing intellectual property protection into the WTO.
- The IMF's policies, in part based on the outworn presumption that **markets**, by themselves, lead to efficient outcomes, failed to allow for desirable government interventions in the market which can make everyone better off

JOSEPH E. STIGLITZ ON THE IMF…

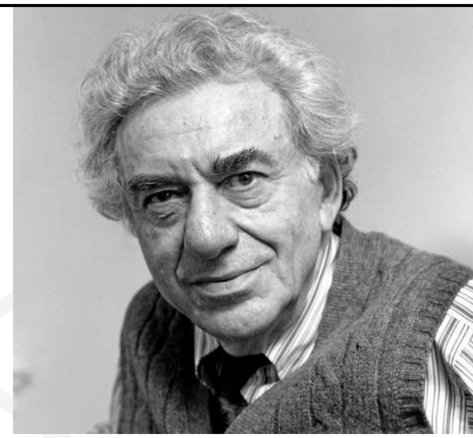
- When crises hit, the IMF prescribes outmoded, inappropriate, if standard solutions, without considering the effects they would have on the **people** in the countries told to follow these policies.
- No discussions of the consequences of alternative policies. Ideology guides policy prescription. IMF structural adjustment policies worsen **poverty**.
- There is no Wall Street or IMF conspiracy. There is ideology at work and antidemocratic policy-making.

THE CORONAVIRUS OUTBREAK IS A 'DIFFERENT KIND OF CRISIS" STIGLITZ MARCH 2020

- This is a different kind of crisis than normal crises. It's just not a problem of aggregate demand.
- The spread of the coronavirus disease, formally known as COVID-19, has disrupted the global economy and supply chains as countries implement strict border controls, massive city-wide lockdowns and quarantines in order to contain the virus.
- Aggressive policy action by the Federal Reserve is "obviously not" enough to help the U.S. avert a downturn caused by the coronavirus outbreak.
- Given the nature of the uncertainties, given the nature of the collapsing incomes of so many people, it can help stabilize financial markets at best and it's clear that it didn't do that!
- Stiglitz advocated for targeted assistance to help people and sectors weather the public health emergency: "It is clearly a case where targeted fiscal policy is what is needed. It's been true for a long while that monetary policies has had only have limited efficacy."

HYMAN MINSKY

(1919-1996)



MINSKY AND THE *RECURRING* FRAGILITY OF FINANCIAL STRUCTURES

- Economic stability brings about speculation, which creates a rift between asset prices and output prices. That breeds economic volatility, credit contraction and the need for central bank intervention.
- **Crisis cycles**: economic stability itself encourages excessive credit creation, leading to financial instability and speculative euphoria, then credit restraint and contraction and, finally, economic contraction and volatility!

https://www.ucm.es/data/cont/media/www/pag-41460/Minsky%20theory%20of%20financial%20crisis.pdf

MINSKY : WEALTH EFFECT AND DEBT CRISIS in 2020?

► Prolonged economic stability encourages deregulation + financial innovation + debt accumulation = higher leverage, leading to liquidity and solvency crisis

Over-indebtedness + Corona crisis= Debt crisis!

MINSKY'S THREE STAGES OF A FINANCIAL CRISIS

1. **Hedge finance** = debt is typically a small proportion of liabilities and readily renewable because of the adequacy of cash flows in relation to contractual payments.
2. **Speculative finance** = future cash flows < payment commitments, but the present value of expected cash receipts is greater than that of payment commitments. Need to keep issuing new debt to finance maturing debt commitments.
3. **Ponzi finance** = Ongoing need to raise ever greater amounts of debt to finance all commitments and to repay principal or even debt service. Asset values will collapse with serious deflationary consequences and damaging implications for the economy.

BENOIT MANDELBROT
(1924-2010)

Markets are not rational nor self-regulating!

- World of winner take-all : extreme wealth concentration.
- The economic world is driven primarily by random jumps. Yet the common tools of finance were designed for random walks in which the market always moves in small steps.
- Despite increasing empirical evidence that concentration and volatility better characterize market reality, the reliance on the bell-shaped curve still prevails
- The global market economy has become an echo chamber leading to contamination and spill-over effect: volatility breeds volatility
- 1970s-80s: Fractal geometry: a new analytical tool for predicting and managing crisis

Mandelbrot & Hudson: (Mis)Behavior of Markets
https://www.forbes.com/2009/09/28/mandelbrot-madoff-math-intelligent-investing-cycles.html

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THOMAS PIKETTY:
INCOME INEQUALITY AND WEALTH DISTRIBUTION IN XXI° CENTURY CAPITALISM

- Marx: capital accumulation leads to wealth concentration
- Kuznets: growth, competition, and technological progress lead to reduced inequality and greater social harmony
- Piketty: rate of return on capital **(r)** > overall growth rate of output **(g),** hence rising ratio of capital/income, reflecting the rising size of countries' total weath stock relative to the income generated (K= 5x Y)

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CONCLUSION: COUNTRY RISK IN 2020-25?

- Country Risk has had a spectacular increase since the emergence of the globalized market economy in the 1980s. This is due to crisis contamination and volatility contagion.
- Globalization makes considerably more complex country risk analysis given the interplay between a country's economic and socio-political system and the regional and global environment.
- Abrupt increases in financial and geopolitical volatility can destabilize countries and lead to spill-over effects!
- A global virus makes difference between developed countries and emerging market countries?!

Centre international de formation européenne

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

CIFE SEMINAR NICE MAY 6-8, 2020

MICHEL-HENRY BOUCHET

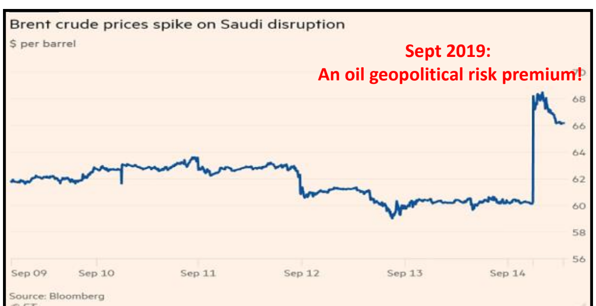
«YESTERDAY'S» COUNTRY RISK

▶ Traditional definition of cross-border risk:

Assessment of a foreign entity's ability <u>and</u> willingness to meet its external obligations in full and on time

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

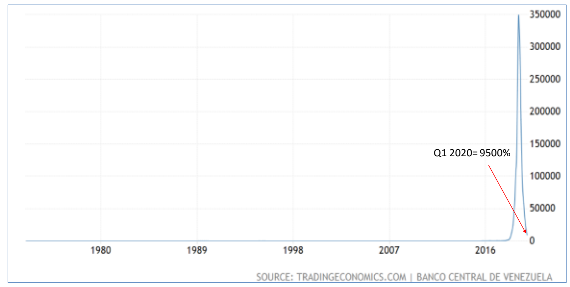
Country risk is composed of a complex combination of **political, financial and macro-economic risk**



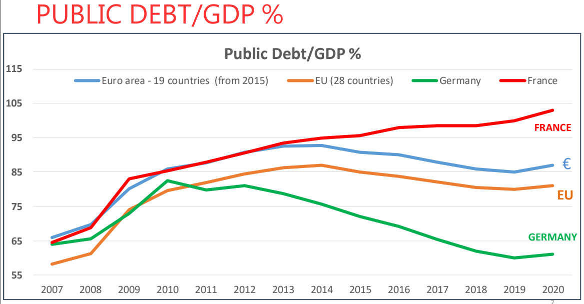
Sept 2019: An oil geopolitical risk premium!

Q1 2020 : THE ABRUPT EXTERNAL SHOCK OF THE CORONA VIRUS WIPES OUT 50% OF BANKS' CAPITAL

CHAVES + MADURO = HYPERINFLATION!



PUBLIC DEBT/GDP %



« 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**

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 goverment 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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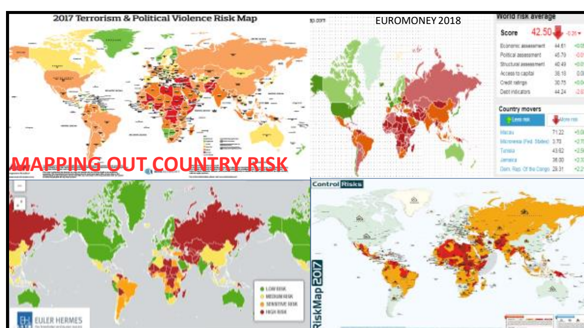
Michel H. Bouchet/ 2020



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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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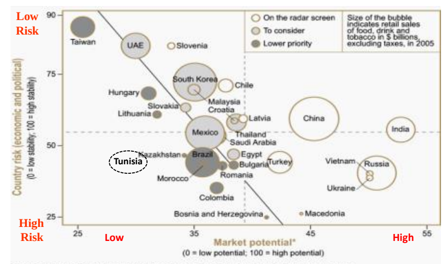
MOST ATTRACTIVE EMERGING MARKETS?

= COMBINING RISK EXPOSURE + MARKET OPPORTUNITIES



* Based on weighted score of market attractiveness, market saturation and time pressure scores
Source: A.T. Kearney

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AT KEARNEY FDI CONFIDENCE INDEX

GOVERNANCE MATTERS!

Ranking 2017	2018	2019		Score
1	1	1	United States	2.10
2	3	2	Germany	1.90
5	2	3	Canada	1.87
4	4	4	United Kingdom	1.85
7	7	5	France	1.79
6	6	6	Japan	1.78
3	5	7	China	1.72
13	10	8	Italy	1.67
9	8	9	Australia	1.67
10	12	10	Singapore	1.65
11	15	11	Spain	1.62
14	13	12	Netherlands	1.61
12	9	13	Switzerland	1.59
–	20	14	Denmark	1.58
15	14	15	Sweden	1.55
8	11	16	India	1.54
18	18	17	South Korea	1.54
22	21	18	Belgium	1.54
23	16	19	New Zealand	1.52
20	19	20	Ireland	1.52
24	24	21	Austria	1.50
–	–	22	Taiwan (China)	1.50
–	–	23	Finland	1.50
–	23	24	Norway	1.49
17	17	25	Mexico	1.49

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INTERPLAY OF **COUNTRY RISK** WITH THE **GLOBAL MARKET ECONOMY**

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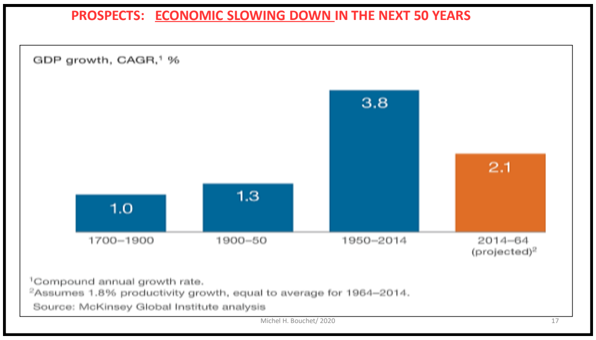
PROSPECTS: ECONOMIC SLOWING DOWN IN THE NEXT 50 YEARS
GDP growth, CAGR,[1] %
1.0
1.3
3.8
2.1
1700–1900
1900–50
1950–2014
2014–64 (projected)[2]
[1]Compound annual growth rate.
[2]Assumes 1.8% productivity growth, equal to average for 1964–2014.
Source: McKinsey Global Institute analysis
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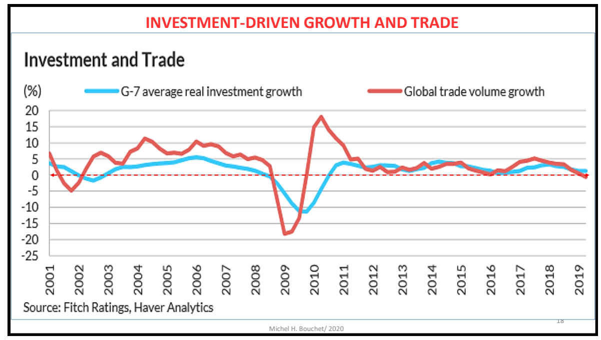
INVESTMENT-DRIVEN GROWTH AND TRADE
Investment and Trade
(%)
G-7 average real investment growth
Global trade volume growth
20
15
10
5
0
-5
-10
-15
-20
-25
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
Source: Fitch Ratings, Haver Analytics
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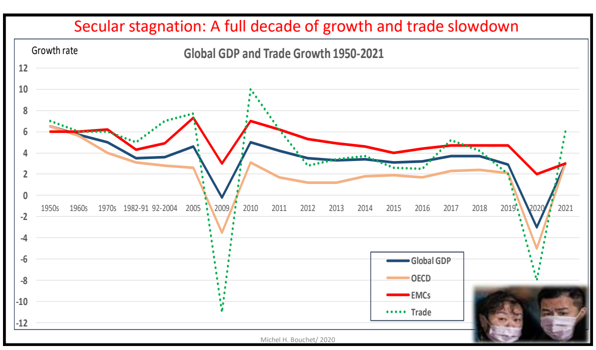
Secular stagnation: A full decade of growth and trade slowdown
Growth rate
Global GDP and Trade Growth 1950-2021
12
10
8
6
4
2
0
-2
-4
-6
-8
-10
-12
1950s
1960s
1970s
1982-91
92-2004
2005
2009
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
Global GDP
OECD
EMCs
Trade
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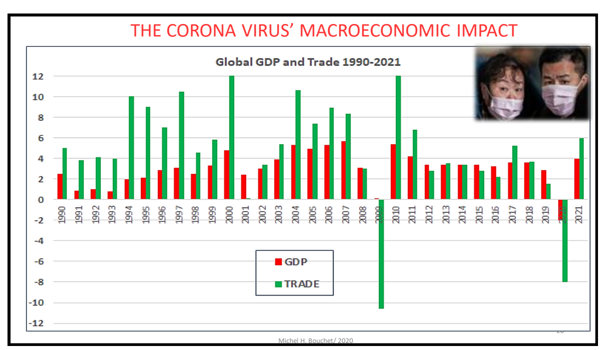
THE CORONA VIRUS' MACROECONOMIC IMPACT
Global GDP and Trade 1990-2021
12
10
8
6
4
2
0
-2
-4
-6
-8
-10
-12
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
GDP
TRADE
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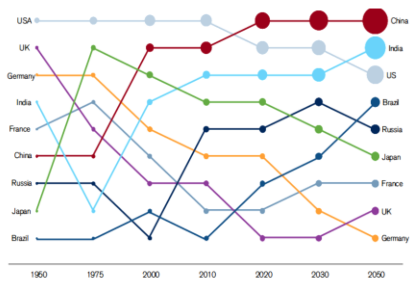
THE TOP GLOBAL GDP 1950-2050

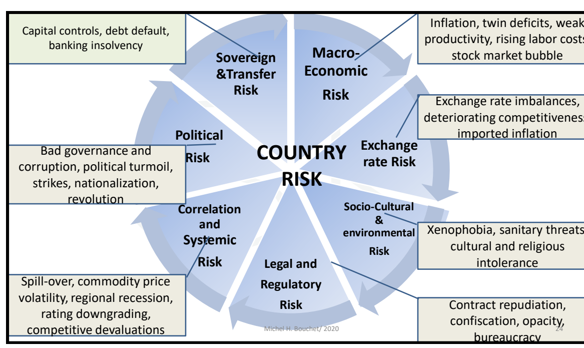


World Bank, PWCs, Credit Suisse

WHAT ABOUT THE KEY COMPONENTS OF COUNTRY RISK?

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



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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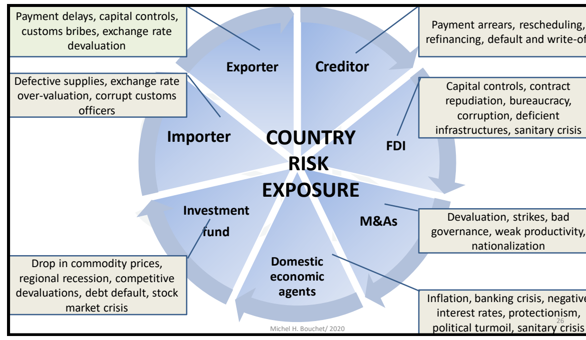
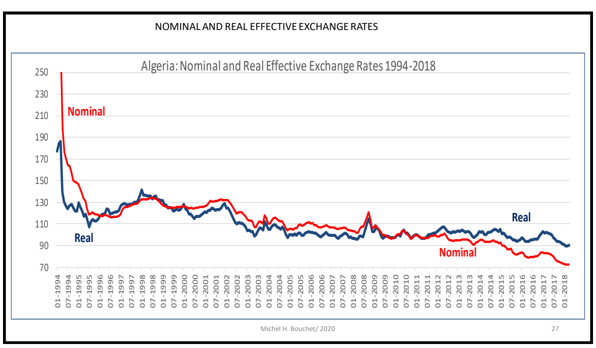
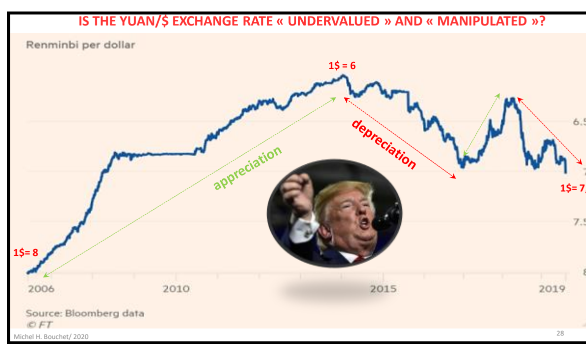
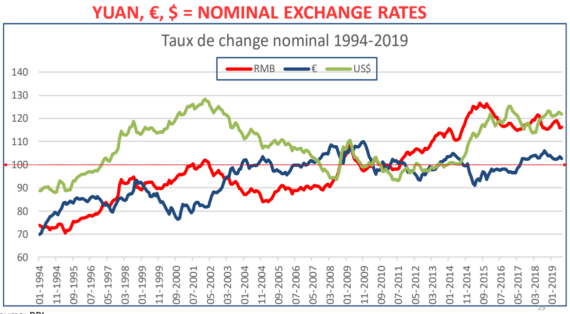




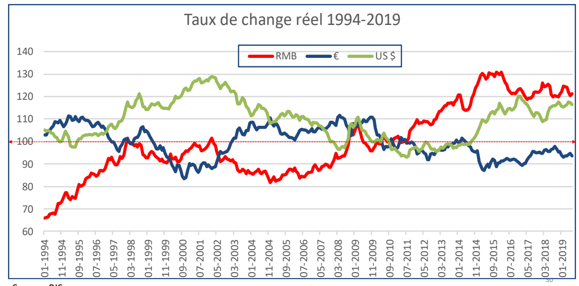


YUAN, €, $ = NOMINAL EXCHANGE RATES



Source: BRI

YUAN, €, $ = REAL EFFECTIVE EXCHANGE RATES

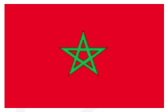


Source: BIS

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**

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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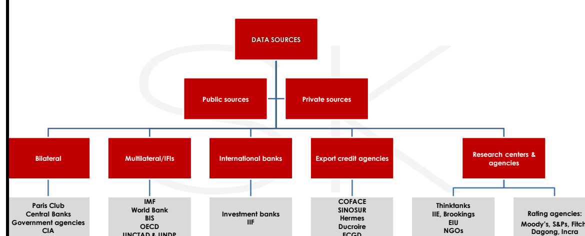
COUNTRY RISK ASSESSMENT

Reliable and updated information

= Economic intelligence

➔**Robust risk analysis**

MAJOR SOURCES OF COUNTRY RISK INTELLIGENCE



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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

Centre international
de formation européenne

NICE BERLIN BRUXELLES ISTANBUL

GLOBAL RISK, GOVERNANCE AND THE MOUNTING WEALTH GAP

CIFE SEMINAR NICE MAY 6-8, 2020

MICHEL-HENRY BOUCHET

FACTS: THE JURY IS STILL OUT

- 2016 research report: World Bank re-definition of extreme poverty: moving from \$1,20 to **\$1,90/day**
- **10% of world population** still < poverty line (767 million down from 881 million in 2012), mainly in South Asia and Sub-saharan Africa
- Small number of countries experiencing declining inequality since 2008 (UK, Germany, US, Brazil, China)

MYTH = GLOBALIZATION GENERATES GROWING ECONOMIC WEALTH AND WELL-BEING FOR ALL…

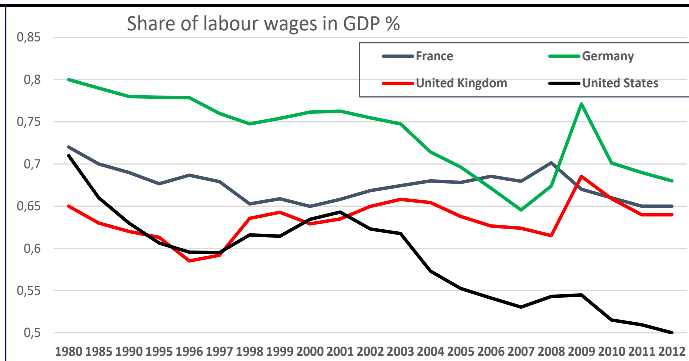
Fact: Economic growth boils down to rising GDP, that is **not** development!

- GDP says nothing regarding **wealth distribution** nor regarding inclusiveness and sustainability

FACT: INCOME UNEQUALITY IS NOT A MONOPOLY OF DEVELOPING COUNTRIES!

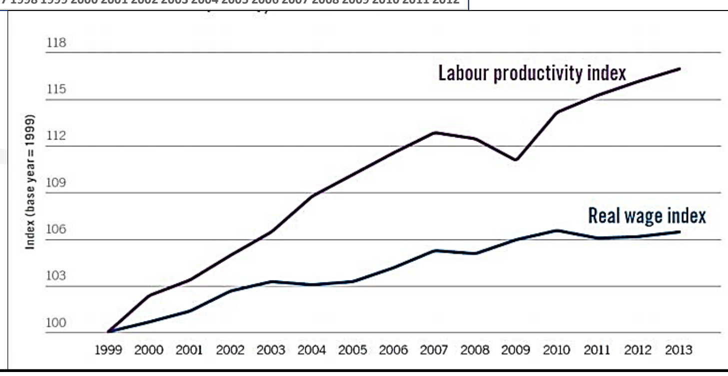
1. GINI **index of revenue inequality** worsens for many OECD countries since the global financial crisis (including France)
2. Since the mid-1980s and the worldwide extension of the market economy, unprecedented **distortion** in value-added distribution in developed countries
3. Rising share of profits in **GDP/falling share of wages**: income equality has worsened

According to McKinsey, 2/3 of households in 25 advanced economies, the equivalent of 550 million people, had their wages and income flat or falling in 2015 compared with 2005.



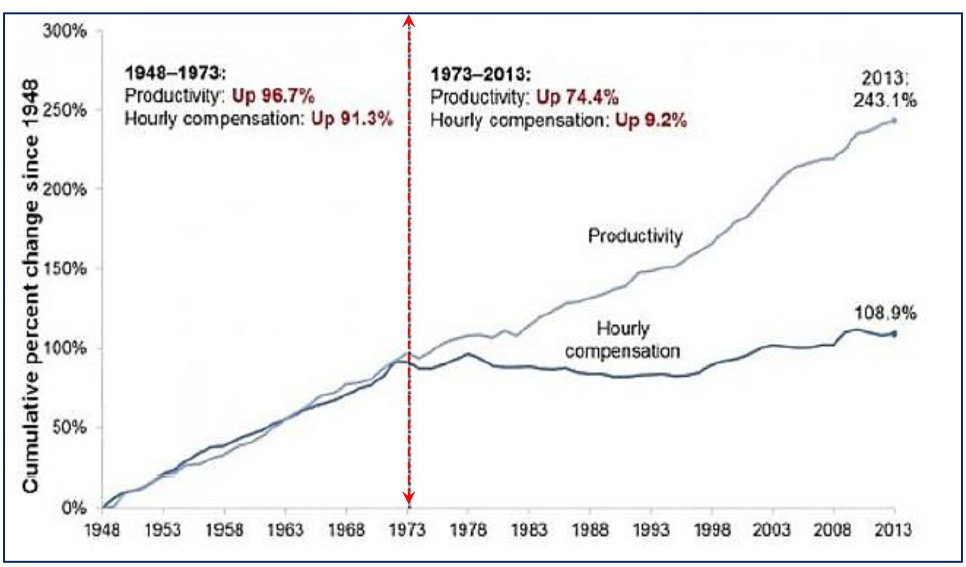
FALLING SHARE OF WORK SALARY IN GLOBAL VALUE ADDED 1980-2015

Scissor effect: gap between average wages and labour productivity in the OECD



Source: OECD data

THE RACE BETWEEN WAGES AND PRODUCTIVITY IN THE US (AND MOST OECD COUNTRIES!)



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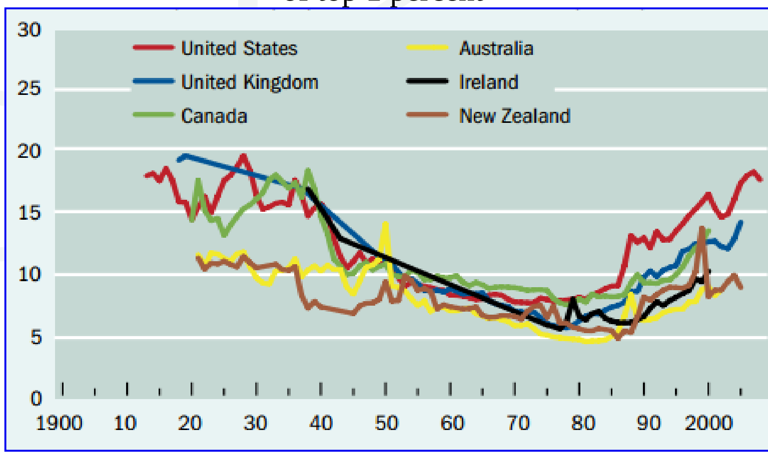
GLOBALIZATION & INCOME INEQUALITY: AFTER DECLINING IN THE FIRST HALF OF THE 20TH CENTURY, INCOME INEQUALITY MAKES A COMEBACK!

Hyperfinance's emergence in the 1980s coincides with the rising share of income for capital owners and top executives

Share in **income distribution** of top 1 percent



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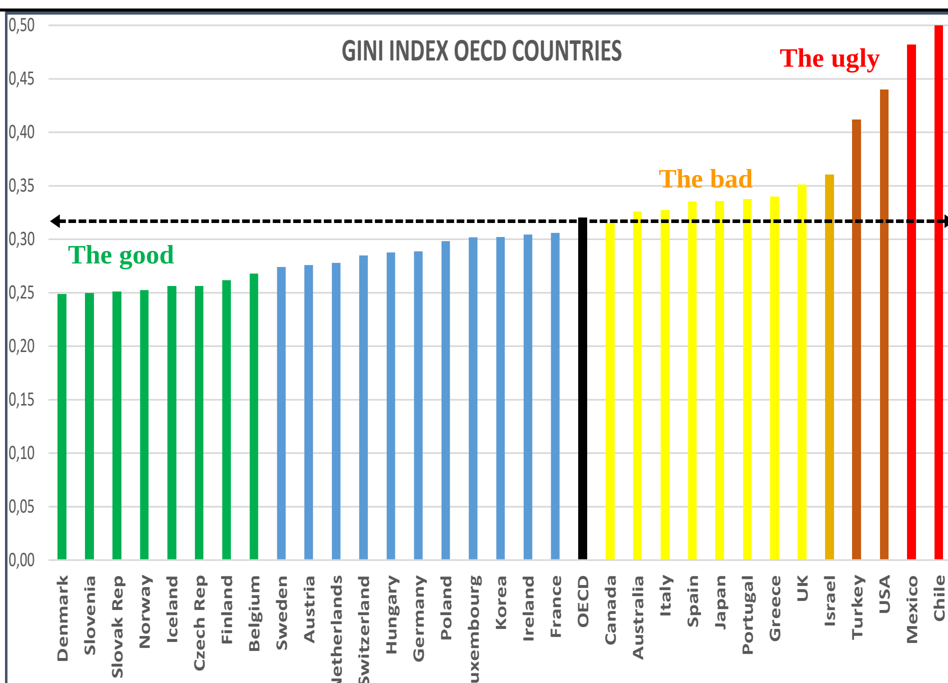
Source: IMF



OECD 2016

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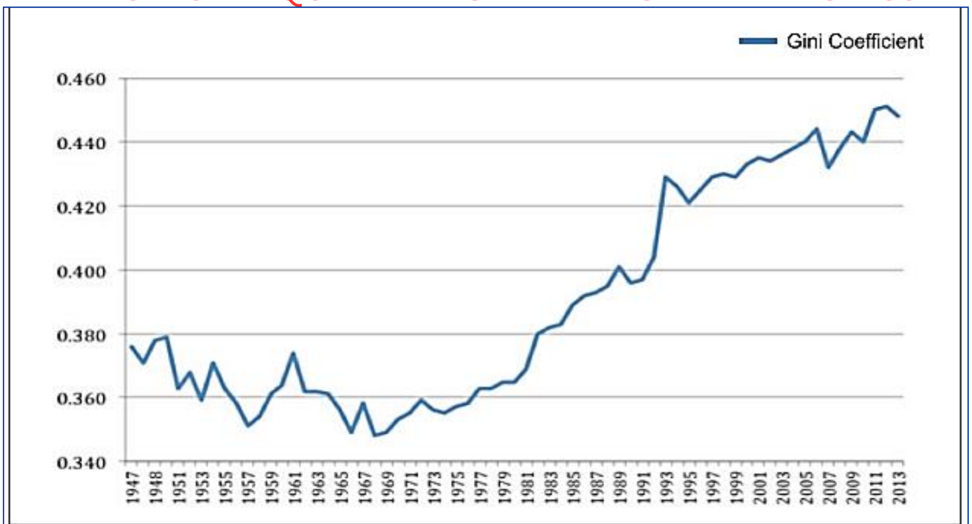
US FAMILIES' INCOME DISTRIBUTION GAP

GINI INDEX 1947-2015

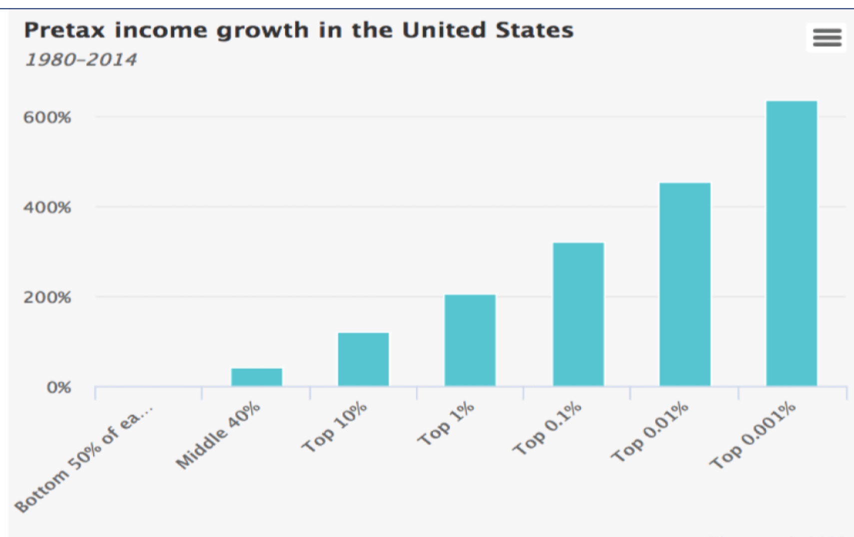
= RISING INEQUALITY + SHRINKING MIDDLE-CLASS



Source: U.S. Census Bureau, *Historical Income, Families*

US REAL MEDIAN HOUSEHOLD INCOME 1980-2014

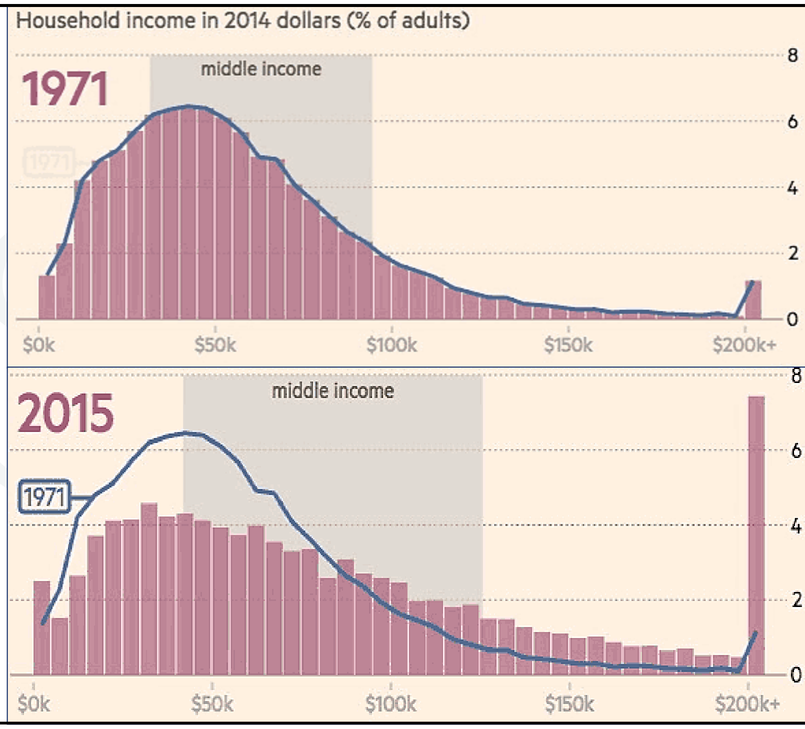
In 2010-15 growth has been slow, and big businesses and wealthy investors have been its major beneficiaries, rather than middle-class wage earners, but it has not been a job-less recovery with wage stagnation. However, median income is still <1999, and it does not say anything regarding distribution. Moreover, income is a flow and can hide wide wealth gaps.



SOURCE: Chicago Booth

BUSINESS INSIDER

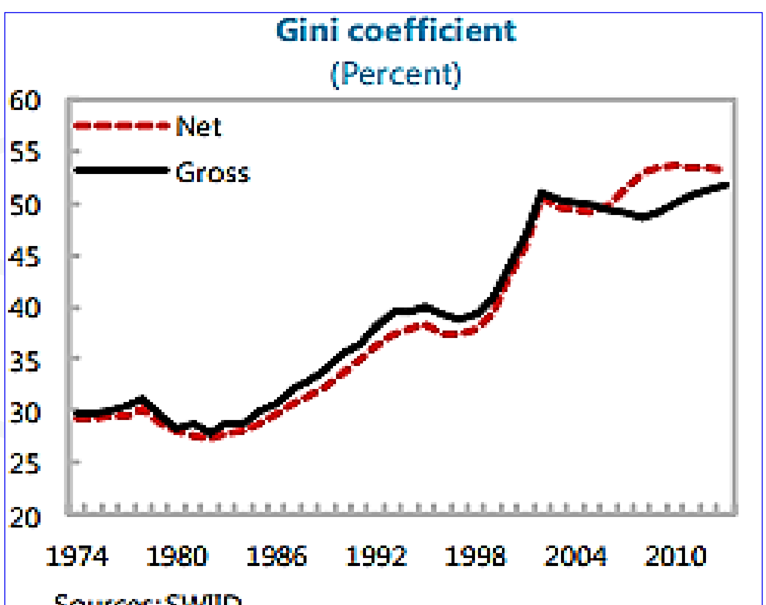
THE SHIFT IN US INCOME DISTRIBUTION 1971-2015



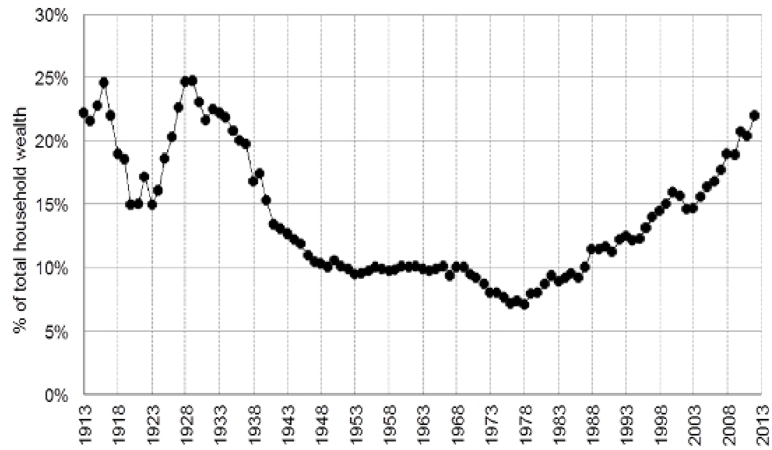
Source: Pew Research Center 12/15

CHINA'S RISING WEALTH GAP

Gini coefficient reaches 0,5



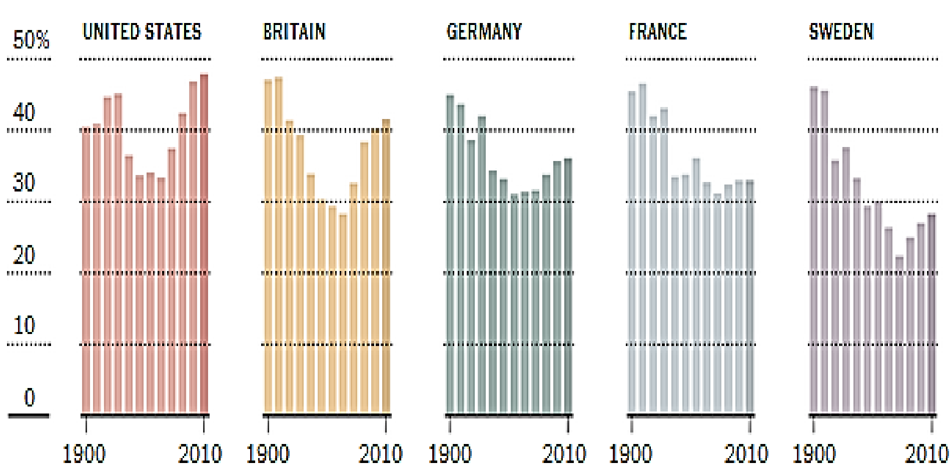
US **WEALTH** ACCUMULATION: TOP 0,1% 1913-2013 = 22%



Notes: Wealth is total assets (including real estate and funded pension wealth) net of all debts. Wealth excludes the present value of future government transfers (such as Social Security or Medicare benefits).
Source: Saez, Emmanuel and Gabriel Zucman "Wealth Inequality in the United States since 1913: Evidence from Capitalized Income Tax Data", NBER Working Paper, October 2014, online at http://gabriel-zucman.eu/uswealth/

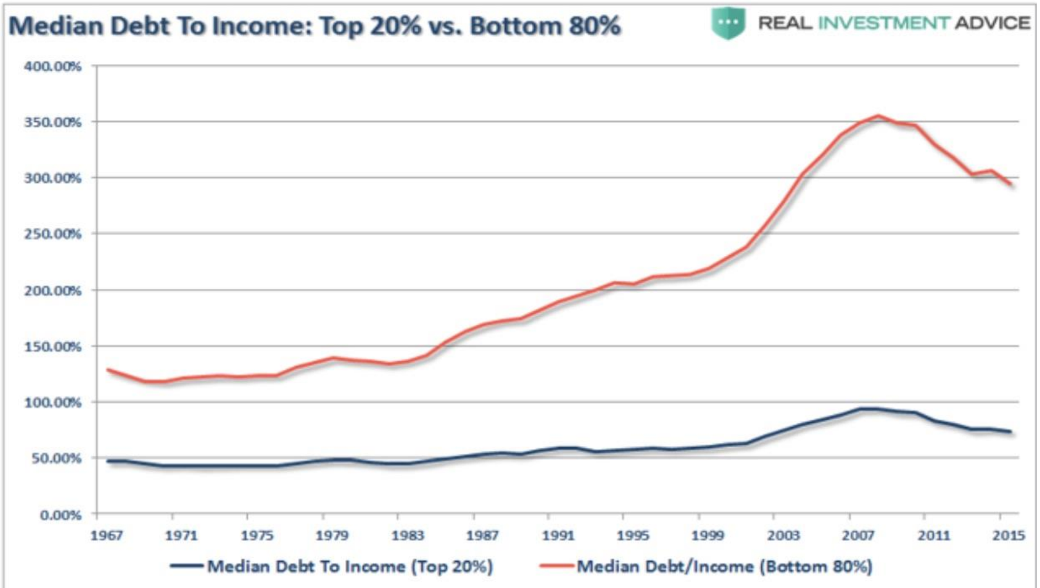
RISING GROWTH OF CAPITAL RETURN> ECONOMIC GROWTH RATE = LARGER INCOME INEQUALITY

Share of total income of the richest 10 percent



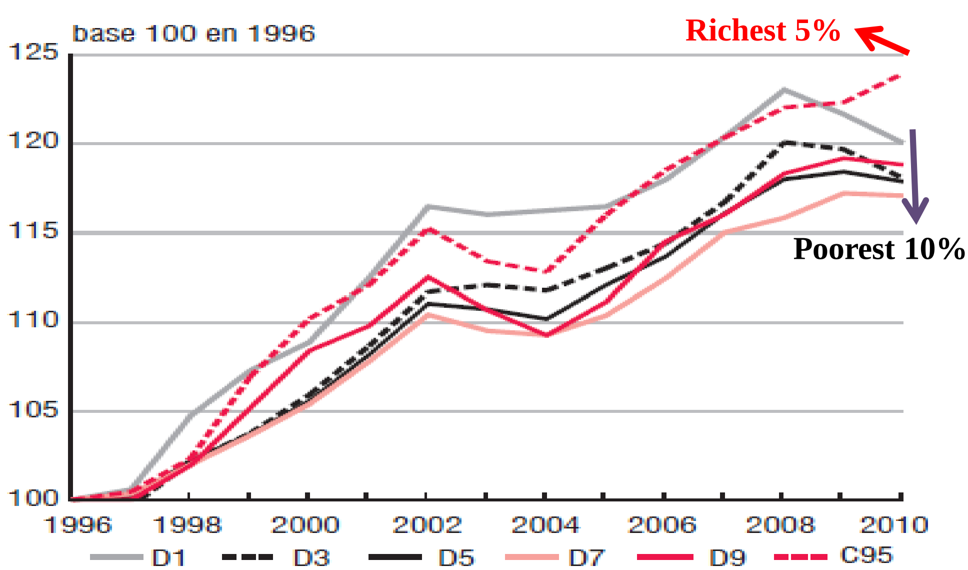
Source: T. Picketty 2014

THE POOR IN THE US HAVE NOT BENEFITTED FROM MUCH DELEVARAGING: COMBINATION OF MEDIOCRE SOCIO-ECONOMIC PROSPECTS AND LARGE DEBT/INCOME RATIO!



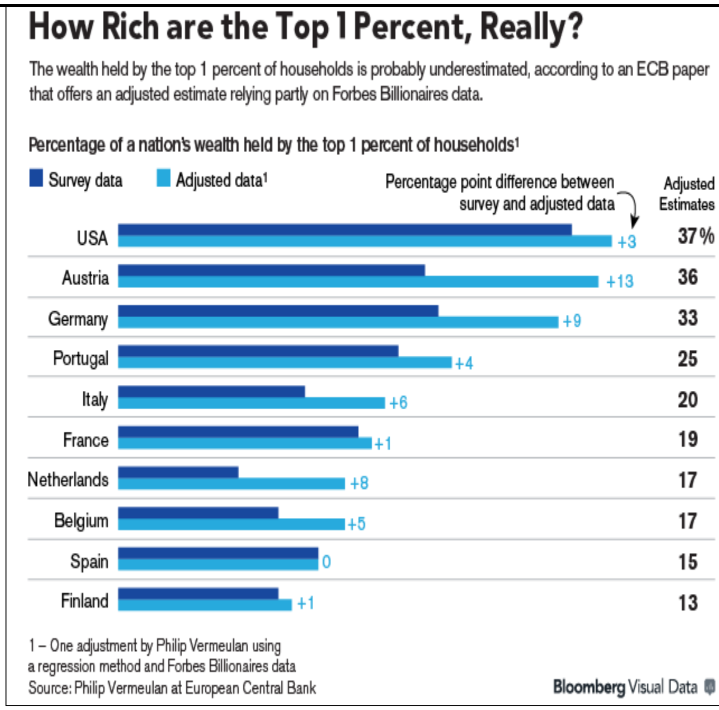
MH BOUCHET/SKEMA -CIFE 2020

FRANCE: EVOLUTION IN PER CAPITA INCOME BETWEEN 10% POOREST AND 5% RICHEST 1996-2010



INSEE 09/2012

MH BOUCHET/SKEMA -CIFE 2020



ASSESSING WEALTH CONCENTRATION IN THE OECD

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WHAT TO DO, THEN?
NO SILVER BULLET SOLUTION

▶ STIGLITZ

Capitalism is failing: Need of **fiscal stimulus** to boost consumer spending, minimum wage increase, and tax incentives for labour-intensive investment

☞ Kuznets and Liberal school

Patience! **Trickle-down economics**

Better education, life-long learning and retraining, labour market mobility, human capital investment

▶ PIKETTY

After WWII, « golden age » of capitalism, followed by **soaring inequality?**

= Global wealth tax

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PIKETTY'S GROWING WEALTH GAP: RIGHT OR WRONG?

- **Rate of return k** (5%) on financial assets **> g** real economy's **growth rate** (2,5%) = rising share of K in GDP = growing inequality = patrimonial capitalism
- Rising value of K due to monopoly power, rents, stock markets, land value speculation

1. **However**, rate of return on K lower than assumed by Piketty
2. Innovation and technology lead to temporary higher income for entrepreneurs
3. Only real estate owners and not financial capitalists get richer and richer!
4. Each and every « capitalist » is not a *rentier*
5. Change in savings rate can offset change in income distribution
6. Decreasing share of wages due to lower union membership and de-skilling process

Brookings Inst., 03-2015
IMF 08-2016

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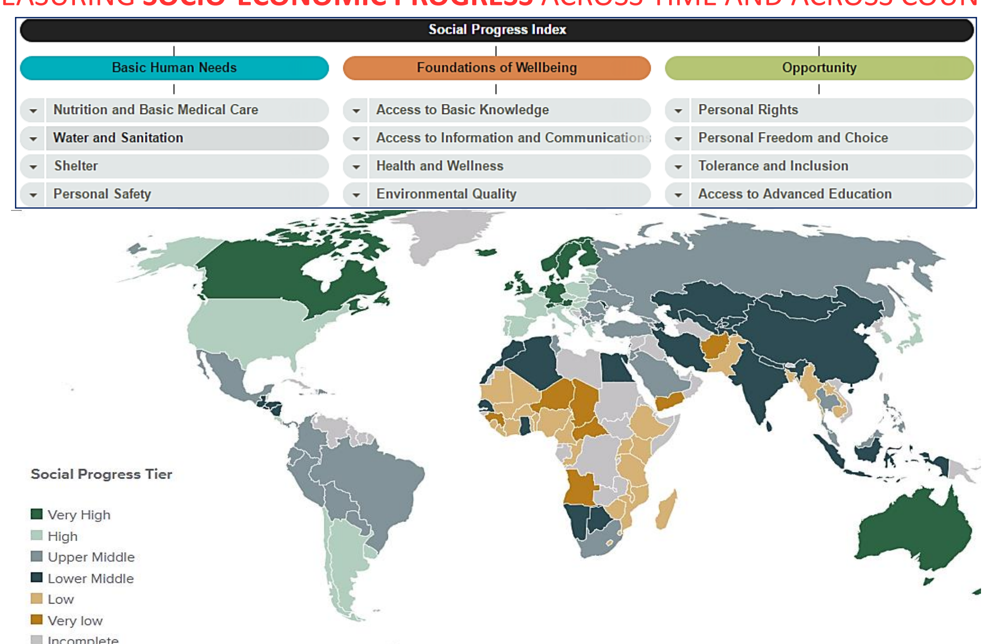
MEASURING **SOCIO-ECONOMIC PROGRESS** ACROSS TIME AND ACROSS COUNTRIES?



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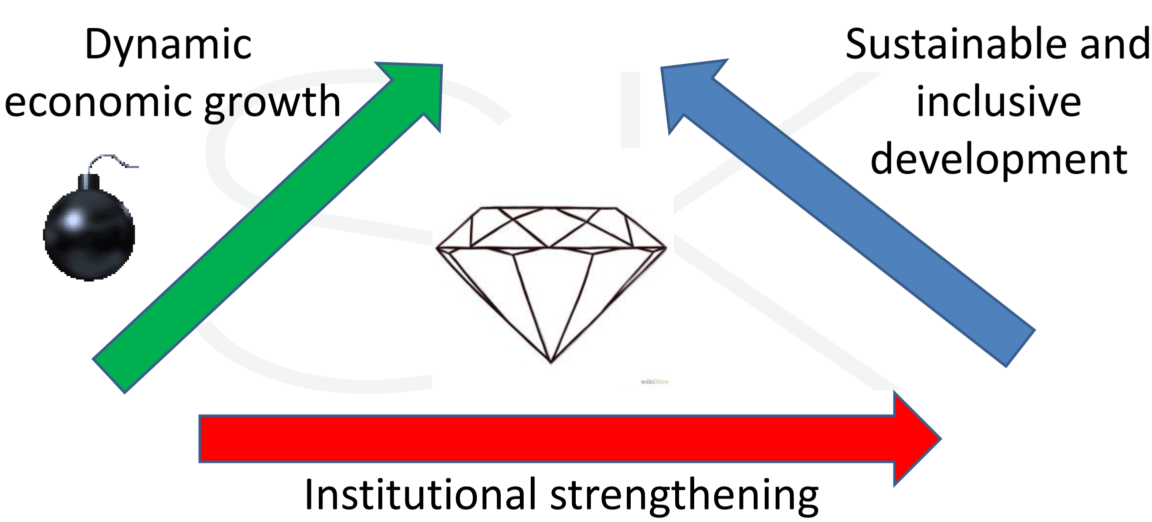
COUNTRY RISK HAS TO DO WITH INCOME DISTRIBUTION, WEALTH GAP, INCLUSIVE GROWTH AND SOCIO-ECONOMIC DEVELOPMENT!

SUSTAINABLE GROWTH REQUIRES SOCIAL MOBILIZATION AND POLITICAL STABILITY WITHIN A « NATION » RATHER THAN IN A « COUNTRY »

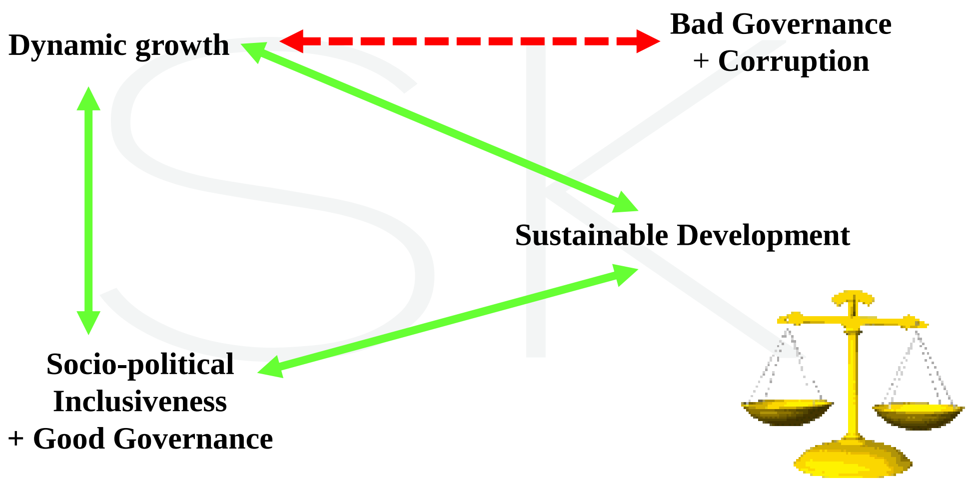
- Development = social inclusiveness

Σ (policy choices + political choices)

THE REQUIRED SOCIO-POLITICAL STABILITY TRIANGLE



TRILEMMA OF GROWTH AND DEVELOPMENT?



Centre international de formation européenne

NICE BERLIN BRUXELLES ISTANBUL

COUNTRY RISK ECONOMIC INTELLIGENCE AND INFORMATION SOURCES

CIFE SEMINAR NICE MAY 6-8, 2020

MICHEL-HENRY BOUCHET

1

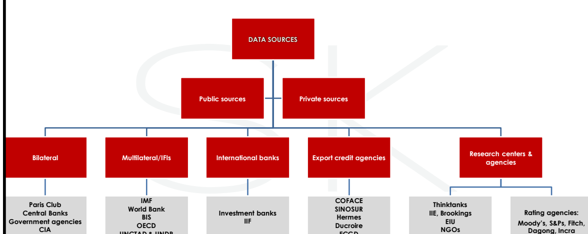
COUNTRY RISK ASSESSMENT

Reliable and updated information

= Economic intelligence

➔**Robust risk analysis**

MAJOR SOURCES OF COUNTRY RISK INTELLIGENCE



MH Bouchet/Skema-CIFE 2020

3

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

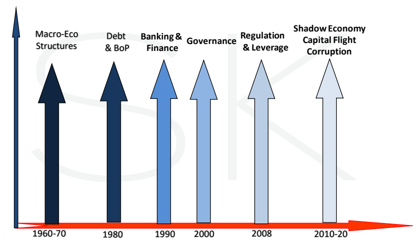
MH Bouchet

4

ECONOMIC INTELLIGENCE = THE KEY OF RELIABLE RISK ANALYSIS AND MITIGATION!

- www.developingfinance.org
- https://www.theglobaleconomy.com/rankings/Nonperforming_loans/
- https://www.coface.com/fr/Etudes-economiques-et-risque-pays
- https://www.theglobaleconomy.com/
- https://www.bis.org/statistics/consstats.htm
- https://etudes-economiques.credit-agricole.com/
- https://www.fitchratings.com/site/sovereigns/political
- https://www.imf.org/en/Publications
- https://www.heritage.org/index/
- https://www.doingbusiness.org/en/rankings
- https://www.weforum.org/reports/how-to-end-a-decade-of-lost-productivity-growth
- https://www.transparency.org/cpi2019
- http://etudes-economiques.credit-agricole.com/
- http://cib.natixis.com/research/economic/publications.aspx?lang=fr
- http://economic-research.bnpparibas.com/
- http://www.societegenerale.com/fr/s-informer-et-nous-suivre/econews/
- MarketAxess Daily btdata@marketaxess.com
- Fed St Louis, The Economist, US Treasury, World Bank
- S&Ps GlobalRatings, Fitch Rating https://www.spratings.com/en_US/home
- OCDE: https://stats.oecd.org/
- BCE: https://www.ecb.europa.eu/home/languagepolicy/html/index.fr.html
- FMI: https://www.imf.org/external/french/index.htm

ECONOMIC INTELLIGENCE =
TRANSFORMING INFORMATION INTO RISK STRATEGY



FINANCIAL, MACROECONOMIC AND SOCIO-POLITICAL INFORMATION AND INTELLIGENCE SOURCES

Official sources

1 . Multilateral sources
- IMF
- World Bank
- BIS, OECD
- RDBs

2. **Official bilateral sources**
- Country governments (CBs, CIA)
- ECAs (Coface, Hermes, Eximbank, ECGD, SACE, CESCE)
- Paris Club

Private sources

1. Insurance agencies (Coface, AON OPIC)
2. Research institutes (IIE, IIF, Brookings, Transparency Int.)
3. Thinktanks (Cato, Heritage, Freedom House, Heritage F.)
4. Magazines (Euromoney, Institutional Investor…)
5. Academic centers (CforGD, Global Finance…)
6. Rating agencies (S&Ps, Dagong, Incra)

OFFICIAL **INFORMATION** SOURCES

- 4 IFIs = IMF + World Bank + BIS + OECD
- 4 RDBs= AsDB, AfDB, EBRD, IADB
- 2 UNs= UNCTAD + UNDP
- Export credit agencies (Coface, EFIC, Hermes…)
- Paris Club
- Central Banks
- Governments and Intelligence agencies (https://www.cia.gov/library/publications/the-world-factbook/wfbExt/region_eur.html)

IMF AS SOURCE OF RISK INFORMATION

International Financial Statistics (monthly)

Global tables:

IMF Credits

Official reserves and MS

Exchange rates (nominal and real effective rates)

CPI and interest rates

Trade Flows (M/X)

Commodity prices

Country data

Balance of payments

Government budget

National accounts (GDP/GNP)

International liquidity

Monetary survey (bank credit, money and quasi-money)

Interest rates

Debt ratios

IMF AS SOURCE OF MACRO-ECONOMIC INFORMATION

Table 5. Ecuador: Balance of Payments, 2008–21

(Millions of U.S. dollars, unless otherwise indicated)

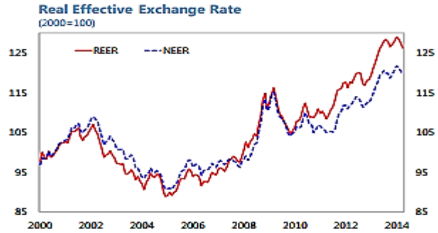
								Est.	Proj.					
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Current account	1,766	309	-1,586	-403	-166	-968	-567	-2,247	-2,280	-978	-874	-140	596	-834
Trade account	1,549	144	-1,504	-303	50	-493	-53	-1,700	-1,311	538	165	799	1,260	-276
Exports, f.o.b.	19,461	14,412	18,137	23,082	24,569	25,686	26,604	18,998	16,225	18,147	18,666	19,136	19,636	20,025
Oil	11,721	6,965	9,673	12,945	13,792	14,108	13,302	6,610	5,565	6,577	6,891	7,103	7,349	7,553
Non-Oil	7,740	7,447	8,464	10,137	10,777	11,578	13,302	12,389	10,660	11,570	11,775	12,033	12,287	12,472
Imports (f.o.b.)	-17,912	-14,268	-19,641	-23,385	-24,519	-26,178	-26,657	-20,699	-17,536	-17,609	-18,501	-18,337	-18,375	-20,301
Oil	-3,358	-2,338	-4,043	-5,087	-5,441	-5,927	-6,417	-3,950	-2,916	-3,370	-3,798	-3,904	-3,932	-4,258
Non-Oil	-14,554	-11,930	-15,598	-18,298	-19,078	-20,251	-20,240	-16,748	-14,620	-14,239	-14,704	-14,433	-14,443	-16,043
Services (net)	-3,003	-2,556	-2,564	-2,822	-2,696	-2,874	-2,778	-2,625	-3,089	-3,561	-3,429	-3,375	-3,242	-3,290
Transfers (net)	3,221	2,722	2,481	2,722	2,480	2,399	2,264	2,078	2,120	2,045	2,391	2,435	2,578	2,733

China: Selected Economic Indicators

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
						Projections					
NATIONAL ACCOUNTS											
Real GDP (base=2015)	7.9	7.8	7.3	6.9	6.7	6.7	6.4	6.4	6.3	6.0	5.8
Total domestic demand	7.9	8.1	7.2	7.2	7.4	7.0	6.9	6.8	6.6	6.2	5.9
Consumption	8.7	7.2	7.2	8.3	8.4	8.6	8.0	7.4	7.1	6.6	6.2
Investment	7.1	9.1	7.1	6.1	6.3	5.2	5.5	6.0	6.0	5.8	5.6
Fixed	9.0	9.3	6.8	6.7	6.7	5.2	5.6	6.1	6.2	6.0	5.8
Inventories (contribution)	-0.6	0.1	0.2	-0.2	-0.1	0.1	0.0	0.0	0.0	0.0	0.0
Net exports (contribution)	0.3	0.1	0.4	-0.1	-0.5	-0.1	-0.2	-0.2	-0.2	-0.2	-0.1
Total capital formation (percent of GDP)	47.2	47.3	46.8	44.7	44.2	43.7	42.9	42.4	42.0	41.7	41.4
Gross national saving (percent of GDP) 1/	49.7	48.8	49.0	47.5	45.9	45.1	44.3	43.6	42.9	42.3	41.8

THE IMF AS SOURCE OF EXCHANGE RATE AND MONETARY DATA: **CHINA**

Real Effective Exchange Rate
(2000=100)



Sources: IMF, Information Notice System; and IMF staff calculations.

THE IMF'S WEO

World Economic Outlook **UPDATE**
An update of the key WEO projections

FOR RELEASE
Washington, DC: July 16, 2018, 10:00 a.m. EST

STRICTLY CONFIDENTIAL
UNTIL RELEASED

Less Even Expansion, Rising Trade Tensions

- *Global growth is projected to reach 3.9 percent in 2018 and 2019, in line with the forecast of the April 2018* World Economic Outlook *(WEO), but the expansion is becoming less even, and risks to the outlook are mounting. The rate of expansion appears to have peaked in some major economies and growth has become less synchronized. In the United States, near-term momentum is strengthening in line with the April WEO forecast, and the US dollar has appreciated by around 5 percent in recent weeks. Growth projections have been revised down for the euro area, Japan, and the United Kingdom, reflecting negative surprises to activity in early 2018. Among emerging market and developing economies, growth prospects are also becoming more uneven, amid rising oil prices, higher yields in the United States, escalating trade tensions, and market pressures on the currencies of some economies with weaker fundamentals. Growth projections have been revised down for Argentina, Brazil, and India, while the outlook for some oil exporters has strengthened.*

IMF Managing Director Kristalina Georgieva's Statement Following a G20 Ministerial Call on the Coronavirus Emergency
March 23, 2020

"The human costs of the Coronavirus pandemic are already immeasurable and all countries need to work together to protect people and limit the economic damage. This is a moment for solidarity—which was a major theme of the meeting today of the G20 Finance Ministers and Central Bank Governors."I emphasized three points in particular:
"First, the outlook for global growth: for 2020 it is negative—a recession at least as bad as during the global financial crisis or worse. But we expect recovery in 2021. To get there, it is paramount to prioritize containment and strengthen health systems—everywhere. The economic impact is and will be severe, but the faster the virus stops, the quicker and stronger the recovery will be. "We strongly support the extraordinary fiscal actions many countries have already taken to boost health systems and protect affected workers and firms. We welcome the moves of major central banks to ease monetary policy.
"**Second, advanced economies are generally in a better position to respond to the crisis**, but many emerging markets and low-income countries face significant challenges. They are badly affected by outward capital flows, and domestic activity will be severely impacted as countries respond to the epidemic. Investors have already removed US$83 billion from emerging markets since the beginning of the crisis, the largest capital outflow ever recorded. We are particularly concerned about low-income countries in debt distress—an issue on which we are working closely with the World Bank.
"**Third, what can we, the IMF, do to support our members**? We are concentrating bilateral and multilateral surveillance on this crisis and policy actions to temper its impact. We will massively step up emergency finance—nearly 80 countries are requesting our help—and we are working closely with the other international financial institutions to provide a strong coordinated response. We are replenishing the Catastrophe Containment and Relief Trust to help the poorest countries. We welcome the pledges already made and call on others to join. We stand ready to deploy all our US$1 trillion lending capacity.

WORLD BANK AS SOURCE OF RISK INFORMATION

Global Development Finance (annual)

- Vol. 1 = Global tables

Total debt stock and flows of EMCs broken down by creditors & maturities

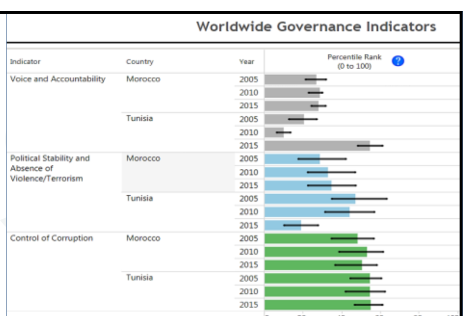
- Vol.2 = country tables

Total debt and debt servicing payments

Country economic reports

- Structural indicators
- Economic policy issues
- WB project lending
- Debt sustainability analysis
- Governance analysis

WORLD BANK: CROSS-COUNTRY COMPARISON OF GOVERNANCE INDICATORS: **TUNISIA VS MOROCCO**



http://info.worldbank.org/governance/wgi/#reportsindicators: **Tunisia vs Morocco**

BIS = KEY SOURCE OF FINANCIAL RISK INFORMATION

Global tables

International Banking statistics (quarterly)
+ Annual BIS report

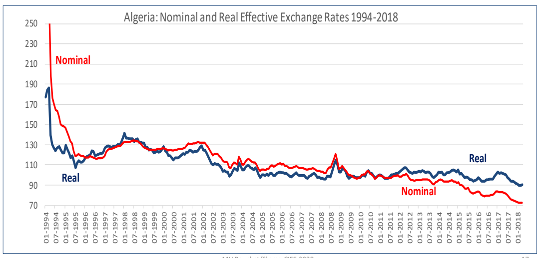
- International banking market
- International debt securities market
- Derivatives market

Country Tables

- External positions of BIS reporting banks: assets (claims) and liabilities (deposits) vis à vis all sectors and the non-bank private sector
- Breakdown by creditor banks and by maturities
- Real effective exchange rates

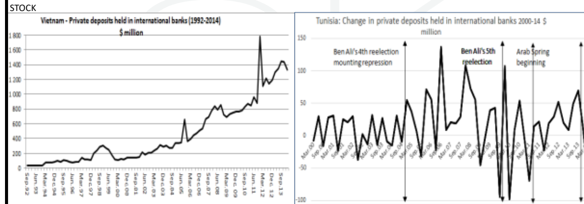
http://stats.bis.org/statx/srs/table/b4

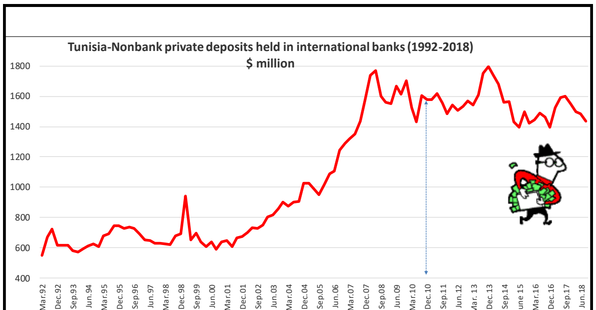
THE BIS: NOMINAL AND REAL EFFECTIVE EXCHANGE RATES



BIS: A SOURCE OF CAPITAL FLIGHT DATA

Private capital outflows in international banks as measure of socio-political volatility or exchange rate distortions





Source: BIS 2020

OECD, CENTRAL BANKS AND TREASURIES

- Ex. FFIEC: US Federal Financial Institution Examination Council

- **US banks' claims on CHILE = US$ 3.22 billion o/w**

1. On banks= $ 903 million
2. On public sector= $320 million
3. On private sector= $1970 million
4. Total ST debt < 1 year loans= 51%

PARIS CLUB = SOURCE OF DEBT-RELATED INFORMATION

- There are no established institutionalized mechanisms for dealing with **private** sector cross-border debt in arrears! This is not the case of **official-source** debt that is renegotiated under the auspices of the Paris Club since 1956! Cf. Argentina's debt crisis
- The Paris Club: A confidential ad-hoc forum of debt negotiations between OECD country creditors and sovereign debtors.
- It only deals with official or officially-guaranteed credits (Coface, Hermes, ECGD, US Eximbank…).
- Consensus-based agreements.

THE PARIS CLUB

- The first meeting with a debtor country was in 1956 when Argentina agreed to meet its public creditors in Paris. Since then, the Paris Club has reached >430 agreements concerning 90 debtor countries. The total amount of debt covered in these agreements has been $583 billion.
- The Paris Club has remained strictly informal. It is the voluntary gathering of creditor countries willing to treat in a co-ordinated way the debt due to them by the developing countries.
- It can be described as a "non institution".

THE PARIS CLUB'S KEY NUMBERS

KEY NUMBERS

Total amount of agreements	433
Total amount of debtor countries	90
Total amount of debt	583 Billion $
Total amount of countries in "Classic Terms"	60
Total amount of countries in "Houston Terms"	21
Total amount of countries in "Naples Terms"	36
Total amount of countries in "Cologne Terms"	33

TOTAL CLAIMS OF PARIS CLUB MEMBERS ON EMERGING MARKET COUNTRIES

Créances du Club de Paris au 31 décembre 2016, hors intérêts de retard (en millions de dollars)

APD : Aide Publique au Développement
NAPD : non consenties aux conditions de l'APD

Pays débiteurs	Créances APD	Créances NAPD	TOTAL
Afghanistan	1	1 250	1 251
Afrique du Sud	766	173	939
Albanie	495	23	517
Algérie	520	2	522
Angola	451	853	1 304
Antigua-et-Barbuda	3	118	121
Arabie Saoudite	-	2 925	2 925
Argentine	661	5 288	5 949
Arménie	452	16	467
Azerbaïdjan	758	34	791
Bangladesh	3 121	431	3 552
Barbade	2	-	2
Belize	-	-	-
Bénin	5	14	19
Biélorussie	26	6 359	6 385
Bolivie	105	2	106
Bosnie-Herzégovine	250	374	624
Botswana	19	-	19
Bulgarie	186	74	260
Burkina Faso	140	0	140
Burundi	-	-	-
Cambodge	915	1 399	2 314
Cameroun	537	24	562
Cap Vert	111	47	158
Chili	90	-	90
Chine	14 710	1 030	15 740

PARIS CLUB DEBT RESTRUCTURING TERMS

Restructuring Terms	Eligibility	Rescheduling term (T/Grace)	Debt Reduction Terms ODA	Debt Reduction Terms Non ODA	Debt Conversion
Houston 09/90	GDP per capita <$2995 and debt/GDP>50 %	ODA: 20/10 Non ODA: 15/2-3	Rescheduled at an interest rate at least as favourable as the original concessional interest rate applying to these loans	Repayment periods are lengthened	ODA: no limit Non ODA: up to 20% of the outstanding amount or 15-30 million SDR
Toronto 10/88	Poorest countries	ODA: 25/14 Non ODA: 14/8		33,33%	
London, 12/91	23 countries	ODA: 30/12 Non ODA: 23/6		50%	
Naples 12/94	Poorest countries	ODA: 25/14 Non ODA: 14/8		67%	
Lyon 11/96	Poorest countries	ODA: 40/16 Non ODA: 23/6		80%	
Cologne 11/99	41 HIPC	ODA: 40/16 Non ODA: 23/6		90%	

NIGERIA: 10/2005 PARIS CLUB DEBT RESTRUCTURING

- **Total stock of public sector debt= US$ 36.2 billion, o/w US$ 30 billion due to the Paris Club**

- Debt agreement follows the IMF's Policy Support Instrument (PSI) on 17 October 2005, including a debt reduction under Naples terms on eligible debts and a buy back at a market-related discount on the remaining eligible debts after reduction. Two conditonal phases:
- 1. Nigeria undertakes to pay arrears due on all categories of debts and Paris Club creditors grant a 33% cancellation of eligible debts;
- 2. After the first review of the PSI, planned for March 2006, Nigeria will pay amounts due under post-cut off date debt, and Paris Club creditors will grant a further tranche of cancellation of 34%, and Nigeria will buy back the remaining eligible debts.
- Total debt cancellation of **US$ 18 billion** (including moratorium interest) representing an overall cancellation of about 60% of Paris Club debt. Paris Club creditors will be paid an amount of US$ 12.4 billion, representing regularization of arrears.

UNDP AND UNCTAD

UNDP

- **HDI**
- **Social and development indicators**

UNCTAD

- **Trade, FDI and development indicators**
- **Role of MNCs in EMCs**

UNDP
HUMAN DEVELOPMENT INDEX

1	Norway	171	Côte d'Ivoire
2	Australia	172	Djibouti
2	Switzerland	173	Gambia
4	Germany	174	Ethiopia
5	Denmark	175	Mali
5	Singapore	176	Congo (Dem R)
7	Netherlands	177	Liberia
8	Ireland	178	Guinea-Bissau
9	Iceland	179	Eritrea
10	Canada	179	Sierra Leone
10	United States	181	Mozambique
12	Hong Kong	181	South Sudan
13	New Zealand	183	Guinea
14	Sweden	184	Burundi
15	Liechtenstein	185	Burkina Faso
16	United Kingdom	186	Chad
17	Japan	187	Niger
18	Korea	188	Central Af Rep

Often rich countries with poor people!

CIA

- The World FactBook
- https://www.cia.gov/library/publications/the-world-factbook/wfbExt/region_eur.html

COUNTRY COMPARISON GDP (PURCHASING POWER PARITY)

GDP (purchasing power parity) compares the gross domestic product (GDP) or value of all final goods and services produced within a nation in a given year. A nation's GDP at purchasing power parity (PPP) exchange rates is the sum value of all goods and services produced in the country valued at prices prevailing in the United States.

DOWNLOAD DATA

RANK	COUNTRY	GDP (PURCHASING POWER PARITY)	DATE OF INFORMATION
1	CHINA	$21,140,000,000,000	2016 EST.
2	EUROPEAN UNION	$19,970,000,000,000	2016 EST.
3	UNITED STATES	$18,560,000,000,000	2016 EST.
4	INDIA	$8,721,000,000,000	2016 EST.
5	JAPAN	$4,932,000,000,000	2016 EST.
6	GERMANY	$3,979,000,000,000	2016 EST.
7	RUSSIA	$3,745,000,000,000	2016 EST.
8	BRAZIL	$3,081,000,000,000	2016 EST.
9	INDONESIA	$3,028,000,000,000	2016 EST.
10	UNITED KINGDOM	$2,788,000,000,000	2016 EST.

SPECIALIZED COUNTRY **RISK ANALYSIS** INSTITUTIONS

- IIF (Washington) The Institute for International Finance
- IIE (Washington), EIU (London), Brookings (D.C.)
- Bond rating agencies: Dun and Bradstreet, Moody's, S&P, FITCH IBCA, Dagong
- BERI (Business Environment Risk Index)
- Institutional Investor, Euromoney
- Frost & Sullivan
- INCRA (Bertelsmann Foundation)
- Transparency International
- Heritage Foundation, Davos-WEF, Cato Institute, IMD, AT Kearney, Global Finance-SKEMA
- ICRG, PRS
- Insurance companies: AON

RATING AGENCIES

- Bond rating: Moody's, Fitch, S&Ps
- DAGONG
- Risk rating: COFACE
- INCRA (non-profit credit-rating agency for sovereign risk)
- Country risk rating: BERI, Euromoney, Institutional Investor
- CountryRisk io

CountryRisk.io A COMMUNITY-BASED COUNTRY RISK RATING PLATFORM

Toward a transparent and independent country and sovereign risk rating models!?
The long-term Sovereign Risk Score measures a country's economic and financial strength, as well as its ability and willingness to honour its foreign debt obligations
The long-term Sovereign Risk Score is a quantitatively-derived index based on a large set of indicators, and assesses a country's economic and financial strength. Available on an annual frequency, with values ranging between 0 and 100.
Higher values indicate higher sovereign risk and weaker economic and financial fundamentals. >140 countries with five-year forecasts

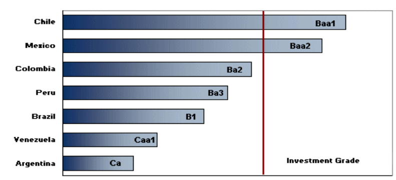
GOVERNMENTS ARE BYPASSED BY MARKET FORCES AND UNDER THE SCRUTINY OF IFIS AND RATING AGENCIES

Rating Distribution of Sovereign Issuers on Selected Dates

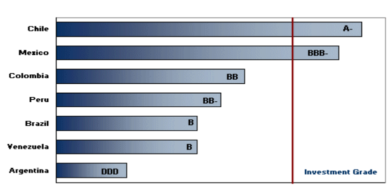
Rating	1983	1990	1995	2000	2005	2010	2011	2012
Aaa	79%	33%	16%	12%	19%	15%	14%	13%
Aa	21%	28%	25%	15%	7%	15%	11%	12%
A	0%	17%	18%	10%	22%	13%	14%	8%
Baa	0%	8%	18%	21%	14%	18%	21%	26%
Ba	0%	8%	16%	19%	15%	16%	15%	16%
B	0%	6%	5%	18%	17%	23%	23%	22%
Caa-C	0%	0%	0%	5%	5%	1%	2%	3%
Investment-grade	100%	86%	78%	59%	63%	61%	59%	59%
Speculative-grade	0%	14%	22%	41%	37%	39%	41%	41%

Moody's-Summer 2013

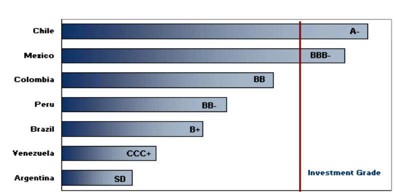
MOODY'S INVESTORS SERVICE LONG-TERM FOREIGN CURRENCY RATINGS



FITCH IBCA, DUFF AND PHELPS LONG-TERM FOREIGN CURRENCY RATINGS



STANDARD AND POOR'S LONG-TERM FOREIGN CURRENCY RATINGS



Information sources: Standard & Poor's: Sovereign risk indicators

Sovereign Risk Indicators: Economic Data

	LT FC rating	Nominal GDP (bil. LC) 2016e	Nominal GDP (bil. US$) 2016e	GDP per capita (US$) 2016e	Real GDP growth (%) 2016e	Real GDP per capita growth (%) 2016e	Real investment growth (%) 2016e	Investment /GDP (%) 2016e	Savings /GDP (%) 2016e	Exports/ GDP (%) 2016e	Unemployment rate (% of work force) 2016e
Abu Dhabi	AA	769	209	71,647	2.0	(2.9)	N/A	N/A	N/A	69.1	3.0
Albania	B+	1,523	12	4,216	3.2	3.4	8.0	27.9	15.6	26.5	17.1
Andorra	BBB-	3	3	36,564	1.0	0.8	N/A	N/A	N/A	N/A	3.7
Angola	B	14,367	95	3,718	1.3	(1.2)	0.4	28.4	16.0	36.9	35.0
Argentina	B-	8,069	547	12,550	(1.8)	(2.8)	(0.3)	17.4	14.6	14.1	8.9
Aruba	BBB+	5	3	24,324	0.4	(0.7)	1.1	22.3	22.6	71.0	7.5
Australia	AAA	1,655	1,205	49,934	2.7	1.3	(3.6)	25.7	21.2	18.8	5.9
Austria	AA+	350	389	45,125	1.4	0.9	2.0	23.4	25.4	53.2	6.2
Azerbaijan	BB+	59	35	3,603	(3.5)	(4.6)	4.5	35.8	33.0	39.1	5.5
Bahamas	BBB-	9	9	22,754	0.3	(1.1)	(7.1)	26.2	10.5	38.6	14.0
Bahrain	BB-	12	31	22,039	2.0	(1.5)	3.0	25.1	19.2	72.9	3.4
Bangladesh	BB-	17,296	220	1,355	7.1	6.3	8.0	29.4	31.1	16.3	3.5
Barbados	B-	9	4	15,791	1.0	0.7	2.1	12.8	5.9	36.8	11.5
Belarus	B-	930,842	45	4,772	(2.7)	(2.7)	(2.3)	32.4	28.6	53.8	1.0
Belgium	AA	420	467	41,416	1.3	0.7	3.5	23.9	25.6	85.3	8.1
Belize	CC	3	2	4,562	(1.6)	(4.1)	(1.6)	20.9	10.5	60.1	11.7
Bermuda	A+	6	6	99,669	2.0	2.1	(13.8)	11.0	23.7	48.3	8.0
Bolivia	BB	248	36	3,296	4.1	2.5	4.1	19.2	13.8	30.9	4.0

MH Bouchet/Skema-CIFE 2020

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THE INSTITUTE OF INTERNATIONAL FINANCE (IIF)

IIF INSTITUTE OF INTERNATIONAL FINANCE

The Institute of International Finance is the global association of the financial industry, with close to 500 members from 70 countries. Its mission is to support the financial industry in the prudent management of risks; to develop sound industry practices; and to advocate for regulatory, financial and economic policies that are in the broad interests of its members and foster global financial stability and sustainable economic growth. IIF members include commercial and investment banks, asset managers, insurance companies, sovereign wealth funds, hedge funds, central banks and development banks.

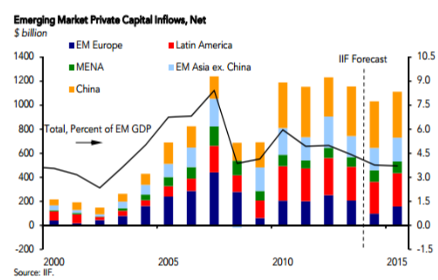
IIF'S ANALYSIS OF CAPITAL FLOWS

Emerging Market Economies: Capital Flows
$ billion

	2012	2013	2014	2015
Capital Inflows				
Total Inflows, Net:	*1269*	*1188*	*1079*	*1164*
Private Inflows, Net	1232	1156	1032	1112
Equity Investment, Net	668	626	657	675
Direct Investment, Net	545	548	540	560
Portfolio Investment, Net	124	78	117	114
Private Creditors, Net	564	530	375	437
Commercial Banks, Net	118	193	124	151
Nonbanks, Net	446	338	251	287
Official Inflows, Net	37	32	47	53
International Financial Institutions	5	-3	19	27
Bilateral Creditors	31	35	28	25
Capital Outflows				
Total Outflows, Net	*-1299*	*-1360*	*-1348*	*-1339*
Private Outflows, Net	-946	-825	-981	-950
Equity Investment Abroad, Net	-332	-403	-368	-381
Resident Lending/Other, Net	-614	-422	-613	-570
Reserves (- = Increase)	-352	-534	-367	-388
Memo:				
Net Errors and Omissions	*-246*	*-65*	*0*	*0*
Current Account Balance	*276*	*236*	*269*	*174*

Source: IIF

IIF MACRO RESEARCH ON CAPITAL FLOWS



COFACE
(COMPAGNIE FRANÇAISE D'ASSURANCE POUR LE COMMERCE EXTÉRIEUR)

- The Coface Group facilitates and secures trade throughout the world. The Group offers a range of solutions spanning rating, protection and services, including country risk data and analysis.
- Country risk analysis is expressed in a rating/ranking format but based on a qualitative analysis aimed at integrating the socio-political and economic specificities of each country.

COFACE

- Coface takes into account several types of country risk around six different analytical modules:

1. political risk;
2. liquidity and non-transfer risk;
3. sovereign risk;
4. market crisis risk;
5. systemic banking crisis;
6. macroeconomic growth risk

- www.coface.org

COFACE 2020 GLOBAL RISK MAP

TUNISIE

POPULATION 11,7 MILLIONS

PIB PAR HABITANT 3 422 $US

C — EVALUATION DES RISQUES PAYS

B — ENVIRONNEMENT DES AFFAIRES

CHANGER DE PAYS

COMPARER LES PAYS

SYNTHÈSE

Localiser le pays

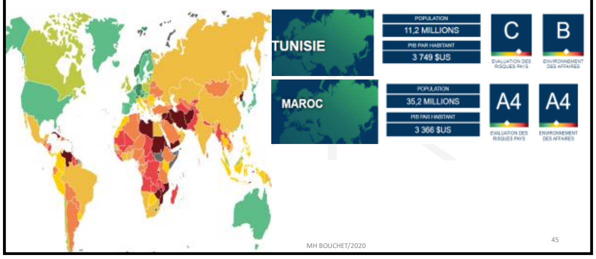
Imprimer

PRINCIPAUX INDICATEURS ÉCONOMIQUES

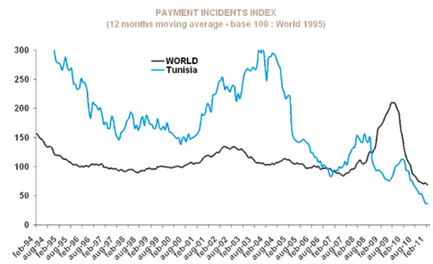
	2017	2018	2019 (e)	2020 (p)
Croissance PIB (%)	1,8	2,5	1,4	1,9
Inflation (moyenne annuelle, %)	5,3	7,3	6,8	6,1
Solde public / PIB (%)	-6,2	-4,8	-4,4	-3,8
Solde courant / PIB (%)	-10,2	-11,1	-8,7	-8,5
Dette publique / PIB (%)	70,4	77,0	75,7	78,7

(e) : Estimation. (p) : Prévision.

CROSS-COUNTRY RISK COMPARISON



TUNISIA 1994-2011 PAYMENT ARREARS INDEX (COFACE)



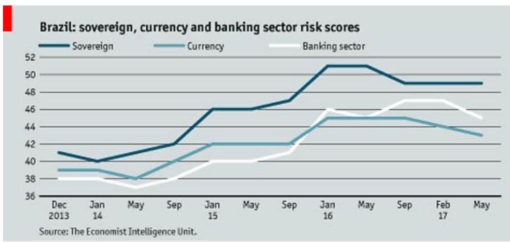
EFIC-AUSTRALIA

- http://www.efic.gov.au/COUNTRY/COUNTRYPROFILES/Pages/countryprofiles.aspx

EIU 5 RISK ANALYSIS SERVICES

- **Country analysis**–Political and economic analysis, business environment analysis, cross-country benchmarking and market-trends tracking.
- **Risk assessment**–Sovereign debt risk assessment and operational risk analysis on 190 countries
- **Market entry and sizing**–Market entry strategies, market sizing, market potential and pricing data.
- **Strategic industry analysis**–Industry benchmarking, strategic trend analysis and global commodities analysis.
- **Economic modelling and forecasting**–Data customisation, demand forecasts and econometric analysis of industry drivers.

EIU ►London-based Economic Intelligence Unit



EIU

London-based Economic Intelligence Unit

July 31st 2017 Print Share

Overview

Brazil: risk assessment

	Sovereign risk	Currency risk	Banking sector risk	Political risk	Economic structure risk	Country risk
May 2017	BB	BB	BB	BB	BB	BB

Robert Wood (lead analyst); Fiona Mackie (analyst). Published 05 May 2017, 2100 GMT.

These ratings are restated from the Ratings Report indicated above, which was produced outside the European Union, and therefore are not issued by The Economist Intelligence Unit credit rating agency, which is registered in accordance with Regulation (EC) No 1060/2009 of 16 September 2009, on credit rating agencies, as amended. This report and the ratings, therefore, are not issued pursuant to such Regulation and do not fall within its scope.

Download the numbers in Excel

Sovereign risk

The president, Michel Temer, is resisting pressure to resign following corruption allegations made against him in May. Even if he does survive (we now assume that he will), governability will weaken, reducing the likelihood that pension reforms will be approved in Congress. This will set back medium-term fiscal consolidation plans and rekindle lingering concerns about debt sustainability.

Currency risk

The latest political crisis caused a sell-off in the Real, but it has since regained ground (to R3.15:US$1 in late July). Narrowing interest-rate differentials will weaken the Brazilian currency as the Banco Central do Brasil (the central bank) continues to ease monetary policy while US policy rates rise. Brazil has a large reserves cushion.

Business Environment Risk Intelligence BERI provides a Political Risk Index assessing the social and political environment of a country. It is built on the opinion and scores provided by a hundred experts with a diplomatic or political science background. Governance quality is included into political risk analysis along with government effectiveness and social indicators. http://beri.com	**Political Risk Services**[1] The PRS analyses cover a hundred countries and are updated on a quarterly basis. **International Country Risk Guide** measures and tracks corruption perception in government, law and order, expropriation risk, as well as the quality of bureaucracy. These measures stem from the subjective assessment of experts around the world. http://prsgroup.com	Thanks to its unique policy dialogue with more than 180 countries, the **World Bank** has developed a comprehensive database of composite governance indicators, measuring perceptions of voice and accountability, political stability, government effectiveness, regulatory quality, rule of law, and corruption. www.worldbank.org/wbi/governance/
The London-based **Economist Intelligence Unit** (EIU) provides a comprehensive é-year forecasting country risk analysis on some 100 EMCs., on a quarterly basis. The EIU method flows from expert's answers to a series of 77 predetermined qualitative and quantitative questions. http://eiu.com	To look upon governance and corruption, Moody's takes into consideration the structures of social interaction, social and political dynamics, as well as the economic fundamentals. Moody's relies on the judgment of a group of credit risk professionals to weigh the various risk factors as well as the impact of each of these factors upon business prospects. http://moodys.com	**Standard and Poor's** rating approach is both quantitative and qualitative. It is based on a checklist of 10 categories, including governance and political risk. The political risk factors gauge the impact of politics on economic conditions, as well as the quality of governance and the degree of government support in the population. S&P assigns short term and long-term ratings. http://standardandpoors.com
Euromoney publishes ratings of some 180 countries since 1982 on a semi-annual basis. The methodology is built from a blend of quantitative criteria and qualitative factors coming from surveys with about 40 political analysts and economists. Political risk receives a 25% weighting, as much as economic performance. Countries are graded on scale from 0 (worst) to 100 (best). www.euromoney.com	**Institutional Investor**'s ratings are published twice a year since 1979 to assess the creditworthiness of about 150 countries, based on a survey of some 100 international bankers' perception of creditworthiness, including economic, financial and socio-political stability criteria. The resulting score scales from zero (very high chance of default) to 100 (least chance of default). www.institutionalinvestor.com	**Transparency International**, a non-profit non-governmental organization in Berlin, provides an annual survey of corruption practices in nearly 90 countries since 1995. The Corruption Perception Index is based on a wide network of information sources with local NGOs, domestic and foreign corporations, investors, and business contacts. www.transparency.org

Heritage Foundation established since 1985, in partnership with the WSJ, an economic freedom index for some 160 countries, both industrialized and developing. The ranking is based on various socio-political and economic criteria, including political stability, state interference, regulatory framework, institutional strength, and corruption scope. www.heritage.org	PricewaterhouseCoopers's **Opacity Index** measures the lack of clear, accurate, formal and widely accepted practices in a country's business environment. As such, it focuses on the relative state of corrupt business practices, the transparence of the legal system and the regulatory framework. It represents a quantitative approach to measuring opacity and its resulting extra risk premium that stems from the additional business and economic costs. www.opacityindex.com/	The Institute for Management Development's **World Competitiveness Report** analyses 49 industrialized and emerging economies around the world based on a far-reaching survey since 1989. Its analysis of the institutional framework addresses issues such as state efficiency, transparency of government policy, public service's independence from political interference, bureaucracy as well as bribery and corruption. www.imd.ch
Freedom House focuses since 1972 on corruption levels in a number of developing and transition economies around the world. FH publishes an annual assessment of state of freedom in various countries on the base of political rights and civil liberties. Political stability and civil liberties are ranked on a scale of 1 (best) to 7 (worst). www.freedomhouse.org/ratings.index.html	**The Political and Economic Stability** Index of Lehman Brothers and Eurasia measures relative stability in around 20 EMCs by integrating political science theories with financial markets developments. The monthly evaluation uses both quantitative and qualitative criteria, including institutional efficiency, political legitimacy, economic performance, and government effectiveness. www.legsi.com	**Political and Economic Risk Consultancy** (PERC) specializes in strategic business information and analysis in East and Southeast Asia, with emphasis on corruption and business costs. Annual risk reports survey over 1,000 senior expatriates living in to obtain their perceptions of corruption, labor quality, intellectual property rights risks and other systemic shortcomings. www.asiarisk.com

Centre international de formation européenne

NICE BERLIN BRUXELLES ISTANBUL

COUNTRY RISK AND THE BALANCE OF PAYMENTS
CURRENT ACCOUNT

CIFE SEMINAR NICE MAY 6-8, 2020

MICHEL-HENRY BOUCHET

▶ **Country risk assessment starts with the Balance of payments!**

1. Inflation and trade deficits
2. Currency volatility
3. Exchange rates and competitiveness
4. External financing flows
5. Capital flight
6. Liquidity or solvency problems?
7. Debt crisis!

BALANCE OF PAYMENTS

Accounting framework and statistical record of all economic and financial flows between residents of the reporting country and the rest of the world

The time period itself is arbitrary:

monthly, quarterly and yearly basis

BALANCE OF PAYMENTS RECORDING OF TRADE AND FINANCIAL FLOWS

Exports
Imports
Services (tourism)
Transfers (remittances)
FDI
Portfolio
Capital inflows and outflows
Reserve Change
Arrears

BALANCE OF PAYMENTS AND EXTERNAL DEBT

Balance of Payments | Assets & Liabilities

Change in flows

Double-entry accounting system

- Receipts = **Inflows** (exports GS + capital)
- Debits = **Outflows** (Imports, interest and debt payments)

External Debt and Reserves

- Change in **stocks**

Δ+ Reserve Assets
Debt repayment

Δ- Reserves
Δ+ Debt Stock

THE BALANCE IS ALWAYS BALANCED!

Changes in the stock of reserve assets, emergency financing, payment arrears… or debt default, will balance the national accounts

Residents? = Government, households, individuals, NGOs & private non-profit entities, and firms.

- MNCs are by definition resident in more than one country. The MNC's subsidiaries are treated as <u>resident</u> in the country in which they are located even if their shares are actually owned by foreign residents.
- IFIs are always <u>foreign</u> residents (IMF…)
- Tourists and students are <u>foreign</u> residents if they stay in the reporting country **< 1 year**

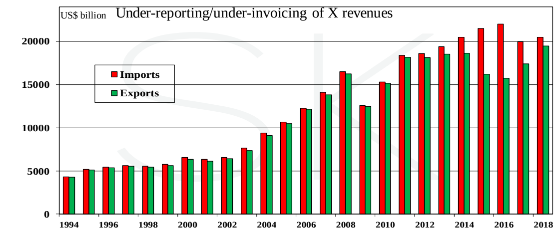
BALANCE OF PAYMENTS ACCURACY ?

- Data collection and methodological errors
- Inconsistencies in the time of recording and valuation of the corresponding debit and credit entries
- Undercoverage (overinvoicing/underinvoicing)
- Revisions policy
- Use of sample surveys rather than complete enumeration
- Trade-off between accuracy and timeliness!

THE WORLD "MISSING" EXPORTS

A « ***black hole*** »

>US$300 b



Source: IMF-2018

INTERPRETING THE BALANCE OF PAYMENTS

Different accounts in the balance of payments make it possible to see whether or not a country lives

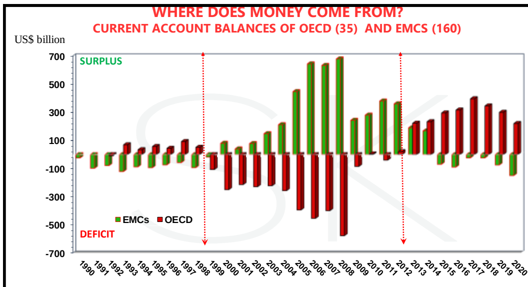
"beyond its means"

Merchandise exports or imports can be broken down by product and by market source and destination (incompressible imports or volatile exports!)

Useful for determining how a country's balance of payments and overall economic performance will react to different situations (elasticities, exchange rate adjustment, domestic absorption, terms of trade, trade barriers, deflation…)

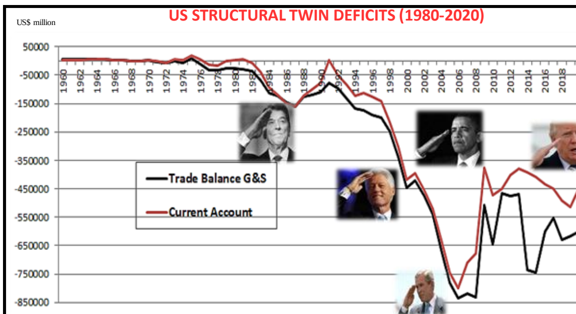
WHERE DOES MONEY COME FROM?

CURRENT ACCOUNT BALANCES OF OECD (35) AND EMCS (160)



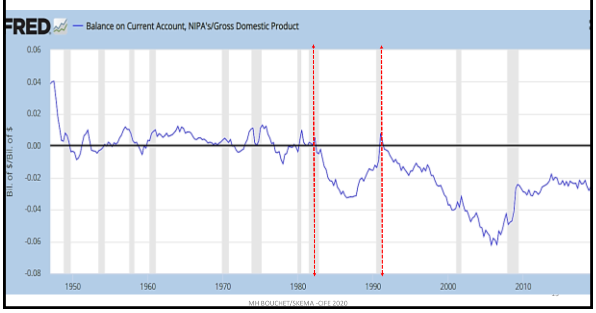
Source: IMF-WEO 2020

US STRUCTURAL TWIN DEFICITS (1980-2020)



Source: US Treasury 2020/FED

THE US CURRENT ACCOUNT DEFICIT IN % OF US GDP (1947-2019)



INTERPRETING THE BALANCE OF PAYMENTS

- Living beyond its means?
- Current account balance = saving - domestic spending
- A country that **saves > it invests** at home sends its surplus abroad to purchase foreign assets
- One that **saves < it invests** finances the shortfall by issuing liabilities to foreign investors = △ debt!
- The accumulated history of current account surpluses or deficits, along with capital gains and losses on past investments, determines a country's **net international investment position**.

NATIONAL INCOME IDENTITY

Y = National income
C = Domestic Consumption
I = Investment
G = Government expenses
T = Taxes & Government revenues
X = Exports
M = Imports
S = Domestic Savings (income > consumption)

DOMESTIC AND EXTERNAL FINANCIAL EQUILIBRIUM

What is disposable income?

Y = gross income - imports & taxation

Y = C + I + G + X – M – T + (KM – K flight)

Savings = Y – C

(S – I) + (T – G) = **(X – M)** + **(KM – K flight)**

Savings — Fiscal balance — Trade balance — Net capital inflows

BOOSTING SAVINGS TO FINANCE INVESTMENT WITHOUT EXTERNAL DEFICIT?

if S > I ⇒ X > M

If S <I ⇒ **M >X**

- a trade imbalance is always rooted in low savings and excessive domestic spending (absorption)
- It requires macroeconomic correction (interest rate hike, devaluation, ↑ taxation, credit reduction, ↑ reserve requirements…)

Two principal sub-accounts

1. **current account** plays a role similar to a private company's income statement= country's economic performance vis-à-vis the rest of the world.

2. **capital account** shows how the country's economic growth gets financed.

The basic balance draws the line under "other long-term capital" to emphasize the role of economic performance and stable long-term financing. Another presentation is the **Table of Uses & Sources**

BALANCE OF PAYMENTS: CURRENT & CAPITAL ACCOUNTS

1. **Balance of trade** = Exports of merchandise – Imports
2. **Balance of services** ("invisible")
   = freight, insurance, shipping, banking, tourism, interest and dividend payments (i.e. services of capital!)
3. **Unilateral transfers**

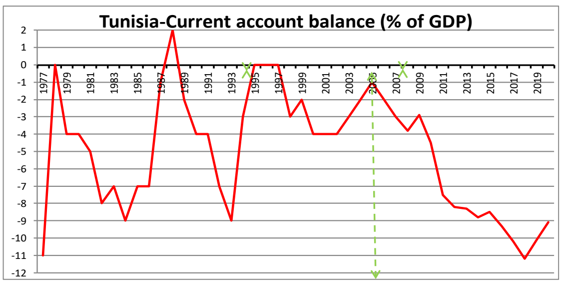
= CURRENT ACCOUNT

- *A deficit in the current account must be financed by a surplus in the capital account!*

THE CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS

From less liquid items toward more liquid items!

\+ Export of goods f.o.b.
\- Imports of goods f.o.b.
= Trade balance
\+ Exports of non-financial services
\- Imports of non-financial services
\+ Investment income (credit)
\- Interest payments
\+ Private unrequited transfers
\+ Official unrequited transfers
= Current account balance



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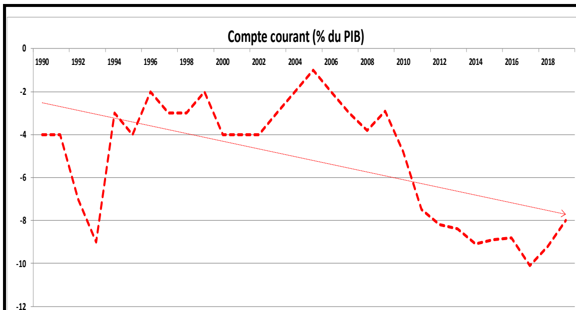

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1. The trade balance comprises

1. **Merchandise exports**: all movable goods such as equipment, cars, trucks, textile, appliances, oil etc.

2. **Imports are recorded "free on board**" (f.o.b.): services (freight, insurance, shipping and handling performed on goods up to the customs frontier of the economy from which the goods are exported), are **not** included in the trade balance.

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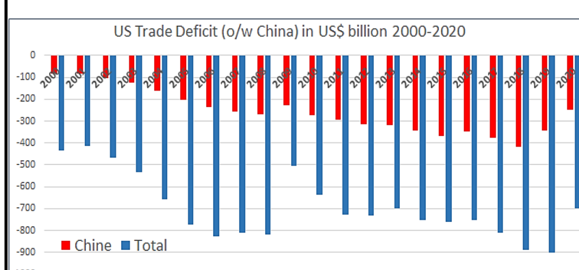
BLAMING CHINA?



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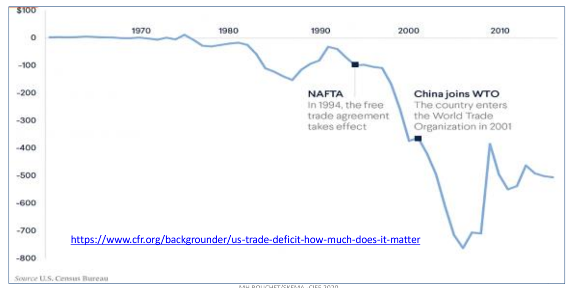
THE US TRADE BALANCE

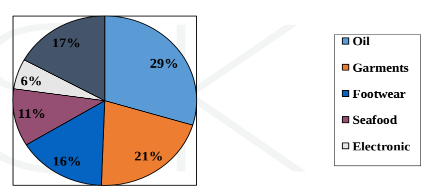
- In 2018 the United States exported $2.500 trillion in goods and services while it imported $3.121 trillion, hence a $621 billion deficit.
- Major goods exported include aircraft, medical equipment, refined petroleum, and agricultural commodities.
- Major imports are dominated by capital goods, such as computers and telecom equipment; consumer goods, such as apparel, electronic devices, and automobiles; and crude oil.
- Services, such as tourism, intellectual property, and finance, make up roughly one-third of exports.
- The deficit in goods, at $891 billion, is higher than the overall deficit, since a portion of the goods deficit is offset by the surplus in services trade.

BLAMING FREE TRADE, CHINA AND EMCS? THE US TRADE DEFICIT OVER TIME



BLAMING CHINA??

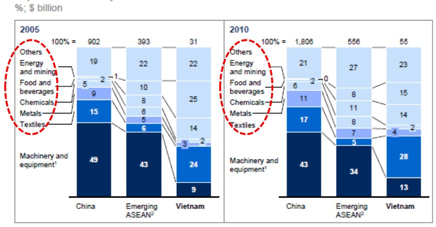
VIETNAM'S EXPORTS OF GOODS



Vietnam's exports are concentrated in low-value-added products compared with ASEAN countries

Export breakdown by subsector

%; $ billion



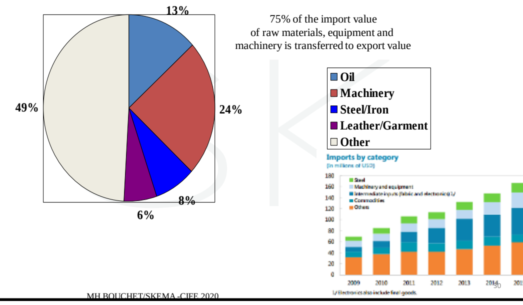
1 Includes electric equipment, electronic products, and general machinery and equipment.

2 Including Indonesia, Malaysia, the Philippines, and Thailand.

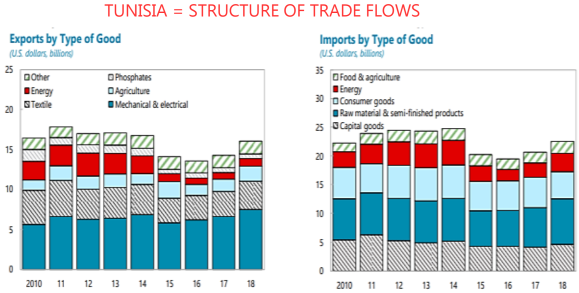
NOTE: Numbers may not sum due to rounding.

SOURCE: Global Insight 2011; McKinsey Global Institute analysis

VIETNAM'S IMPORTS OF GOODS



TUNISIA = STRUCTURE OF TRADE FLOWS



2. Non-financial services =

Freight, insurance, passenger services, tourism, and travel!

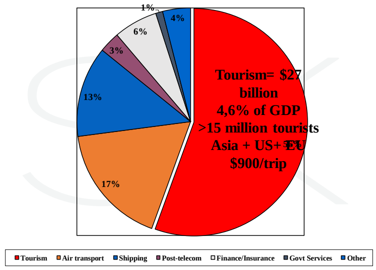
The transportation of persons represents the largest component of passenger services.

Tourism earnings: Cuba, Morocco, Tunisia?, Vietnam, Thailand, Spain, France...

Freight refers mainly to the carriage or transport of goods between national economies (Malta, Cyprus, Liberia, Panama...)

Insurance comprises insurance on movable goods during the course of shipment between economies as well as insurance on the carriers and other types of insurance such as life insurance.

SERVICE EXPORTS OF VIETNAM



3. Financial services: =
Investment income and interest payments

Investment income covers income derived from the ownership of foreign financial assets (interest and dividends for portfolio investment + non-distributed earnings of incorporated enterprises)

Distinction between portfolio investment and direct investment revolves around the investor's intentions concerning the foreign company.

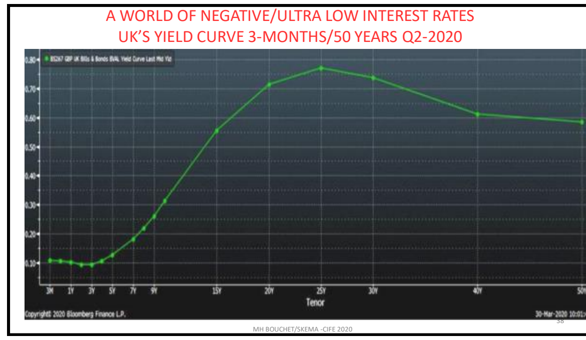
Investment debits = **interest payments** on foreign liabilities

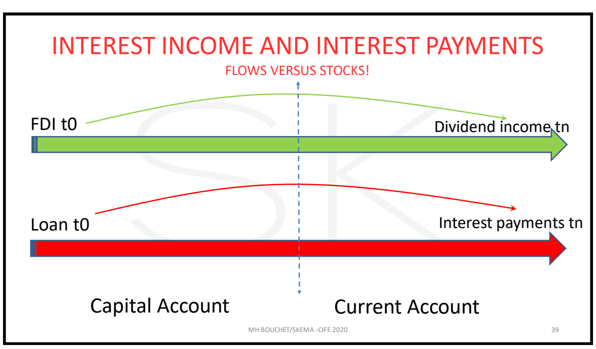
(interest on debt!)

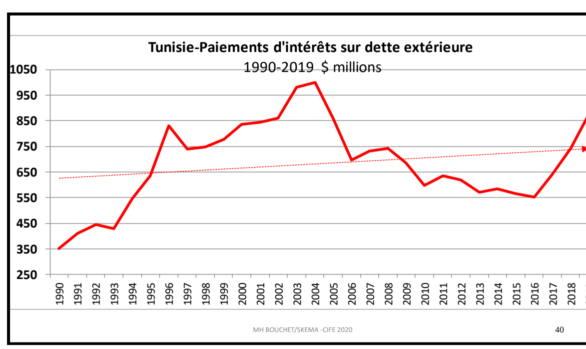
THE RISE AND FALL OF US 10-YEAR TREASURY YIELDS 1790-2019

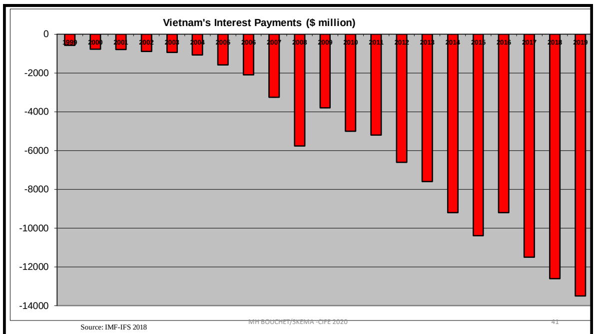
10 YEAR-TREASURY RATE 1960-2019


I YEAR LIBOR RATE 1980-2019
11.00%
10.00%
9.00%
8.00%
7.00%
6.00%
5.00%
4.00%
3.00%
2.00%
1.00%
1990
1995
2000
2005
2010
2015
2,07%


A WORLD OF NEGATIVE/ULTRA LOW INTEREST RATES
UK'S YIELD CURVE 3-MONTHS/50 YEARS Q2-2020
Tenor
MH BOUCHET/SKEMA -CIFE 2020


INTEREST INCOME AND INTEREST PAYMENTS
FLOWS VERSUS STOCKS!
FDI t0
Dividend income tn
Loan t0
Interest payments tn
Capital Account
Current Account
MH BOUCHET/SKEMA -CIFE 2020
39


Tunisie-Paiements d'intérêts sur dette extérieure
1990-2019 $ millions
1050
950
850
750
650
550
450
350
250
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
MH BOUCHET/SKEMA -CIFE 2020
40



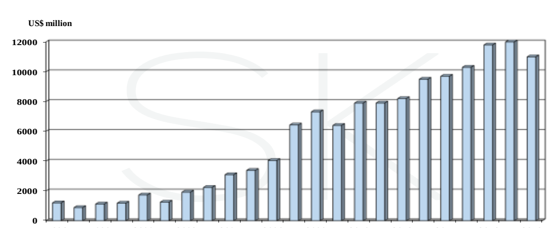
Source: IMF-IFS 2018

4. Private and official unrequited transfers

Private unrequited transfers refer mainly to immigrant workers' remittances to their country of origin as well as gifts, inheritances, prizes, charitable contributions, etc.: Morocco, Mexico, Algeria, Tunisia, India, Pakistan...

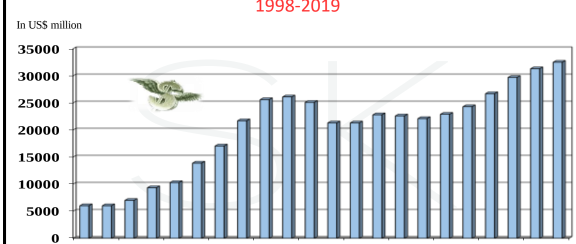
Official unrequited transfers include grants, subsidies, military aid, voluntary debt cancellation, contributions to international organizations, indemnities imposed under peace treaties, technical assistance, etc. : Large inflows for most HIPC-eligible countries (Benin, Tanzania, Haiti...)

VIETNAM'S TRANSFERS REVENUES 1996-2018



Source: IMF-2018

MEXICO'S NET CURRENT TRANSFERS INFLOWS (REMITTANCES) 1998-2019



Source: IMF-IFS/IIF 2019

REMITTANCES BETWEEN LATIN AMERICA AND THE US UNDER TRUMP??

- = Migrant worker's earnings sent back from the country of employment to the country of origin
- Key for Morocco, Tunisia, Indonesia, Vietnam, Philippines, Mexico…
- What linkages between remittance flows to Latin America and the U.S. business cycle?

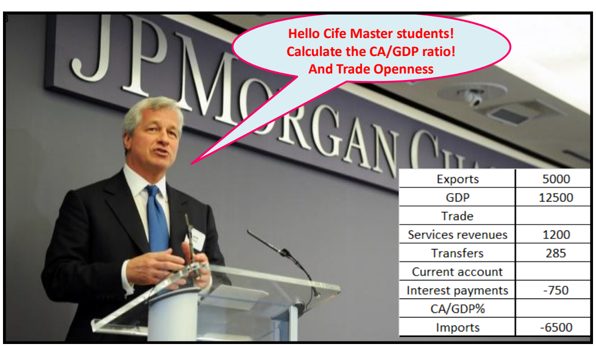
All of the evidence suggests that remittance flows are relatively **insensitive** to fluctuations in the U.S. cycle, underlining their role as a stable source of external financing… until the 2008-09 global financial crisis!

Source: IMF Working Paper, 12/2007= http://www.imf.org/external/pubs/ft/wp/2007/wp07273.pdf

Centre international de formation européenne
NICE BERLIN BRUXELLES ISTANBUL

THE BALANCE OF PAYMENTS II
CURRENT ACCOUNT DEFICIT ADJUSTMENT

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



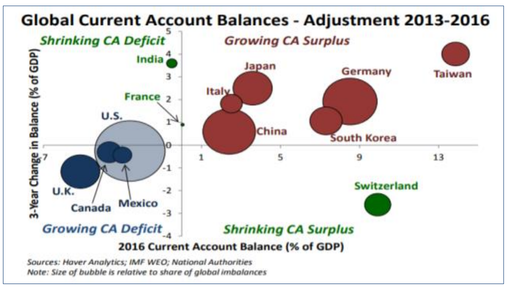
Exports	5000
GDP	12500
Trade	
Services revenues	1200
Transfers	285
Current account	
Interest payments	-750
CA/GDP%	
Imports	-6500

THE CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS

From less liquid items toward more liquid items!

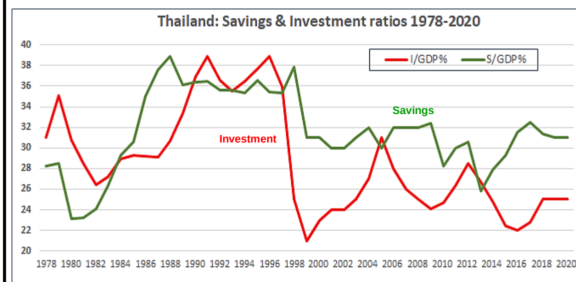
\+ Export of goods f.o.b.
\- Imports of goods f.o.b.
= **Trade balance**
\+ Exports of non-financial services
\- Imports of non-financial services
\+ Investment income (credit)
\- **Interest payments**
\+ Private unrequited transfers
\+ Official unrequited transfers
= **Current account balance**

ADJUSTING CURRENT ACCOUNT IMBALANCES?



Source: US Treasury Report 2017

THE LONG-TERM DYNAMICS OF INVESTMENT AND NATIONAL SAVINGS

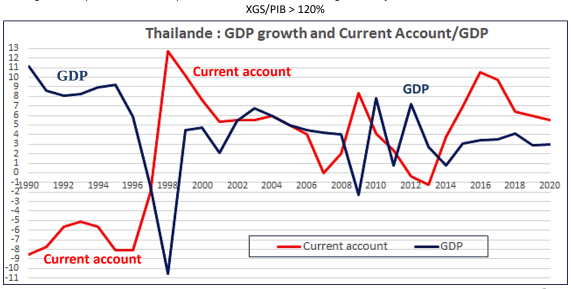


Source: WB and IMF 2020

Thailand in the Global Economy

Large trade openness leads to spectacular current account and growth adjustment after 1998 crisis Σ

XGS/PIB > 120%



POLICY TOOLS TO FIGHT A BOP DEFICIT?

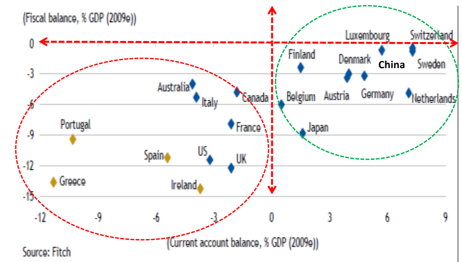
- Reducing absorption and boosting income with:

1. Tight monetary policy (increase in interest rates and higher bank reserve requirements)
2. Exchange rate adjustment
3. Tight fiscal policy (taxes and spending cuts)
4. Cooling down the overheated economy by reducing private consumption and shrinking public expenditures… at the risk of killing growth?
5. Boosting competitiveness and improving productivity?

FACTORS AFFECTING A CURRENT ACCOUNT DEFICIT

- 1. **National income variation: economic overheating**
  - growth/contraction relative to other countries
    - current account surplus decreases (deficit increases)
    - greater wealth implies greater demand of foreign goods (e.g. US econom growth)
- 2. **Inflation and its impact on trade competitiveness: "CPI differentials"...**
    - Higher CPI leads to increased imports and decreased exports due to eroded competitiveness

LARGE DOMESTIC PRIVATE + PUBLIC CONSUMPTION= OVERHEATING= TWIN DEFICITS

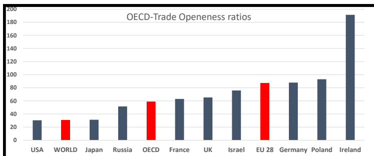


FACTORS AFFECTING A CURRENT ACCOUNT

- 3. **Government restrictions**
  - Import tariff (tax on imported goods)
    - increases prices & lowers demand on imported goods
    - increases current account of the country
    - US tariffs on apparel and farm products
    - "banana war": exports from European former colonies (Africa-Caribbean-Pacific): USA entitled to impose US$191 million sanctions on Europe
  - Non-tariff barriers (health norms and regulations) and quotas:
  - Export and loan Subsidies

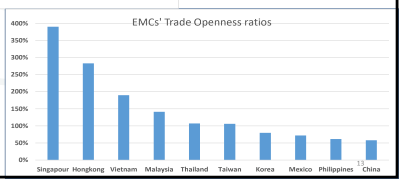
FACTORS AFFECTING A CURRENT ACCOUNT

- 4. **Exchange rates**
  - = currency valued in terms of another currency
  - = stronger exchange rate (overvaluation) might lead to lower exports, decrease in current account surplus, or rising deficit
    - exported goods would cost more for foreign importers, thus decreasing demand for the good
    - assuming price-elastic goods (sensitive to price changes!?)
    - Stronger Euro and weaker US$ throughout 2003-08 mean export-led recovery in the US and gloomy growth scope in Europe! Only advantage: no imported inflation due to rising oil prices
    - Trump considers that the Yuan, the Yen and the Euro are too weak!



TRADE OPENNESS RATIO

(X+M/GDP%)



1. CORRECTING A TRADE DEFICIT?

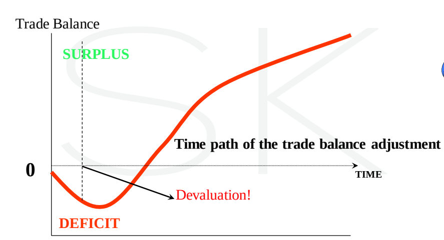
- **Impact of domestic currency devaluation**
  - prices should increase for imports
    - foreign exporters may reduce price to maintain market share
  - other currencies may also weaken to stay competitive
    - no net gain from weaker domestic currency
  - international trade contracts create a lag effect
    - 18+ month lag exists in US
  - intra-company trade is resistant to currency fluctuations
    - 50% of all international trade
    - 60% of European exports are intra-European transactions

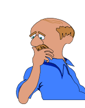
HOW TO SHRINK A TRADE DEFICIT?

- **Boosting Exports?** depends on the price elasticity of foreign demand but also on the supply elasticity of exported products at home

- **Reducing Imports**? depends on relative share of "incompressible" imports (foodstuffs, energy resources, capital goods, machinery, any import for re-export…), but also on the price elasticity of domestic demand

TIME LAGS, ELASTICITIES AND THE ADJUSTMENT MECHANISM: "**J CURVE**"





TRADE ELASTICITIES

What about the price effects of exchange rate changes on the BOP?

- **Import demand elasticity** to prices = **$\Delta MD / \Delta P\$ < 0$**
- **Export elasticity** to exchange rate change = **$\Delta X / \Delta P\$ > 0$**
- **Supply elasticity** to increased export demand = **$\Delta S / \Delta XD > 0$?**

This elasticity depends on the availability of finance, equipment, (imported) inputs, labor...

- Terms of trade (deterioration post devaluation): it takes more units of Exports to buy x units of imports

DEVALUATION: THE DAY AFTER ?

KEY ROLE OF ELASTICITIES = RATIO OF TWO VARIATIONS

Supply elasticities

- $\dfrac{\Delta + \text{Domestic production}}{\Delta + \text{Foreign demand}}$

Demand elasticities

- $\dfrac{\Delta - \text{Domestic consumption}}{\Delta + \text{Import prices}}$

$\dfrac{\Delta + \text{Foreign demand}}{\Delta - \text{export prices}}$

REDUCING THE TRADE DEFICIT?

- Import elasticity of domestic economic growth

$\Delta M / \Delta Y$ = Income elasticity of demand for imports: percentage of (induced) change in imports divided by the percentage of change in income: if M double while Y is growing 50%, **the value of income elasticity = 2**.

TIME LAGS, ELASTICITIES AND THE ADJUSTMENT MECHANISM

The J-Curve and **Marshall-Lerner** conditions:

- A devaluation will improve the trade balance if the **sum** of price elasticities of imports and exports is > 1

- In the long-term, if goods exported are elastic to price, export revenue will increase if foreign export demand increases proportionately more than the decrease in price. If goods imported are elastic, total import expenditure will decrease. Both will improve the trade balance!

To boost export competitiveness, what should a country's central bank devalue?

The nominal exchange rate or the real effective exchange rate?

REAL EXCHANGE RATES

- The RER is the product of the nominal exchange rate between two currencies and the ratio of prices

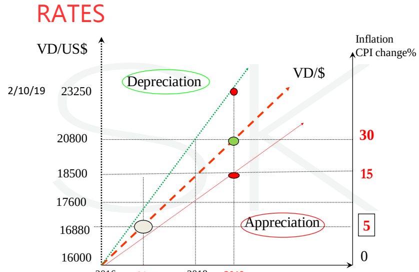
$$RER = NR \times \frac{Px}{Py}$$

If the €/$ exchange rate is 1€= 1,5 $, and if average prices for the same basket of goods are 2,5 € in the EU and 3,70$ in the US,
then the **RER = 1**

RER €/$= 1,5 * (2,5/3,7)

See: Finance & Development, September 2007, pp. 46-47.

NOMINAL AND REAL EXCHANGE RATES



MEASURING COUNTRY COMPETITIVENESS? NOMINAL AND REAL EFFECTIVE EXCHANGE RATES

- **Nominal EERs**= geometric weighted averages of bilateral exchange rates (weighted by trading shares)
- **Real EERs** = weighted averages of bilateral exchange rates adjusted by **relative prices.**

$$REER_{\text{country } i} = \sum_{j=1}^{N} \text{trade weight (country j)} \times \text{Real Exchange Rate (country j)}$$

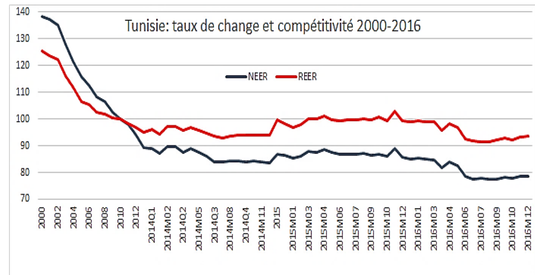
country j=1,2,...N are country i's trading partners, exchange rates in natural logarithms (geometric averages)

REAL EFFECTIVE EXCHANGE RATES

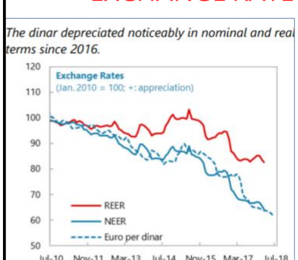
▶ **Real**: inflation- adjusted exchange rate
ex.: will the devaluation fully offset inflation in country x?

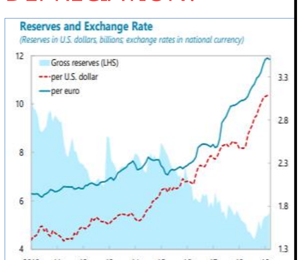
▶ **Real Effective**: exchange rate adjusted for inflation-differential with **major trading partners**: a tool of exchange rate management policy (e.g. Mexico)

TUNISIA: NOMINAL AND REAL EFFECTIVE EXCHANGE RATES



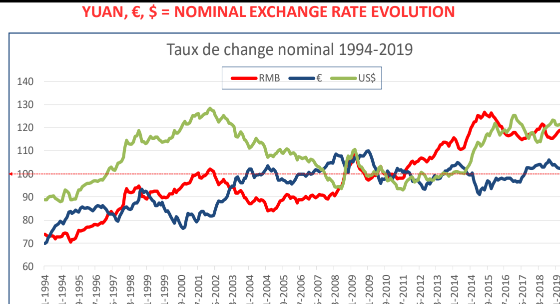
EXCHANGE RATE DEPRECIATION?





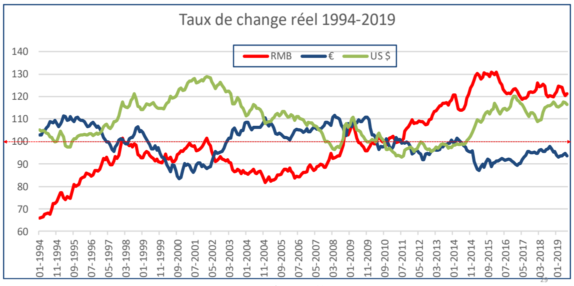
http://data.imf.org/regular.aspx?key=60998108

YUAN, €, $ = NOMINAL EXCHANGE RATE EVOLUTION

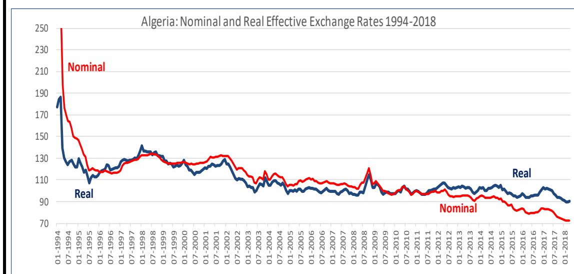


Source: BRI

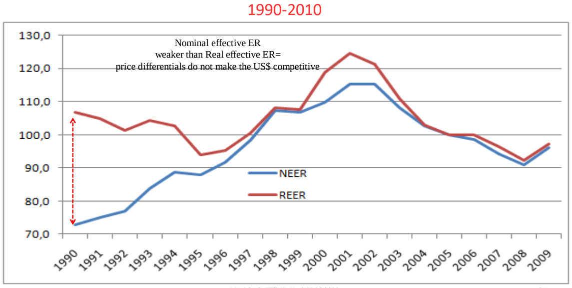
YUAN, €, $ = REAL EXCHANGE RATE EVOLUTION



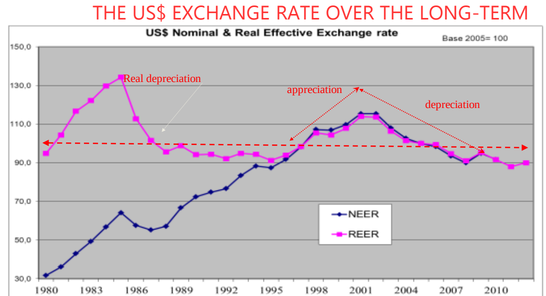
NOMINAL AND REAL EFFECTIVE EXCHANGE RATES



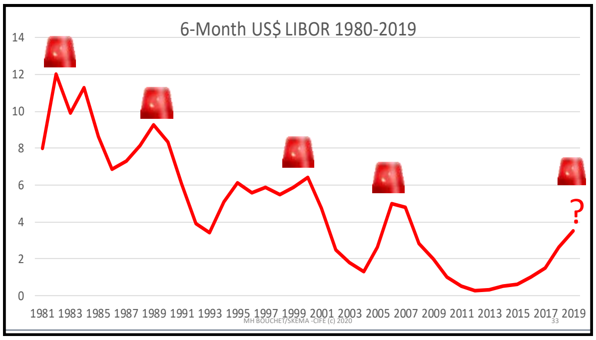
US $ NOMINAL/REAL EFFECTIVE EXCHANGE RATES 1990-2010

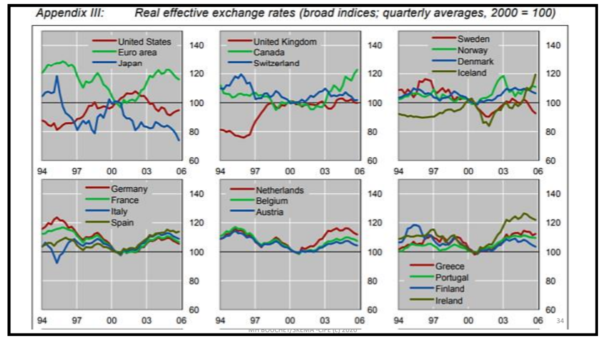


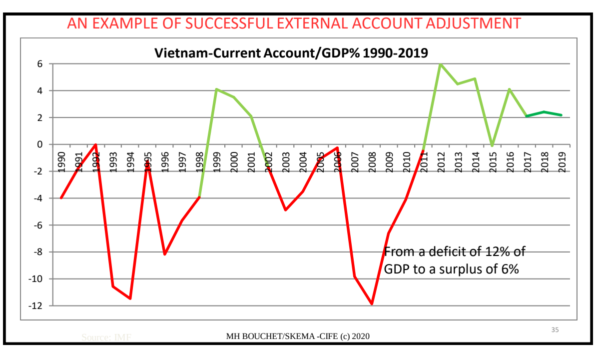
THE US$ EXCHANGE RATE OVER THE LONG-TERM

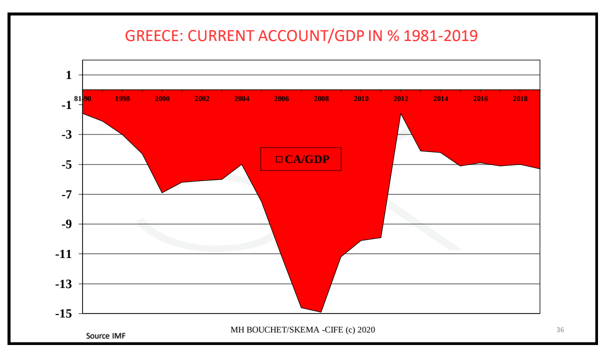


Source: IMF-OECD

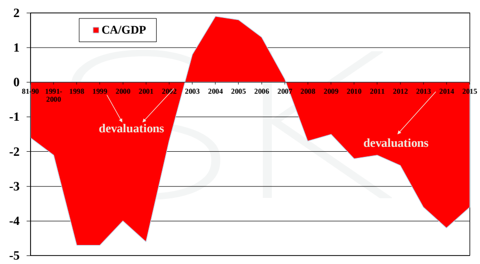

6-Month US$ LIBOR 1980-2019
?
1981 1983 1985 1987 1989 1991 1993 1995 1997 1999 2001 2003 2005 2007 2009 2011 2013 2015 2017 2019
MH BOUCHET/SKEMA -CIFE (c) 2020


Appendix III: Real effective exchange rates (broad indices; quarterly averages, 2000 = 100)
United States
Euro area
Japan
United Kingdom
Canada
Switzerland
Sweden
Norway
Denmark
Iceland
Germany
France
Italy
Spain
Netherlands
Belgium
Austria
Greece
Portugal
Finland
Ireland


AN EXAMPLE OF SUCCESSFUL EXTERNAL ACCOUNT ADJUSTMENT
Vietnam-Current Account/GDP% 1990-2019
From a deficit of 12% of
GDP to a surplus of 6%
MH BOUCHET/SKEMA -CIFE (c) 2020

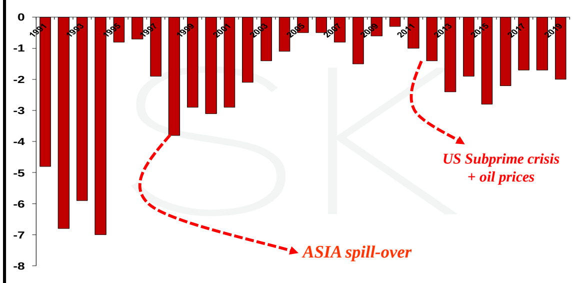

GREECE: CURRENT ACCOUNT/GDP IN % 1981-2019
CA/GDP
Source IMF
MH BOUCHET/SKEMA -CIFE (c) 2020

BRAZIL: CURRENT ACCOUNT/GDP IN %



IMF 2015

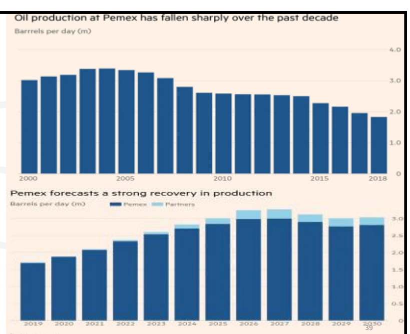
MEXICO : CURRENT ACCOUNT BALANCE/GDP RATIO % 1990-2019



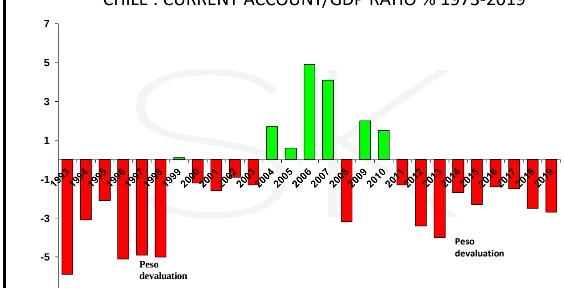
Source: IMF & IIF 2016

MEXICO'S OIL PRODUCTION, EXPORT REVENUE PROSPECTS AND CURRENT ACCOUNT DEFICIT

(Oil = 20% of budget revenues and 8% only of export receipts)

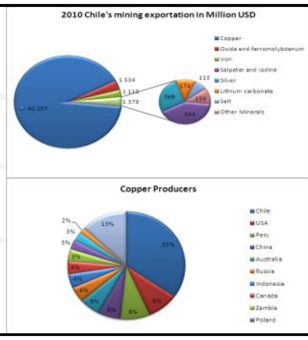


CHILE : CURRENT ACCOUNT/GDP RATIO % 1973-2019

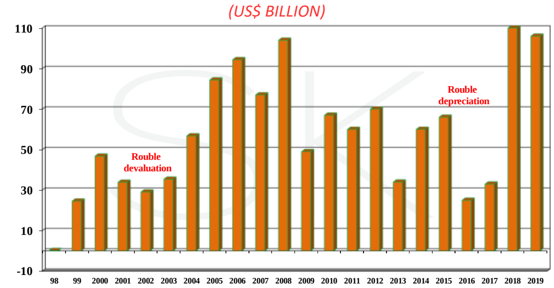


Source: IMF 2019/CDD

CHILE'S TRADE BALANCE: STRUCTURAL DEPENDENCE ON COMMODITIES



RUSSIA: CURRENT ACCOUNT BALANCE
(US$ BILLION)



Source: IMF & IIF

TUNISIA'S BOP 2016-2024 (IMF 2020 ART.IV)

	2016 Annual	2017 Annual	2018 Q1	2018 Q2	2018 Q3	2018 Q4 Est.	2018 Annual Est.	2018 Annual 4th Rev	2019 Q1 Proj.	2019 Q2 Proj.	2019 Q3 Proj.	2019 Q4 Proj.	2019 Annual Proj.	2019 Annual 4th Rev	2020 Annual Proj.	2020 Annual 4th Rev	2021 Annual Proj.	2022 Annual Proj.	2023 Annual Proj.	2024 Annual Proj.
Current account balance	-3,901	-4,080	-1,164	-1,122	-1,135	-1,053	-4,474	-3,909	-881	-1,058	-902	-605	-3,648	-3,415	-3,187	-3,247	-2,970	-2,840	-2,698	-2,644
Trade balance	-4,806	-5,308	-1,187	-1,483	-1,890	-1,390	-5,951	-5,473	-1,176	-1,412	-1,761	-1,089	-5,438	-5,170	-5,411	-5,057	-5,382	-5,228	-5,078	-4,881
Exports	13,568	14,231	4,176	4,045	3,346	3,917	15,485	16,135	4,132	3,835	3,497	3,958	15,522	17,004	16,153	17,775	16,843	17,669	18,536	19,503
Energy	765	846	235	221	171	253	880	983	218	163	169	219	769	1,072	813	1,083	932	945	967	994
Non-energy	12,804	13,384	3,941	3,824	3,175	3,665	14,605	15,152	3,914	3,773	3,328	3,739	14,754	15,933	15,340	16,632	15,910	16,724	17,569	18,509
of which: non-food	11,368	11,844	3,270	3,268	2,806	3,216	12,561	13,265	3,451	3,312	3,020	3,374	13,156	14,051	13,676	14,629	14,172	14,881	15,611	16,428
Imports	-18,374	-19,538	-5,363	-5,528	-5,236	-5,306	-21,435	-21,609	-5,308	-5,347	-5,258	-5,047	-20,960	-22,174	-21,564	-22,772	-22,225	-22,897	-23,614	-24,384
Energy	-2,024	-2,513	-802	-697	-942	-718	-3,159	-3,242	-665	-709	-680	-573	-2,627	-2,942	-2,674	-2,861	-2,706	-2,793	-2,915	-3,057
Non-energy	-16,351	-17,025	-4,561	-4,831	-4,294	-4,590	-18,276	-18,367	-4,643	-4,638	-4,578	-4,473	-18,333	-19,232	-18,890	-19,911	-19,519	-20,104	-20,699	-21,327
of which: non-food	-14,567	-15,101	-4,025	-4,319	-3,783	-4,154	-16,280	-16,272	-4,075	-4,136	-4,091	-3,961	-16,263	-16,835	-16,684	-17,435	-17,249	-17,769	-18,293	-18,848
Services and transfers (net)	905	1,228	23	361	755	337	1,476	1,565	295	353	859	284	1,790	1,755	2,224	1,810	2,412	2,388	2,380	2,238
Services	113	305	-44	137	421	200	714	648	224	281	582	180	1,266	689	1,678	827	1,473	1,422	1,375	1,178
of which: tourism	1,105	1,170	239	321	627	359	1,546	1,464	290	375	599	343	1,607	1,560	1,781	1,620	1,852	1,831	1,820	1,717
Transfers (net)	792	923	68	224	333	137	762	917	71	72	277	104	524	1,065	546	983	939	966	1,005	1,060
of which: workers' remittances	1,794	1,861	437	444	583	380	1,845	2,006	388	409	497	389	1,683	2,102	1,633	2,193	1,740	1,853	1,984	2,121
of which: interest payments on external debt	-756	-607	-234	-147	-197	-108	-685	-794	-240	-255	-131	-282	-908	-896	-972	-1,028	-1,106	-1,240	-1,369	-1,487
Capital and financial account	2,506	4,079	538	1,119	1,438	2,004	5,099	4,225	941	982	751	1,054	3,728	4,433	3,003	3,806	3,318	3,592	3,607	3,984
Capital account balance	95	184	5	3	3	116	127	77	18	42	42	23	124	32	71	66	71	71	70	70
Financial account balance	2,411	3,895	532	1,116	1,435	1,888	4,972	4,147	923	941	709	1,031	3,604	4,401	2,932	6,387	3,247	3,522	3,536	3,915
Direct investment and portfolio (net)	638	746	169	200	231	338	938	723	178	230	218	277	903	958	986	1,093	953	1,057	1,171	1,263
Medium- and long-term loans (net)	762	2,280	77	118	375	447	1,017	1,891	410	643	-236	-179	638	1,627	-143	1,450	968	1,281	966	949
Disbursements	2,191	4,266	401	463	735	865	2,464	3,920	760	1,298	567	249	2,875	4,030	1,924	3,526	3,572	3,025	3,064	3,606
Amortization	-1,428	-1,986	-323	-344	-361	-418	-1,447	-2,029	-350	-656	-803	-428	-2,237	-2,403	-2,067	-2,077	-2,604	-1,744	-2,098	-2,657
Short-term debt and other capital flows (net)	1,010	869	286	798	829	1,104	3,017	1,534	336	68	727	934	2,064	1,816	2,089	1,197	1,326	1,184	1,400	1,702
Overall balance	-1,396	-1	-626	-3	303	951	625	316	60	-77	-152	249	80	1,019	-184	559	347	752	909	1,341
Errors and omissions 2/	-350	-342	24	-282	-407	-589	-1,253	0	391	0	0	0	391	0	0	0	0	0	0	0
Financing	1,746	343	602	285	104	-362	629	-316	-451	77	152	-249	-472	-1,019	184	-559	-347	-752	-909	-1,341
Gross international reserves ("-": accumulation)	1,460	348	408	424	-23	-488	402	-545	-293	-70	227	-612	-748	-1,627	-467	-680	-267	-624	-652	-920

2. CUTTING INFLATION AND SLOWING DOWN OVERHEATING ECONOMY WITH EXCHANGE RATE APPRECIATION?

Principle:

- 1. A currency appreciation would cut the cost of imported goods and services, as well as import commodities (gasoline, machinery, production materials), hence helping to reduce the CPI.
- 2. Lowering imported costs will make them cheaper and more competitive, forcing local producers to lower prices to maintain their market share (?)

2. CUTTING INFLATION AND SLOWING DOWN OVERHEATING ECONOMY WITH EXCHANGE RATE APPRECIATION?

- 3. Improbable trio: a central bank cannot stabilize the exchange rate and liberalize the capital account while implementing an independent monetary policy to control inflation. Floating rate frees the central bank from the need to buy foreign exchange and to increase the money supply.
- 4. Appreciating exchange rate leads people to wish to hold the currency and to own assets priced in this currency, hence reducing the demand pressure and the CPI.

- All in all, appreciation of the local currency can help control inflation? This much depends on the composition of imports and the « pass through » between importers and consumers!

US CURRENT ACCOUNT, IMPORT PRICES AND DOLLAR EXCHANGE RATE

- Key: Rate of exchange rate « **pass through** » = degree to which a change in the value of a country's currency induces a change in the price of the country's imports and exports
- Pass-through is always incomplete: in the OCDE countries import prices have become progressively less responsive to changes in exchange rates over the past decade or so
- The dollar's depreciation has had little impact on import prices and on the reduction of the US current account deficit (about 50% of the cumulative change in the $ has been transmitted to higher US import prices over 2002-05)

Source: Fed RBNY Current Issues 09/2006 and June 2007

US CURRENT ACCOUNT, IMPORT PRICES AND DOLLAR EXCHANGE RATE IN 2019-20?

Weaker $ = Lower US demand? Stronger exports?

- The European exporter must decide what share of the dollar depreciation to absorb in his profit margin and what share to pass on to US consumers

US CURRENT ACCOUNT, IMPORT PRICES AND DOLLAR EXCHANGE RATE

- Why will a weaker $ boost foreign demand for US exports but with little impact on lower US imports, hence is unlikely to close the US trade deficit?

1. Special role of the US$ in invoicing international trade transactions = insensitivity of import prices to exchange rates
2. Competitive market share concerns of foreign exporters
3. High US marketing and distribution costs that form part of the final consumption prices of imported goods. All these costs reduce the share of the final price that is affected by exchange rates movements.

The History of the U.S. Balance of Payments

Stage I: The U.S. is a *young debtor nation* (1770-1870) -Current account deficit due to the need to import most goods and inability to produce many goods for export. -Capital account surplus due to a great deal of foreign investment in the U.S. in the areas of roads, farming, cattle ranches, railroads, and canals.
Stage II: The U.S. is a *mature debtor nation* (1870-1920) - Current account deficit due to large investment income being paid back to foreign investors based on the investment of stage I. Merchandise account in surplus -- exports > imports.
Stage III: The U.S. is a *young creditor nation* (1920-1945) -Huge surplus in the current account due to large volume of postwar (WWI) exports. -Capital account in deficit due to a great deal of U.S. investment in Europe for postwar reconstruction.

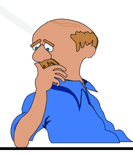
Source: http://www.digitaleconomist.com/bop_4020.html

Stage IV: The U.S. is a *mature creditor nation* (1945-1980) -Merchandise deficit -- *exports < imports* but an investment income surplus with a slight net surplus overall. -Capital account is in deficit largely due to postwar (WW II) reconstruction in Europe and Japan.

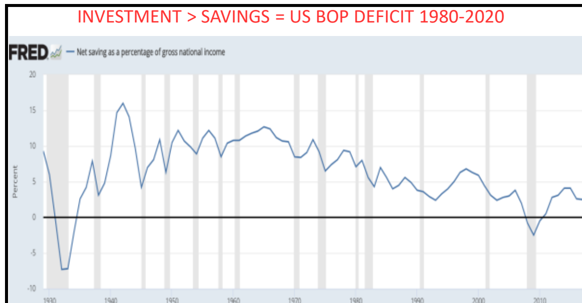
Stage V: (1980-) -Large (and growing) deficit in the merchandise accounts (Trade Deficit) and slight surplus in the investment income accounts. -Large surplus in the capital account partially to finance the above merchandise deficit (foreign individuals and banks lending money to individuals in the U.S.) Additionally, since the U.S. has had a low inflation rate since 1982 and consistent economic growth , the U.S. has been a good place to invest relative to the rest of the world. However the current inflow of capital investment could eventually lead to large investment income payments in the near future. The investment income surplus may soon be eroded thus worsening the current account deficit.

THE US CURRENT ACCOUNT DEFICIT DILEMMA

- Shrinking the deficit requires a weaker $
- Financing the deficit requires a strong $ by attracting US$2 billion/day foreign capital inflows

INVESTMENT > SAVINGS = US BOP DEFICIT 1980-2020



FRBSF March 2020

THE RISE AND FALL OF US 10-YEAR TREASURY YIELDS 1790-2018

FINANCING THE US CA DEFICIT?

Record US CA deficit in 2003-2018 >7% of GDP

Mounting deficit in 2018-19 under Trump

- How to finance it? By importing K inflows from outside the US economy: need for high interest rates and/or strong US$ currency, or pressure on surplus countries (China, Korea, Japan)!
- Damocles' sword: Japanese investors massively withdraw their investments in US$ assets and UST bills and repatriate their funds in Japan. Meanwhile, nearly 50% of US securities remain in foreign hands
- US and Japan compete to lower their exchange rates to gain competitive trade advantage! **$ Crash Lending?**

FINANCING THE US CAD?

- Morgan Stanley : Why is the dollar not (yet) crashing?

  The runaway CAD against Asian nations is not unduly worrying as long as Asia continues to park its capital surpluses in US assets (**60%** of the CAD is run against Asia and **bulk** of the US external deficit funded by Asian central banks)

  « As long as Asia stays in the dollar zone, the dollar cannot **crash**»
- But mounting risk over the funding of the structural deficit leading to repatriation flows by foreign investors (hence weakening $/€ to $1,4 against the € in 10/2008)

FINANCING THE US CA DEFICIT IN 2019-20?

Record US CA deficit in 2003-2008 >7% of GDP

and 5% of GDP in 2009-2019

- How to finance it? By importing K inflows from outside the US economy: need for >0 real interest rates and/or strong US$ currency, or pressure on surplus countries (China, Korea, Japan and Germany)!
- Damocles' sword: Japanese investors massively withdraw their investments in US$ assets and UST bills and repatriate their funds in Japan. Meanwhile, nearly 50% of US securities remain in foreign hands. Declining share of China
- US and Japan compete to lower their exchange rates to gain competitive trade advantage! **$ Crash Lending?**

Centre international de formation européenne

NICE BERLIN BRUXELLES ISTANBUL

THE BALANCE OF PAYMENTS III
CAPITAL ACCOUNT AND EXTERNAL FINANCING

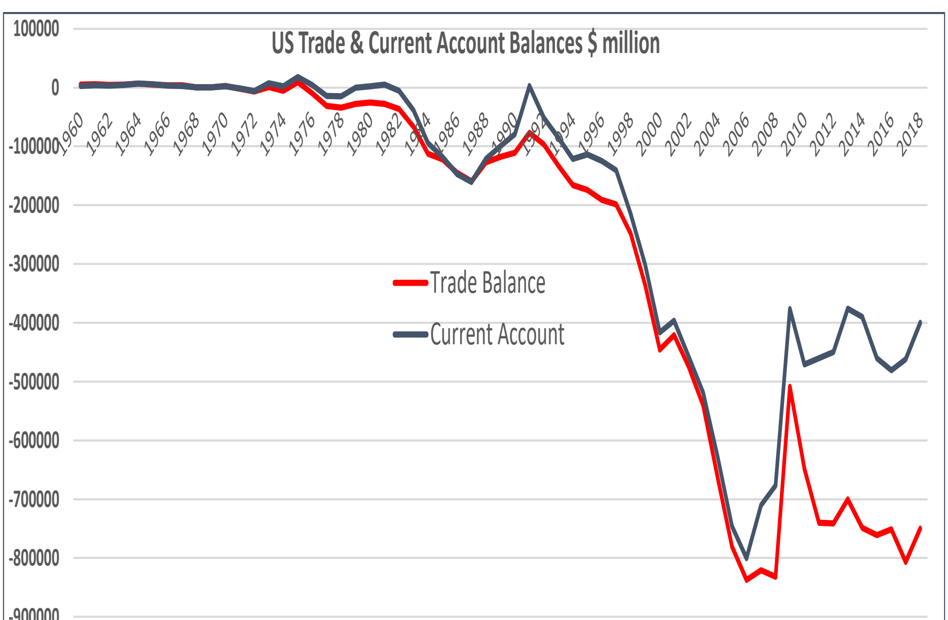
CIFE SEMINAR NICE MAY 6-8, 2020

MICHEL-HENRY BOUCHET

1

US$ million

US STRUCTURAL TWIN DEFICITS (1980-2019)



Source: US Treasury 2018/FED

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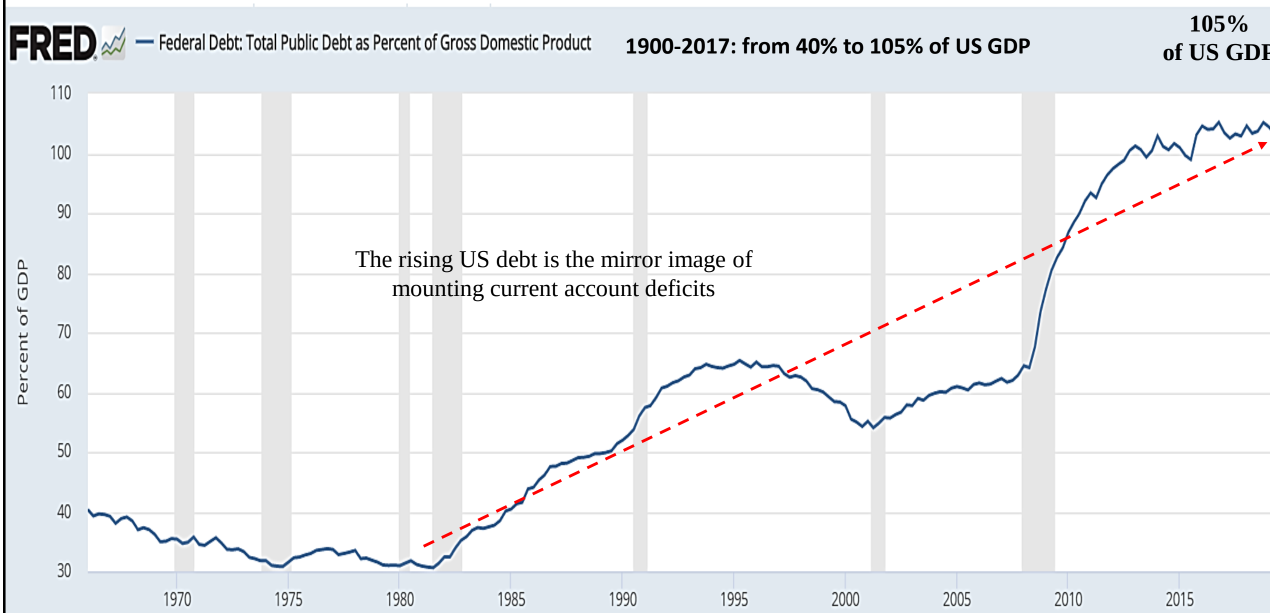
US DEFICIT ACCUMULATION AND DEBT GROWTH 1960-2020



▶ Capital account

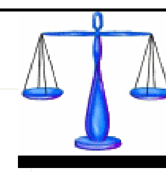
- Reflects changes in country's ownership of assets
- Leads to increase/decrease in official reserve assets
- Reflects international market access
- Financing **flows** lead to changes in external debt stock, and to future debt servicing payment outflows
- Financing sources: LT debt, equity/FDI, international borrowing in the capital markets (Eurobonds, Eurocredits), official financing, ODA, short-term flows…

CAPITAL ACCOUNT

The financial analyst must focus on :

- the **volume** of financing to match the financing requirements of the current account deficit
- the **nature** of financing sources (private/public) and
- the **sustainability** of the financing (short term/long term, volatility, currency mismatch, floating/fixed rates, repayment conditions, legal clauses…)

THE CAPITAL ACCOUNT



Capital account

+ (-) Direct investment (non debt creating flows)
+ (-) Portfolio investment (NDCF if equity)
+ (-) Other long-term capital (private + official)
+ (-) Other short-term capital (private + official)
+ (-) Net errors and omissions
+ (-) Counterpart items
+ (-) **Change in reserves**

= Capital account balance

+ **Exceptional Financing (or arrears)**

From less liquid items to more liquid items!

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Exports	5000
Portfolio	150
LT K	1200
Transfers	285
Debt repayments	-1650
ST K	350
Current account	
FDI	325
Imports	-6500
Trade	
Services revenues	1200
Interest payments	-750
E&Os	-455
Counterpart items	100
Change in reserves	
CA/GDP%	
GDP	12500
R/M ratio (months)	
Reserve level 12/2017	4500

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Exports	5000
Imports	-6500
Trade	-1500
Services revenues	1200
Interest payments	-750
Transfers	285
Current account	-765
FDI	325
Portfolio	150
LT K	1200
Debt repayments	-1650
ST K	350
E&Os	-455
Counterpart items	100
Change in reserves	745
CA/GDP%	-6,12%
GDP	12500
R/M ratio (months)	6,9
Reserve level 12/2017	4500

TABLE OF USES AND SOURCES

USES (outflows)	SOURCES (inflows)
1. Imports of goods	1. Exports of goods
2. Imports of services	2. Exports of services
3. Interest payments	3. Transfers & Remittances
4. Principal debt payments	4. Dividends
5. ST capital outflows	5. FDI
6. E&Os	6. Portfolio K flows
7. Reserve decrease	7. ST and LT K inflows
	8. Debt cancellation
	9. Arrears

SOURCES OF EXTERNAL FINANCING

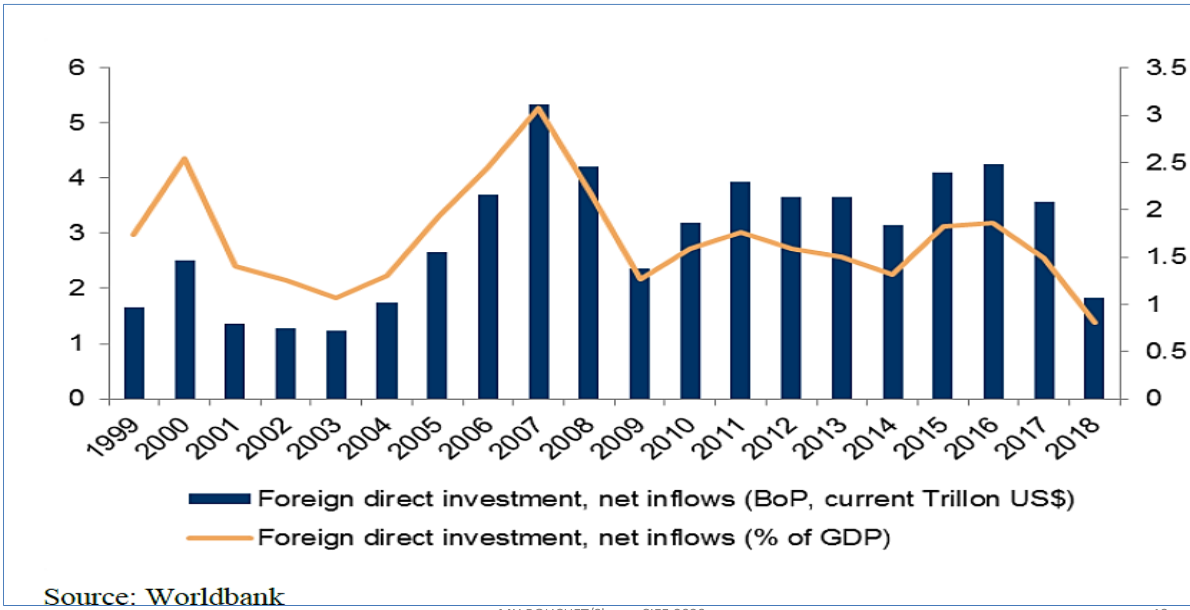
Official (bilateral + multilateral)

- Paris Club (government to government credits)
- Export credit guarantees
- IFIs (WB + IMF)
- Regional development banks
- Debt rescheduling
- Debt cancellation

Private

- FDI
- Portfolio Investment
- London Club (International bank loans)
- Working capital lines
- ST Trade credits
- Bonds & International debt securities
- Arrears and rescheduling

THE GLOBAL DECLINE IN FDI FLOWS



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Other capital is a residual category that groups all the capital transactions that have not been included in direct investment and portfolio investment:

Two categories of capital inflows:

▶ **Long-term capital**

▶ **Short-term capital**

Non-negotiable instruments > 1 year or more such as London Club bank loans and mortgages, syndicated credits, euroloans...

* Financial assets < 1 year, such as currency, deposits and bills, interbank credit lines, trade credits... (Source: BIS)

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Change in reserves

Reserves include:

- Hard currency assets + Monetary gold (gold held by the authorities as a financial asset)
- Special drawing rights (SDRs): reserves created by the IMF and credited to the accounts of IMF member countries according to national quotas

https://www.imf.org/external/np/sec/memdir/members.aspx

- Reserve position in the Fund: (member's quota + other claims on the Fund)

THE IMF QUOTAS

When a country joins the IMF, it is assigned an initial quota in the same range as the quotas of existing members of broadly comparable economic size and characteristics. The IMF uses a quota formula to help assess a member's relative position= weighted average of GDP (weight of 50 percent), openness (30 %), economic variability (15 %), and international reserves (5 %).
For this purpose, GDP is measured through a blend of GDP—based on market exchange rates (weight of 60 %) and on PPP exchange rates (40 %). The formula also includes a "compression factor" that reduces the dispersion in calculated quota shares across members.
Quotas are denominated in Special Drawing Rights (SDRs), the IMF's unit of account. The largest member of the IMF is the United States, with a quota of SDR83 billion (about US$118 billion), and the smallest member is Tuvalu, with a quota of SDR2.5 million (about US$3.5 million)

Source: IMF quotas 2019

Foreign Exchange Reserves

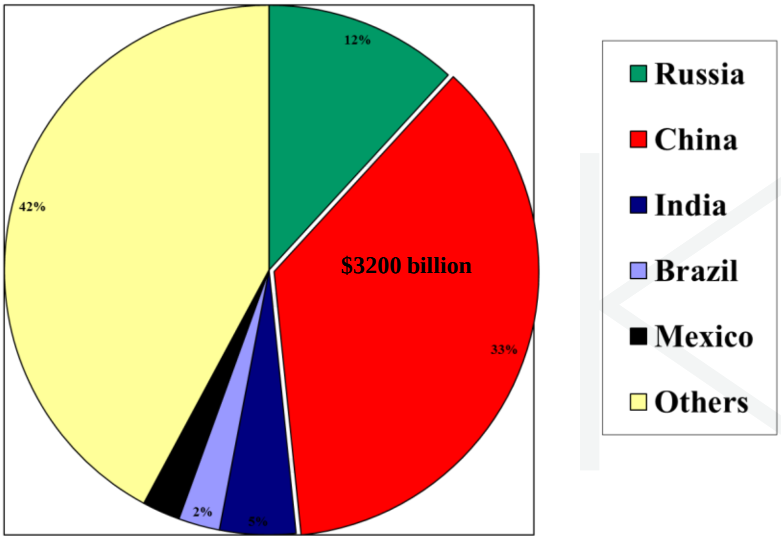
The largest component of total international liquidity. It includes monetary authorities' claims on non-residents in the form of bank deposits, treasury bills, short-term and long-term government securities, and other claims usable in the event of balance of payments need, including non-marketable claims from inter-central bank and intergovernmental arrangements

A **+ sign** in the BOP means a financing flow in the capital account, i.e., a decrease in the stock of reserves!

FX RESERVES AS BUFFER OF LIQUIDITY CRISIS

	FX Reserves as % of short term debt	FX reserves as % of GDP
India	427%	15%
China	399%	27%
Mexico	334%	16%
Korea	330%	26%
Taiwan	277%	82%
Switzerland	63%	96%
Japan	45%	23%
Canada	13%	5%
Italy	5%	2%
UK	2%	4%
Germany	2%	1%
France	2%	2%

Reserves and GDP for 2016, short-term debt as of 2016Q3
Sources: National Authorities; World Bank; International Monetary Fund; Haver Analytics



Σ world reserves 2019= $11,500 billion

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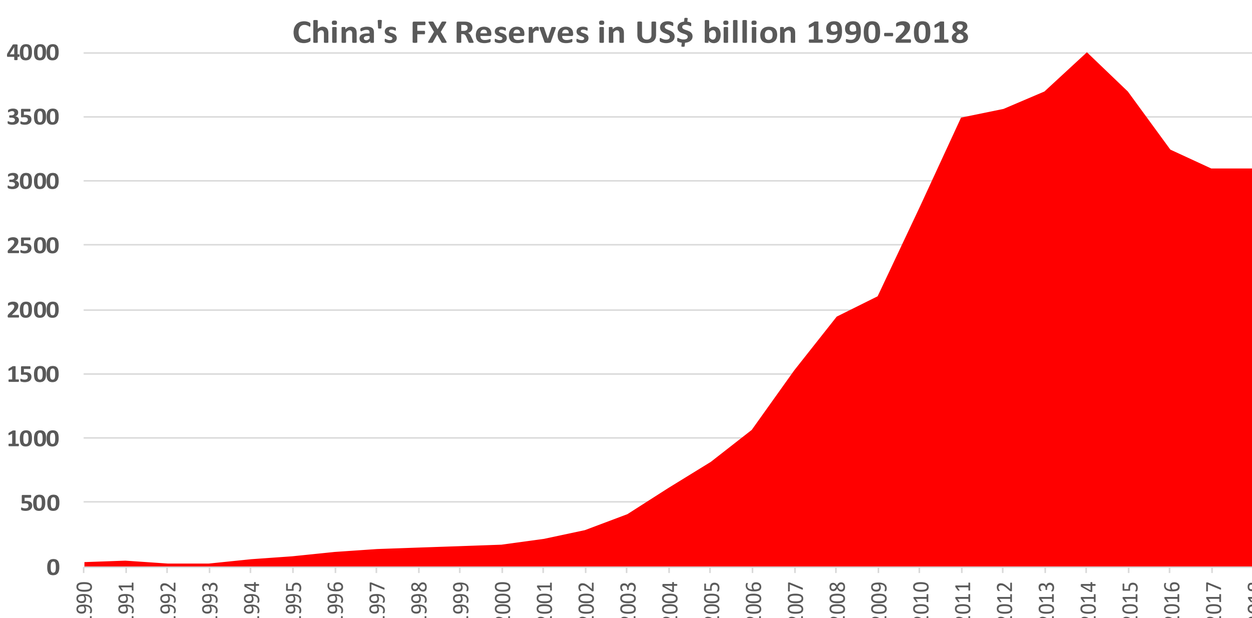

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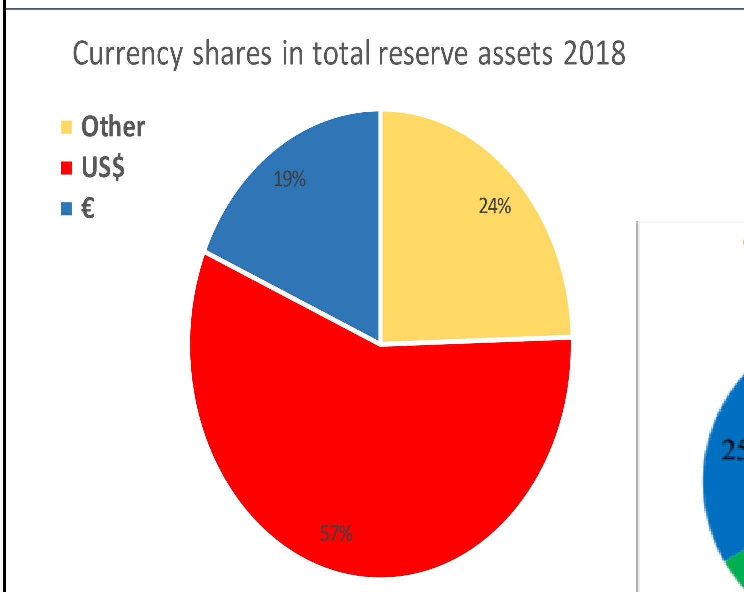
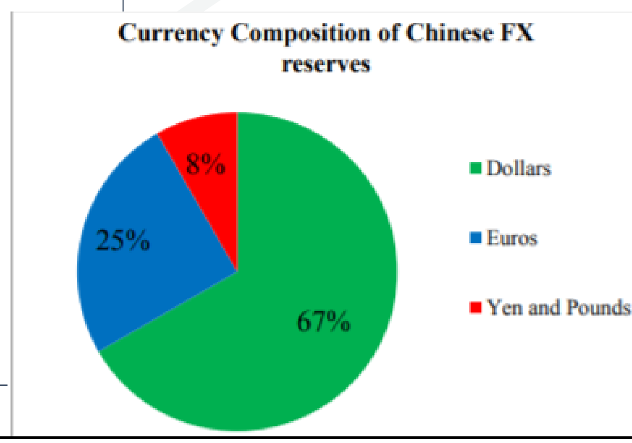
THE SHRINKING SHARE OF DOLLAR HOLDINGS ?





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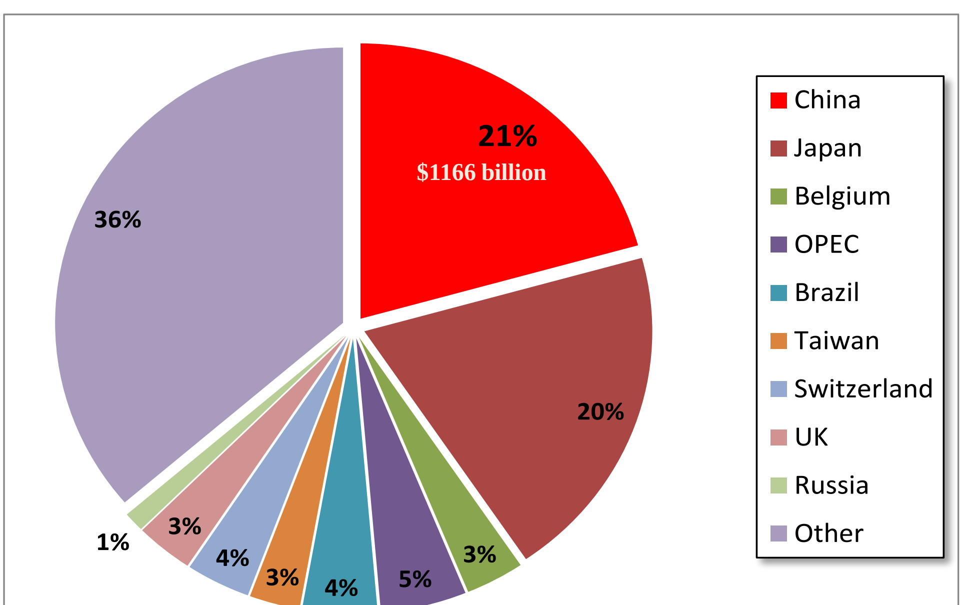
CHINA = > 1/5 OF FOREIGN HOLDING OF US DEBT



US Treasury

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4. Net errors and omissions

Statistical gaps involved in gathering balance of payments data (and capital flight!)

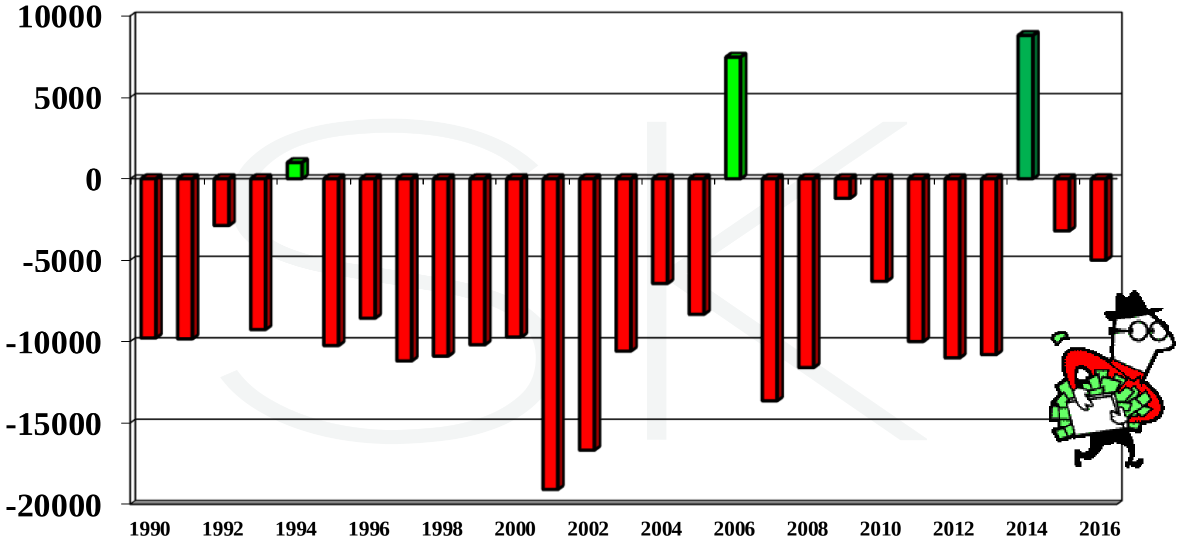
Other sources of E&Os:

1. leads and lags in trade flows
2. underinvoicing of exports
3. overinvoicing of imports
4. undeclared short-term capital movements…

NET ERRORS AND OMISSIONS ?

- An examination of the size and direction of NE&Os may shed light on the accuracy of BoP estimates. The adoption of the double entry accounting system means that the net sum of all credit and debit entries should equal zero.
- In practice, any discrepancies are recorded in NE&Os, reflecting the net effect of differences in coverage, timing and valuation.
- An amount > 5% of the gross sum of merchandise exports and imports is a source of concern!

RUSSIA: **NET ERRORS & OMISSIONS** US$ BILLION



Source: IMF-IFS/IIF

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CAPITAL FLIGHT IN RUSSIA (1994-2012)

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Source: BIS

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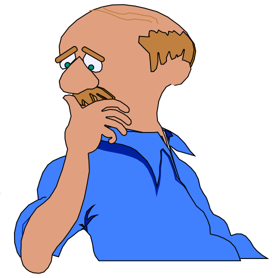
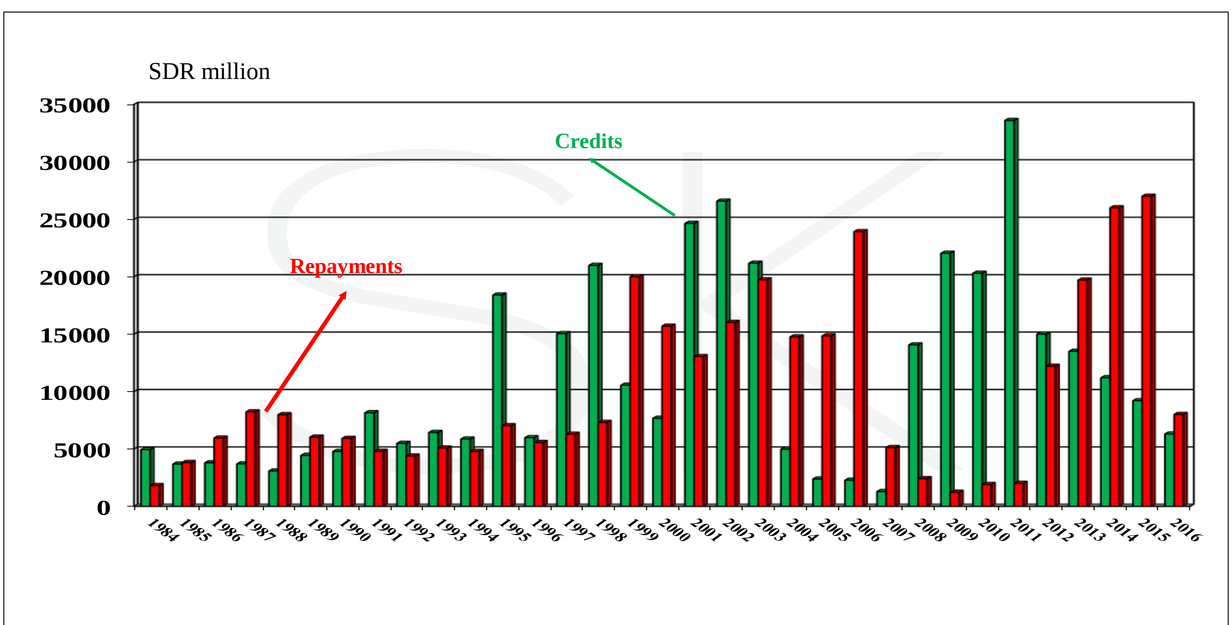
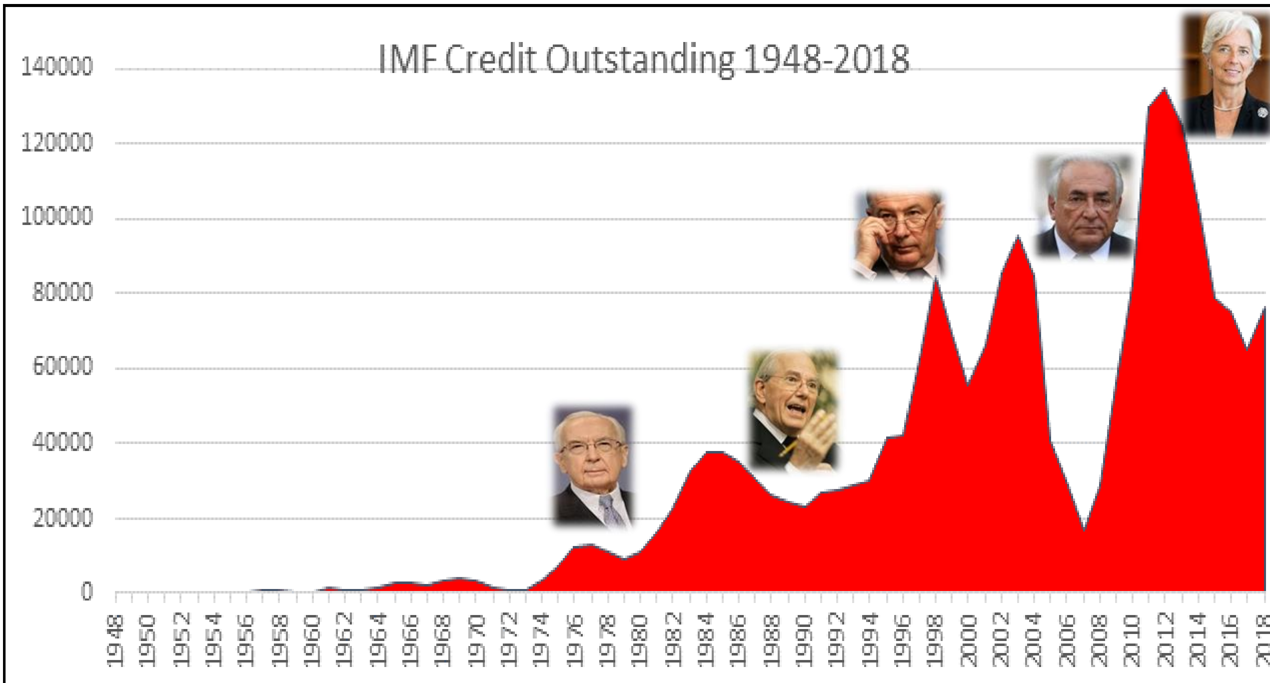
6. EXCEPTIONAL FINANCING



- IMF SDR Drawings
- World Bank’s HIPC Initiative
- London Club debt reduction and restructuring workouts
- Paris Club debt relief
- Debt swap transactions

IMF DISBURSEMENTS & REPAYMENTS





MOROCCO

Table1 Joint BIS-IMF-OECD-World Bank Statistics on External Debt (mill. US$)

Data are in millions	2016Q2	2016Q3	2016Q4	2017Q1	2017Q2
A1. Loans and other credits (Debt of)					
01_Cross-border loans, by BIS reporting banks	10,063	10,556	10,600	..	..
02___o/w to nonbanks	6,666	7,064	7,144	..	..
03_Official bilateral loans, total	..	..	..	..	..
04___o/w aid loans		..	..	..	..
05___o/w other	..	..	..	..	..
06__Multilateral loans, total	8,299	8,516	8,215	8,335	0
07___o/w IMF	0	0	0	0	0
08___o/w other institutions	8,299	8,516	8,215	8,335	..
09_Insured export credit, Berne Union	7,200	7,272	6,599	..	..
10___o/w short term	4,601	4,775	4,310	..	..
11_SDR allocations	785	784	755	762	781
A2. Loans and other credits (Debt due within a year)					
12_Liabilities to BIS banks (cons.), short term	2,792	2,929	2,948	..	..
13_Multilateral loans, IMF, short term	..	..	..	..	..
B1. Debt securities (All maturities)					
14_Debt securities held by nonresidents	5,761	..	..	..	..
B2. Debt securities (short term, original maturity)					
15_Debt securities held by nonresidents	97	..	..	..	..
C. Supplementary information on debt (liabilities)					
16_International debt securities, all maturities	8,029	8,044	8,197	8,234	..
17___o/w issued by nonbanks	7,728	7,744	7,897	7,935	..
18_International debt securities, short term	555	558	527	535	..
19___o/w issued by nonbanks	555	558	527	535	..
20_Paris Club claims (ODA)	..	..	4,479	..	..
21_Paris Club claims (non ODA)	..	..	270	..	..
22_Liabilities to BIS banks, locational, total	13,990	14,548	12,089	..	..

TUNISIA

Table1 Joint BIS-IMF-OECD-World Bank Statistics on External Debt (mill. US$)

Data are in millions	2016Q2	2016Q3	2016Q4	2017Q1	2017Q2
A1. Loans and other credits (Debt of)					
01_Cross-border loans, by BIS reporting banks	2,726	2,894	2,830	..	..
02___o/w to nonbanks	1,656	1,862	1,871	..	..
03_Official bilateral loans, total	..	..	..	..	..
04___o/w aid loans	..	..	..	..	..
05___o/w other	..	..	..	..	..
06__Multilateral loans, total	6,772	6,676	6,860	6,839	1,902
07___o/w IMF	1,721	1,700	1,620	1,619	1,902
08___o/w other institutions	5,052	4,976	5,240	5,221	..
09_Insured export credit, Berne Union	2,841	2,686	2,572	..	..
10___o/w short term	2,137	2,004	1,914	..	..
11_SDR allocations	382	381	367	370	380
A2. Loans and other credits (Debt due within a year)					
12_Liabilities to BIS banks (cons.), short term	528	585	584	..	..
13_Multilateral loans, IMF, short term	149	231	328	448	531
B1. Debt securities (All maturities)					
14_Debt securities held by nonresidents	3,458	..	..	..	..
B2. Debt securities (short term, original maturity)					
15_Debt securities held by nonresidents	24	..	..	..	..
C. Supplementary information on debt (liabilities)					
16_International debt securities, all maturities	4,924	5,459	5,182	6,246	..
17___o/w issued by nonbanks	4,924	5,459	5,182	6,246	..
18_International debt securities, short term	500	599	586	589	..
19___o/w issued by nonbanks	500	599	586	589	..
20_Paris Club claims (ODA)	..	..	2,608	..	..
21_Paris Club claims (non ODA)	..	..	856	..	..
22_Liabilities to BIS banks, locational, total	3,661	3,767	3,317	..	..

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THE BALANCE OF PAYMENTS IV
EXTERNAL DEBT ASSESSMENT
“HOW MUCH GETS TOO MUCH?”

CIFE SEMINAR NICE MAY 6-8, 2020

MICHEL-HENRY BOUCHET

1

Roots of external financial crisis

Rising money supply
+ large and cheap bank credit
+ budget deficit

→ Consumption > Savings = excessive absorption

Large spending on domestic and foreign goods
= Mounting twin deficits

← Inflationary pressures
+ exchange rate overvaluation
+ declining FX reserves + flight capital

Balance of payments crisis → **DEBT DEFAULT**

ADJUSTMENT →

- Exchange rate adjustment + control of the money supply: shrinking creation of reserve money + declining money multiplier of the deposit money banks + interest rate rise + Δ reserve requirements
- Fiscal adjustment + cuts in public spending
- Structural measures to stimulate competitiveness

IMF’s financing + macroeconomic stabilization

→ **Debt restructuring + return to market access (?)**

chel Henry Bouchet (c) Skema-Cife 2020

2

THE CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS

From less liquid items toward more liquid items!

+ Export of goods f.o.b.
- Imports of goods f.o.b.

= **Trade balance**

+ Exports of non-financial services
- Imports of non-financial services
+ Investment income (credit)
- **Interest payments**
+ Private unrequited transfers
+ Official unrequited transfers

= **Current account balance**

The capital account of the balance of payments

Capital account

+ (-) Direct investment (non debt creating flows)

+ (-) Portfolio investment (NDCF)

+ **LT capital inflows (private + official)**

- **LT debt repayments (bonds/loans)**

+ **ST capital inflows (private + official)**

- **ST debt repayments**

+ (-) Net errors and omissions

+ (-) Counterpart items

+ (-) Change in reserves

= **Capital account balance**

+ **Exceptional Financing (or arrears)**

From less liquid items to more liquid items!

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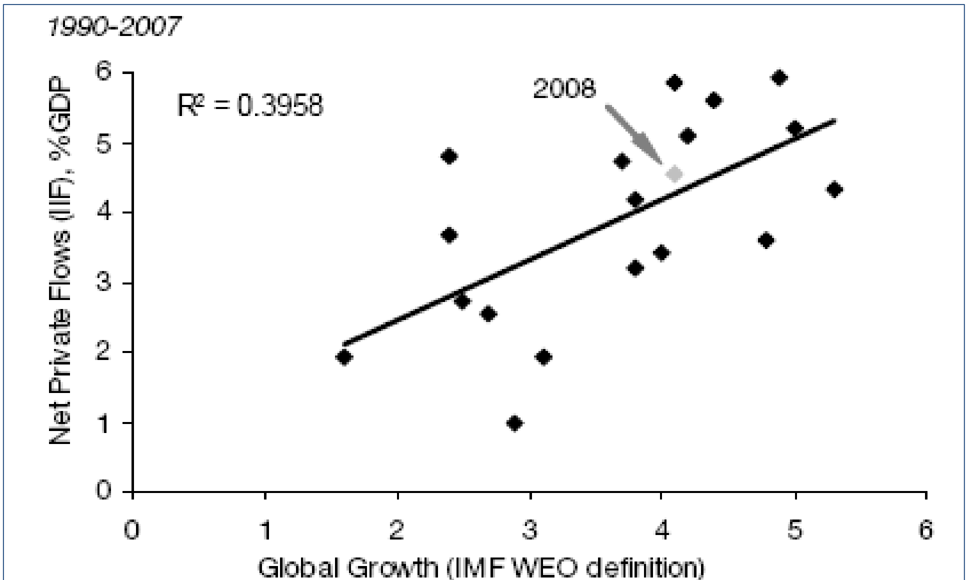
Exports	5000
Portfolio	150
LT K	1200
Transfers	285
Debt repayments	-1650
ST K	350
Current account	
FDI	325
Imports	-6500
Trade	
Services revenues	1200
Interest payments	-750
E&Os	-455
Counterpart items	100
Change in reserves	
CA/GDP%	
GDP	12500
R/M ratio (months)	
Reserve level 12/2017	4500

7

Exports	5000
Imports	-6500
Trade	-1500
Services revenues	1200
Interest payments	-750
Transfers	285
Current account	-765
FDI	325
Portfolio	150
LT K	1200
Debt repayments	-1650
ST K	350
E&Os	-455
Counterpart items	100
Change in reserves	745
CA/GDP%	-6,12%
GDP	12500
R/M ratio (months)	6,9
Reserve level 12/2017	4500

8

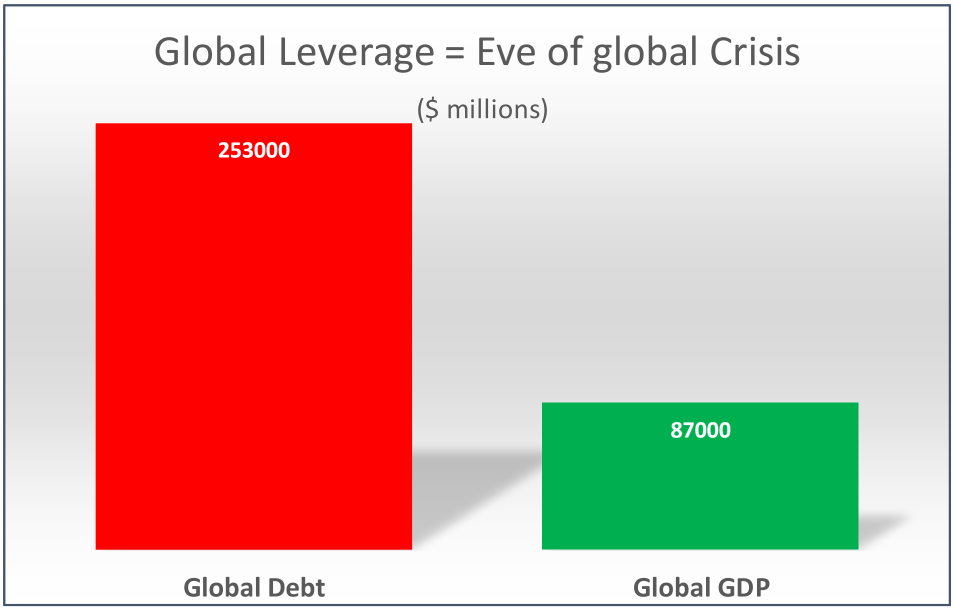
EXTERNAL FINANCING HELPS BOOSTING GDP GROWTH



IIF, Washington, D.C.

US FEDERAL FUNDS RATES 1950-2020

HOW MUCH IS TOO MUCH?



Source: IMF & IIF 2020

WHY/WHEN DOES A FINANCIAL CRISIS ERUPT?
GROSS AND NET FLOWS

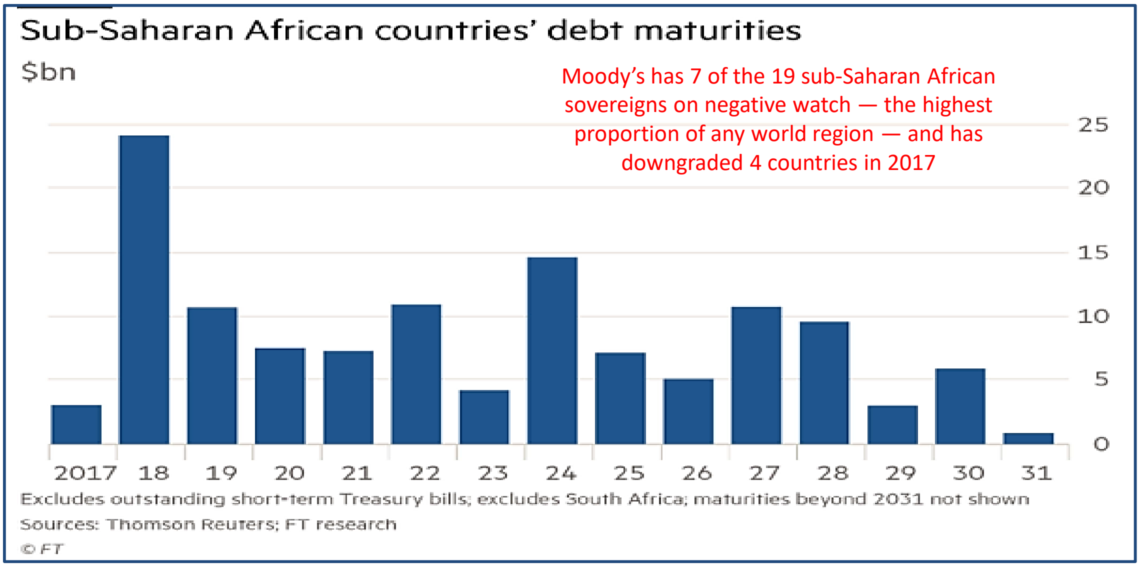
▶ **Gross Capital Inflows** =
Σ Long-term + Short-term capital flows

▶ **Net Flows** =
Σ Gross Inflows - Debt Repayments

▶ **Net Transfers** =
Σ Net Flows - Interest Payments

▶ **Total debt service payments** =
Σ Debt payments + Interest payments

SUB-SAHARAN AFRICA:
CONCERNS OVER HIGH DEBT
LEVELS AND CREDIT RISK RESONATE FOR 2018 AND BEYOND!



EXTERNAL DEBT ANALYSIS

FLOWS

Balance of payments analysis and capital flight

- Liquidity (net flows)
- Sustainability of debt strategy (refinancing, market access, rescheduling, restructuring)

STOCKS

Structure of debt by creditors, maturity (ST/LT), currency and interest rates (fixed/floating)

- Mismatch (interest rate, currency, maturity)
- Solvency ratios
- London Club debt : secondary market discounts
- Spread/margin over US T Bills
- CDS

Emerging Market Economies: Capital Flows

$ billion

	2012	2013	2014	2015
Capital Inflows				
Total Inflows, Net:	*1269*	*1188*	*1079*	*1164*
Private Inflows, Net	1232	1156	1032	1112
Equity Investment, Net	668	626	657	675
Direct Investment, Net	545	548	540	560
Portfolio Investment, Net	124	78	117	114
Private Creditors, Net	564	530	375	437
Commercial Banks, Net	118	193	124	151
Nonbanks, Net	446	338	251	287
Official Inflows, Net	37	32	47	53
International Financial Institutions	5	-3	19	27
Bilateral Creditors	31	35	28	25
Capital Outflows				
Total Outflows, Net	*-1299*	*-1360*	*-1348*	*-1339*
Private Outflows, Net	-946	-825	-981	-950
Equity Investment Abroad, Net	-332	-403	-368	-381
Resident Lending/Other, Net	-614	-422	-613	-570
Reserves (- = Increase)	-352	-534	-367	-388
Memo:				
Net Errors and Omissions	*-246*	*-65*	*0*	*0*
Current Account Balance	*276*	*236*	*269*	*174*

Source: IIF

RISK MANAGEMENT AND BOP ANALYSIS

\+ Export of goods f.o.b.

\- Imports of goods f.o.b.

= **Trade balance**

+/- Exports/Imports of non-financial services

\- Interest payments

\+ Investment income (dividends) credit/debit)

\+ (-) Private/Official unrequited transfers

= **Current account balance**

+/- FDI

+/- Portfolio capital Flows

+ LT Capital Inflows

- Debt Servicing Payments

+/- ST Capital Flows

+/- Reserve Variation

EXTERNAL DEBT ANALYSIS:
THE DUAL FACE OF COUNTRY RISK

Liquidity Risk	Solvency Risk
▶ Debt Service Ratio: (P+I/X)	▶ Debt/Export ratio
▶ Interest Ratio (I/X)	▶ Debt/GDP ratio
▶ Current account/GDP	▶ Debt/Reserves
▶ Growth rate of exports/ Average external interest rate	▶ ST Debt/Total Debt
	▶ ST Debt/Reserves
	▶ Reserve/Import ratio

LIQUIDITY AND SOLVENCY THRESHOLDS

Stock variables

▶ **Solvency** = Debt/GDP < 100% (66% = EMCs)

Debt/Exports < 150%

Reserves/months of Imports > 6 months

Flow variables

▶ **Liquidity** = Debt Service ratio < 33% of X

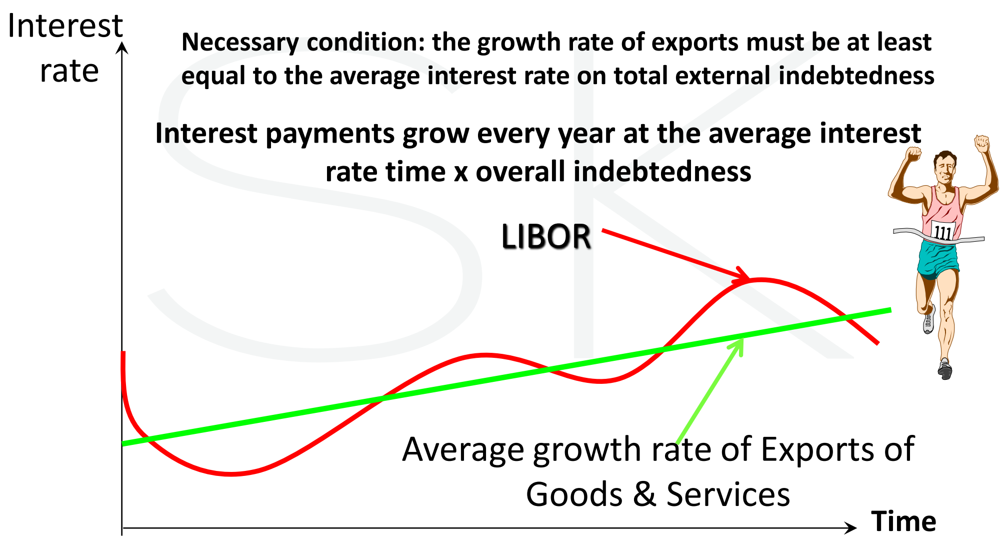
Interest/X ratio < 25%

EXTERNAL DEBT ANALYSIS I

How to stabilize the Interest/Export ratio?

Necessary condition: the growth rate of exports must be at least equal to the average interest rate on total external indebtedness

Interest payments grow every year at the average interest rate time x overall indebtedness



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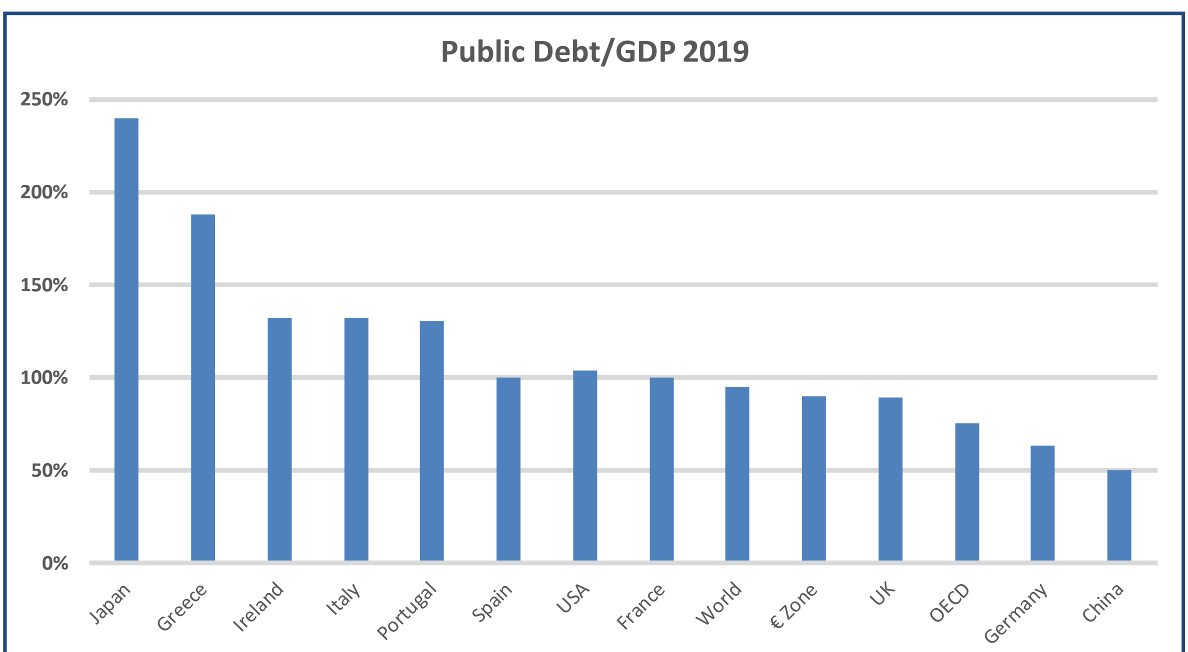

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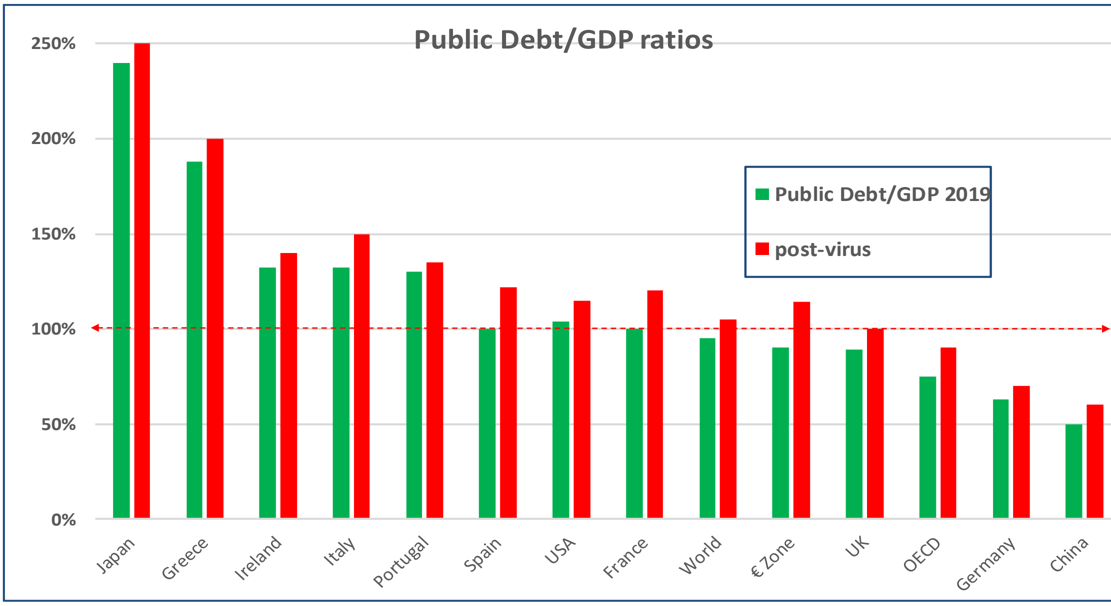
THE BUDGETARY AND DEBT IMPACT OF THE CORONA VIRUS CRISIS



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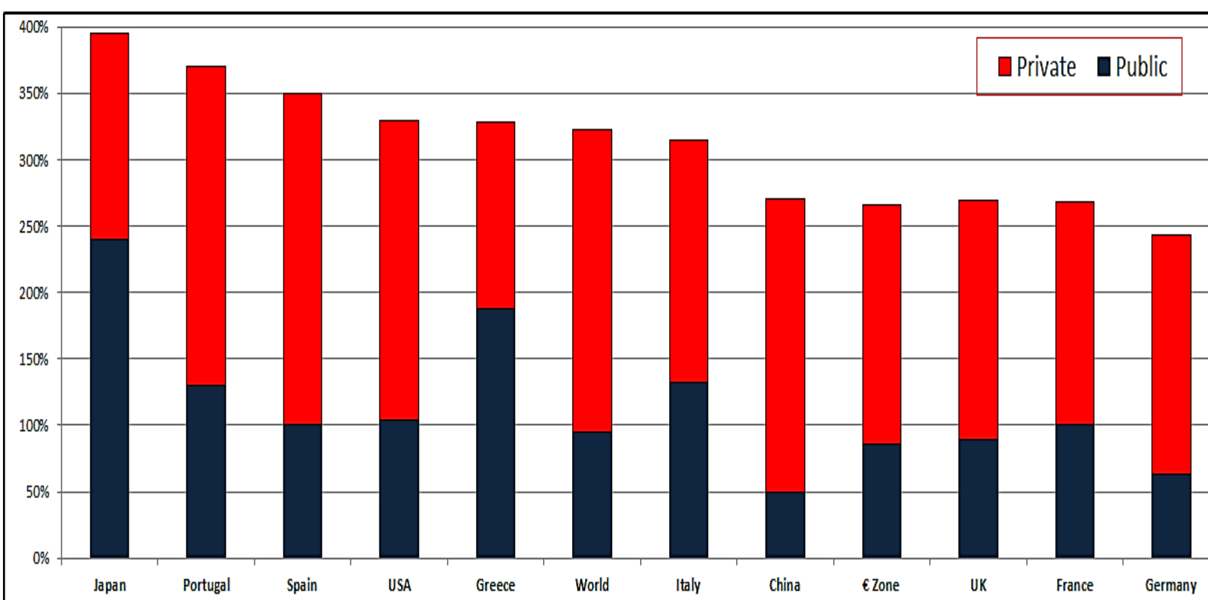
HOW MUCH IS TOO MUCH?



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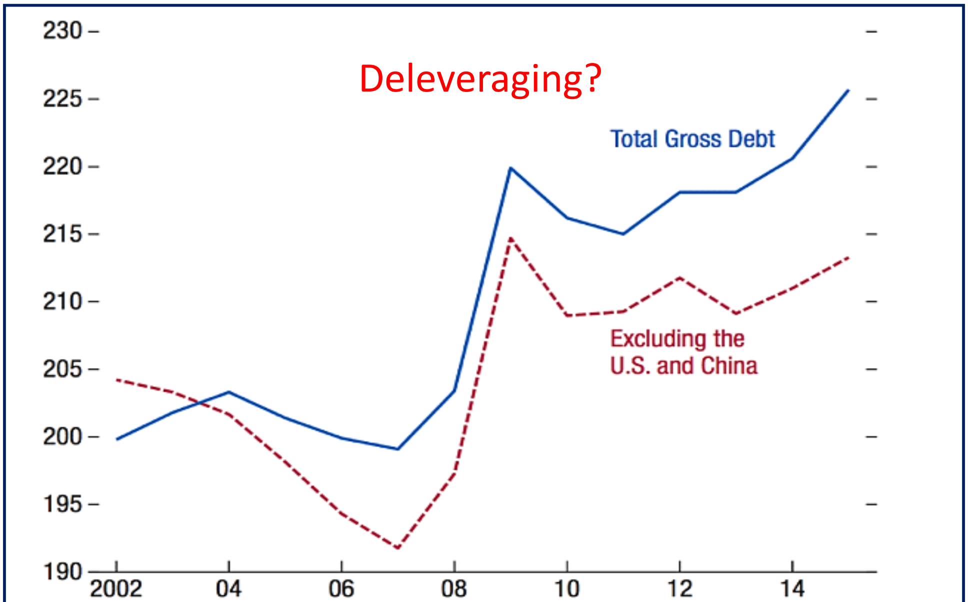
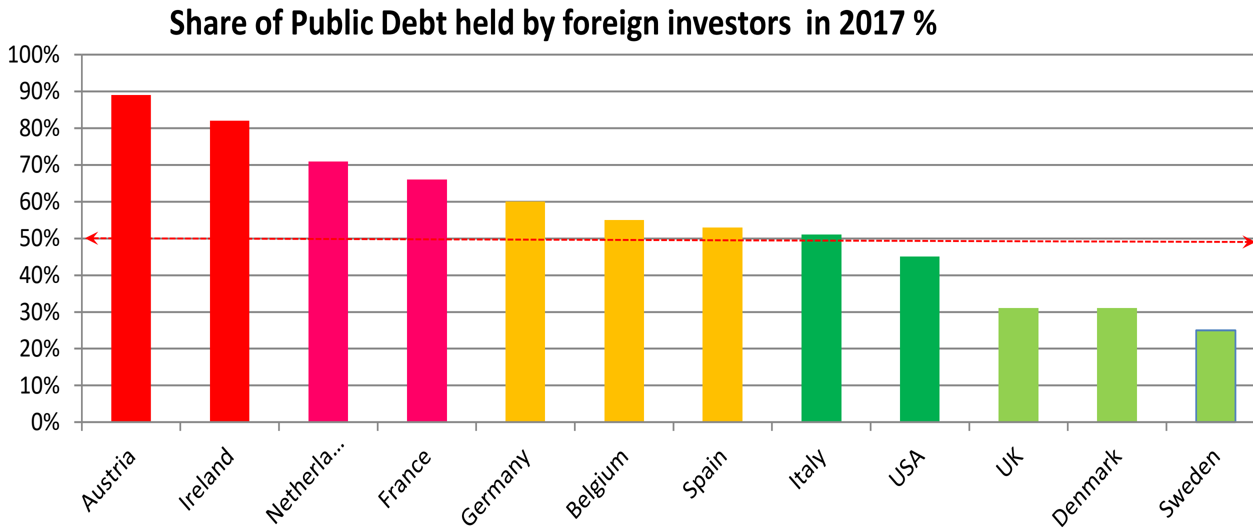
GLOBAL PRIVATE SECTOR DEBT IN % OF GLOBAL GDP
(COMPANIES AND HOUSEHOLDS)



CAPITAL MARKET GLOBALIZATION = INVESTMENT FUNDS AND RATING AGENCIES IN THE DRIVING SEAT



Source: FT, IMF, Natixis, US Treasury 2017

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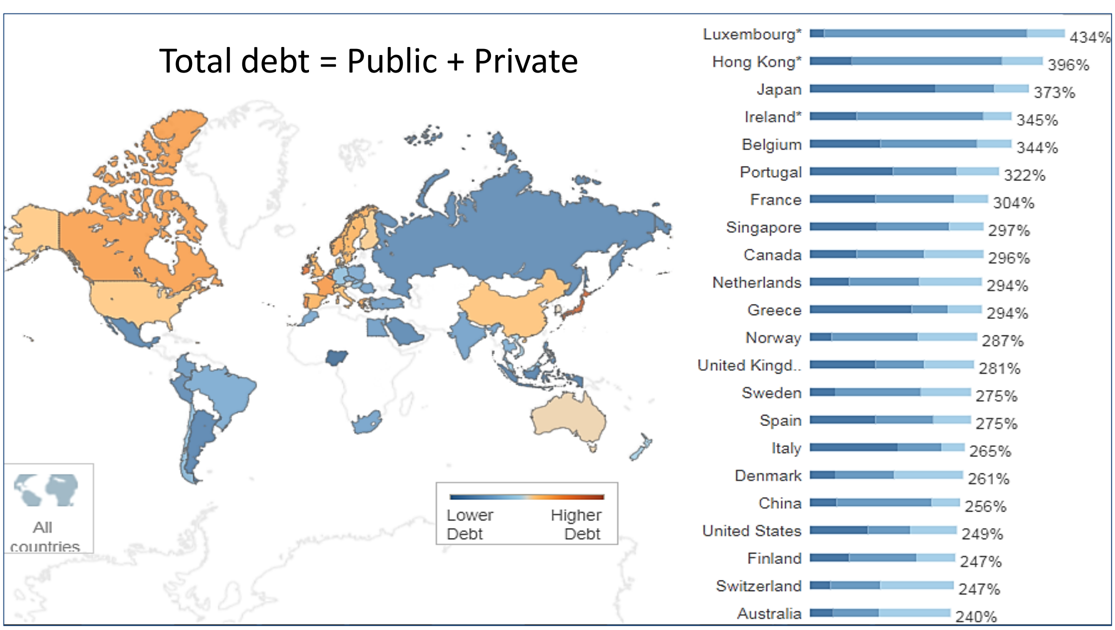
SOVEREIGN DEBT 2008-2018: NOT MUCH DELEVERAGING!



Source: McKinsey Global Institute 2018

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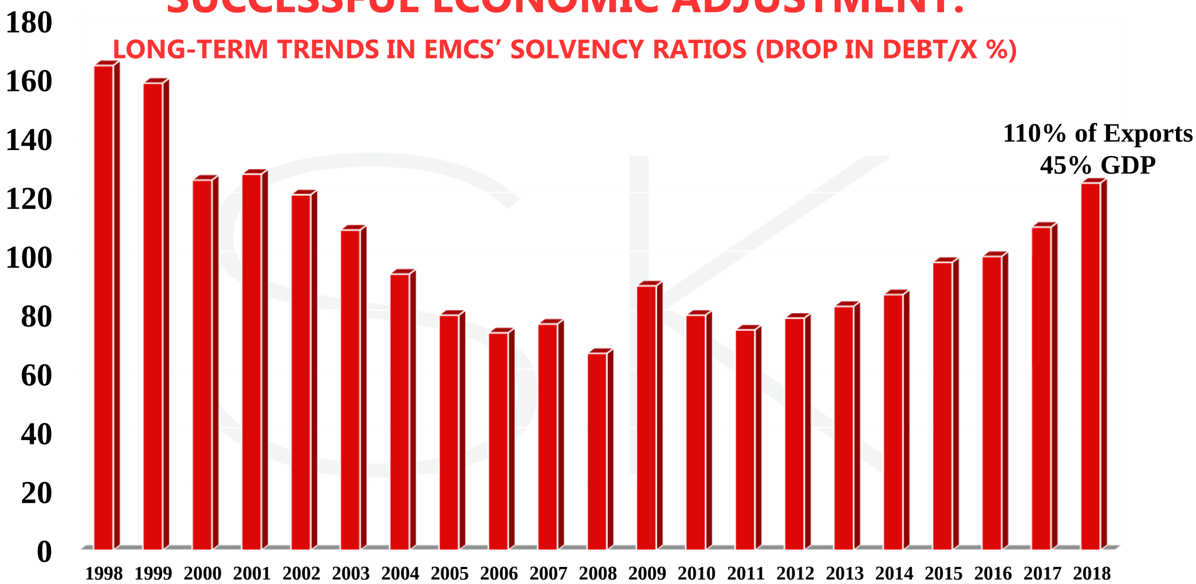
SUCCESSFUL ECONOMIC ADJUSTMENT:

LONG-TERM TRENDS IN EMCS' SOLVENCY RATIOS (DROP IN DEBT/X %)



Source: IMF

TWO COUNTRIES = TWO DEBT TRAJECTORIES

Solvencia

Public Debt/GDP= 100%

- Diversified export base
- Diversified markets
- Mainly official creditors
- Long-term maturities= 12 years
- Fixed rate for 80% of debt
- Similar currency structure X revenues/liabilities

= no mismatch!

Liquidia

Public Debt/GDP= 100%

- Main export: hydrocarbons
- One main export destination: EU
- X revenues in €/debt payments in $
- Average debt maturity: 3 years
- 66% of debt on floating rates
- Large and growing private debt (corporate, bank and households)
- Large reliance on private capital markets

EXTERNAL FINANCING PROFILES IN 2020



RATIOS	VIETNAM	GABON	ECUADOR
1. CA/GDP	+2,2%	-4%	0,5%
2. Debt/GDP	47%	40%	43%
3. Coface	B/B	C/C	C/B
4. GDP pc $	2200	7700	6500
5. R/M	2	5	2
6. FDI/GDP	9%	7%	<1%
7. Doing Bus/190	69	169	123

DEBT DATA?

- http://www.bis.org/statistics/annex_map.htm
- http://stats.bis.org/statx/srs/table/A6?c=TN&p=20144
- http://www.clubdeparis.org/en/communications/page/as-of-31-december-2015

Morocco

Table1 Joint BIS-IMF-OECD-World Bank Statistics on External Debt (mill. US$)

Data are in millions	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
A1. Loans and other credits (Debt of)					
01_Cross-border loans, by BIS reporting banks	8,288	8,758	8,882	8,125	8,514
02___o/w to nonbanks	6,868	6,040	6,235	6,058	6,344
03_Official bilateral loans, total	..	..	..	..	..
04___o/w aid loans	..	..	..	..	..
05___o/w other	..	..	..	..	..
06_Multilateral loans, total	6,788	7,113	7,285	..	..
07___o/w IMF	0	0	0	..	..
08___o/w other institutions	6,788	7,113	7,285	7,621	7,725
09_Insured export credit, Berne Union	7,607	7,721	7,650	7,144	7,173
10___o/w short term	4,613	4,684	4,690	4,421	4,494
11_SDR allocations	774	780	788	778	781
A2. Loans and other credits (Debt due within a year)					
12_Liabilities to BIS banks (cons.), short term	2,674	2,301	2,429	2,379	2,617
13_Multilateral loans, IMF, short term	..	..	..	..	..
B1. Debt securities (All maturities)					
14_Debt securities held by nonresidents	..	8,442	..	..	..
B2. Debt securities (short term, original maturity)					
15_Debt securities held by nonresidents	..	132	..	..	..
C. Supplementary information on debt (liabilities)					
16_International debt securities, all maturities	8,864	7,863	8,120	8,037	8,102
17___o/w issued by nonbanks	8,664	7,862	7,820	7,738	7,802
18_International debt securities, short term	84	65	65	64	0
19___o/w issued by nonbanks	84	65	65	64	0
20_Paris Club claims (ODA)	..	..	..	..	..
21_Paris Club claims (non ODA)	..	..	..	..	..
22_Liabilities to BIS banks, locational, total	12,828	12,632	12,676	12,784	13,237
23_Liabilities to BIS banks, consolidated, total	10,834	10,309	10,558	10,783	11,184
D. Memorandum items: selected foreign assets					
24_International reserves (excluding gold)	17,864	18,752	21,680	22,264	24,327
25___o/w SDR holdings	770	785	773	763	778
26_Portfolio investment assets	..	..	..	..	..
27_Cross-border deposits with BIS rep. banks	4,839	6,767	6,071	5,372	5,797
28___o/w deposits from nonbanks	2,804	2,869	2,472	2,333	2,484

Solvencia - case study

BALANCE of PAYMENTS ($ million)	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Trade Balance	-1 130	-411	-1 577	-2 494	-4 000	-1 050	1 040	1 270	300	-500	-1 500	**-4 000**	**-3 850**	**750**
Merchandise exports	4 882	6 151	7 910	8 061	9 000	10 500	11 000	12 000	13 800	14000	13500	12000	13650	15000
Merchandise imports	-6 012	-6 562	-9 487	-10 555	-13 000	-11 550	-9 960	-10 730	-13 500	-14500	-15000	-16000	-17500	-14250
Balance on Services, Income & Transfers	-699	-529	-1 044	-2 201	-3 281	-2 107	-75	629	403	465	-184	-1 967	-3 010	-1 263
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	1500	1850
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	-2 796	-3 207	-2 825	-3 452	-4 611	-5 385	-4 913
Imports of services	-902	-984	-1 423	-1 583	-1 950	-1 733	-1 494	-1 610	-2 025	-2 175	-2 250	-2 400	-2 625	-2 138
Interest payments	-831	-835	-1 681	-2 831	-3 197	-2 460	-1 433	-1 006	-992	-450	-802	-1 711	-2 235	-2 224
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
Current Account	-1 829	-940	-2 621	-4 695	-7 281	-3 157	965	1 899	703	-35	-1 684	-5 967	-6 860	-513

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FROM COUNTRY RISK, TO VOLATILITY, TURMOIL AND CRISIS

CIFE SEMINAR NICE MAY 6-8, 2020

MICHEL-HENRY BOUCHET

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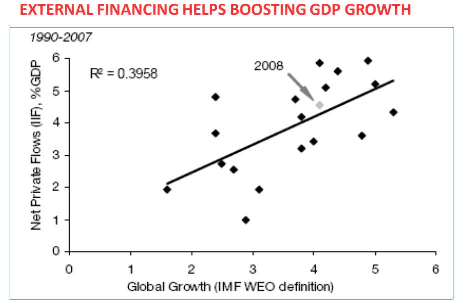
- Lee Buchheit: https://www.iflr.com/Article/3866554/Q-A-with-sovereign-debt-legend-Lee-Buchheit.html
- file:///C:/Users/bouchetm/Downloads/chapter-8-the-debt-restructuring-process%20(1).pdf
- https://www.youtube.com/watch?v=U1HZik7swFI

EXTERNAL DEBT ANALYSIS

5 Objectives:

1. Examining the robustness of debt-driven **growth** and the sources of **vulnerability**
2. Tackling the **structure** of the external liabilities
3. Assessing debt servicing **sustainability** , i.e., **liquidity & solvency** prospects
4. Identifying **warning indicators** of upcoming debt crisis?
5. Analyzing **debt restructuring** workouts

EXTERNAL FINANCING HELPS BOOSTING GDP GROWTH



IIF, Washington, D.C.

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Rising money supply
+ large and cheap bank credit
+ budget deficit

Consumption > Savings = excessive absorption

Inflationary pressures
+ exchange rate overvaluation
+ declining FX reserves + flight capital

Large spending on domestic and foreign goods
= Mounting twin deficits

Balance of payments crisis

DEBT DEFAULT

ADJUSTMENT

IMF's financing + macroeconomic stabilization

- Exchange rate adjustment + control of the money supply: shrinking creation of reserve money + declining money multiplier of the deposit money banks + interest rate rise + Δ reserve requirements
- Fiscal adjustment + cuts in public spending
- Structural measures to stimulate competitiveness

Debt restructuring + return to market access (?)

DOMESTIC AND EXTERNAL FINANCIAL EQUILIBRIUM

What is disposable income?

Y = gross income - imports & taxation

Y = C + I + G + X – M – T + (KM – K flight)

Savings = Y – C

(S – I) + (T – G) = (X – M) + (KM – KX)

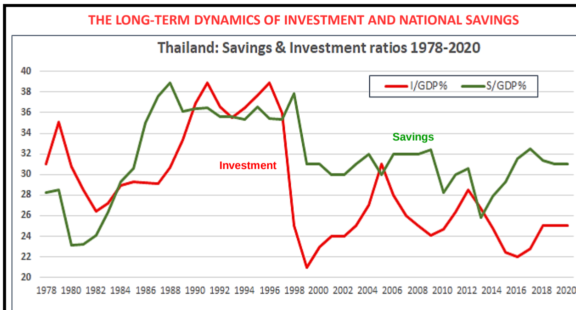
Net savings, Fiscal balance, Trade balance, Net capital inflows

BOOSTING SAVINGS TO FINANCE INVESTMENT WITHOUT EXTERNAL DEFICIT?

if S < I ⇒ X < M

- a **trade imbalance** is always rooted in low savings and excessive domestic spending (absorption).
- It requires macroeconomic correction (interest rate hike, devaluation, ↑ taxation, credit reduction, ↑ reserve requirements…)
- Non-debt creating domestic flows
- Non-debt creating external capital inflows (FDI)

THE LONG-TERM DYNAMICS OF INVESTMENT AND NATIONAL SAVINGS

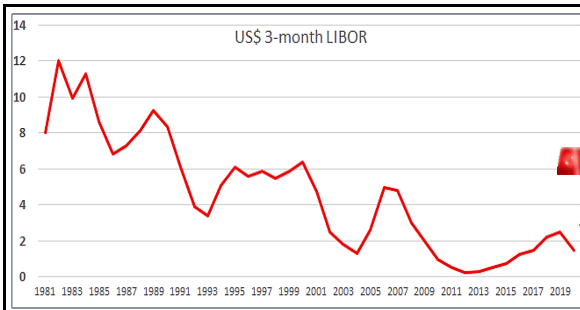


Source: WB and IMF 2020

THE CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS

From less liquid items toward more liquid items!

\+ Export of goods f.o.b.
\- Imports of goods f.o.b.
= **Trade balance**
\+ Exports of non-financial services
\- Imports of non-financial services
\+ Investment income (credit)
\- **Interest payments**
\+ Private unrequited transfers
\+ Official unrequited transfers
= **Current account balance**



Capital account

From less liquid items to more liquid items!

\+ (-) Direct investment (non debt creating flows)
\+ (-) Portfolio investment (NDCF)
\+ **LT capital inflows (private + official)**
\- **LT debt repayments (bonds/loans)**
\+ **ST capital inflows (private + official)**
\- **ST debt repayments**
\+ (-) Net errors and omissions
\+ (-) Counterpart items
\+ (-) Change in reserves
= Capital account balance
\+ **Exceptional Financing (or arrears)**

WHY/WHEN DOES A FINANCIAL CRISIS ERUPT?
GROSS AND NET FLOWS

▶**Gross Capital Inflows** =
Σ Long-term + Short-term capital flows
▶**Net Flows** =
Σ Gross Inflows - Debt Repayments
▶**Net Transfers** =
Σ Net Flows - Interest Payments
▶**Total debt service payments** =
Σ Debt payments + Interest payments

RISK MANAGEMENT AND BOP ANALYSIS

+ Export of goods f.o.b.
- Imports of goods f.o.b.

= **Trade balance**

+/- Exports/Imports of non-financial services
- Interest payments
+ Investment income (dividends) credit/debit)
+ (-) Private/Official unrequited transfers

= **Current account balance**

+/- FDI
+/- Portfolio capital Flows
+ LT Capital Inflows
- Debt Servicing Payments
+/- ST Capital Flows
+/- Reserve Variation

	2016	2017
Foreign Direct Investment	375	100
Imports of Goods	-4650	-5250
Long-term capital inflows	1225	1300
Portfolio Investment (net)	200	150
Reserve variation		
Short-term capital payments	-465	-1200
Private unrequited transfers	125	100
Net Errors and omissions	-275	-950
Official unrequited transfers	300	125
Long-term capital payments	-985	-1200
Short-term capital inflows	325	1000
Service Income (net)	625	500
Current account balance		
Trade balance	900	-1100
Interest Payments	-1750	-1855
Exports of Goods		
Note: Country GDP: 15000 (end-2017)		
Official Reserve Assets (end-2015): 5500		
External Debt Stock (end-2015)		17000

	2016	2017
Exports of Goods	5550	4150
Imports of Goods	-4650	-5250
Trade balance	**900**	**-1100**
Service Income (net)	625	500
Interest Payments	-1750	-1855
Official unrequited transfers	300	125
Private unrequited transfers	125	100
Current account	200	-2230
Portfolio Investment (net)	200	150
Foreign Direct Investment	375	100
Long-term capital inflows	1225	1300
Long-term capital payments	-985	-1200
Short-term capital inflows	325	1000
Short-term capital payments	-465	-1200
Net Errors and omissions	-275	-950
Reserve variation	-600	3030
	0	0

	2017
DSR (P+I) / XGS	**92%**
Liquidity Int/Exports of GS	**40%**
SOLVENCY	**113%**
Reserves 2016	**6100**
Reserves 2017	**3070**
Gross inflows	**1050**
Net inflows	**-1350**
Net transfers	**-3205**
R/M in months	**7,02**
Trade Ratio end-2017	**66%**
DSR end-2017	**92%**
Current account/GDP end-2017	**-15%**
Reserve level end-2017	**3070**
Reserve ratio	**7**
Average rate	-11%
External debt 2017	17000

EXTERNAL DEBT ANALYSIS

FLOWS: Balance of payments analysis and capital flight
- Liquidity
- Sustainability of debt strategy (refinancing, market access, rescheduling, restructuring)

→ Liquidity

STOCKS: Structure of debt by creditors, maturity (ST/LT), currency and interest rates (fixed/floating)
- Mismatch (interest rate, currency, maturity)
- Solvency ratios
- London Club debt : secondary market discounts
- Spread/margin over US T Bills and CDS

→ Solvency

EXTERNAL DEBT ANALYSIS: THE DUAL FACE OF COUNTRY RISK

Liquidity Risk	*Solvency Risk*
Debt Service Ratio: (P+I/X)	Debt/Export ratio
Interest Ratio (I/X)	Debt/GDP ratio
Current account/GDP	Debt/Reserves
Growth rate of exports/ Average external interest rate	ST Debt/Total Debt
	ST Debt/Reserves
	Reserve/Import ratio

LIQUIDITY AND SOLVENCY THRESHOLDS

Flow variable

Liquidity = Debt Service ratio < 33% of X Interest/X ratio < 25%

Stock variable

Solvency = Debt/GDP < 66%*

Debt/Exports < 150%

Reserves/months of Imports > 6 months

* average debt crisis threshold 1970-2010 Reinhart/Rogoff (Maastricht)

SOURCES OF EXTERNAL FINANCING

Official (bilateral + multilateral)
- Paris Club (government to government credits)
- Export insurance credit
- IFIs
- RDBs
- Debt cancellation

Private
- FDI
- Portfolio Investment
- London Club (International bank loans)
- Working capital lines
- ST Trade credits
- Bonds & International debt securities
- Arrears and rescheduling

TWO COUNTRIES = TWO DEBT TRAJECTORIES

Solvencia
Public Debt/GDP= 100%

- Diversified export base
- Diversified markets
- Mainly official creditors
- Long-term maturities= 12 years
- Fixed rate for 80% of debt
- Similar currency structure X revenues/liabilities = no mismatch!

Liquidia
Public Debt/GDP= 100%

- Main export: hydrocarbons
- One main export destination: EU
- X revenues in €/debt payments in $
- Average debt maturity: 3 years
- 66% of debt on floating rates
- Large and growing private debt (corporate, bank and households)
- Large reliance on private capital markets

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NORTH SEA GLOBAL EQUITY MANAGEMENT

Risk Categories	I no.	Indicators	Risk Assessment	Data Frequency	Source
1. Real Economy					
"+, -, 0	1	GDP growth rate - %	performance	quarterly	WB
"+, -, 0	2	Budget Deficit/GDP - %	overheating	quarterly	WB/IMF
only > 0	3	REER 2005=100	competitiveness	quarterly	BIS
"+, -, 0	4	Credit growth %	overheating	quarterly	WB/IMF
"+, -, 0	5	CPI%	overheating	quarterly	IMF & CB
2. External Finance					
"+, -, 0	6	current account/GDP - %	competitiveness	quarterly	IMF&IIF
only > 0	7	DSR - % XGS	liquidity	quarterly	IMF&IIF
only > 0	8	Ext. Debt/Exports %	liquidity	quarterly	IMF&IIF
only > 0	9	Ext. Debt/GDP - %	solvency	quarterly	IMF&IIF
"+, -, 0	10	Reserves coverage - months	liquidity	quarterly	IMF&IIF
only > 0	11	Net Ext Liabilities/GDP%	sustainability	quarterly	BIS/IMF
only > 0	12	Reserves/ST DEBT - %	liquidity	quarterly	IMF
3. Spill-over					
only > 0	13	Trade openness ratio - %	performance	quarterly	WB
only > 0	14	Capital Flight / Reserves - %	capital flight	quarterly	BIS
4. Risk Ratings					
in bp	15	5-year CDS	default	weekly	Bloomberg
only > 0	16	Corruption Index	governance	annual	TI
only > 0	17	Credit Rating	risk assessment	randomly	S&P
only > 0	18	Human Developt Index	governance	annual	UNDP
only > 0	19	Doing Business index	performance	annual	WB

FX RESERVES AS BUFFER OF LIQUIDITY CRISIS

	FX Reserves as % of short term debt	FX reserves as % of GDP
India	427%	15%
China	399%	27%
Mexico	334%	16%
Korea	330%	26%
Taiwan	277%	82%
Switzerland	63%	96%
Japan	45%	23%
Canada	13%	5%
Italy	5%	2%
UK	2%	4%
Germany	2%	1%
France	2%	2%

Reserves and GDP for 2016, short-term debt as of 2016Q3
Sources: National Authorities; World Bank; International Monetary Fund; Haver Analytics

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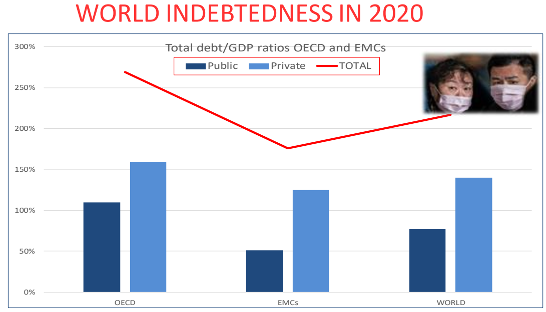
WORLD INDEBTEDNESS IN 2020



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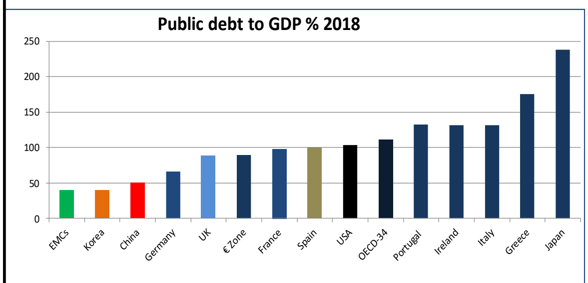
PUBLIC DEBT : STILL UNDER CONTROL?



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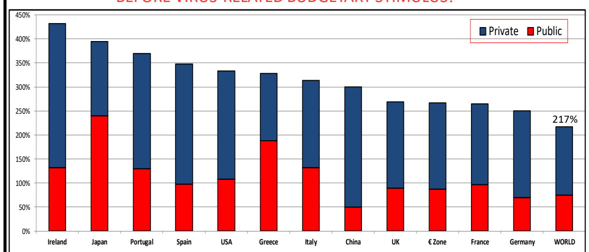
OVERALL NATIONAL DEBT BURDENS IN 2020

BEFORE VIRUS-RELATED BUDGETARY STIMULUS!



Source: IMF & BIS 2020

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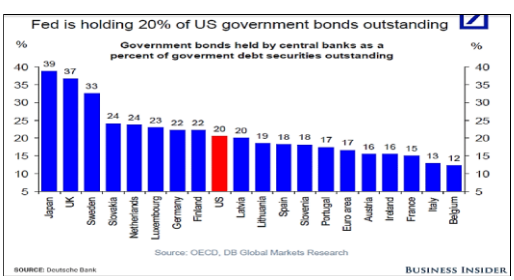
CENTRAL BANKS' ACCOMODATIVE MONETARY POLICY AND SOVEREIGN DEBT



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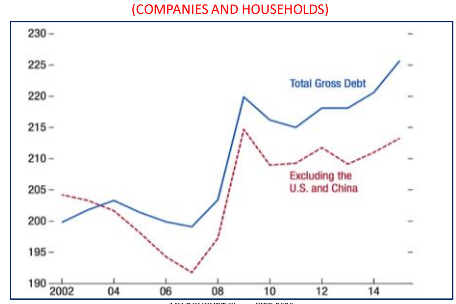
GLOBAL PRIVATE SECTOR DEBT IN % OF GLOBAL GDP

(COMPANIES AND HOUSEHOLDS)



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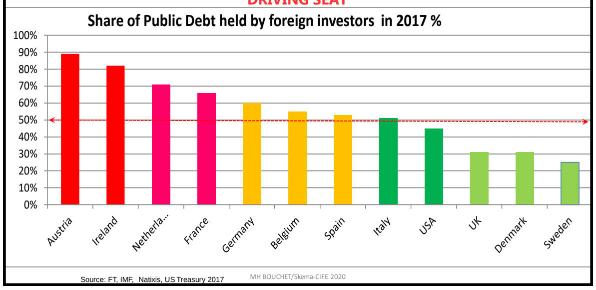
CAPITAL MARKET GLOBALIZATION =
INVESTMENT FUNDS AND RATING AGENCIES IN THE DRIVING SEAT



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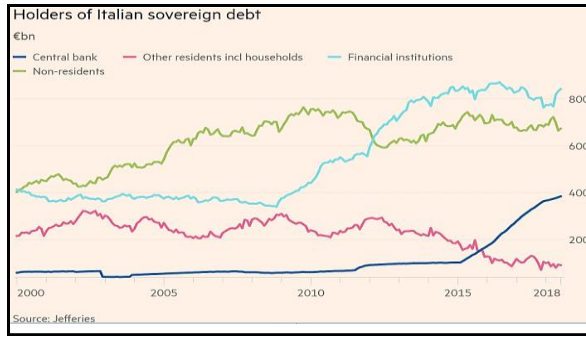
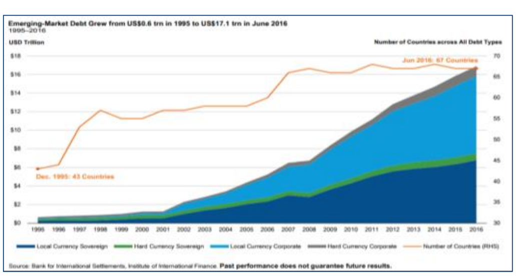


EMERGING MARKET LOCAL CURRENCY BONDS 1995-2017



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REVERSAL IN THE HISTORIC GAP BETWEEN EM LOCAL CURRENCY BOND YIELDS AND SUPPOSEDLY SAFER US-DOLLAR BONDS

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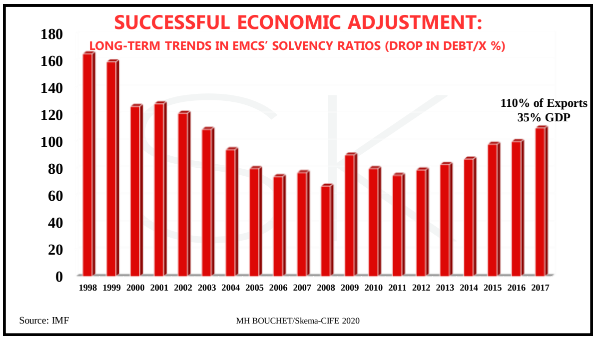

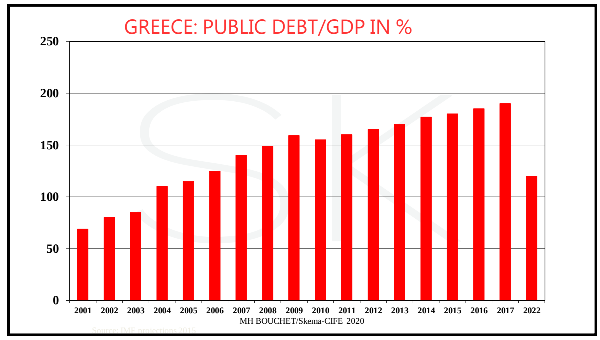

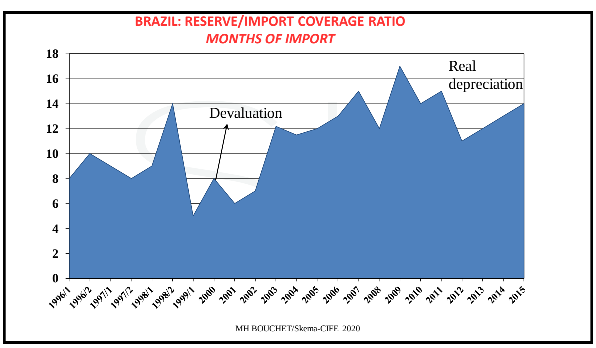

EXTERNAL FINANCING PROFILES

RATIOS	VIETNAM	GABON	ECUADOR
1. CA/GDP	+2%	-4%	2%
2. Debt/GDP	50%	45%	35%
3. Coface	B	C	C
4. GDP pc $	2200	7700	6500
5. R/M	2	5	2
6. FDI/GDP	8%	8%	<1%
7. Doing Bus	82	164	114

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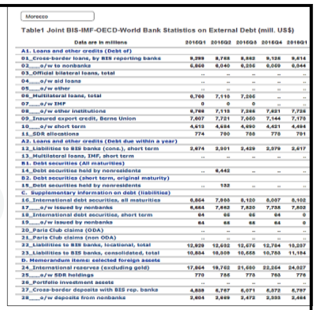
DEBT DATA?

- http://www.bis.org/statistics/annex_map.htm
- http://stats.bis.org/statx/srs/table/A6?c=TN&p=20144
- http://www.clubdeparis.org/en/communications/page/as-of-31-december-2015



Morocco

Table1 Joint BIS-IMF-OECD-World Bank Statistics on External Debt (mill. US$)

Data are in millions	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
A1. Loans and other credits (Debt of)					
01_Cross-border loans, by BIS reporting banks	9,289	8,788	8,862	9,126	9,614
02___o/w to nonbanks	6,860	6,040	6,236	6,059	6,044
03_Official bilateral loans, total	..	..	..	..	..
04___o/w aid loans	..	..	..	..	..
05___o/w other	..	..	..	..	..
06_Multilateral loans, total	6,760	7,116	7,206	..	..
07___o/w IMF	0	0	0	..	..
08___o/w other institutions	6,760	7,113	7,266	7,621	7,726
09_Insured export credit, Berne Union	7,807	7,721	7,650	7,144	7,170
10___o/w short term	4,613	4,684	4,690	4,421	4,494
11_SDR allocations	774	760	758	776	761
A2. Loans and other credits (Debt due within a year)					
12_Liabilities to BIS banks (cons.), short term	2,874	2,301	2,429	2,379	2,617
13_Multilateral loans, IMF, short term	..	..	..	..	..
B1. Debt securities (All maturities)					
14_Debt securities held by nonresidents	..	6,442	..	..	..
B2. Debt securities (short term, original maturity)					
15_Debt securities held by nonresidents	..	132	..	..	..
C. Supplementary information on debt (liabilities)					
16_International debt securities, all maturities	6,864	7,668	8,120	8,037	8,102
17___o/w issued by nonbanks	6,664	7,662	7,820	7,738	7,802
18_International debt securities, short term	64	66	66	64	0
19___o/w issued by nonbanks	64	66	66	64	0
20_Paris Club claims (ODA)	..	..	..	..	..
21_Paris Club claims (non ODA)	..	..	..	..	..
22_Liabilities to BIS banks, locational, total	12,929	12,602	12,676	12,784	10,207
23_Liabilities to BIS banks, consolidated, total	10,884	10,309	10,658	10,783	11,184
D. Memorandum items: selected foreign assets					
24_International reserves (excluding gold)	17,864	19,762	21,680	22,254	24,027
25___o/w SDR holdings	770	786	773	763	776
26_Portfolio investment assets	..	..	..	..	..
27_Cross-border deposits with BIS rep. banks	4,888	6,767	6,071	6,372	6,787
28___o/w deposits from nonbanks	2,604	2,669	2,472	2,333	2,464

THE DEBT TRAP IN A NUTSHELL

« Austerity + deficits »

- Deficit shrinking with spending cuts + wage reduction + tight fiscal and monetary policy = **GDP fall** =
- solvency ratios worsening = **Rating downgrading** = Higher borrowing costs

« Deficit-driven stop & go »

- Large primary fiscal deficit = higher consumption = larger external deficit = larger unfunded financing requirements =
- GDP rises = « stop & go » =
- **Rating downgrading!** = Higher borrowing requirements

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EXTERNAL DEBT ANALYSIS II

r = average rate of interest and g = average GDP growth rate

- DEBT t= DEBT t-1 * (1+r) – Primary Budget Balance
- GDP t = GDP t-1 * (1 + g)
- $\frac{\text{DEBT t}}{\text{GDP}} = \frac{\text{DEBT t-1} * (1+r)}{\text{GDP t-1} * (1+g)} - \frac{\text{Primary Budget Balance}}{\text{GDP}}$

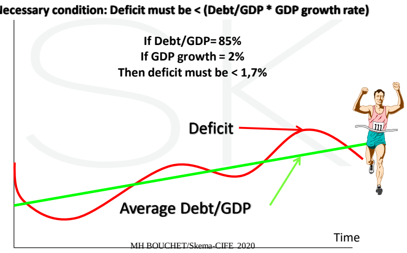
$$\frac{\text{DEBT}}{\text{GDP t}} = \frac{\text{DEBT}}{\text{GDP t-1}} * \frac{1+r}{1+g} - \frac{\text{Primary Budget Balance}}{\text{GDP}}$$

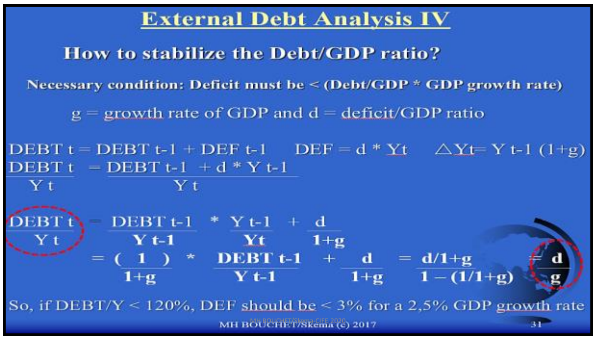
Reducing DEBT= Reducing r, increasing g, or boosting primary surplus

EXTERNAL DEBT ANALYSIS III

How to stabilize the Debt/GDP ratio?

Necessary condition: Deficit must be < (Debt/GDP * GDP growth rate)




External Debt Analysis IV
How to stabilize the Debt/GDP ratio?
Necessary condition: Deficit must be < (Debt/GDP * GDP growth rate)
g = growth rate of GDP and d = deficit/GDP ratio
DEBT t = DEBT t-1 + DEF t-1 DEF = d * Yt △Yt= Y t-1 (1+g)
DEBT t / Y t = DEBT t-1 + d * Y t-1 / Y t
DEBT t / Y t = DEBT t-1 / Y t-1 * Y t-1 / Yt + d / 1+g
= (1 / 1+g) * DEBT t-1 / Y t-1 + d / 1+g = d/1+g / 1 – (1/1+g) = d / g
So, if DEBT/Y < 120%, DEF should be < 3% for a 2,5% GDP growth rate
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31

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FROM COUNTRY RISK, TO FINANCIAL CRISIS AND DEBT NEGOTIATIONS!

CIFE SEMINAR NICE MAY 6-8, 2020

MICHEL-HENRY BOUCHET

What about country debt data?

Bank for International Settlements
International Monetary Fund
Organization for Economic Cooperation and Development
Statistical Data and Metadata eXchange
World Bank Group

Joint External Debt Hub | **JEDH**

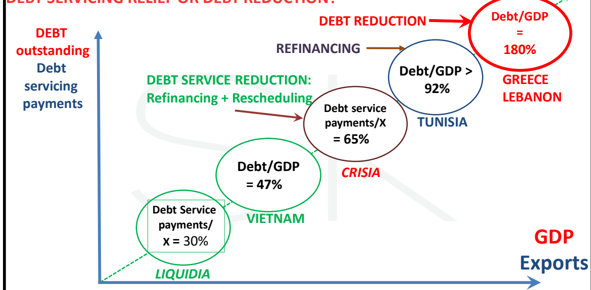
ARGENTINA

Data are in millions	2018Q1	2018Q2	2018Q3	2018Q4	2019Q1
A1. Loans and other credits (Debt of)					
01_Cross-border loans, by BIS reporting banks	20,166	21,701	23,424	22,195	22,698
02___o/w to nonbanks	17,230	18,499	20,695	19,153	19,122
03_Official bilateral loans, total	..	..	..	..	..
04___o/w aid loans	..	..	..	..	..
05___o/w other	..	..	..	..	..
06__Multilateral loans, total	18,276	18,211	32,978	47,930	28,062
07___o/w IMF	0	0	14,809	28,113	28,062
08___o/w other institutions	18,276	18,211	18,169	19,817	..
09_Insured export credit, Berne Union	24,149	23,103	23,103	22,897	22,897
10___o/w short term	7,040	7,315	7,315	6,519	6,519
11_SDR allocations	2,937	2,841	2,818	2,809	2,804
A2. Loans and other credits (Debt due within a year)					
12_Liabilities to BIS banks (cons.), short term	16,764	17,310	16,122	16,659	18,347
13_Multilateral loans, IMF, short term	0	0	425	945	998
B1. Debt securities (All maturities)					
14_Debt securities held by nonresidents	..	81,457	..	..	..
B2. Debt securities (short term, original maturity)					
15_Debt securities held by nonresidents	..	9,892	..	..	..
C. Supplementary information on debt (liabilities)					
16_International debt securities, all maturities	129,404	125,274	124,172	123,355	122,776
17___o/w issued by nonbanks	126,606	122,788	121,918	121,089	120,566
18_International debt securities, short term	4,189	5,692	5,374	4,625	5,068
19___o/w issued by nonbanks	4,189	5,692	5,374	4,625	4,777
20_Paris Club claims (ODA)	..	..	..	434	..
21_Paris Club claims (non ODA)	..	..	..	3,354	..
22_Liabilities to BIS banks, locational, total	24,790	25,500	26,322	24,707	25,399
23_Liabilities to BIS banks, consolidated, total	26,722	27,778	26,089	27,296	29,280
D. Memorandum items: selected foreign assets					
24_International reserves (excluding gold)	59,691	59,268	46,532	63,964	63,775
25___o/w SDR holdings	2,595	3,805	3,730	4,354	3,322

SPAIN

Data are in millions	2018Q1	2018Q2	2018Q3	2018Q4	2019Q1
A1. Loans and other credits (Debt of)					
01_Cross-border loans, by BIS reporting banks	264,010	236,827	230,056	238,536	239,419
02___o/w to nonbanks	66,427	62,294	66,982	77,781	74,538
03_Official bilateral loans, total	..	..	..	..	..
04___o/w aid loans	..	..	..	..	..
05___o/w other	..	..	..	..	..
06__Multilateral loans, total	0	0	0	0	0
07___o/w IMF	0	0	0	0	0
08___o/w other institutions	..	..	..	..	..
09_Insured export credit, Berne Union	68,939	61,790	61,790	68,879	68,879
10___o/w short term	62,278	54,637	54,637	62,146	62,146
11_SDR allocations	4,111	3,977	3,945	3,933	3,925
A2. Loans and other credits (Debt due within a year)					
12_Liabilities to BIS banks (cons.), short term	136,142	127,157	124,859	127,061	134,382
13_Multilateral loans, IMF, short term	..	..	..	..	..
B1. Debt securities (All maturities)					
14_Debt securities held by nonresidents	..	793,937	..	..	..
B2. Debt securities (short term, original maturity)					
15_Debt securities held by nonresidents	..	49,684	..	..	..
C. Supplementary information on debt (liabilities)					
16_International debt securities, all maturities	561,901	525,192	520,780	518,825	519,386
17___o/w issued by nonbanks	405,762	379,790	368,741	366,453	365,205
18_International debt securities, short term	66,464	56,327	49,251	52,746	61,060
19___o/w issued by nonbanks	40,427	37,498	29,379	33,544	46,408
20_Paris Club claims (ODA)	..	..	..	..	..
21_Paris Club claims (non ODA)	..	..	..	..	..
22_Liabilities to BIS banks, locational, total	457,471	420,753	414,349	421,867	434,802
23_Liabilities to BIS banks, consolidated, total	394,292	366,833	360,447	356,608	376,819
D. Memorandum items: selected foreign assets					
24_International reserves (excluding gold)	58,380	57,713	57,332	59,030	59,853
25___o/w SDR holdings	4,164	3,938	3,911	3,834	3,835

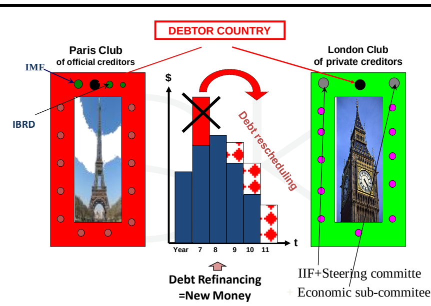
DEBT SERVICING RELIEF OR DEBT REDUCTION?



WHO's WHO?

Five main groups of private and official creditors:

1. The IFIs: IMF and World Bank + RDBs
2. The Paris Club of OECD governments
3. Private suppliers: trade debt
4. The London Club of international banks
5. Institutional investors (pension and investment funds, hedge funds): Eurobond holders



THE PARIS CLUB

KEY NUMBERS

Total amount of agreements	433
Total amount of debtor countries	90
Total amount of debt	583 Billion $
Total amount of countries in "Classic Terms"	60
Total amount of countries in "Houston Terms"	21
Total amount of countries in "Naples Terms"	36
Total amount of countries in "Cologne Terms"	33

PARIS CLUB DEBT RESTRUCTURING

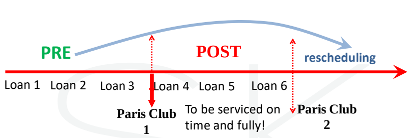
- **Official bilateral debt (government to government)** is renegotiated under the auspices of the Paris Club since 1956
- Since then, the 21 Paris Club creditors have reached 433 agreements concerning 90 debtor countries.
- Total amount of debt covered = **$583 billion**
- Only official debt + officially-guaranteed credits (Coface, Hermes, ECGD, US Eximbank…)
- Total claims on EMCs end-2017: $310 billion

- 10 times meetings/year, for negotiation sessions or to discuss the situation of the external debt of debtor countries or debt related methodological issues (sometimes with the IIF)
- Russia joined in 1997 and Brazil in end-2016, as sizeable lender in African countries such as Nigeria, Angola and Mozambique.

PARIS CLUB: 7 DEBT RESTRUCTURING GUIDELINES

1. Consensus
2. Comparability of treatment
3. Solidarity among creditors with on-going information exchanges
4. Case by case treatment of debt crisis
5. Conditionality based on IMF adjustment program and monitoring
6. No restructuring of « post-cut off date » debt so as to preserve access to new financing
7. Secretariat provided by French Treasury

PRE AND POST CUT-OFF DATE DEBT?



- Time + Money = To preserve new money and market access, only **pre cut-off date** debt is eligible to debt relief negotiations through rescheduling, refinancing, debt conversion and debt reduction

TOTAL DEBT OUTSTANDING OF ARGENTINA

Argentina

Table1 Joint BIS-IMF-OECD-World Bank Statistics on External Debt (mill. US$)

Data are in millions	2017Q1	2017Q2	2017Q3	2017Q4	2018Q1
A1. Loans and other credits (Debt of)					
01_Cross-border loans, by BIS reporting banks	11,919	13,134	16,582	18,352	..
02___o/w to nonbanks	10,080	10,973	14,377	15,685	..
03_Official bilateral loans, total	..	..	..	..	..
04___o/w aid loans	..	PARIS CLUB		..	..
05___o/w other	..	..	..	..	..
06__Multilateral loans, total	17,507	17,520	17,632	18,590	18,275
07___o/w IMF	0	0	0	0	0
08___o/w other institutions	17,507	17,520	17,632	18,590	18,275
09_Insured export credit, Berne Union	21,201	21,410	22,780	24,149	..
10___o/w short term	4,247	5,118	6,079	7,040	..
11_SDR allocations	2,741	2,811	2,866	2,877	2,937
A2. Loans and other credits (Debt due within a year)					
12_Liabilities to BIS banks (cons.), short term	12,117	11,129	14,436	17,875	..
13_Multilateral loans, IMF, short term	0	0	0	0	0
B1. Debt securities (All maturities)					
14_Debt securities held by nonresidents	..	68,025	..	..	..
B2. Debt securities (short term, original maturity)					
15_Debt securities held by nonresidents	..	3,941	..	..	..
C. Supplementary information on debt (liabilities)					
16_International debt securities, all maturities	102,842	136,678	138,776	145,698	..
17___o/w issued by nonbanks	100,469	134,070	136,226	142,833	..
18_International debt securities, short term	2,391	3,493	3,422	4,206	..
19___o/w issued by nonbanks	2,041	3,443	3,372	4,206	..
20_Paris Club claims (ODA)	..	..	..	..	..
21_Paris Club claims (non ODA)	..	..	..	..	..
22_Liabilities to BIS banks, locational, total	15,932	17,044	22,117	24,450	..
23_Liabilities to BIS banks, consolidated, total	19,321	18,853	24,069	28,132	..
D. Memorandum items: selected foreign assets					
24_International reserves (excluding gold)	48,573	46,453	47,622	53,031	59,691
25___o/w SDR holdings	2,423	2,484	2,523	2,542	2,595
26_Portfolio investment assets	..	25,401	..	..	..
27_Cross-border deposits with BIS rep. banks	26,264	21,214	25,812	23,266	..
28___o/w deposits from nonbanks	18,400	17,688	17,812	15,040	[illegible]

The London Club
of debt restructuring

WHAT IS THE « LONDON CLUB »?

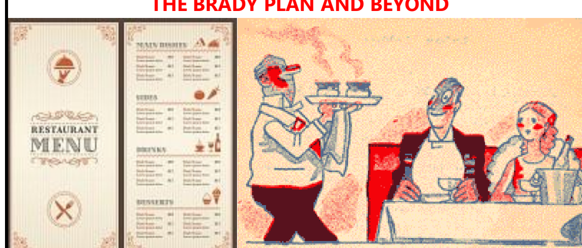
- Since the 1970s, countries facing default have used the London Club process to restructure sovereign debt owed to banks.
- The London Club has evolved as an ad hoc forum for restructuring negotiations.
- Each London Club is formed at the initiative of the **debtor country** and is dissolved when a restructuring agreement is signed.
- Ad hoc London Club "Advisory Committees" are chaired by a leading financial bank.
- The IIF plays a key role in London Club meetings:

BOP and debt analysis!

WHAT IS THE IIF?

- The Institute of International Finance, Inc. (IIF), is the world's only global association of financial institutions.
- Created in 1983 in response to the international debt crisis, the IIF has evolved to meet the changing needs of the financial community.
- Members include most of the world's largest commercial banks and investment banks, as well as insurance companies and investment management firms. Among the Institute's Associate members are MNCs, trading companies, ECAs, and multilateral agencies.
- The Institute has > **450 members** headquartered > 70 countries.

MENU-BASED DEBT RESTRUCTURING
THE BRADY PLAN AND BEYOND



IS THERE LIFE AFTER ARREARS AND DEBT DEFAULT?

Bank loans may be delinquent on their repayments or in default of the loan entirely = Loss for the bank on expected income

Arrears + Default = Accounting losses in banking portfolios

Loan-loss reserves (provisions against NPLs)

In the event of a default, no loss in cash flows=
the bank will use the amount set aside to cover the loss.
The provision is tax deductible and can be used in the bank's capital (Bâle III)

Expected income loss — Loan-loss provision

Loan sale at market value

Debt swaps

Discounted debt trading

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THE BRADY PLAN OF DEBT RESTRUCTUIRNG

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THE 1989-2019 PROCESS OF LONDON CLUB DEBT RESTRUCTURING

- **London Club banks** grant debt relief to debtor nations, in some proportion of secondary market discount through interest or debt stock reduction
- Accounting and regulatory incentives (loan-loss provisioning)
- Shift to specific purpose financing and voluntary lending

- **Debtor countries** adopt tough macroeconomic adjustment programs under the monitoring of the IMF/WB (SALs)
- Current account financing + Reserve build-up
- Objective: back to market-access for EMCs or to grants for low-income countries

Means and Tools

- Defaulted sovereign London Club debt to be exchanged for easily tradeable **Brady bonds** guaranteed by 30-year zero-coupon US Treasury bonds which the defaulting nation purchases with its reserves and official financing support (IFIs + Paris Club)
- Principal guarantee + x semi-annual interest payments, whose guarantee is rolled over
- **Bullet repayment** (e.g., 30 years)
- **Cross-default clause**
- **Debt conversion clauses**

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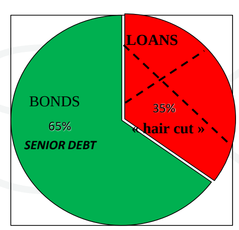
THE BRADY PLAN IN ACTION

New senior debt with long-term maturity, principal collateralization, rolling interest
Guarantee + cross-default clause



Debt cancellation backed up by commercial banks' reserves for loan-losses with regulatory incentives

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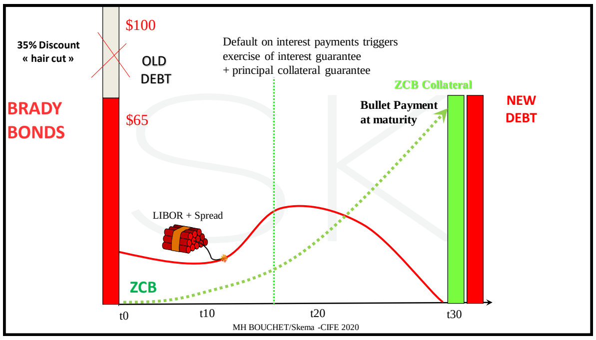

Types of Brady Bonds

- **Buybacks at discount**
- **Par Bonds** *Maturity:* Registered 30 year bullet issued at par *Coupon:* Fixed rate semi-annual below market coupon *Guarantee:* Rolling interest guarantees from 12 to 18 months. Principal collateralized by U.S. Treasury zero-coupon bonds
- **Discount Bonds (DB)** *Maturity:* Registered 30 year bullet amortization issued at discount *Coupon:* Floating rate semi-annual LIBOR *Guarantee:* Rolling interest guarantees from 12 to 18 months.
- **Front Loaded Interest Reduction Bonds (FLIRB)** *Maturity:* Bearer 15 to 20 year semi-annual bond. Bond has amortization feature in which a set proportion of bonds are redeemed semi-annually. *Coupon:* LIBOR market rate until maturity. *Guarantee:* Rolling interest guarantees generally of 12 months available only the first 5 or 6 years.

TYPES OF BRADY BONDS

- **Debt Conversion Bonds (DCB)** *Maturity:* Bearer bonds maturing between 15-20 years. Bonds issued at par. *Coupon:* Amortizing semi-annual LIBOR market rate. *Guarantee:* No collateral is provided
- **New Money Bonds (NMB)** *Maturity:* Bearer bonds maturing 15-20 years. *Coupon:* Amortizing semi-annual LIBOR. No collateral
- **Past Due Interest (PDI)** *Maturity:* Bearer bonds maturing 10-20 years. *Coupon:* Amortizing semi-annual LIBOR. No collateral
- **Capitalization Bonds (C-Bonds)** Issued in 1994 by Brazil's Brady plan. Maturity: Registered 20 year amortizing bonds initially offered at par. Coupon: Fixed below market coupon rate stepping up to 8% during the first 6 years and holding until maturity. Both capitalized interest and principal payments are made after a 10 year grace period.

VIETNAM = LONDON CLUB DEBT RESTRUCTURING

Brady debt restructuring (12/97)=

- (P= 335 million) + (PDI= 515) *interest arrears*

= $**850 million**

- 30-year bonds with 50% discount + par bonds + buyback at 44%

Paris Club Debt Restructuring 12/1993: LONDON Terms = 54% debt reduction

LEGAL CLAUSES AND CONVENANTS IN DEBT RESTRUCTURING NEGOTIATIONS

- Waiver on negative pledge clause: it prevents a borrower from pledging any assets if doing so would jeopardize the lender's security : risk of subordination with regard to a senior status lender!
- It ensures **financial equality** and democracy in a community of creditors
- In Brady deals, the Paris Club, the IMF and the World Bank **waive the clause**

SNAPSHOT AT VIETNAM'S GOVERNMENT SECURITIES

VIETNM (12 Found) Cpn Typ All Mty Typ All Exclude None

Issuer	Coupon	Maturity	Series	Rtg	Freq	Mty Type	Cntry	Curr	Ask Px
1)VIETNAM (REP OF)	6.875	01/15/16	REGS	B+	S/A	BULLET	VN	USD	106.2500
2)VIETNAM (REP OF)	6.875	01/15/16	144A	B+	S/A	BULLET	VN	USD	106.2500
3)VIETNAM-PDI	VAR	03/12/16	US	NR	S/A	SINKABLE	VN	USD	N.A.
4)VIETNAM-PDI	VAR	03/12/16	18YR	NR	S/A	SINKABLE	VN	USD	88.0000
5)VIETNAM (REP OF)	6.750	01/29/20	REGS	B+	S/A	BULLET	VN	USD	101.5000
6)VIETNAM (REP OF)	6.750	01/29/20	144A	B+	S/A	BULLET	VN	USD	102.2500
7)VIETNAM-PAR	3.750	03/12/28	US	NR	S/A	CALL/SINK	VN	USD	N.A.
8)VIETNAM-PAR	4.000	03/12/28	30YR	B+	S/A	CALL/SINK	VN	USD	75.0000
9)VIETNAM-DISC	FLOAT	03/13/28	30YR	B+	S/A	BULLET	VN	USD	84.0000
10)VIETNAM-DISC	FLOAT	03/13/28	US	NR	S/A	BULLET	VN	USD	N.A.
11)VIETNAM-DM LOAN	0.000	12/29/49	DM	NR	S/A	CALL/SINK	VN	DEM	N.A.
12)VIETNAM-US$ LOAN	0.000	12/29/49	US$	NR	S/A	CALL/SINK	VN	USD	N.A.

VIETNAM'S 30-YEAR BRADY BOND 1998-2028

Floating-rate US$ Brady bond, with principal repayment secured by 30-year zero-coupon US$ bond collateral + rolling interest payment guarantee

THE GREEK 2011-13 MENU-BASED « BRADY DEBT RESTRUCTURING » = 65% « *HAIR CUT* »

1. **Par Bond** Exchange into a 30 year instrument (4% coupon)
2. **Par Bond** with refinancing of rolling-over maturing Greek government bonds over 30 years
3. **Discount Bond** Exchange into a 30 year instrument with 20% discount and 5% coupon
4. **Discount Bond** Exchange into a 15 year instrument with 5,9% coupon
5. **Buyback** at 35% price (65% discount) of London Club debt (11/2012)

- For instruments, 1, 2 and 3 the principal is fully collateralized by 30 year zero coupon AAA Bonds.
- For instrument 4, the principal is partially collateralized through funds held in an escrow account.

Calculation: IIF & http://www.voxeu.org/index.php?q=node/6818

CHALLENGES OF THE GREEK DEBT RESTRUCTURING WORKOUT 2011-20

- 1. *Pari passu*: Private investors insist that government bail-out lenders would be treated the same way as the private sector, to lessen the risk of another cut in their payouts down the line
- 2. New bonds issued to private investors as part of the hair cut to be governed by London rather than Greek law
- 3. Threat of free riders and legal actions: VEGA Hedge Fund

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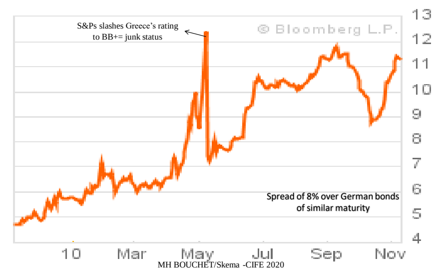
MARKET PRICE OF RISK: YIELD ON GREECE'S 10-YEAR BONDS 2009-2010



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IVORY COAST'S BANK DEBT RESTRUCTURING SAGA

- 03/1998 - Ivory Coast issued six bonds totalling $2.4 billion under the Brady scheme in a restructuring of outstanding external commercial debt.
- 09/2000 - Default on the bonds, following a coup in 1999.
- 03/2009 - The IMF and the World Bank declared Ivory Coast eligible for debt relief under the HIPC (highly indebted poor countries) initiative.
- 03/2009 - Paris Club agreement leading to immediate cancellation of $845 million in debt (**80% debt relief**)
- 04/2010 - **Debt exchange of the defaulted Brady bonds**, replacing the old bonds with a $2.3 billion bond **due 2032**, with semi-annual coupon payments and 6-year grace period (2016): discount of 20 percent on the exchangeable debt.
- 11/2010 - Presidential run-off ballot : Gbagbo is declared winner = civil war
- 12/2010 - World Bank freezes funding
- 12/2010 - Ivory Coast does not make $29 million coupon payment on $2.3 billion bond. Failure to pay = "event of default"

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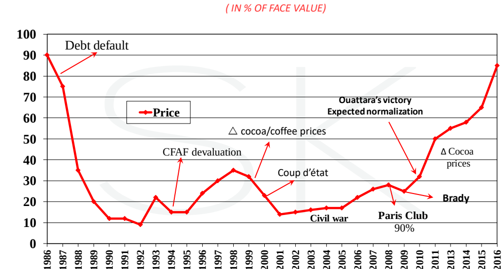
IVORY COAST'S SECONDARY MARKET DEBT PRICE

(IN % OF FACE VALUE)



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UKRAINE'S DEBT RESTRUCTURING 09/2015

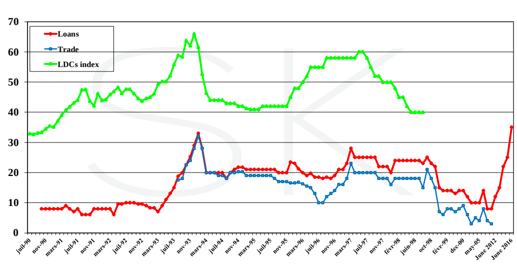
- 20% write off on $18 billion of bonds, condition for the IMF to press ahead with 4-year $40 billion package
- Main creditors: PTG Pactual, T Rowe Price, TCW, Franklin Templeton…
- Inclusion of GDP-linked instrument
- Between 2021-40 investors will receive up to 40% of the value of economic growth > 4%

BRADY BONDS PRICES AFTER RESTRUCTURING NEGOTIATIONS

Arg Par	48.000	50.000
Arg FRB	41.000	42.000
Arg '27	31.000	33.000
Brz C	75.250	75.437
Brz '27	72.750	73.000
Bul IAB	85.000	85.500
Mex Par	93.000	93.250
Pol Par	75.250	76.250
Rus '28	107.750	108.000
Ven DCB	78.250	78.750
Vie Par	44.000	45.000

SECONDARY MARKET PRICES OF CUBA'S LONDON CLUB DEBT

(1990-2017 in percent of face value)



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HYPER-EXOTIC DEBT PRICES

- Myanmar 20%
- Cambodia 20%
- Mongolia 22%
- North Korea 10%

- Argentina (2033 bonds)= 62% following ruling by NY court in 11/2012)
- Cuba Loans 10-35%
- Cuba Trade 15%
- Albania 36%
- Bosnia 36%
- Serbia 44%

- Irak Bonds 90%
- Libya 25-35%
- Syria 6-11%
- Yemen 30%

- Angola 60%
- Ethiopia 60%
- Senegal 35%
- Sudan 11-14%
- Uganda 14-16%
- Zimbabwe 1-4%

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EMCS SECONDARY MARKET DEBT PRICES

COUNTRY / ISSUE	Low Price	High Price
Africa Hyper-Exotics		
Angola / Trade	50.000%	55.000%
Angola / Loans	55.000%	59.000%
Cameroon / Trade (non-HIPC)	14.000%	20.000%
Congo / Trade (non-HIPC)	22.000%	26.000%
DR Congo / Loans, Trade (non-HIPC)	16.000%	20.000%
Ghana / Trade (non-HIPC)	78.000%	82.000%
Kenya / Trade	39.000%	49.000%
Mozambique / Trade (non-HIPC)	20.000%	26.000%
Senegal / Loans, Trade (non-HIPC)	12.000%	16.000%
Sudan / Loans (non-HIPC)	11.000%	14.000%
Tanzania / Loans, Trade (non-HIPC)	10.000%	13.000%
Uganda / Trade (non-HIPC)	14.000%	16.000%
Zambia / Loans, Trade (non-HIPC)	13.000%	20.000%
Zimbabwe / Trade	1.000%	4.000%
Latin America & Caribbean Hyper-Exotics		
Cuba / Trade	2.000%	4.000%
Cuba / Loans	5.000%	10.000%
Suriname / Loans, Trade	14.000%	18.000%

COUNTRY / ISSUE	Low Price	High Price
Eastern Europe Hyper-Exotics		
Azerbaijan / Trade	18.000%	23.000%
Bosnia / Trade	36.000%	41.000%
Georgia / Trade	11.000%	15.000%
Serbia / Trade	44.000%	54.000%
Turkmenistan / Trade	23.000%	33.000%
Ukraine / Trade	18.000%	25.000%
Uzbekistan/Trade	20.000%	24.000%
Middle East Hyper-Exotics		
Egypt Trade	65.000%	75.000%
Iraq / Paris Club	84.000%	89.000%
Iraq / Bonds	91.000%	92.000%
Libya / Trade	25.000%	35.000%
Syria / Trade	6.000%	11.000%
Asia Hyper-Exotics		
Mongolia / Trade	22.000%	30.000%
North Korea / Loans, Certificates	9.000%	12.000%

Weak Liquidity:

Angola, Nicaragua, Cameroon, Albania, Congo, Tanzania, Zaire (Rep. Democr.), Zambia, Iraq, North Korea

Limited Liquidity:

Cuba, Egypt, Jordan, Madagascar, Panama, Jamaica, Ivory Coast, Senegal

Moderate Liquidity:

Nigeria, Morocco, Costa Rica, Bulgaria, Peru, Russia, Vietnam

Good Liquidity

Brady Bonds + Eurobonds= Argentina, Brazil, Ecuador, Mexico, Philippines, Poland, Venezuela. South Africa, Turkey

Debt trading and EMTA

E M T A

405 Lexington Avenue
Suite 5304.
New York, NY 10174
646 676 4293

Contact: Jonathan Murno
EMTA
jmurno@emta.org

For Immediate Release

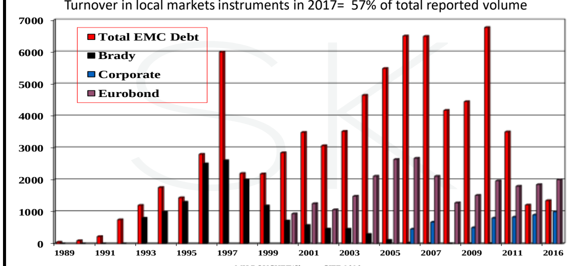
**EMTA SURVEY:
QUARTERLY EMERGING MARKETS DEBT TRADING
AT US$1.132 TRILLION**

Volumes Decline 17% on Year-on-Year Basis

NEW YORK, September 19, 2017—Emerging Markets debt trading volumes stood at US$1.132 trillion in the second quarter of 2017, according to a report released today by EMTA, the trade association for the Emerging Markets debt trading and investment industry. This compares with US$1.357 trillion reported for the second quarter of 2016, a 17% decrease, and down 14% from US$1.323 trillion reported in the first quarter.

EMERGING MARKET DEBT TRADING 1989-2016 (US$ BILLION)

Turnover in local markets instruments in 2017= 57% of total reported volume



Source: EMTA-London

WHO'S WHO IN HIGHLY DISCOUNTED AND EXOTIC DEBT TRADING?

1. **Trading**: FH International (Eric Herman), Omni Bridgeway (Amsterdam, Geneva, Singapore, London, Guernesey), MarketAxess, Société Générale, BNP, Lazard Brothers
2. **Holdout creditors** and « *vulture funds* »: hedge funds that seek to enforce contractual claims against distressed sovereign debtors through litigation: they buy defaulted government debts on the cheap and refuse to join in a restructuring, "holding out" for a better deal and sue for the full amount (***pari passu clauses*** promise equal treatment of creditors preventing EMCs from paying its restructured bondholders but not hedge funds: i.e., borrower's promise to ensure that the obligations will always rank equally in right of payment)
3. Key players: NML Capital (Argentina), Paul E. Singer's Elliott Capital Management (Argentina), Aurelius Capital Management (Argentina's 2001 $132 billion default, Peru), Franklin Templeton, BlueMountain Capital, Stone Lion Capital, Monarch Alternative Capital, Canyon Capital, First Tree Partners, Marathon Asset Management (Puerto Rico, Greece), Dart (Brazil), Greylock Capital (Venezuela).

DEBT COLLECTION, ASSET TRACING AND DEBT TRADING

Omni Bridgeway

Debt Recovery

Debt recovery/collection:

- "Softball" Consensual Debt Collection: through amicable means
- "Hardball" – non consensual debt collection: through legal means
- "Passing the ball" to investor: sale of the debt

Recovery case: National Bank of Ukraine

1. Summons to pay to National Bank of Ukraine. No full payment followed
2. Concerted attachments were effectuated in France, Germany, Luxembourg and The Netherlands.
3. Assets attached > amount owed
4. Main legal proceedings initiated.
5. National Bank of Ukraine forced to the negotiating table to reach an amicable settlement.
6. A settlement agreement was signed between the creditor and the National Bank of Ukraine for the amount of USD 13 million (i.e. full principal amount *plus* overdue interest).

Recovery Case: Zimbabwe

Country	: Zimbabwe
Lender	: West European Bank
Borrower	: Ministry of Health and Ministry of Finance
Principal	: EUR 25 million, maturity 1993-2000
Award	: No

Solution: Asset tracing and subsequent attachments in various western jurisdictions

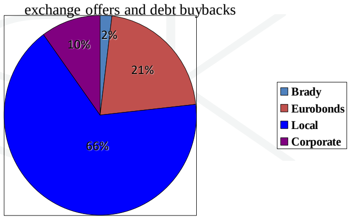
Negotiation started soon after attachments were made.

Recovery within one year :

- approx. EUR 10 million +
- for the remainder: restructuring agreement with improved conditions

TRADING VOLUME BY INSTRUMENT TURNOVER

Bradys transactions which accounted for 50% of debt trading in the mid-1990s have shrunk due to early redemption, exchange offers and debt buybacks



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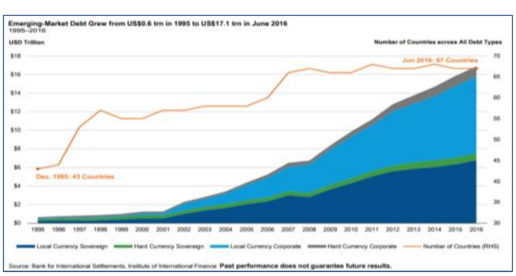
THE EVOLVING STRUCTURE IN THE SECONDARY DEBT MARKET

MARKET SHARE COMPARISON

	2005	1997
Eurobonds	48%	23%
Local Instruments	47%	25%
Options and Warrants	2%	6%
Brady Bonds	2%	41%
Loans	>1%	5%

Source: EMTA

EMERGING MARKET LOCAL CURRENCY BONDS 1995-2017



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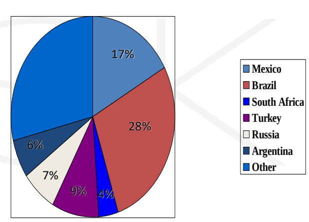
TRADING VOLUME BY COUNTRY (EMTA)



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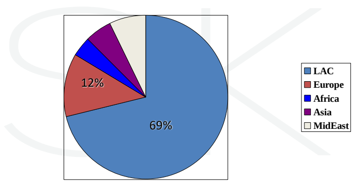
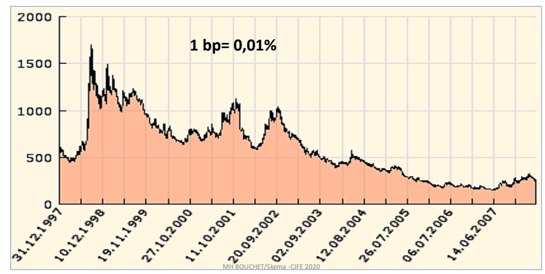
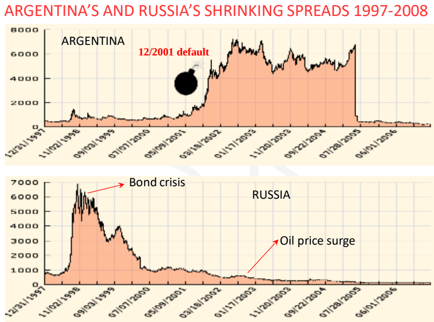
TRADING VOLUME BY REGION



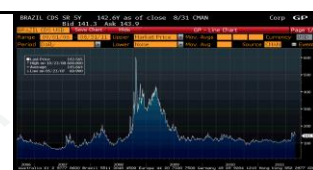
ASIAN + RUSSIA + ARGENTINA CRISES
EMERGING MARKET BOND SPREAD INDEX 1997-2008



ARGENTINA'S AND RUSSIA'S SHRINKING SPREADS 1997-2008



RISK CONTAMINATION = BRAZIL AND PERU 5-YEAR CDS PRICES: THE GLOBAL SPILL-OVER EFFECT 2006-2012



600 bp= $600,000
to insure
$10 million/year

CDS IN 2016-20?

Nigeria CDS spread of 590 bp implies that it costs $590,000/year to insure $10 million worth of debt

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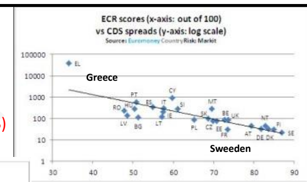
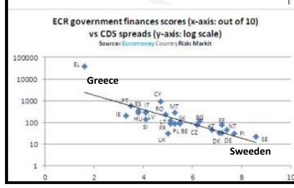
CDS SPREADS AS EARLY COUNTRY-RISK WARNING INDICATORS

(EUROMONEY COUNTRY RISK SCORES)





CDS spread of 200 bp implies that it costs $200,000/year to insure $10 million worth of debt

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JANUARY 2011: YIELD BOND 06-2020

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VOLATILITÉ DU YIELD SUR L'OBLIGATION SOUVERAINE DE LA TUNISIE 2025 $1 MILLIARD

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BTUN CDS USD SR 5Y D14 370.000
At 13 Oct
357.500 / 382.500
Source CMAN
Bar Chart
Last Price 370.000
High on 02/29/16 520.275
Average 377.059
Low on 11/11/14 259.345
2013
2014
2015
2016
2017
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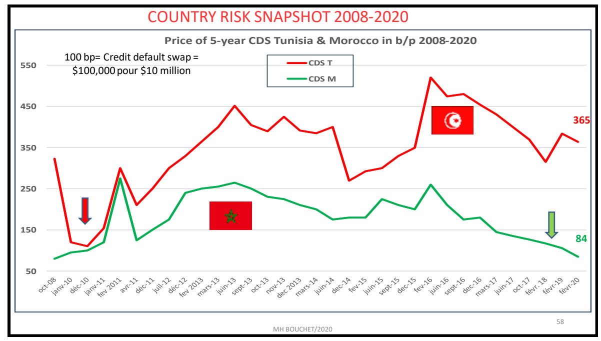
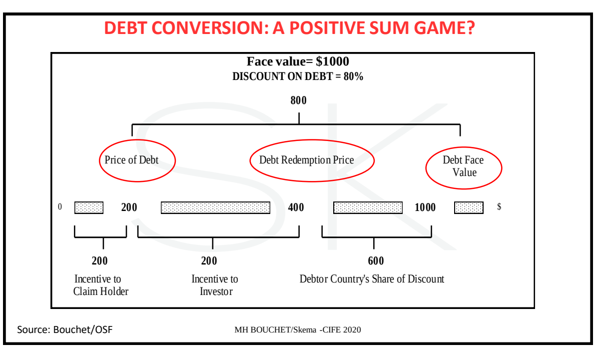
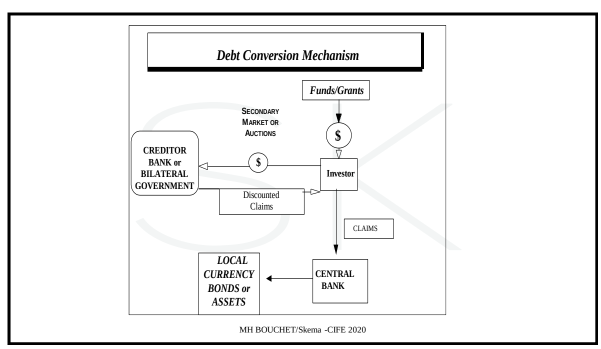


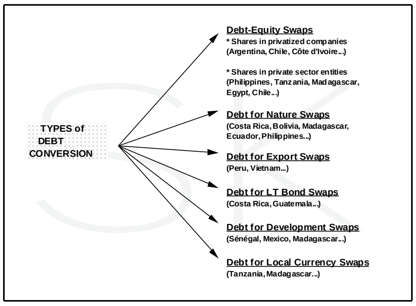
COUNTRY RISK SNAPSHOT 2008-2020
Price of 5-year CDS Tunisia & Morocco in b/p 2008-2020
100 bp= Credit default swap =
$100,000 pour $10 million
CDS T
CDS M
365
84
MH BOUCHET/2020



DEBT CONVERSION: A POSITIVE SUM GAME?
Face value= $1000
DISCOUNT ON DEBT = 80%
800
Price of Debt
Debt Redemption Price
Debt Face Value
0
200
400
1000
$
200
Incentive to Claim Holder
200
Incentive to Investor
600
Debtor Country's Share of Discount
Source: Bouchet/OSF
MH BOUCHET/Skema -CIFE 2020



Debt Conversion Mechanism
Funds/Grants
SECONDARY MARKET OR AUCTIONS
$
CREDITOR BANK or BILATERAL GOVERNMENT
$
Investor
Discounted Claims
CLAIMS
LOCAL CURRENCY BONDS or ASSETS
CENTRAL BANK
MH BOUCHET/Skema -CIFE 2020



Source: Bouchet/OSF

CORPORATE DEBT SWAP TRANSACTIONS

- 04/2001: South Korea's largest builder HEC (Hyundai Engineering & Constr.) makes a debt swap with its creditors to reduce debt ratios from **1240 % to 250%,** by issuing new shares and bonds to creditors as a part of the rescue package after Hyundai reported losses >US$2.2 billion that wiped out its equity capital!

POSITIVE SUM GAME!

- Debtor: debt cancellation with local currency payments while stimulating foreign direct investment and enhancing the role of private sector activity in the local economy (privatization)

- Creditor: cleaning up of portfolio with upfront cash payment while accounting losses get absorbed by loan-loss reserves

- Investor: access to local currency at a discounted exchange rate that boils down to an investment subsidy, thereby mitigating the overall country risk and the specific project risk

Centre international de formation européenne

NICE BERLIN BRUXELLES ISTANBUL

GLOBAL RISK MANAGEMENT: HOW TACKLING POLITICAL RISK?

INTRODUCTION

CIFE SEMINAR NICE MAY 6-8, 2020

MICHEL-HENRY BOUCHET

Wars and armed conflicts all over the world

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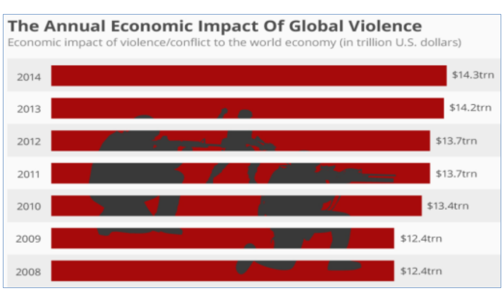
THE COST OF GLOBAL POLITICAL RISK



https://www.statista.com/chart/3948/the-annual-economic-impact-of-global-violence/

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MIGA: THE KEY CHALLENGE OF POLITICAL RISK

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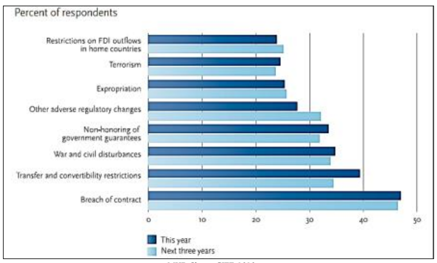
MIGA: TYPES OF POLITICAL RISK OF HIGHER CONCERN TO MNCS IN EMCS



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RANKING OF TOP RISKS REPORTED BY FTSE 100 FIRMS (FT)

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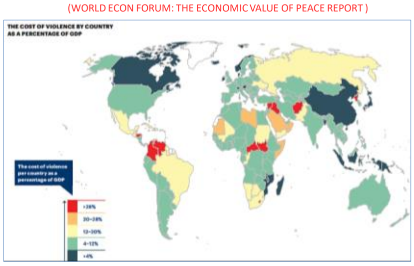
THE COST OF VIOLENCE IN % OF GDP

(WORLD ECON FORUM: THE ECONOMIC VALUE OF PEACE REPORT)



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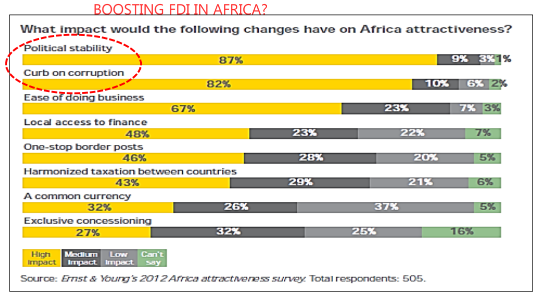
BOOSTING FDI IN AFRICA?



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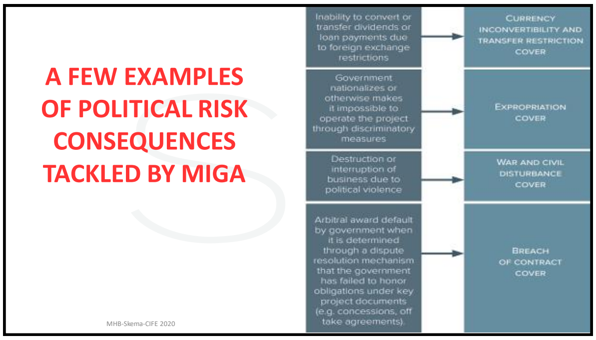
A FEW EXAMPLES OF POLITICAL RISK CONSEQUENCES TACKLED BY MIGA
Inability to convert or transfer dividends or loan payments due to foreign exchange restrictions
CURRENCY INCONVERTIBILITY AND TRANSFER RESTRICTION COVER
Government nationalizes or otherwise makes it impossible to operate the project through discriminatory measures
EXPROPRIATION COVER
Destruction or interruption of business due to political violence
WAR AND CIVIL DISTURBANCE COVER
Arbitral award default by government when it is determined through a dispute resolution mechanism that the government has failed to honor obligations under key project documents (e.g. concessions, off take agreements).
BREACH OF CONTRACT COVER
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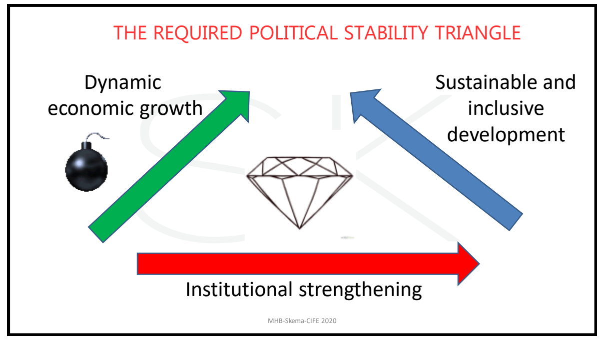
THE REQUIRED POLITICAL STABILITY TRIANGLE
Dynamic economic growth
Sustainable and inclusive development
Institutional strengthening
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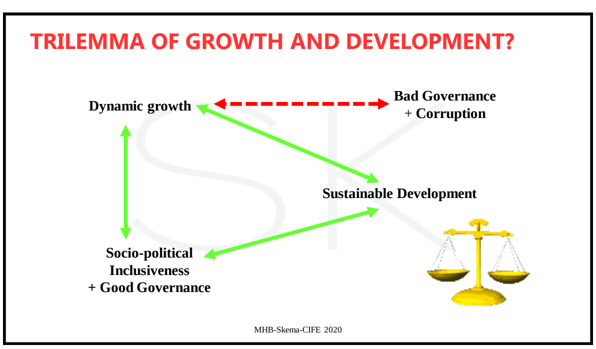
TRILEMMA OF GROWTH AND DEVELOPMENT?
Dynamic growth
Bad Governance + Corruption
Sustainable Development
Socio-political Inclusiveness + Good Governance
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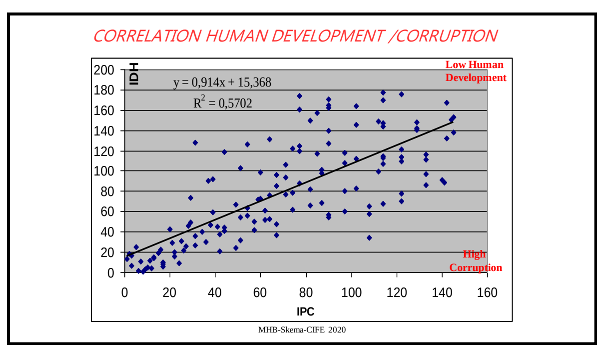
CORRELATION HUMAN DEVELOPMENT /CORRUPTION
IDH
y = 0,914x + 15,368
R2 = 0,5702
Low Human Development
High Corruption
IPC
0
20
40
60
80
100
120
140
160
180
200
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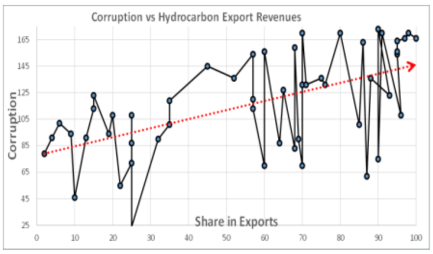
OIL-BASED GROWTH LEADS TO POWER AND WEALTH CONCENTRATION, AND CORRUPTION



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DEVELOPMENT = ECONOMIC GROWTH + KEY CONDITIONS THAT MAKE IT SUSTAINABLE!

	CHILE	COSTA RICA	Turkmenistan	GABON
GDP/per capita	$15,000	$11,000	$15,000	$14,000
Life Expectancy	80	81	68	65
HDI Rank	42	68	108	115

	ARMENIA	SRI LANKA	NIGERIA	ANGOLA
GDP per capita	$5000	$5000	$5000	$5500
Life expectancy	75	77	54	60
HDI Rank	81	97	158	1489

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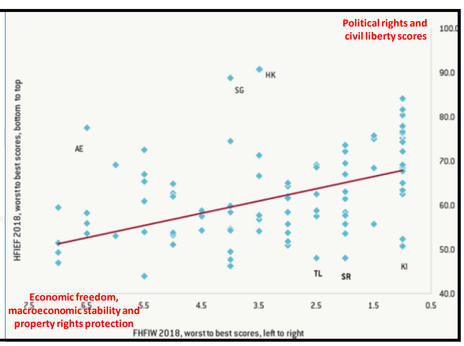
IS THERE A CORRELATION BETWEEN **POLITICAL FREEDOM & ECONOMIC FREEDOM?**



Source: Bruegel, 2018

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HOW MOVING FROM GROWTH TO SUSTAINABLE AND INCLUSIVE DEVELOPMENT?

Assumption n°1

- Primacy of **human capital for both growth and democratization:** human and social capital shape both institutional and productive capacities of a society.
- Growth in **income and human capital** causes institutional improvement with better political institutions even with pro-market dictators: **policy choices matter** while institutional quality rises as a country grows richer
- Economic growth and human capital accumulation cause institutional improvement, rather than the other way around

Assumption n°2

- **Democracy** and other checks on government are the **key mechanisms for securing property rights and boosting growth**
- **Good and stable institutions will enhance the pace and quality of economic growth**
- **Robust institutions and good governance matter!**

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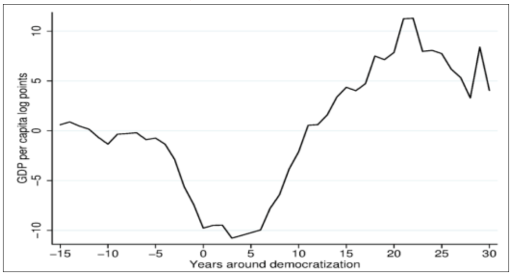
DEMOCRACY BREEDS GDP PER CAPITA GROWTH WHILE ECONOMIC GROWTH LEADS TO DEMOCRACY
(ACEMOGLU & ROBINSON)



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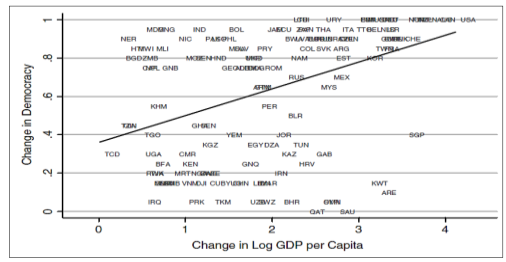
DEMOCRATIZATION AND INCOME GROWTH 1500-1995
INCOME PER CAPITA AND DEMOCRACY ARE CORRELATED BECAUSE ECONOMIC AND SOCIO-POLITICAL INSTITUTIONS TRANSFORM GROWTH INTO SUSTAINABLE AND INCLUSIVE DEVELOPMENT



J. Robinson, 2006

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MEASURING SOCIO-POLITICAL RISK

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UKRAINE:

THE PRICE OF POLITICAL RISK IN THE WAKE OF THE REVOLUTION AND THE RUSSIAN INVASION OF CRIMEA IN 2014

Sept 2017: back to market access?
bond swap with $3 billion global bond issue over 15 year, with 7,375% in exchange for bonds maturing 2019-20

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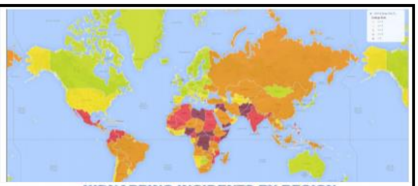
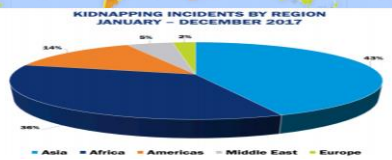
TOP 20 KIDNAP RANKING

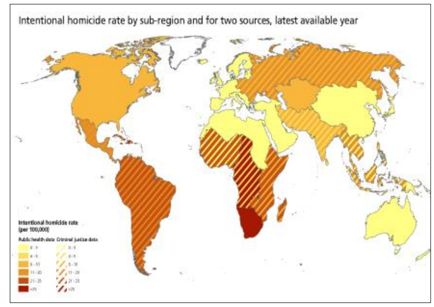
1. South Africa
2. Pakistan
3. Mexico
4. India
5. Nigeria
6. Venezuela
7. Lebanon
8. Philippines
9. Afghanistan
10. Colombia
11. Iraq
12. Syria
13. Guatemala
14. Yemen
15. Libya
16. Egypt
17. Brazil
18. Kenya
19. Nepal
20. Malaysia

: >7,770 kidnaps for ransom!

Source: Hiscox Group/FT/ AIG







HTTP://WWW.UNODC.ORG/UNODC/INDEX.HTML?REF=MENUTOP

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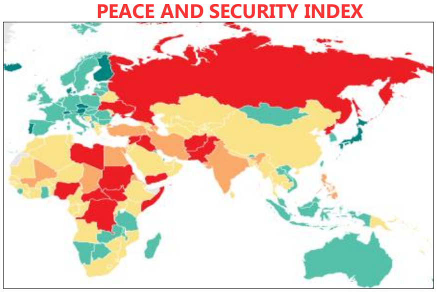
PEACE AND SECURITY INDEX



http://www.visionofhumanity.org/sites/default/files/Global%20Peace%20Index%20Report%202016_0.pdf

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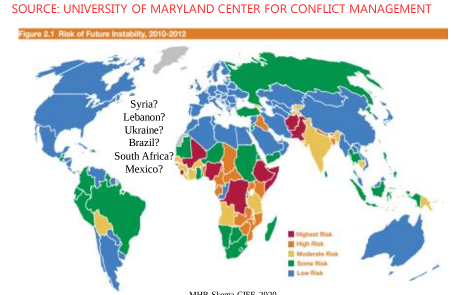
BLINDNESS? **RISK OF FUTURE POLITICAL CRISIS 2010-12**

SOURCE: UNIVERSITY OF MARYLAND CENTER FOR CONFLICT MANAGEMENT



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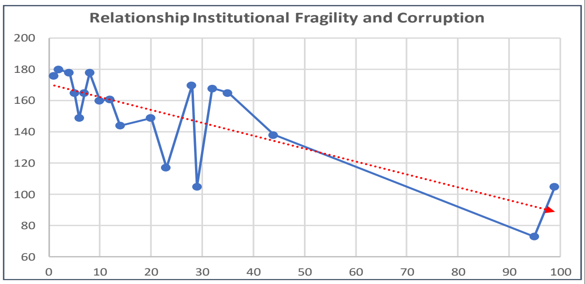
INSTITUTIONAL FRAGILITY AND CORRUPTION



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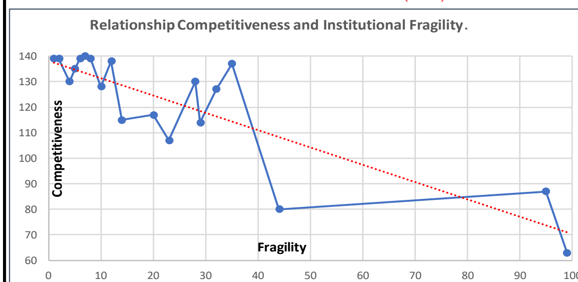
INSTITUTIONAL FRAGILITY AND COMPETITIVENESS (WEF)



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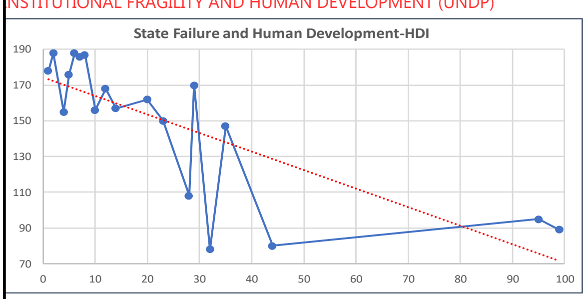
NSTITUTIONAL FRAGILITY AND HUMAN DEVELOPMENT (UNDP)



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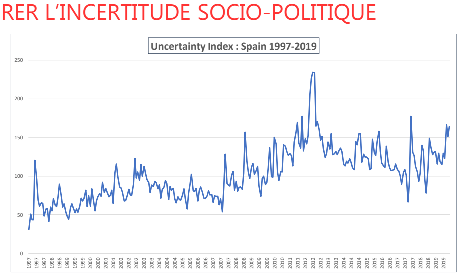
MESURER L'INCERTITUDE SOCIO-POLITIQUE



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EPU index for Spain developed by Corinna Ghirelli, Javier J. Pérez and Alberto Urtasun.

BETTER OFF IN TUNISIA OR IN ALGERIA ?

TUNISIA
- GDP Per capita = $10500
- HDI= 97
- Life expectancy f = 77
- Infant mortality= 13
- Gender inequality: 0,28
- Doing Business= 77
- Corruption = 75

ALGERIA
- GDP Per capita=13500
- HDI= 83
- Life expectancy= 75
- Infant mortality= 22/1000
- Gender inequality: 0,43
- Doing Business= 156
- Corruption = 108

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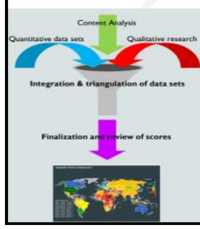
THE METHODOLOGY BEHIND THE **FRAGILE STATES INDEX**

The Fragile States Index produced by The Fund for Peace is a critical tool in highlighting not only the normal pressures that all states experience, but also in identifying when those pressures are outweighing a states' capacity to manage those pressures.



Annual ranking for 178 countries with 12 political, economic and social indicators and >100 sub-indicators, coupled with qualitative analysis and expert validation:
Economic decline, uneven development, brain drain, state legitimacy, public services, human rights, demographic pressures, refugees, external intervention, rule of law…

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KEY FEATURES OF FAILED AND FRAGILE STATES

	n/178	Index TI/180	UNDP/188	Index **	WEF 140	KF/GDP%	Human flight **	%	% (3 year av.)	
Weak States	Ranking	Corruption **	HDI **	GINI	Competitiv.	Capital flight	& Brain drain	Unempl.	Invest/GDP	Ext Debt/GDP%
Yemen	1	176	178	38	139	2%	7,3	35	12	30%
Somalia	2	180	188	39	*139*	1%	9,5	6	10	75%
Syria	4	178	155	36	*130*	3%	8,4	50	10	16%
Congo DR	5	165	176	49	135	39%	7	15	12	20%
CAR	6	149	188	44	139	4%	7,1	7	13	36%
Chad	7	165	186	43,3	140	2%	8,5	6	16	27%
South Sudan	8	178	187	35	*139*	1%	6,5	15	11	111%
Zimbabwe	10	160	156	43	128	5%	7,6	10	12	77%
Haiti	12	161	168	61	138	3%	8,4	15	25	30%
Nigeria	14	144	157	49	115	3%	6,9	23	15	70%
Uganda	20	149	162	42	117	3%	7,3	5	24	40%
Pakistan	23	117	150	33,5	107	1%	6,8	6	16	31%
Libya	28	170	108	42	*130*	22%	6,3	20	15	20%
Côte d'Ivoire	29	105	170	42	114	2%	7,3	5	16	37%
Venezuela	32	168	78	40	127	23%	6,1	35	14	33%
Angola	35	165	147	43	137	11%	6,9	9	24	57%
Lebanon	44	138	80	32	80	17%	5,6	9	20	200%
Tunisia	95	73	95	40	87	5%	5,9	16	21	90%
Peru	99	105	89	44	63	5%	7,1	10	21	35%

* Nonbank private deposits in international banks/BIS A6-1
** the higher, the worse

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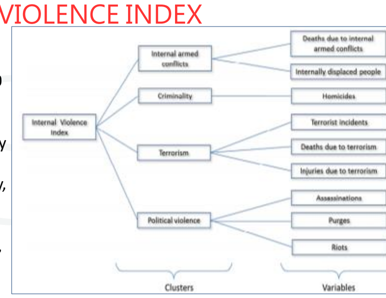
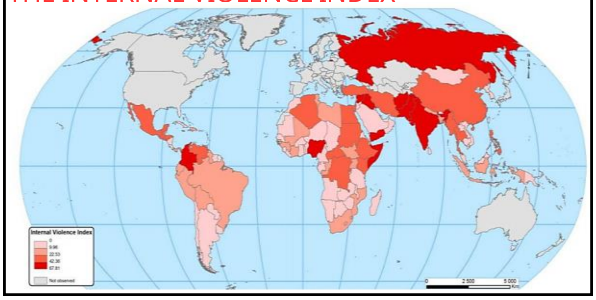
THE INTERNAL VIOLENCE INDEX

The composite index measures a narrow concept of fragility for 130 developing countries through their level of violence in its many different forms: internal armed conflicts, criminality, terrorism, and political violence: Iraq, Pakistan, Afghanistan, Yemen, Syria, and Nigeria.



MHB-Skema-CIFE 2020 SOURCE: FERDI April 2016: Feindouno / Goujon /Wagner

THE INTERNAL VIOLENCE INDEX



AON POLITICAL RISK MAP

- ►The Aon Political Risk Map measures political risk in 163 locations and territories.
- ►Risk ratings are standardized across each location, on a six-point scale ranging from low to very high, with all risks updated once per quarter.
- ►EU and OECD countries are not rated in the map!!
- ►Political risk is calculated as a simple average of six core risk measures :
  1. • Political Violence
  2. • Exchange Transfer
  3. • Sovereign Non-Payment
  4. • Political Interference
  5. • Supply Chain Disruption
  6. • Legal & Regulatory

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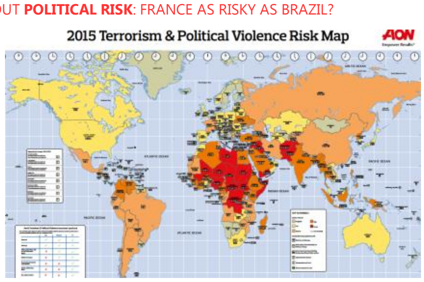
MAPPING OUT **POLITICAL RISK**: FRANCE AS RISKY AS BRAZIL?



http://www.aon.com/terrorismmap/2013-Terrorism-Map-14-05-2013.pdf

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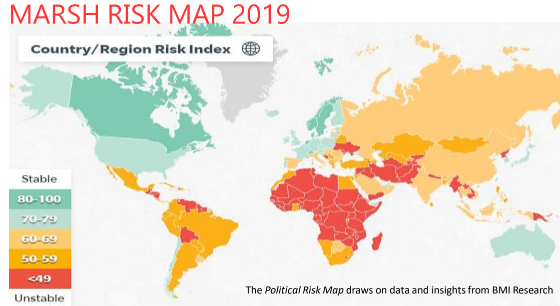
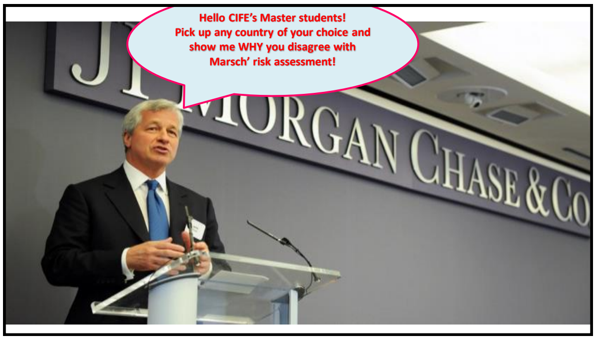
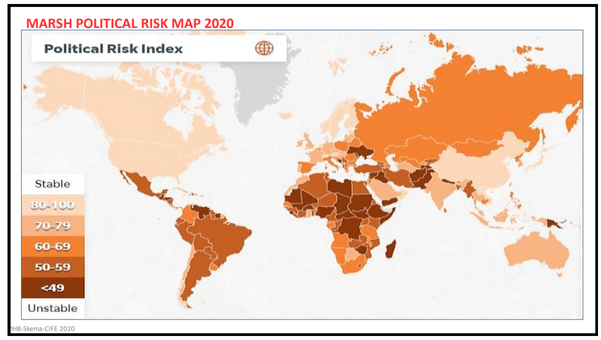
MARSH RISK MAP 2019



MHB-Skema-CIFE 2020


Hello CIFE's Master students!
Pick up any country of your choice and
show me WHY you disagree with
Marsch' risk assessment!
J.P. MORGAN CHASE & CO


MARSH POLITICAL RISK MAP 2020
Political Risk Index
Stable
80-100
70-79
60-69
50-59
<49
Unstable

Centre international de formation européenne

WHERE DOES POLITICAL RISK COME FROM? POLITICAL RISK ASSESSMENT

MICHEL-HENRY BOUCHET

CIFE 6-8 MAY 2020

POLITICAL RISK ASSESSMENT

- **Origins? Political risk** stems from the **threat** related to the exercise of power by a foreign government, its ramifications, and private domestic agents.
- **Impact?** Arbitrary political decisions, conditions, and events in a country will affect the business climate in such a way that investors, exporters, creditors, as well as domestic residents will confront risks and losses

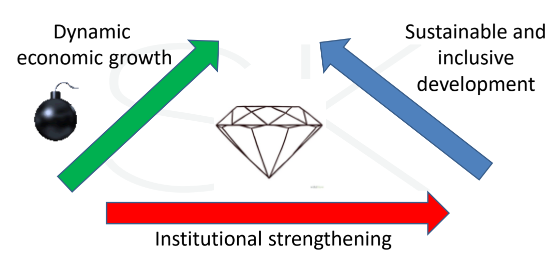
AMBASSADOR PAUL BREMER

(US STATE DEPARTMENT)

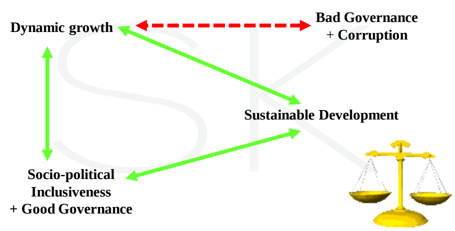
- *Political risk analysis is both an art and a science but many types of risk are amenable to rigorous analysis:*
- *How resilient is the political system? Is there a tradition of peaceful transitions of power? How robust are the social shock absorbers that provide buffers between individual citizens and governments?*

Harvard Business School Review, 2002

THE REQUIRED POLITICAL STABILITY TRIANGLE



TRILEMMA OF GROWTH AND DEVELOPMENT?



Political risk and Threat materialization

Contract repudiation, capital controls, currency inconvertibility, sham contracts and bribery, corruption, blocked funds, ideological shift, political upheaval, strikes, expropriation, nationalization, coup d'état, martial law, revolution, civil strife damage, terrorism, war damage, kidnapping, crimes….

Three Sources of Political Risk

Direct «hard risks»	• **Risk materialization directly hurts the company:** Nationalization, expropriation and confiscation, contract repudiation, sham contracting, bribery and corruption, blocked funds, kidnapping, crimes
Indirect «surrounding risks»	• **Risk materialization stems from the hostile environment:** Revolution and civil unrest, martial law, terrorism, war damage, ideological and cultural shifts. Capital and dividend remittance constraints, ineffective legal and regulatory systems, non-compliance, strikes, currency inconvertibility, regional crisis and volatility spill-over
Collateral «soft risks»	• **Risk materialization is the byproduct of unfavorable interactions between power groups:** Legal and ethical risks, protectionism, fiscal uncertainty, wealth gaps, bureaucracy and weak institutions, pressure groups and hostile NGOs, ethnic/linguistic fragmentation

WHERE DOES POLITICAL RISK COME FROM?

- Terrorism
- External shock (commodity price volatility)
- Gap between socio-economic and political/institutional evolution
- Cultural fragmentation (riots, government crises, corruption)
- Internal violence and power struggle (martial law, guerrilla warfare…)
- Rapid pace of urbanization coupled with religious fundamentalism
- Regional contamination
- Ethnic/linguistic fragmentation
- Fragmented identity and "*archipelagos*"

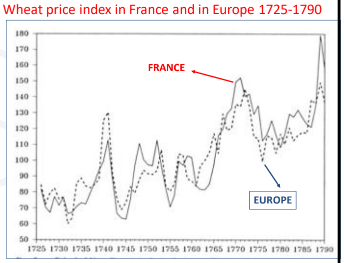
FOOD STRESS, WHEAT PRICES & REVOLUTIONS: WHAT RELATIONSHIP?

Where does a **revolution** come from?

In the XVIII° century, bread constitutes nearly 50% of expenditures of households in France.

- 1788: bad weather and severe drought
- 1789: Necker's alarmist warnings and urgent imports of wheat
- Very cold winter
- 6 pounds of bread cost 12 « sous », the equivalent of one day salary.
- Fast inflation will continue until 1795

Wheat price index in France and in Europe 1725-1790



Source: David Weir, Annales, 1991, Vol.46

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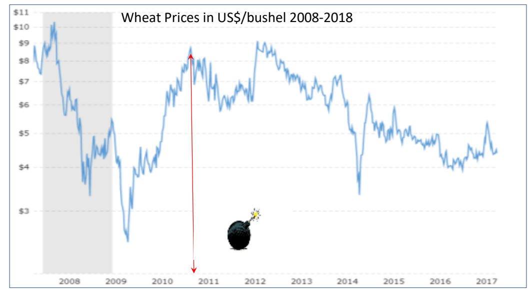
LOOKING FOR THE ROOT CAUSES OF THE 2011 ARAB SPRING?



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LOOSENING IDENTITY AND SOCIO-POLITICAL FRAGMENTATION: « THE ARCHIPELAGO »*

- Combination of modernization, slower growth, wider wealth gaps, and rapid immigration can produce **eroding national identity and socio-political fragmentation**
- A « **Nation** » then becomes a « **Country** » where a territory is shared by multiple ethnocultural groups with divergent interests
- Weakening institutions (parties, associations, unions, religious entities…) are unable to **agregate diverse socio-political and cultural interests**, hence growing tensions and violence.

* See for instance: Jerôme Fourquet, L'Archipel Français, Seuil, 2019

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SAMUEL HUNTINGTON

Political order in changing societies

The Clash of Civilization

- http://markweatherall.wordpress.com/2009/10/12/political_order_in_changing/

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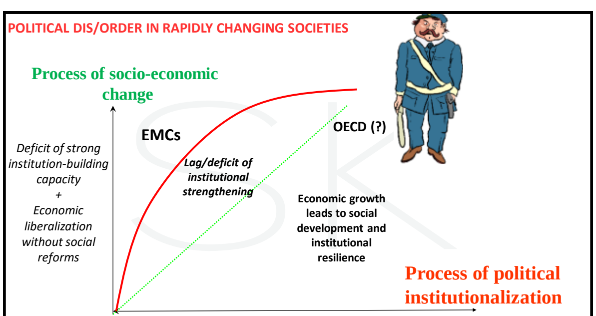
HUNTINGTON AND THE ROOT CAUSES OF POLITICAL TURMOIL

- Contrary to the expectations of modernization theory, **violence and instability stem from:**
  1. **rapid social change**
  2. **Centralized** decision-making system
  3. mobilization of **new groups into politics**
  4. **slow development of political institutions**.
- As societies modernize, they become more complex and disordered. If the process of **socio-economic** modernization is not matched by a process of **political and institutional** modernization with political institutions capable of managing the stress of modernization—the result is violence!

SAMUEL HUNTINGTON
ANALYZING THE ROOTS OF POLITICAL UPHEAVAL

- Primary problem of politics = **lag** in the development of political institutions behind socio- economic change.
- Instability = (rapid social change + rising mobilization of new groups into politics) **>** development of political institutions.

POLITICAL DIS/ORDER IN RAPIDLY CHANGING SOCIETIES



A DEFICIT IN INSTITUTION-BUILDING ALWAYS LEADS TO SOCIAL UPHEAVAL

ECONOMIC GROWTH + POLITICAL MODERNIZATION IN CHINA?

- Shenzhen = home to economic reform in China?

PM Wen Jiabao: « *Political reform is a necessary companion to economic modernization: without the safeguard of political reform, the fruits of economic reform would be lost* »

(August 2010)

INSTITUTIONAL STRENGTHENING, ECONOMIC DEVELOPMENT AND POLITICAL STABILITY: CHALLENGING TRIANGLE!

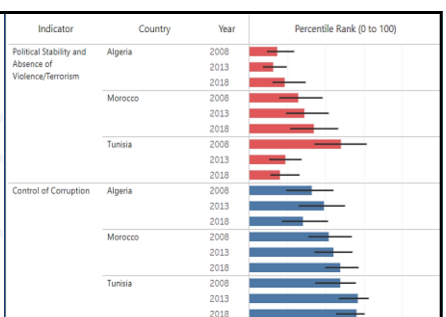
- **Chile's President Bachelet:**

links between democratic strengthening, economic growth and social protection

- « *In Latin America , there are countries where people are uneasy about the process of economic liberalization, because structural economic reforms were not accompanied by the social policies that were necessary! The problem has not been with open economies per se but rather the lack of action in addressing poverty and social injustice* »

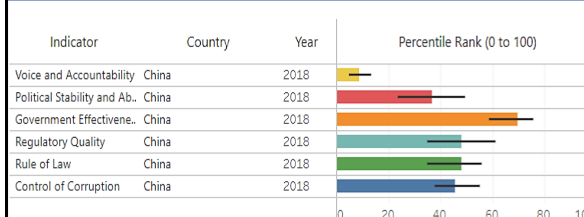
Interview by McKinsey Quarterly, 2007

POLITICAL ORDER ENFORCEMENT AND CONTROL OF CORRUPTION IN THE MAGHREB



Source: World Bank 2020

WORLD BANK ASSESSMENT OF GOVERNANCE IN CHINA



WORLD BANK'S STRATEGY OF INSTITUTIONAL STRENGTHENING

"To achieve our goal of ending extreme poverty, we must focus on people living in countries that suffer ***from conflict and fragility.***
Our new strategy aims to address the underlying causes of fragility and invest in the long-term development that helps create the conditions for ***peace and prosperity****".*

(APRIL 16, 2019 World Bank CEO Kristalina Georgieva)
https://www.worldbank.org/en/news/press-release/2019/04/16/world-bank-group-launches-worldwide-consultations-on-future-strategy-for-fragility-conflict-and-violence

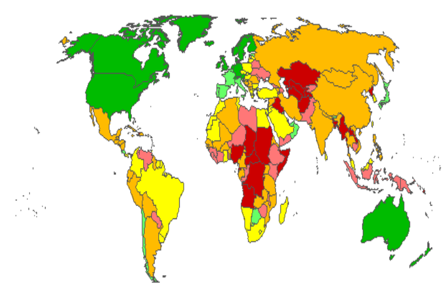
MEASURING GOVERNANCE?

WORLD BANK: WHAT IS GOVERNANCE?

Governance consists of the traditions and institutions by which authority in a country is exercised.
This includes the process by which governments are selected, monitored and replaced; the capacity of the government to effectively formulate and implement sound policies; and the respect of citizens and the state for the institutions that govern economic and social interactions among them with 6 dimensions:

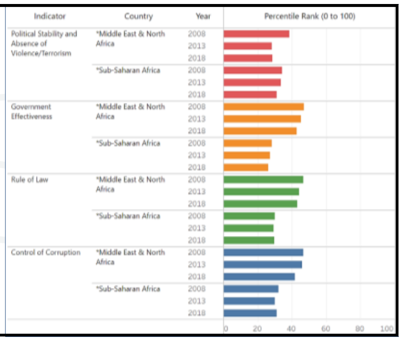
Voice and Accountability
Political Stability and Absence of Violence
Government Effectiveness
Regulatory Quality
Rule of Law
Control of Corruption

WORLD BANK'S WORLD MAP OF GOVERNANCE



Source: Kaufman, World Bank

WORDL BANK **GOVERNANCE INDICATORS** 2020



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IBRAHIM INDEX OF GOVERNANCE IN AFRICA

The Index groups governance and political freedom indicators into four main categories:

1. Safety and Rule of Law,
2. Participation and Human Rights,
3. Sustainable Economic Opportunity,
4. and Human Development.

Source: http://www.moibrahimfoundation.org/en/section/the-ibrahim-index

IBRAHIM INDEX OF GOOD GOVERNANCE IN AFRICA

1	Mauritius	83,0	19	Mali	52,9	37	Nigeria	43,3
2	Seychelles	78,5	20	Mozambique	52,1	38	Liberia	43,2
3	Botswana	75,9	21	Burkina Faso	51,9	39	Togo	42,6
4	Cape Verde	75,5	22	Malawi	51,7	40	Niger	42,3
5	South Africa	71,5	23	Libya	51,5	41	Congo	42,0
6	Namibia	67,3	24	Uganda	50,8	42	Angola	39,3
7	Ghana	64,6	25	Swaziland	50,8	43	Guinea-Bissau	39,1
8	Tunisia	62,1	26	Kenya	50,5	44	Côte d'Ivoire	36,8
9	Egypt	60,5	27	Gabon	50,1	45	Guinea	35,6
10	Lesotho	60,1	28	Madagascar	48,7	46	Equatorial Guinea	34,7
11	São Tomé and Príncipe	58,2	29	Comoros	48,5	47	Sudan	32,9
12	Benin	56,6	30	Djibouti	48,5	48	Central African Republic	32,7
13	Morocco	56,6	31	Rwanda	47,2	49	Zimbabwe	32,7
14	Senegal	56,3	32	Sierra Leone	46,0	50	Eritrea	31,8
15	Algeria	55,2	33	Burundi	44,7	51	Congo, Democratic Rep.	31,1
16	Tanzania	55,0	34	Cameroon	44,2	52	Chad	28,8
17	Zambia	54,9	35	Ethiopia	43,5	53	Somalia	7,9
18	Gambia	53,0	36	Mauritania	43,4			

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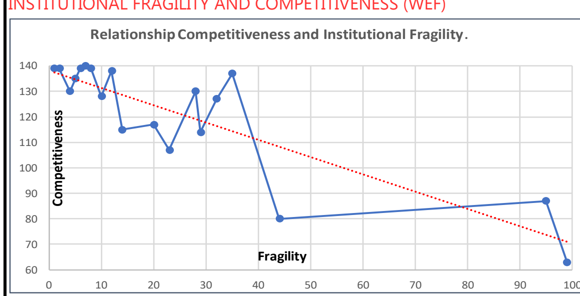
INSTITUTIONAL FRAGILITY AND COMPETITIVENESS (WEF)



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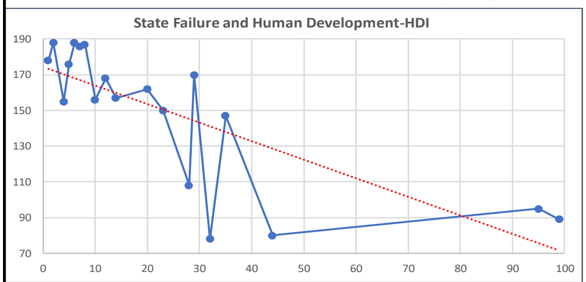
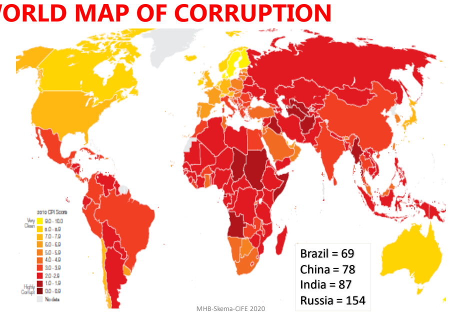
NSTITUTIONAL FRAGILITY AND HUMAN DEVELOPMENT (UNDP)



MEASURING CORRUPTION?

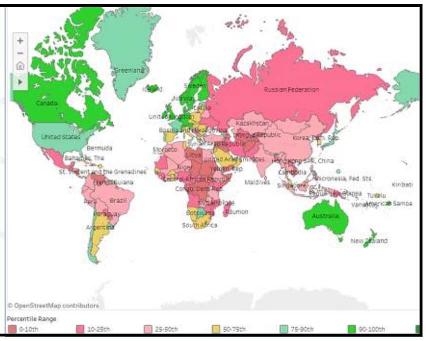
TI WORLD MAP OF CORRUPTION



POLITICAL TURMOIL AND CORRUPTION

In 2018-19, public anger and legal action over corruption have toppled political leaders in Malaysia, Peru, Slovakia, South Africa, and other countries.
More than 10 percent of nations around the world have experienced corruption-fueled political change in the last five years (Carnegie, 2018).
In many countries, corruption has fueled terrorist recruitment and sparked violent insurgencies.
The World Bank estimates $1.5 trillion in bribes are paid every year, squandering business capital and stymying development.

WORLD BANK MAP OF **CONTROL OF CORRUPTION** 2020



MEASURING CORRUPTION?

TRANSPARENCY INTERNATIONAL CPI

1	New Zealand		162	Guinea-Bissau
2	Denmark		162	Kyrgyzstan
3	Singapore		162	Venezuela
3	Sweden		168	Burundi
5	Switzerland	**France = 22**	168	Equatorial Guinea
6	Finland		168	Guinea
6	Netherlands	**Brazil = 72**	168	Haiti
8	Australia	**China = 80**	168	Iran
8	Canada	**India= 94**	168	Turkmenistan
8	Iceland	**Russia = 133**	174	Uzbekistan
11	Norway		175	Chad
12	Hong Kong		176	Iraq
12	Luxembourg		176	Sudan
14	Germany		178	Myanmar
14	Ireland		179	Afghanistan
16	Austria		180	Somalia

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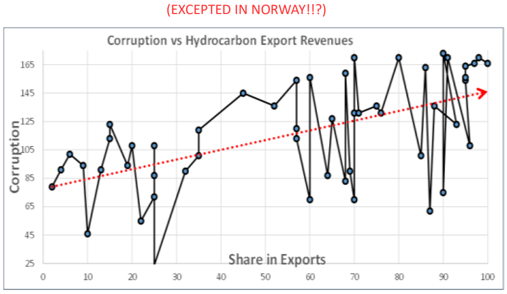
OIL-BASED GROWTH LEADS TO POWER AND WEALTH CONCENTRATION, AND CORRUPTION

(EXCEPTED IN NORWAY!!?)



Source: Bouchet & alii Palgrave 2019

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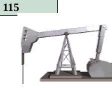
DEVELOPMENT = ECONOMIC GROWTH + KEY CONDITIONS THAT MAKE IT SUSTAINABLE!

	CHILE	COSTA RICA	Turkmenistan	GABON
GDP/per capita	$15,000	$11,000	$15,000	$14,000
Life Expectancy	80	81	68	65
HDI Rank	42	68	108	115



	ARMENIA	SRI LANKA	NIGERIA	ANGOLA
GDP per capita	$5000	$5000	$5000	$5500
Life expectancy	75	77	54	60
HDI Rank	81	97	158	1489

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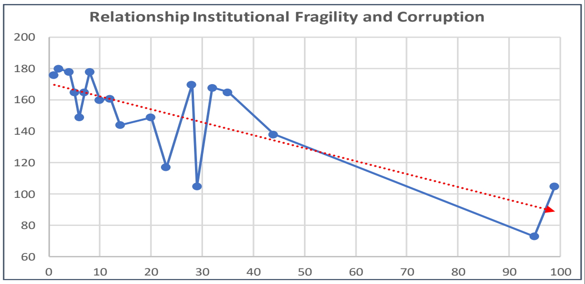
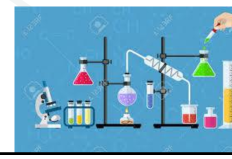
INSTITUTIONAL FRAGILITY AND CORRUPTION



TECHNIQUES TO ASSESS POLITICAL RISK

1. Economic intelligence: in-depth socio-political analysis
2. Checklist approach
   To examine key political factors that affect a country's risk:
   the **Prince Model**
3. Delphi technique
   - establish surveys
   - collect information and independent opinions
   - analyze results and make predictions
4. Ratings
5. Consultants on political risks



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

- MIG (UK)
- HISCOX
- PLATUS
- AON
- Global Risk Assessments
- EIU
- COFACE, OPIC & MIGA, EULER
- Howell International
- Control Risks Group: www.crg.com
- WMRC

- Frost & Sullivan
- US State Department + US CIA
- Marsh Crisis Consulting
- University of Maryland Center for Conflict Management
- Muir Analytics (Threat Watch, Threat Report, Threat Survey)
- NYA International
- TAC (France)

2. POLITICAL RISK ANALYSIS

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

- ideological (North Korea)
- charismatic (Cuba)
- economic/financial (Brunei)
- authoritarian populism (Thailand)
- ethnic (Ivory Coast, Ghana)
- religious (Iran)
- military (Burma, Venezuela)
- patron-client relationships (Togo, Congo, Gabon)

3. POLITICAL RISK ANALYSIS: **PRINCE** MODEL

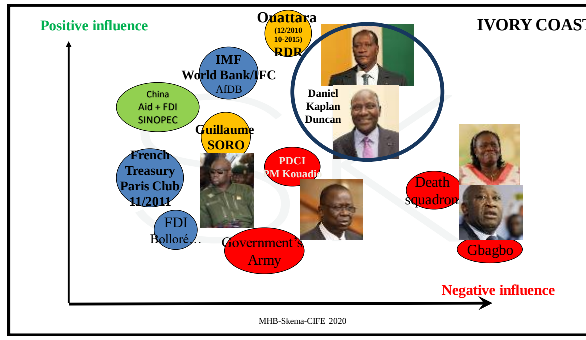
Frost & Sullivan: William D. Coplin and Michael K. O'Leary of the firm Political Risk Services.

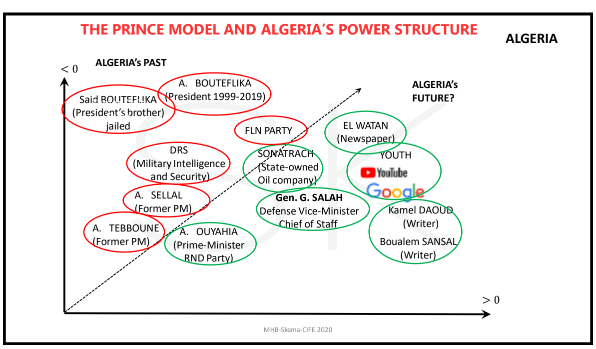
PRINCE = Probe, Interact, Calculate, and Execute

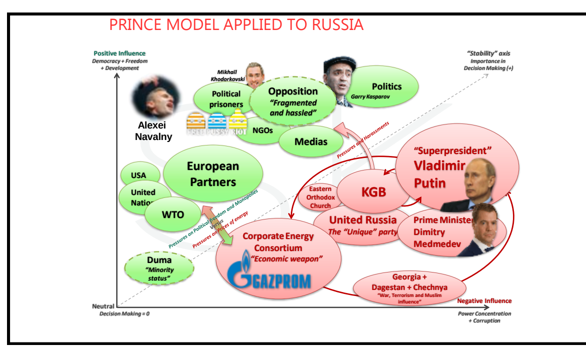
Emphasis on the power structure of a nation by identifying key individuals or groups that can influence a specific risk outcome: destabilization, nationalisation, expropriation…

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 (+/-)

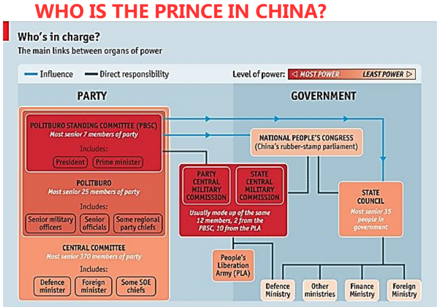
DATA= https://www.cia.gov/library/publications/world-leaders-1/world-leaders-c/cote-divoire.html





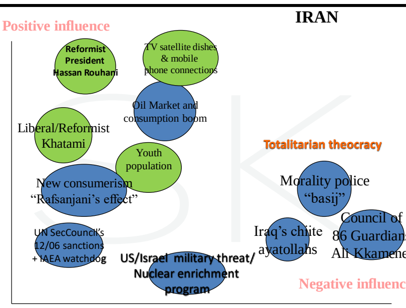


WHO IS THE PRINCE IN CHINA?



The Economist, 12/2012

IRAN



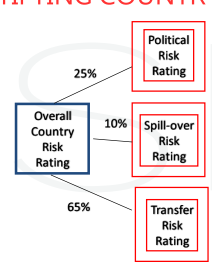
4. QUANTIFYING COUNTRY RISK

▶ **Ratings and Rankings**:

▶ 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's website)*

QUANTIFYING COUNTRY POLITICAL RISK



Political Factors	Weights
Political factor A	30%
Political factor B	50
Political factor C	20

Regional factors

Financial Factors	Weights
Financial factor A	30%
Financial factor B	40
Financial factor C	30

POLITICAL RISK INDICES

- Heritage Foundation
- Freedom House
- Cato Institute
- Fund for Peace
- Transparency International CPI
- PWCs: Opacity Index
- LB: Legsi
- Asiarisk
- Marsh
- Fragile state index

- World Bank (Governance)
- Euromoney (25%)
- Institutional Investor
- IMD
- ICRG-PRS
- MIG
- WMRC
- University of Maryland
- Ibrahim Index of Governance

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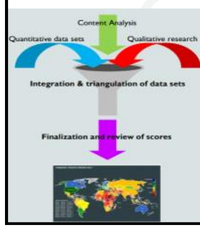
THE METHODOLOGY BEHIND THE **FRAGILE STATES INDEX**

The Fragile States Index produced by The Fund for Peace is a tool in highlighting not only the normal pressures that all states experience, but also in identifying when those pressures are outweighing a states' capacity to manage those pressures.



Annual ranking for 178 countries with 12 political, economic and social indicators and >100 sub-indicators, coupled with qualitative analysis and expert validation:
Economic decline, uneven development, brain drain, state legitimacy, public services, human rights, demographic pressures, refugees, external intervention, rule of law…

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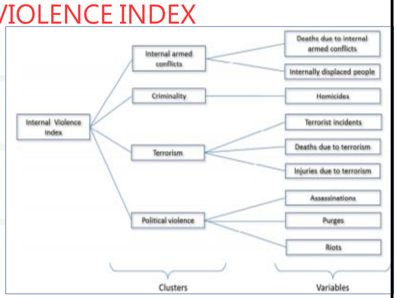
THE INTERNAL VIOLENCE INDEX

The composite index measures a narrow concept of fragility for 130 developing countries through their level of violence in its many different forms: internal armed conflicts, criminality, terrorism, and political violence: Iraq, Pakistan, Afghanistan, Yemen, Syria, and Nigeria.



MHB-Skema-CIFE 2020 SOURCE: FERDI April 2016: Feindouno / Goujon /Wagner

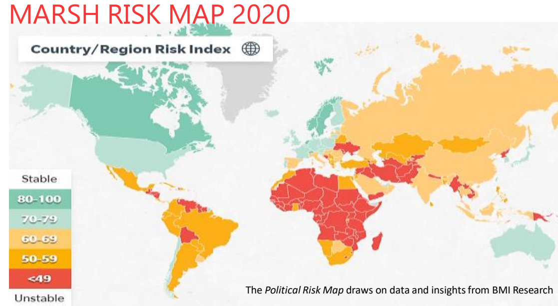
THE INTERNAL VIOLENCE INDEX

AON POLITICAL RISK MAP

- The Aon Political Risk Map measures political risk in 163 locations and territories.
- Risk ratings are standardized across each location, on a six-point scale ranging from low to very high, with all risks updated once per quarter.
- EU and OECD countries are not rated in the map!!
- Political risk is calculated as a simple average of six core risk measures :

1. • Political Violence
2. • Exchange Transfer
3. • Sovereign Non-Payment
4. • Political Interference
5. • Supply Chain Disruption
6. • Legal & Regulatory

MARSH RISK MAP 2020



CROSS-COUNTRY POLITICAL RISK MEASURE BY ICRG

Weights	ICRG's Political Risk Assessment Criteria
12	Government Stability
12	Socio-Economic conditions
12	Investment Profile
12	Internal Conflict
12	External Conflict
6	Corruption
6	Military in Politics
6	Religious Tensions
6	Law and Order
6	Ethnic Tensions
6	Democratic Accountability
4	Bureaucratic Quality
100	Total number of points for weighted influence

THE HERITAGE FOUNDATION: ECONOMIC FREEDOM INDEX

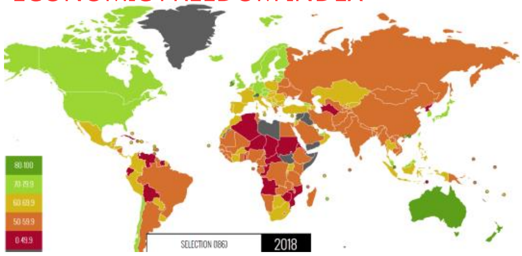
Q.3. How do you measure economic freedom?

We measure economic freedom based on 12 quantitative and qualitative factors, grouped into four broad categories, or pillars, of economic freedom:

1. Rule of Law (property rights, government integrity, judicial effectiveness)
2. Government Size (government spending, tax burden, fiscal health)
3. Regulatory Efficiency (business freedom, labor freedom, monetary freedom)
4. Open Markets (trade freedom, investment freedom, financial freedom)

Each of the twelve economic freedoms within these categories is graded on a scale of 0 to 100. A country's overall score is derived by averaging these twelve economic freedoms, with equal weight being given to each. More information on the grading and methodology can be found in the appendix.

ECONOMIC FREEDOM INDEX



INDEX OF ECONOMIC FREEDOM

Top 10 Countries

RANK	COUNTRY	OVERALL	CHANGE
1	Hong Kong	90.2	0.4
2	Singapore	88.8	0.2
3	New Zealand	84.2	0.5
4	Switzerland	81.7	0.2
5	Australia	80.9	-0.1
6	Ireland	80.4	3.7
7	Estonia	78.8	-0.3
8	United Kingdom	78.0	1.6
9	Canada	77.7	-0.8
10	United Arab Emirates	77.6	0.7

REPRESSED (49.9-40)

RANK	COUNTRY	OVERALL	CHANGE	RANK	COUNTRY	OVERALL	CHANGE
160	Niger	49.5	-1.3	171	Djibouti	45.1	-1.6
161	Sudan	49.4	+0.6	172	Algeria	44.7	-1.8
162	Chad	49.3	+0.3	173	Bolivia	44.1	-3.6
163	Central African Republic	49.2	-2.6	174	Zimbabwe	44.0	0.0
164	Angola	48.6	+0.1	175	Equatorial Guinea	42.0	-3.0
165	Ecuador	48.5	-0.8	176	Eritrea	41.7	-0.5
166	Suriname	48.1	+0.1	177	Republic of Congo	38.9	-1.1
167	Timor-Leste	48.1	+1.8	178	Cuba	31.9	-2.0
168	Togo	47.8	-5.4	179	Venezuela	25.2	-1.8
169	Turkmenistan	47.1	-0.3	180	North Korea	5.8	+0.9
170	Mozambique	46.3	-3.6				

FREEDOM HOUSE:

FREEDOM IN THE WORLD ANNUAL REPORT (1972-)

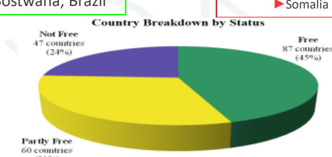
- Since 1972, Freedom House has published an annual assessment of the state of freedom in all countries in the world, based on a checklist of questions on political rights and civil liberties that are derived from the Universal Declaration of Human Rights. Each country is assigned a rating for PR and a rating for CL based on a scale of 1 (best) to 7 (worst).
- http://www.freedomhouse.org/ratings/index.htm

Free countries (87)

- Australia, Finland
- Malta, Slovenia
- Uruguay, Bulgaria
- Chile, Costa Rica
- Mauritius, Poland
- Indonesia, Benin
- Bostwana, Brazil

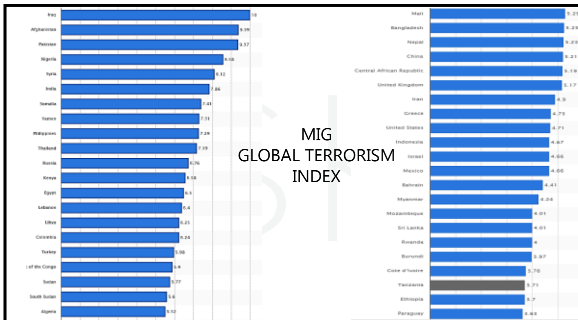
Not Free countries (47)

- Cameroon, Congo
- Haiti, Iran
- China, Vietnam
- North Korea, Burma
- Cuba, Saudi Arabia
- Syria, Turkménistan
- Libya, Sudan
- Somalia



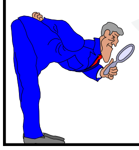
MERCHANT INTERNATIONAL GROUP

- Founded in 1982, it specializes in strategic research and corporate intelligence, focusing on risks and threats that confront companies worldwide.
- MIG operates in over 100 countries.
- www.merchantinternational.com



Centre international de formation européenne

COUNTRY RISK RATING: ASSESSING GOVERNANCE, CORRUPTION AND SUSTAINABILITY?



CIFE SEMINAR NICE MAY 6-8, 2020

MICHEL-HENRY BOUCHET

COUNTRY RISK SPECIFIC INDICES: ASSESSING GOVERNANCE, CORRUPTION AND SUSTAINABILITY?

ICRG
Euromoney
Institutional Investor
Freedom House
UNDP
CPI

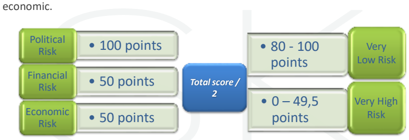
ICRG

- The *ICRG* model for forecasting financial, economic, and political risk was created in 1980 by the editors of International Reports (weekly newsletter)
- To meet the needs of clients the editors created a statistical model to calculate risks and backed it up with analyses that explain the numbers and examine what the numbers do not show.
- the *ICRG* model allows users to make their own risk assessments based on the *ICRG* model or to modify the model to meet their specific requirements.

Source: www.icrg.com

INTERNATIONAL COUNTRY RISK GUIDE (ICRG)

- Monitors 140 countries
- The *International Country Risk Guide* (*ICRG*) rating comprises 22 variables in three subcategories of risk: political, financial, and economic.



- Testing has proven *ICRG's* reliability and its uniqueness:
  - Claim to have the longest history of country risk data for analysis
  - Easy to customize and merge with in-house systems
  - Useful for multinational firms, banks, and equity and currency traders

Source: www.icrg.com

ICRG: POLITICAL RISK COMPONENTS

Weights	ICRG's Political Risk Assessment Criteria
12	Government Stability
12	Socio-Economic conditions
12	Investment Profile
12	Internal Conflict
12	External Conflict
6	Corruption
6	Military in Politics
6	Religious Tensions
6	Law and Order
6	Ethnic Tensions
6	Democratic Accountability
4	Bureaucratic Quality
100	Total number of points for weighted influence

Source: www.icrg.com

ICRG: ECONOMIC RISK COMPONENTS *(50 MAX)*

GDP Per capita	10 points
Real GDP Growth	10 points
Annual inflation rate	10 points
Budget Balance	10 points
Current account/GDP	10 points

Source: www.icrg.com

ICRG: FINANCIAL RISK COMPONENTS *(50 MAX)*

Foreign debt	10 points
Debt service/XGS	10 points
Current account	15 points
Net liquidity	5 points
Exchange rate stability	10 points

Source: www.icrg.com

EUROMONEY : RATING METHODOLOGY

- 186 countries
- 15 critera
- Delphi Technique: Panel of 250 leading economists in international financial institutions evaluing performance in the financial markets (market access, bond issue, spreads, selldown, terms and maturity…)
- Scoring between 100 (excellent) and 0 (high risk)
- Panel of political analysts to measure short-term risk of destabilization

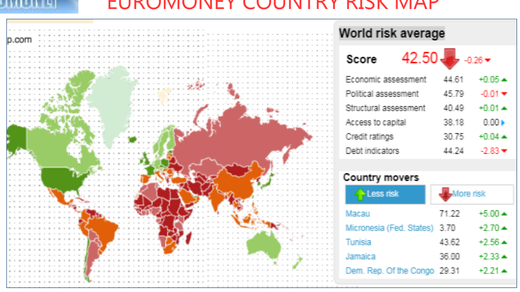
EUROMONEY: RATING WEIGHTS

1. Growth performance: 25% (GDP projection)
2. Political risk: 25%
3. External debt indicators: 10% (debt/GDP and debt/X)
4. External payment default and rescheduling: 10%
5. Credit rating Moody 's or S&P: 10%
6. Short-term credit market access: 5%
7. Commercial bank MT credit: 5%
8. Capital markets access: 5%
9. Spread over US Treasury bills: 5%

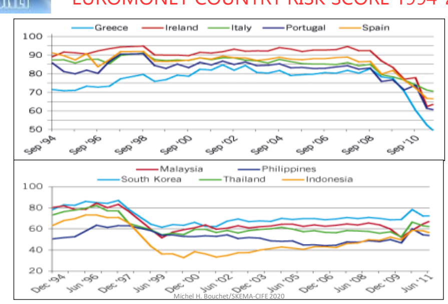
EUROMONEY COUNTRY RISK RATINGS 2001-2016

End-2001	End-2005	End-2006	End-2012	End-2016
14= Singapore	9= Ireland	20=Singapore	11=Singapore	1= Singapore
28= Taïwan	19= Singapore	41=Hungary	15= USA	
30= HongKong	22= New Zealand	44= Poland	19= Chile	
40= Chile	24= Taïwan	**52= China**	41=Hungary	
39= Hungary	35= Hungary	62= Russia	44= Poland	
40= Brunei	**58= China**	77= Algeria	**46= China**	
41. Greece	73= Iran	79= Iran	49= Russia	18= Taïwan
42= Poland	**74= Vietnam**	**82= Vietnam**	76= Indonesia	
45= China	77= Russia	85= Indonesia	**79= Vietnam**	
56= Malaysia	85= Algeria	167= Ivory Coast	**100= Greece**	
89= Romania	96= Indonesia	178= Congo	127= Algeria	
93= Bulgaria	127= Ivory Coast	182= Cuba	141= Ivory Coast	
163= Congo	182= Cuba	185= North Korea	178= Congo	

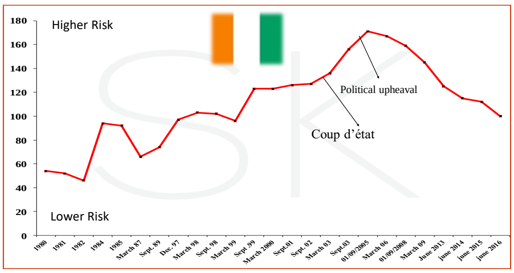
EUROMONEY COUNTRY RISK MAP



EUROMONEY COUNTRY RISK SCORE 1994-2011



EUROMONEY RISK RATING: IVORY COAST 1980-2016



SCORING/RATING OF COUNTRY RISK

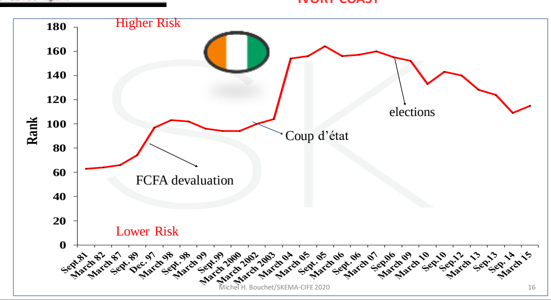
- 0-100 semi-annual Rating of 179 countries' creditworthiness based on survey of 100 leading **international bankers**
- **Best** : Switzerland, Finland, Norway, Germany, Netherlands, France, US, UK, Luxembourg… Singapore, Australia, Taiwan, Chile
- **Worst**: Cuba, Myanmar, Cambodia, Nicaragua, Rwanda, Sudan, Iraq, Congo, Sierra Leone, North Korea, Liberia

Global average risk rating as of 03/2000 = 41
Global average risk rating 03/2015 = 45

INSTITUTIONAL INVESTOR RISK RATING

- Information provided by leading international banks.
- Bankers are asked to grade each of the countries on a scale from 0 to 100 (100 = best creditworthiness)
- Sample updated every six months, ranges from 75 to 100 banks, each of which provides its own ratings. The names of all participants in the survey are kept strictly confidential. Banks are not permitted to rate their home country.
- Individual responses are weighted using an *Institutional Investor* formula that gives more importance to responses from banks with greater worldwide exposure and more sophisticated country analysis systems.

INSTITUTIONAL INVESTOR RISK RANKING 1981-2015
IVORY COAST



Institutional Investor magazine

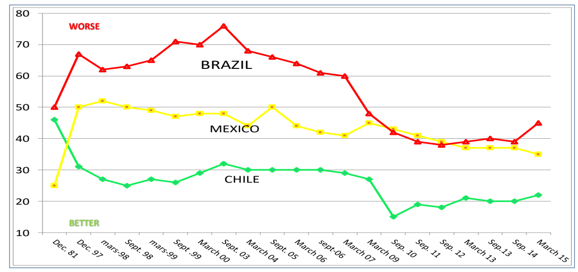
INSTITUTIONAL INVESTOR RISK RATING OF ASIA

- Switzerland = 1
- Norway= 2
- Singapore = 6
- Australia = 11
- HK= 17
- Japan = 19
- South Korea = 20
- Taiwan = 21
- **China = 26**
- Malaysia= 37
- Thailand= 47
- India= 48

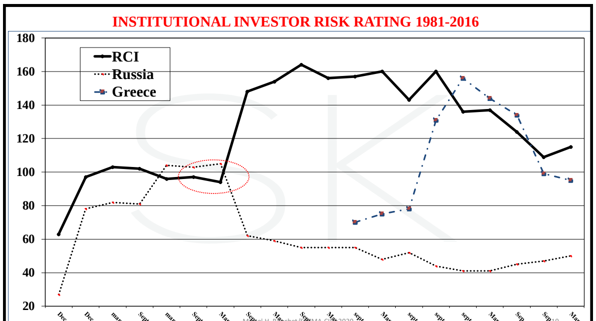
- Philippines=49
- Indonesia= 57
- Vietnam= 73
- Sri Lanka= 103
- Bangladesh= 111
- Cambodia= 119
- Pakistan= 128
- Laos= 136
- Myanmar= 150
- East Timor= 153
- North Korea= 173

Institutional Investor magazine

INSTITUTIONAL INVESTOR RISK RATING 1981-2017



INSTITUTIONAL INVESTOR RISK RATING 1981-2016



COUNTRY RISK: GOVERNANCE MATTERS!

- Corruption
- Regulatory framework
- Business conditions
- Transparency
- Corporate and sovereign governance

Singapore	1
New Zealand	2
Denmark	3
Korea, Rep.	4
Hong Kong SAR,	5
United Kingdom	6
United States	7
Sweden	8
Norway	9
Finland	10
Taiwan, China	11
Macedonia, FYR	12
Australia	13
Canada	14
Germany	15
Estonia	16
Ireland	17
Malaysia	18
Iceland	19
Lithuania	20

WORLD BANK: « DOING BUSINESS » RANKING

189 Countries
10 Parameters

Russia= 51
South Af= 73
China= 84
Brazil= 116
India= 130

Nigeria	169
Yemen, Rep.	170
Djibouti	171
Cameroon	172
Timor-Leste	173
Bangladesh	174
Syria	175
Congo, Rep.	176
Afghanistan	177
Guinea-Bissau	178
Liberia	179
Equatorial Guinea	180
Angola	181
Haiti	182
Chad	183
Congo, Dem. Rep.	184
Central Af Rep	185
Venezuela	186
South Sudan	187
Libya	188
Eritrea	189

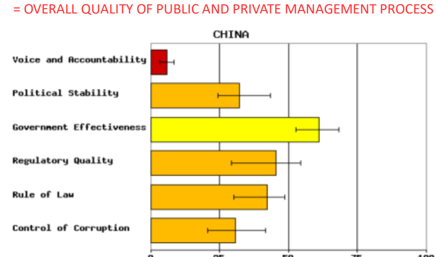
DOING BUSINESS IN CHINA?

TOPICS	DB 2015 Rank
Starting a Business ✔	128
Dealing with Construction Permits	179
Getting Electricity	124
Registering Property	37
Getting Credit	71
Protecting Minority Investors	132
Paying Taxes ✔	120
Trading Across Borders	98
Enforcing Contracts	35
Resolving Insolvency	53

BLOOMBERG DOING BUSINESS RANKING

2014 Rank	Country	Less-tangible costs score	Readiness of local consumer base score
1	Hong Kong	88.8	75.2
2	Canada	91.5	76.2
3	United States	79.7	71.1
4	Singapore	89.5	71.9
5	Australia	83.3	71.6
5	Germany	86.2	74.7
7	United Kingdom	85.2	71.1
8	Netherlands	88.8	70.7
9	Spain	76.0	68.5
10	Sweden	87.1	72.9

GOVERNANCE =
TRADITIONS AND INSTITUTIONS BY WHICH AUTHORITY IS EXERCISED
= OVERALL QUALITY OF PUBLIC AND PRIVATE MANAGEMENT PROCESS



Source: World Bank

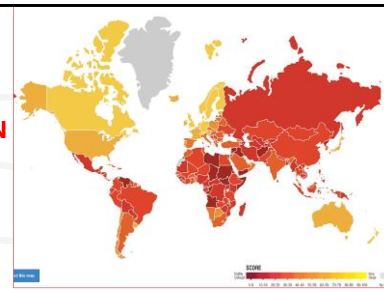
HOW ASSESSING CORRUPTION? TRANSPARENCY INTERNATIONAL'S CPI

- Germany-based NGO, founded in 1993
- Global network with national chapters in >70 countries
- Annual **Corruption perception index** ranking 180 countries
- Annual Bribe index

CPI is a composite index: poll of polls conducted over a 3-year period, drawing on 13 surveys from 8 independent organizations

TI WORLD MAP OF CORRUPTION

South Africa= 73
India = 78
China = 87
Brazil = 105
Russia = 138



MEASURING CORRUPTION?

TRANSPARENCY INTERNATIONAL CPI

1	Denmark
2	New Zealand
3	Finland
3	Singapore
3	Sweden
3	Switzerland
7	Norway
8	Netherlands
9	Canada
9	Luxembourg
11	Germany
11	United Kingdom
13	Australia
14	Austria
14	Hong Kong
14	Iceland
17	Belgium
18	Estonia
18	Ireland
18	Japan
21	France

160	Zimbabwe
161	Cambodia
162	DR Congo
163	Haiti
164	Turkmenistan
165	Angola
166	Chad
167	Congo
168	Iraq
169	Venezuela
170	Burundi
171	Libya
172	Afghanistan
173	Equ. Guinea
174	Guinea Bissau
175	Sudan
176	N. Korea
177	Yemen
178	South Sudan
179	Syria
180	Somalia

EMCS & SHADOW ECONOMY

Country↓	% GNP Informal Economy
Georgia	67.3
Bolivia	67.1
Panama	64.1
Azerbaijan	60.6
Peru	59.9
Zimbabwe	59.4
Tanzania	58.3
Nigeria	57.9
Thailand	52.6
Ukraine	52.2
Guatemala	51.5
Uruguay	51.1
Honduras	49.6
Zambia	48.9
Belarus	48.1
Armenia	46.3
Russia	46.1
Benin	45.2
Nicaragua	45.2
Moldova	45

Sources: World Bank
Hernando de Soto

UNDP HUMAN DEVELOPMENT INDEX

- What is development?
- **Economic growth** + those conditions that make growth **sustainable** over the long-term

=

- Σ life expectancy, education, health, infrastructure, institutions, governance…

HUMAN DEVELOPMENT INDEX

- HDI developed by UNDP
- A composite index measuring average achievement in three basic dimensions of human development-a long and healthy life, knowledge and a decent standard of living, as measured by real GDP per capita on a purchasing power parity basis.

1. Norway
2. Australia
3. United States
4. Netherlands
5. Germany
6. New Zealand
7. Ireland
8. Sweden
9. Switzerland
10. Japan
11. Canada
12. Korea
13. Hong Kong
14. Iceland
15. Denmark
16. Israel
17. Belgium
18. Austria
19. Singapore
20. France

170	Malawi
171	Sudan
172	Zimbabwe
173	Ethiopia
174	Liberia
175	Afghanistan
176	Guinea-Bissau
177	Sierra Leone
178	Guinea
178	Burundi
180	Central African
181	Eritrea
182	Mali
183	Burkina Faso
184	Chad
185	Mozambique
186	Niger
186	Congo (DR)

CONCLUSION: ASSESSING COUNTRY RISK?

1. Market consensus: rating agencies
2. Macroeconomic analysis
3. Balance of payments analysis: liquidity & solvency
4. Socio-political analysis
5. Business environment: corruption, bureaucracy, institutions, transparency
6. Economic Intelligence!

HERITAGE FOUNDATION: INDEX OF ECONOMIC FREEDOM

- **Economic freedom** = *absence of government coercion or constraint on the production, distribution, or consumption of goods and services beyond the extent necessary for citizens to protect and maintain liberty itself.*
- The Index includes a broad array of institutional factors determining economic freedom: corruption, non-tariff barriers to trade, the fiscal burden of government, the rule of law, regulatory burdens, restrictions on banks, labor market regulations, black market activities…

CRITERIA OF ECONOMIC FREEDOM

- To measure economic freedom and rate each country, the *Index* is based on 50 independent economic variables within 10 broad categories of economic freedom:
  1. **Trade policy,**
  2. **Fiscal burden of government,**
  3. **Government intervention in the economy,**
  4. **Monetary policy,**
  5. **Capital flows and foreign investment,**
  6. **Banking and finance,**
  7. **Wages and prices,**
  8. **Property rights,**
  9. **Regulation, and**
  10. **Black market activity**

HERITAGE FOUNDATION'S INDEX OF ECONOMIC FREEDOM

- 1. HongKong
- 2. Singapore
- 3. Luxemburg, New Zealand
- 5. Ireland
- 6. Denmark, Estonia, USA
- 9. Australia, UK
- 11. Finland, Iceland, Netherlands, Sweden
- 15. Switzerland
- 16. Chile
- 18. Canada
- 19. Austria, Belgium, Germany
- 40. France

- Trade + Fiscal Burden, + Government Intervention, + Monetary Policy, + FDI + Inflation + External Competitiveness + Banking sector

WORST:
Argentina, Colombia, Venezuela, China, Russia, Vietnam, Romania, Ukraine, Nigeria, Iran, Syria, Cuba…

FREEDOM HOUSE:
POLITICAL FREEDOM IN THE WORLD ANNUAL REPORT (1972-2011)

- Since 1972, Freedom House has published an annual assessment of the state of freedom in all countries in the world, based on a checklist of questions on political rights and civil liberties that are derived from the Universal Declaration of Human Rights. Each country is assigned a rating for PR and a rating for CL based on a scale of 1 (best) to 7 (worst).
- http://www.freedomhouse.org/ratings/index.htm

FREEDOM HOUSE:
FREEDOM IN THE WORLD ANNUAL REPORT

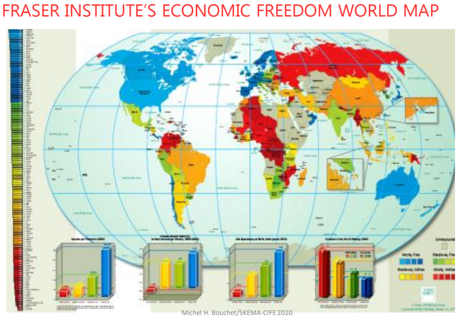
Free countries (89)
- Australia
- Finland
- Malta
- Slovenia
- Uruguay
- Bulgaria
- Chile
- Costa Rica
- Mauritius
- Poland

Not Free countries (47)
- Cameroon
- Congo
- Haiti
- Iran
- China
- Vietnam
- Burma
- Cuba
- Saudi Arabia
- Syria
- Turkménistan

FRASER INSTITUTE

- Since 1975
- Annual Indices of Economic & Human Freedom in the world: reliable measure of cross-country differences in economic freedom, using third-party data to help ensure objectivity
- **Criteria**: government quality, legal structure, security of property rights, access to sound money, personal choice, freedom to exchange with foreigners and to compete in markets, quality of regulations and institutional strength…
- **The Economic Freedom Annual Report** is the measurement of economic freedom, ranking countries based on five areas: size of government, legal structure and security of property rights, access to sound money, freedom to trade internationally, and regulation of credit, labor and business. The report compares 159 countries and territories

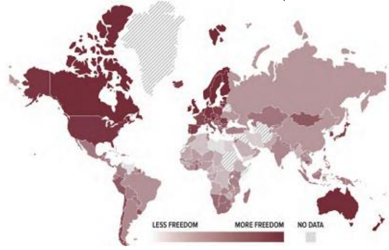
FRASER INSTITUTE'S ECONOMIC FREEDOM WORLD MAP



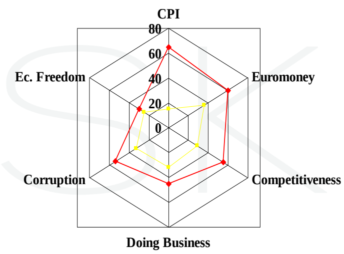
Economic Freedom of the World: 2017 Annual Report
— Sep 28, 2017

FRASER INSTITUTE: HUMAN FREEDOM INDEX

The index ranks 159 countries and jurisdictions based on 79 indicators of personal, civil and economic freedoms (joint project with the Cato Institute in the U.S. and Germany's Friedrich Naumann Foundation for Freedom)



COUNTRIES X & Y: A MULTI-INDEX COMPOSITE GRAPH



Centre international de formation européenne

NICE BERLIN BRUXELLES ISTANBUL

GLOSSARY OF COUNTRY RISK AND DEBT MANAGEMENT

(AN EXTENDED GLOSSARY IS AVAILABLE IN BOUCHET ET ALII: « COUNTRY RISK IN AN AGE OF GLOBALIZATION », PALGRAVE-MACMILLAN, 2018)

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

1. **Acceleration Clause**: a clause providing that the entire principal of a note (or a loan) shall become immediately due and payable in the event of default.
2. **Advance payment**: money received by a supplier in advance of shipment or fabrication.
3. **Arbitration**: A process to settle a legal dispute in which the third party (the arbitrator) acts much like a judge, but in an out-of-court and less formal setting and does not actively participate in the discussions.
4. **Aval**: an endorsement on a bill guaranteeing payment.
5. **Bilateral loans**: loans from governments and their agencies (including central banks), loans from autonomous bodies, and direct loans from official export credit agencies.

6. **Bond, Zero-Coupon**: a bond which pays neither principal nor interest until maturity. It merely states the face payment which is due at maturity and is sold at a discount which reflects the timing of payments (i.e., face value of the discounted value of the future bullet payment at maturity).

7. **Breach of contract**: Loss resulting from government termination of contracts without compensation for existing investments in a product or service.

8. **Bridge Loan**: used in the context of managing a country's debt profile, it is short-term financing provided to a debtor country--usually by the monetary authorities of industrial countries in conjunction with other central banks, governments, multilateral institutions and commercial banks--to supplement the country's foreign reserves prior to finalizing adjustment programs and concerted lending packages. This short-term advance is made pending receipts of funds by the borrower.

9. **Bullet Maturity**: one-time payment of principal at maturity.

10. **Capitalization, Interest**: an arrangement by which interest due is added to the principal of the loan and converted into a capital liability, effectively deferring payment beyond the original schedule.

11. **Co-financing**: a mechanism by which creditors provide project loans in parallel with loans granted by multilateral agencies such as the World Bank. Such "co-financiers" receive the benefit of the multilateral agencies' evaluation of the project and can share in certain benefits resulting from the special relationship between the debtor country and the multilateral agencies. In principle, cross-default clauses prevent debtors from defaulting on amounts owed to co-financiers without defaulting on the official institutions.

12. **Collateral:** guarantee (mortgage, deposit, commodity…)

13. **Commodity-Linked Bonds**: bonds whose value depends on the foreign price of a specified export commodity of the debtor country In the debt workout process, these bonds usually link debt service payments to the price of the exported commodity. Alternatively, warrants may be attached to lower the cost of financing.

14. **Commodity-linked payments**: Traditionally, the interest and/or principal repayments are denominated in units of a particular commodity. In such cases, the amount the bondholder receives depends on the price of the commodity at the time of payment. Payments have been denominated in nominal terms, but the payee has the option of buying or selling certain amounts of the commodity at the specified prices on predetermined dates.

15. **Contingent Lending Agreements/Facilities**: agreements or facilities which establish a linkage between additional financing and specific, pre-defined trigger mechanisms.

16. **Cross-Default Provision**: a legal wrinkle which allows one creditor to declare default and exercise its remedies against the borrower in cases where other loans of the borrower have been suspended, terminated, accelerated or declared in default by other creditors.

17. **Currency Redenomination**: switching of loans denominated in one currency or currencies into the currency of the creditor country. (The mechanism is intended to bring about a better match between the currency mix of debt service payments and the currency composition of export receipts).

18. **Debt Defeasance**: it involves extinguishing debt through the provision of a financial asset (zero-coupon or other financial instrument) to be held in a trust account as collateral against the principal of the debt. The face value and maturity of the collateral instrument are designed to match those of the debt being defeased so that the proceeds of the collateral instrument at maturity may be used to fully repay the principal in a single balloon payment. Since the principal of the debt is secured, the debt service obligations of the debtor are reduced to the payment of interest.
19. **Debt Service** is the sum of principal repayments and interest payments actually made.
20. **Disbursements**: drawings on loan commitments by the borrower during the year.

21. Escrow Account: special account in local or foreign currency, established on behalf of the debtor country in a domestic or in a foreign bank, in which deposits are made by the debtor periodically. Such account ensures creditors that debt payments will be made on time as a portion of the debtor's revenues are set aside for this purpose.

22. Equity-linked bonds: convertible bonds or bonds with equity warrants (amounted to $64 billion in 1997, and $32 billion in 1998).

23. Equity-linked bonds: convertible bonds or bonds with equity warrants (amounted to $64 billion in 1997, and $32 billion in 1998).

24. Eurobonds: long-term financial instruments issued by MNCs or country governments, and denominated in a currency other than that of the country of placement. Eurobonds are underwritten by a multinational syndicate of investment banks and simultaneously placed in many countries. They are issued in bearer form, and coupon payments are made yearly. The US$ accounts for about 70% of eurobonds. Liquidity in the secondary market is monitored by Euro-clear.

25. Euro-commercial paper: short-term euronotes issues by companies.

26. **Eurocredits:** medium to long-term loans denominated in euro-currencies (> 1 year).

27. **Exceptional Financing**: a special "below the line" category in the IMF Balance of Payments used to accomodate transactions undertaken on behalf of the monetary authorities to compensate for any overall imbalance.

28. **Fiduciary Fund** (or Trust Fund): fund in which assets are safeguarded and whose stream of interest income is used to fund a specific project.

29. **Free Rider**: individual banks may refuse to participate in a bailout loan with the international banking community, thereby not matching their expected share of the concerted loan package. Similarly, small-exposure banks might refuse joining debt reduction operations while requiring full payments on their claims. Such "free riders" would then see the value of their lending portfolios rise as other banks write down a country's debt.

30. **FRNs**: medium-term CDs where the interest is fixed as a percentage above six-month LIBOR. Negotiable and transferable securities with flexible interest rate, fixed interest periods, and issued in pre-determined and uniform amounts.

31. **Goodwill Clause**: a statement in Paris Club agreements which would allow the creditors in question to extend the life of a stated rescheduling arrangement, but which is not legally binding. Creditors agree to consider further debt relief after the expiration of the consolidation period, and a commitment to meet at the end of three to four years to consider the matter of the stock of debt.

32. **Guarantee**: a written promise by one party to be liable for a specific obligation of a second party in the event that the second party does not fulfill its financial obligation.

33. **IMF purchases:** Total drawings on the general resources account of the IMF during the year specified, excluding drawings in the reserve tranche.
34. **IMF repurchases**: Total repayments of outstanding drawings from the general resources account during the year specified, excluding repayments due in the reserve tranche.
35. **Interbank Lines**: short-term working capital extended between banks to cover short-term claims on a revolving basis .Such claims are generally not included in rescheduling.
36. **Interest in arrears on long-term debt**: defined as interest payment due but not paid, on previously agreed tenor.

37. **Interest payments:** are the amounts of interest paid in foreign currency, goods, or services in the year specified.

38. **Interest Rate Switching**: selection of a new basis for interest calculations on an existing loan. The options may include LIBOR, a domestic rate, the prime rate or a fixed rate, to which a margin is added.

39. **Interest Retiming**: changing the frequency of interest payments, essentially allowing a debtor to defer one or more interest payments. Retiming boils down to short-term interest rescheduling in that it permits a debtor country to stretch out interest payments.

40. **Loans from multilateral organizations**: Loans and credits from the World Bank, regional development banks, and other multilateral and intergovernmental agencies. Excluded are loans from funds administered by an international organization on behalf of a single donor government; these are classified as loans from governments.

41. **Long-term external debt**: debt that has an original or extended maturity of more than one year and that is owed to nonresidents and repayable in foreign currency, goods, or services.

42. Mandatory repayment clause: a standard clause in loan agreements between debtor countries and commercial bank creditors. It stipulates certain circumstances under which repayment is accelerated. The debtor, by being obligated to prepay any one creditor, must repay all lenders on a pro rata basis. In the context of rescheduling agreements and new money loans to rescheduling countries, the provision is intended to neutralize "free rider" banks which do not participate in debt restructuring and new money agreements. Further, the clause does not apply to non-rescheduled and post cut-off date claims but only to the "reschedulable" portion of the debt.

43. **Mandatory repayment terms:** In that regard, debt conversion and debt buyback transactions amount to payment prior to contractually defined maturity. The provision applies across the universe of public sector borrowers so that a voluntary prepayment of one or more credits by one borrower would trigger mandatory prepayment not only by that borrower but also by the other public sector borrowers.

44. Negative Pledge clause: negative pledge provisions deal with the granting of security interests by a debtor country over its assets to its creditors. In the case of a debt refinancing agreement, the debtor country agrees with the banks not to provide any other group of creditors with security interest on the country's reserves, exports of goods, and public sector companies' assets. The objective of such a clause is to prevent a situation where a debtor would allocate significant assets to other creditors, thereby effectively subordinating the unsecured bank credits.

45. **Net flows on debts** (or net lending or net disbursements): are disbursements minus principal repayments.

46. **Net resource flows** (long term): sum of net resource flows on long-term debt (excluding IMF) plus non-debt-creating flows.

47. **Net transfers on debt**: net flows minus interest payments (or disbursements minus total debt service payments).

48. **New Money Bonds**: bonds issued by debtor countries in exchange for additional financing. Such instruments are usually more senior and tradable than old claims.

49. **Non-debt creating flows**: net foreign direct investment, portfolio equity flows, and official grants (excluding technical cooperation). Grants for technical cooperation are shown as a memorandum item.

50. **Note-issuance facility** (NIF): a medium-term legally-binding commitment under which a borrower can issue a short-term paper in its own name, underwritten by banks which are committed either to purchase any notes the borrower is unable to sell, or to provide credit.

51. **Off-balance sheet activities**: bank activities, often fee-based, that do not involve booking assets or taking deposits. (insurance, swaps, forwards, LCs, advisory assistance, M&As…).

52. **On-Lending**: the process by which funds borrowed by one party are made available to a third party, with the agreement of the creditor. Typically, the funds are recorded as a deposit in the central bank .However, the creditor and the contractual borrower (often the central bank itself) agree to make the loan proceeds available to a third party within the country in local currency equivalent.

53. **Optional prepayment provision**: the optional prepayment provision permits the borrower to prepay all or part of the loan provided it prepays all lenders under the agreement on a pro rata basis

54. **Pari-passu clause**: clause inserted in lending and restructuring agreements that provides for a strict equality of treatment among various categories of debts and various families of creditors.

55. **Prepayment clause**: the prepayment clause is a standard clause in loan agreements between a debtor and a creditor bank. In its various forms, it can provide the debtor with the opportunity to accelerate repayment of the loan on a voluntary basis and/or provide for acceleration of repayment due to changes in laws affecting the creditor. In rescheduling agreements, the clause is intended to prevent the obligor to grant a preferential repayment schedule to other banks which have not signed the convention and which would be paid ahead of normal maturity terms.

56. **Principal in arrears on long-term debt**: principal repayment due but not paid, on a cumulative basis.
57. **Principal repayments**: the amounts of principal (amortization) paid in foreign currency, goods, or services in the year specified.
58. **Private nonguaranteed external debt**: external obligation of a private debtor that is not guaranteed for repayment by a public entity.
59. **Public debt**: external obligation of a public debtor , including the national government, a political subdivision (or an agency of either)

60. **Publicly guaranteed debt**: external obligation of a private debtor that is guaranteed for repayment by a public entity.
61. **Refinancing**: provision of new money to cover obligations on existing loans in part or in full.
62. **Reinsurance**: The process of a risk insurance provider issuing a guarantee with other providers in order to reduce exposure by spreading the risk among the institutions involved
63. **Relending**: an operation in which the external debt repaid by one debtor is lent to another entity in the debtor economy. The second debtor may repay prior to the definitive repayment date and the foreign creditor may relend again to a third debtor within the debtor country. In practice, relending has occurred when the original borrower had the domestic currency to repay its debt (at the going exchange rate) but the Central Bank was not able or willing to provide the foreign exchange.

64. **Rescheduling**: re-timing of the principal due on a loan. Usually, Paris Club debt agreements include interest rescheduling in place of new money.

65. **Revolving Underwriting Facility** (RUF): medium-term facility on which the borrower can draw at any time of its life, usually certificates of deposits (CDs) or short-term promissory notes.

66. **Sharing Provisions**: a legal covenant in commercial bank agreements which specifies that debt service payments are to be made through the agent bank for allocation on a pro rata basis to all creditor banks. Further, payments received or recovered by any one lender must be shared on a pro rata basis with all co-creditors under the loan agreement. Thus, no one lender may be placed in a more favorable position than its co-lenders with respect to payments received and/or recovered.

67. **Short-term external debt**: debt that has an original maturity of one year or less. Available data permit no distinction between public and private nonguaranteed short-term debt. (data sources: OECD/BIS and World Bank)

68. **Spread, Interest Rate**: usually expressed in percentage points over and above a reference rate such as LIBOR or the prime rate in the country of the creditor. The spread added to the reference rate constitutes the interest rate applicable to the loan.

69. **Stand-by Credit**: a commitment to lend up to a specified amount for a specific period, to be used only in a certain contingency (commitment fee paid on the unused portion of a facility).

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70. **Subrogation Rights**: in contracts of indemnity, they allow the insurer to take over the rights of the assured against any third party who is responsible for a loss in respect of which the insurer has made a claim payment.

71. **Suppliers Credit**: export finance which is available to a supplier of items as distinct from credits to the foreign purchasers under buyer's credit.

72. **Tenor**: The term of a loan or a risk insurance contract

73. **Term deposits and CDs**: negotiable instruments that can be traded on the secondary market. Because of higher liquidity, CDs pay lower interest rate (<about 10 basis point: a basis point is 0,01%). Very popular with company treasurers, because of low risk and high flexibility.

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74. **Total debt service due**: contractual debt service payments on total long-term and short-term debt (public and publicly guaranteed and private nonguaranteed) and the use of IMF credit.

75. **Total debt service paid** (TDS): debt service payments on total long-term debt (public and publicly guaranteed and private nonguaranteed), use of IMF credit, and interest on short-term debt.

76. **Total debt stock**: sum of public and publicly guaranteed long-term debt, private nonguaranteed long-term debt, the use of IFM credit, and short-term liabilities.

77. **Unallocated Loan-loss Reserves**: value of anticipated future charge-offs on the existing loan portfolio that cannot yet be identified with any particular asset.

78. **Value Recovery Clause**: clause included in some commercial bank debt restructuring agreements that entitle creditor banks to recover a larger portion of their loans, subject to a specific condition related with a better than expected performance of the debtor country. It is usually associated with the international price of a good or a basket of goods exported by the debtor country, or to its real GDP growth rate. (ex. Greece)

79. **Waiver**: voluntary relinquishment of a legal right as provided for in the loan agreement for the duration of a specified time period or an indefinite period.

80. **Warrant**: options which permit the holder to buy stock for a stated price, thereby providing a capital gain if the price of the stock rises. Bonds that are issued with warrants, like convertibles, carry lower coupon rates than straight bonds.

81. **Write-off debt**: removal from the creditor's balance sheet of obligations due from a debtor. While this presents a "clean" balance sheet for the creditor bank, it need not mean that the creditor is abandoning claims against the debtor.

GLOBAL RISK MANAGEMENT: HOW TACKLING **FAILED STATES** AND INSTITUTIONAL WEAKNESS?

CIFE SEMINAR NICE MAY 8, 2020

MICHEL-HENRY BOUCHET

WHAT ARE FAILED STATES AND ROGUE STATES?

WHY DO STATES FAIL?

HOW CAN ONE MEASURE THE RISK AND DEGREE OF STATE FAILURE?

WHICH COUNTRIES MOST EXEMPLIFY THE FEATURES OF INSTITUTIONAL WEAKNESSES?

WHAT ARE THE EARLY WARNING SIGNALS OF STATE FAILURE?

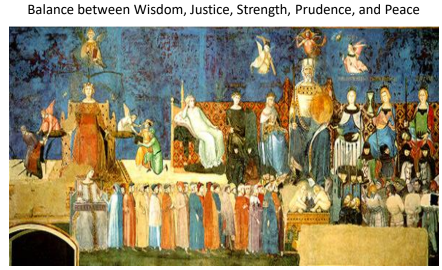
STATE FAILURE AND POLITICAL RISK ASSESSMENT

► **Country Risk** is the possibility that a foreign country may be **unable or unwilling** to fulfill its obligations fully and on time, towards a foreign lender and/or investor, or exporter, or domestic residents!

Bad governance leads to State failure that produces political risk, hence the unexpected unfavorable consequences of the arbitrary exercise of power by a government and its ramifications

WHAT IS « **GOOD GOVERNANCE** »?

XIV°century Sienna: **Good Government Allegory** = Balance between Wisdom, Justice, Strength, Prudence, and Peace



What is a Failed State?
State fragility and state failure…

A "FRAGILE AND WEAK STATE » IS A STATE WHOSE INSTITUTIONAL FRAMEWORK IS TOO WEAK TO MAINTAIN SOCIAL COHESION THROUGHOUT THE PROCESS OF DEVELOPMENT

INSTITUTIONAL WEAKNESSES, CONSEQUENTLY, GENERATE A CRISIS OF SOCIAL MEDIATIONS WHERE PARTIES, UNIONS, SOCIAL INSTITUTIONS AND LOCAL ELITES LOSE CREDIBILITY FOR ADDRESSING SOCIAL FRUSTRATION AND DEMANDS, HENCE RISING TENSIONS.

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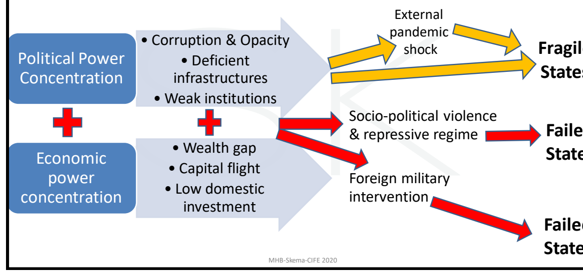
THE UNFOLDING OF STATE FAILURE



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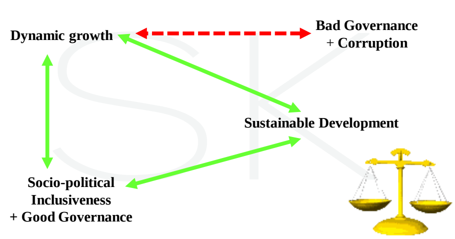
TRILEMMA OF GROWTH AND DEVELOPMENT?



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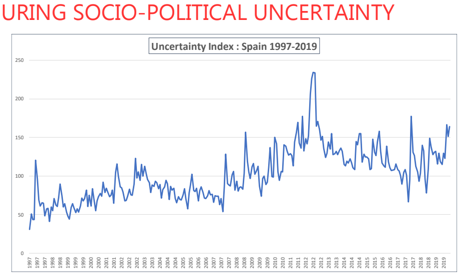
MEASURING SOCIO-POLITICAL UNCERTAINTY



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EPU index for Spain developed by Corinna Ghirelli, Javier J. Pérez and Alberto Urtasun.

THE CANDIDATES FOR FAILED STATES CATEGORY?

Developing countries

- Tajikistan
- Eritrea
- Mozambique
- Uzbekistan
- Zimbabwe
- Cambodia
- DR Congo
- Haiti
- Turkmenistan
- Angola
- Chad
- Congo

Developing countries

- Iraq
- Venezuela
- Burundi
- Libya
- Afghanistan
- Equatorial Guinea
- Guinea Bissau
- Sudan
- North Korea
- Yemen
- South Sudan
- Syria
- Somalia

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THE CANDIDATES FOR FAILED STATES CATEGORY?

Developed countries?

*Saudi Arabia
Croatia
Cuba
Malaysia
Romania
Hungary
Greece
Montenegro
*Belarus
*South Africa

Developed countries?

*Brazil
Tunisia
*Kazakhstan
*Algeria
*Kuwait
Turkey
Argentina
Serbia
Bosnia and Herzegovina
*Indonesia

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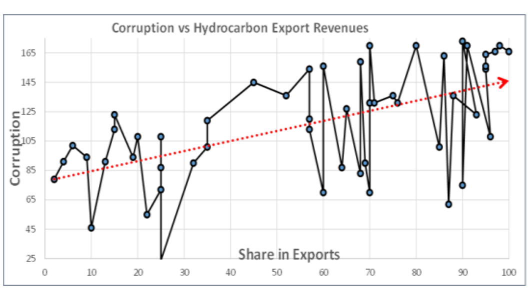
OIL-BASED GROWTH LEADS TO POWER AND WEALTH CONCENTRATION, AND CORRUPTION



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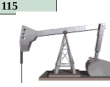
DEVELOPMENT = ECONOMIC GROWTH + KEY CONDITIONS THAT MAKE IT SUSTAINABLE!

	CHILE	COSTA RICA	Turkmenistan	GABON
GDP/per capita	$15,000	$11,000	$15,000	$14,000
Life Expectancy	80	81	68	65
HDI Rank	42	68	108	115



	ARMENIA	SRI LANKA	NIGERIA	ANGOLA
GDP per capita	$5000	$5000	$5000	$5500
Life expectancy	75	77	54	60
HDI Rank	81	97	158	1489

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BETTER OFF IN TUNISIA OR IN ALGERIA ?

TUNISIA

- GDP Per capita = $10500
- HDI= 91
- Life expectancy f = 77
- Infant mortality= 13/1000
- Gender inequality: 0,28
- Doing Business= 77
- Corruption = 75

ALGERIA

- GDP Per capita=13500
- HDI= 82
- Life expectancy f= 75
- Infant mortality= 22/1000
- Gender inequality: 0,43
- Doing Business= 156
- Corruption = 108

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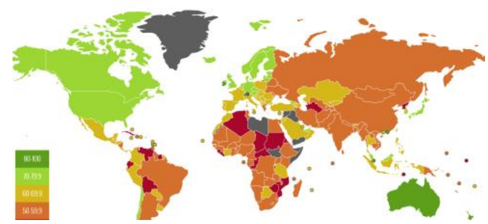
IS THERE A RELATION BETWEEN STATE FAILURE AND SOCIO-ECONOMIC FREEDOM?



https://www.heritage.org/index/heatmap

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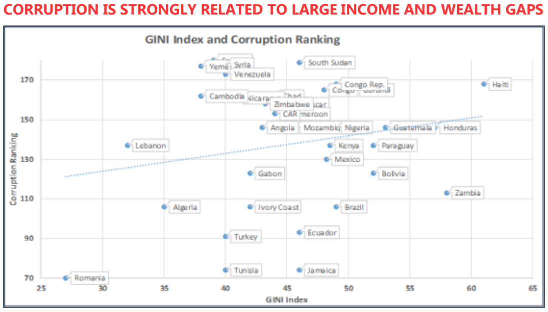
CORRUPTION IS STRONGLY RELATED TO LARGE INCOME AND WEALTH GAPS



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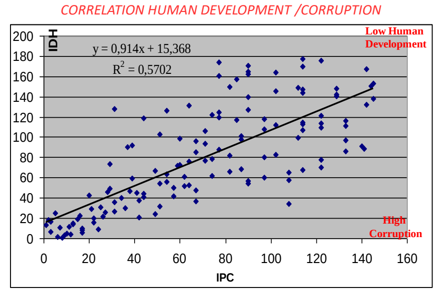
LARGE CORRUPTION IS STRONGLY RLATED TO LOW DEVELOPMENT SCORE!

CORRELATION HUMAN DEVELOPMENT /CORRUPTION



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A FEW FACTS REGARDING DEMOCRACY AND DEVELOPMENT

1. Political regimes have **little** impact on **GDP growth rate**
2. **GDP per capita growth does breed democray**
3. Economic growth provides legitimacy to dictatorships (while increasing demand for political change)
4. **Per capita income grows faster under democracy** (due to human capital and because population rises less fast than under dictatorships)
5. Growth is influenced less by the type of regime than by regime instability: **Democracy provides a stable political and institutional environment, hence a positive impact on sustainable growth!**

Since 1980, of the 124 EMCs that have managed to sustain a 5% growth rate for a full decade, 52 % were democracies. What matters is the implementation of key reforms for growth and development.

Feng, Y. Cambridge, 1997- Przeworski, A/ NYU- Ruchir Sharma 09/2012

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HOW MOVING FROM GROWTH TO SUSTAINABLE AND INCLUSIVE DEVELOPMENT?

Assumption n°1

- Primacy of **human capital for both growth and democratization:** human and social capital shape both institutional and productive capacities of a society.
- Growth in **income and human capital** causes institutional improvement with better political institutions even with pro-market dictators: **policy choices matter** while institutional quality rises as a country grows richer
- Economic growth and human capital accumulation cause institutional improvement, rather than the other way around

Assumption n°2

- **Democracy** and other checks on government are the **key mechanisms for securing property rights and boosting growth**
- **Good and stable institutions will enhance the pace and quality of economic growth**
- **Robust institutions and good governance matter!**

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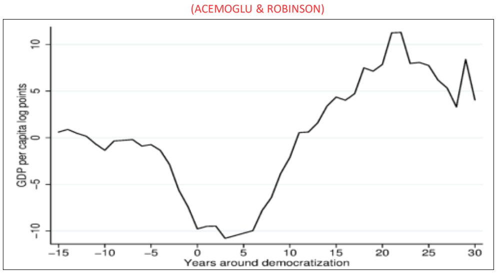
DEMOCRACY BREEDS GDP PER CAPITA GROWTH WHILE ECONOMIC GROWTH LEADS TO DEMOCRACY

(ACEMOGLU & ROBINSON)



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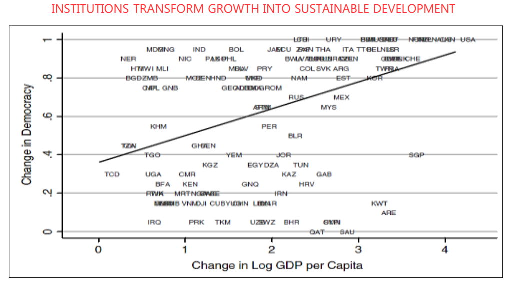
DEMOCRATIZATION AND INCOME GROWTH 1500-1995

INCOME PER CAPITA AND DEMOCRACY ARE CORRELATED BECAUSE ECONOMIC AND SOCIO-POLITICAL INSTITUTIONS TRANSFORM GROWTH INTO SUSTAINABLE DEVELOPMENT



J. Robinson, 2006

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THE ROOT CAUSES OF STATE FAILURE?

	Somalia	Syria	Zimbabwe	Cambodia	Ivory Coast	Angola	Nigeria	Congo Rep.	Venezuela	Tunisia	South Afr	Gabon	Lebanon	Algeria	Argentina	Turkey	Romania
GDP per capita ppp	2000	2800	3000	3600	4200	5700	6000	6000	9500	12500	14000	18000	13000	15500	21000	28000	28000
GINI Index/100	39	40	43	38	42	43	49	49	40	40	63	38	32	35	42	40	27
Top 1% income share	16%	15%	17%	15%	18%	15%	15%	18%	19%	11%	20%	18%	10%	10%	17%	23%	7%
HDI/189	188	154	150	146	165	149	158	179	96	91	113	115	93	82	48	59	52
Corruption /180	180	178	160	161	105	165	149	165	168	73	73	124	138	15	85	78	61
Global Peace/163	158	162	132	89	107	77	148	121	144	82	127	96	147	111	75	152	25
Inclusive Develop/75	61	57	71	55	58	60	63	65	48	39	69	55	42	18	23	16	10
Doing Business/185	190	176	140	144	110	177	131	180	188	78	84	169	143	157	126	33	55
Competitiveness/140	139	135	127	106	118	136	116	139	133	87	60	119	88	89	83	61	51
Economic trigger	livestock	infrastructure	commodity	commodity	commodity	commodity	oil & gaz	commodity	oil & gaz	tourism	commodity	oil & gaz	debt	oil & gaz	exch. rate	EU growth	EU growth
	aid flows		prices	prices	prices	prices	prices	prices	prices	twin deficit	prices	prices	diaspora	imports	debt	bond yield	
	fish	banking								EU growth	debt		exch. rate	prices	bond yield	China	banking
		imports	inflation				inflation		inflation	debt	GDP growth		inflation	GDP growth	GDP growth	GDP growth	GDP growth
Political trigger		repression	ethnic		ethnic		ethnic			radical	ethnic/racial	corruption	governance	army			
		civil war	tensions		tensions		islamism			islamism	tensions	repression	religion				
Foreign trigger		military	disburst.		CFA Franc						migrations		migrants				
		support	suspension										Syria				

Global Peace: Institute for Economics & Peace (Sydney)
23 qualitative and quantitative indicators to measure the state of peace using 3 themes: social safety and security, ongoing domestic and international conflict, and militarization
Top 1% income share: Wealth Inequality Lab (Piketty/Saez) World Inequality Database
Inclusive development: World Economic Forum: GDP, Productivity, wealth gap, poverty, public debt, net savings, life expectency, employment.

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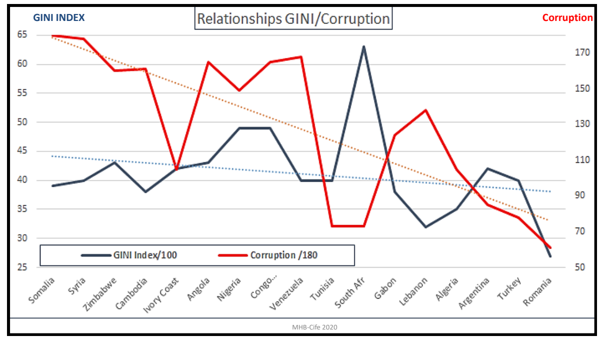

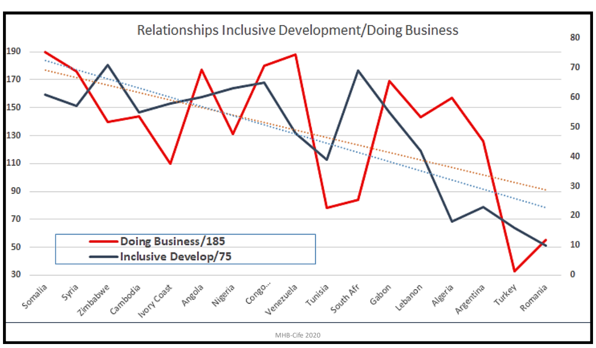

KEY FEATURES OF FAILED AND FRAGILE STATES

	n/178	Index TI/180	UNDP/188	Index **	WEF 140	KF/GDP%	Human flight **	%	% (3 year av.)	
Weak States	Ranking	Corruption **	HDI **	GINI	Competitiv.	Capital flight	& Brain drain	Unempl.	Invest/GDP	Ext Debt/GDP%
Yemen	1	176	178	38	139	2%	7,3	35	12	30%
Somalia	2	180	188	39	*139*	1%	9,5	6	10	75%
Syria	4	178	155	36	*130*	3%	8,4	50	10	16%
Congo DR	5	165	176	49	135	39%	7	15	12	20%
CAR	6	149	188	44	139	4%	7,1	7	13	36%
Chad	7	165	186	43,3	140	2%	8,5	6	16	27%
South Sudan	8	178	187	35	*139*	1%	6,5	15	11	111%
Zimbabwe	10	160	156	43	128	5%	7,6	10	12	77%
Haiti	12	161	168	61	138	3%	8,4	15	25	30%
Nigeria	14	144	157	49	115	3%	6,9	23	15	70%
Uganda	20	149	162	42	117	3%	7,3	5	24	40%
Pakistan	23	117	150	33,5	107	1%	6,8	6	16	31%
Libya	28	170	108	42	*130*	22%	6,3	20	15	20%
Côte d'Ivoire	29	105	170	42	114	2%	7,3	5	16	37%
Venezuela	32	168	78	40	127	23%	6,1	35	14	33%
Angola	35	165	147	43	137	11%	6,9	9	24	57%
Lebanon	44	138	80	32	80	17%	5,6	9	20	200%
Tunisia	95	73	95	40	87	5%	5,9	16	21	90%
Peru	99	105	89	44	63	5%	7,1	10	21	35%

* Nonbank private deposits in international banks/BIS A6-1
** the higher, the worse

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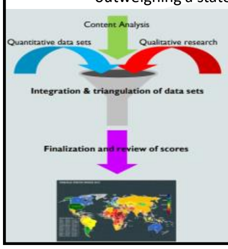
THE FUND FOR PEACE : **FRAGILE STATES INDEX'S METHODOLOGY**

The Fragile States Index = critical tool in highlighting not only the normal pressures that all states experience, but also in identifying when those pressures are outweighing a states' capacity to manage those pressures.



Annual ranking for 178 countries with 12 political, economic and social indicators
>100 sub-indicators, coupled with qualitative analysis and expert validation:

Economic decline, uneven development, brain drain, state legitimacy, public services, human rights, demographic pressures, refugees, external intervention, rule of law…

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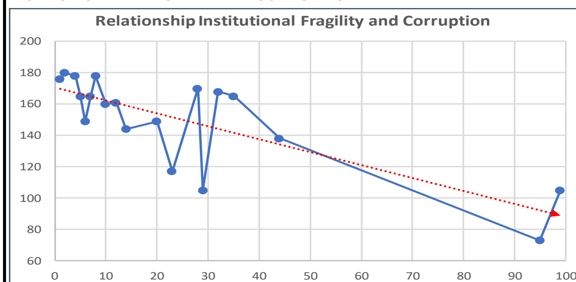
INSTITUTIONAL FRAGILITY AND CORRUPTION



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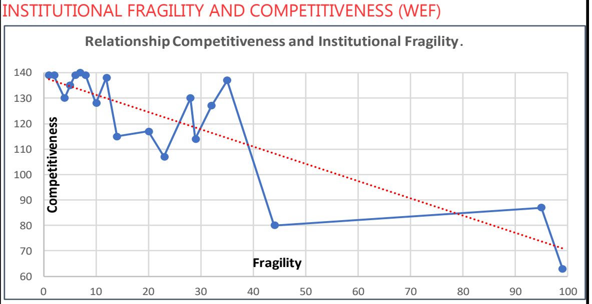
INSTITUTIONAL FRAGILITY AND COMPETITIVENESS (WEF)



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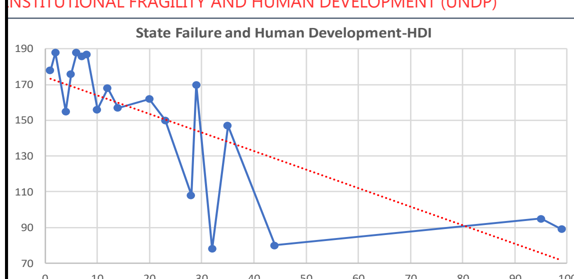
NSTITUTIONAL FRAGILITY AND HUMAN DEVELOPMENT (UNDP)



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RANKING OF TOP RISKS REPORTED BY FTSE 100 FIRMS (FT JULY 2017)

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UKRAINE:

THE PRICE OF POLITICAL RISK IN THE WAKE OF THE REVOLUTION AND THE RUSSIAN INVASION OF CRIMEA IN 2014

Sept 2017: back to market access?
bond swap with $3 billion global bond issue over 15 year, with 7,375% in exchange for bonds maturing 2019-20

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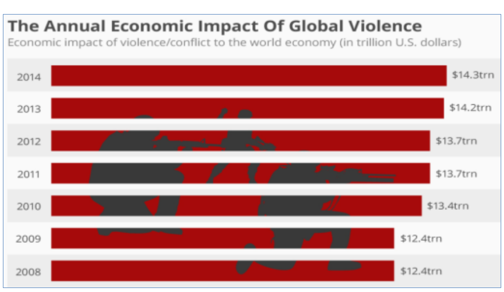
THE COST OF GLOBAL POLITICAL RISK



https://www.statista.com/chart/3948/the-annual-economic-impact-of-global-violence/

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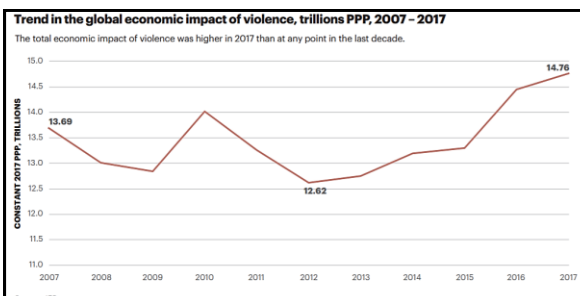

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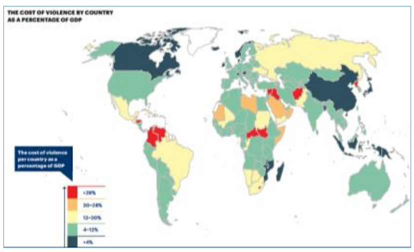
THE COST OF VIOLENCE IN % OF GDP

(WORLD ECON FORUM: THE ECONOMIC VALUE OF PEACE REPORT)



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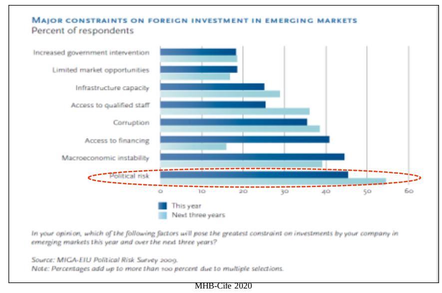
MIGA: THE KEY CHALLENGE OF POLITICAL RISK



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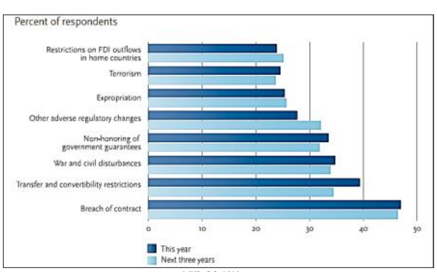
MIGA: TYPES OF POLITICAL RISK OF HIGHER CONCERN TO MNCS IN EMCS



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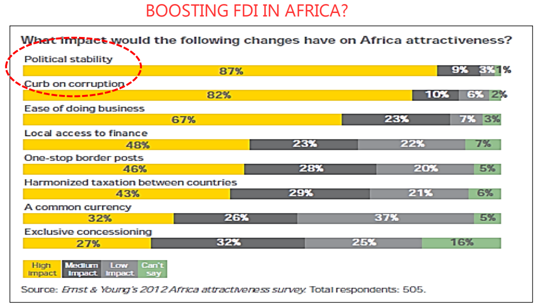
BOOSTING FDI IN AFRICA?



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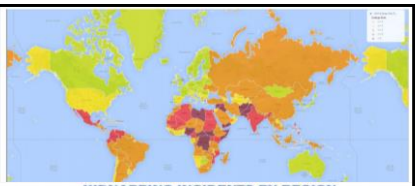
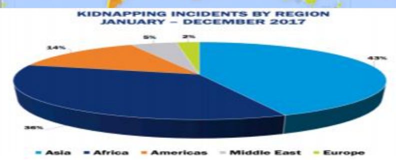
TOP 20 KIDNAP RANKING

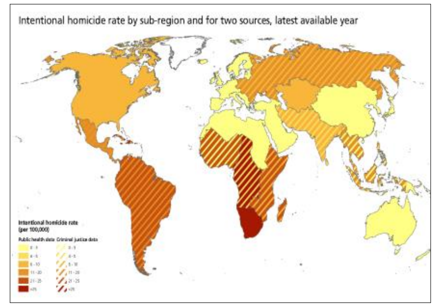
1. South Africa
2. Pakistan
3. Mexico
4. India
5. Nigeria
6. Venezuela
7. Lebanon
8. Philippines
9. Afghanistan
10. Colombia
11. Iraq
12. Syria
13. Guatemala
14. Yemen
15. Libya
16. Egypt
17. Brazil
18. Kenya
19. Nepal
20. Malaysia

: >7,770 kidnaps for ransom!

Source: Hiscox Group/FT/ AIG







HTTP://WWW.UNODC.ORG/UNODC/INDEX.HTML?REF=MENUTOP MHB-Cife 2020

AON POLITICAL RISK MAP

The Aon Political Risk Map measures political risk in 163 locations and territories.

►Risk ratings are standardized across each location, on a six-point scale ranging from low to very high, with all risks updated once per quarter.

►EU and OECD countries are not rated in the map

►Political risk is calculated as a simple average of six core risk measures :

1. **• Political Violence**
2. **• Exchange Transfer**
3. **• Sovereign Non-Payment**
4. **• Political Interference**
5. **• Supply Chain Disruption**
6. **• Legal & Regulatory**

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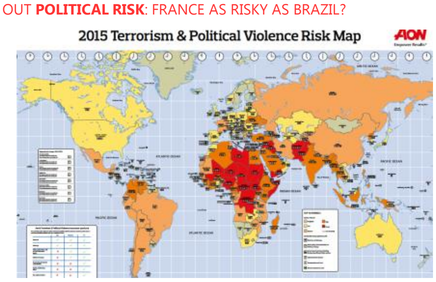
MAPPING OUT **POLITICAL RISK**: FRANCE AS RISKY AS BRAZIL?



http://www.aon.com/terrorismmap/2013-Terrorism-Map-14-05-2013.pdf
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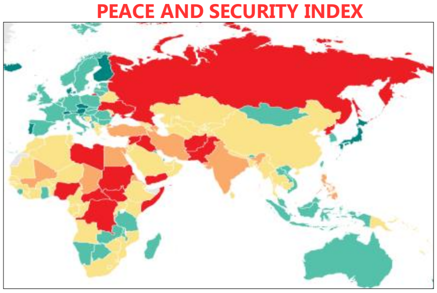
PEACE AND SECURITY INDEX



http://www.visionofhumanity.org/sites/default/files/Global%20Peace%20Index%20Report%202016_0.pdf

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Wars and armed conflicts all over the world

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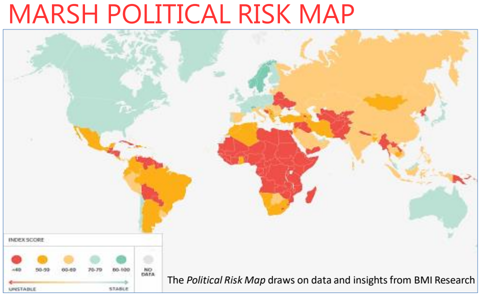
MARSH POLITICAL RISK MAP



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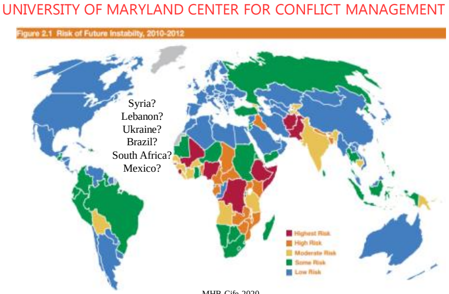
BLINDNESS? **RISK OF FUTURE POLITICAL CRISIS 2010-12**

SOURCE: UNIVERSITY OF MARYLAND CENTER FOR CONFLICT MANAGEMENT



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WHERE DOES POLITICAL RISK COME FROM?

POLITICAL RISK ASSESSMENT

- **Origins? Political risk** stems from the overall **uncertainty** related to the exercise of power by a foreign government and its ramifications
- **Impact?** Arbitrary political decisions, conditions, and events in a country will affect the business climate in such a way that investors, exporters, creditors, as well as domestic residents will confront risks and losses.

AMBASSADOR PAUL BREMER

(US STATE DEPARTMENT)

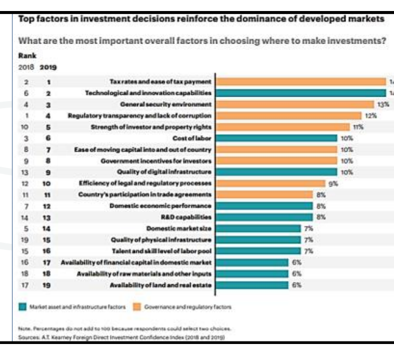
- *Political risk analysis is both an art and a science but many types of risk are amenable to rigorous analysis:*
- *How resilient is the political system? Is there a tradition of peaceful transitions of power? How robust are the social shock absorbers that provide buffers between individual citizens and governments?*

Harvard Business School Review, 2002

Threat materialization

- **Contract repudiation, capital controls, currency inconvertibility, sham contracts and bribery, corruption, blocked funds, ideological shift, political upheaval, strikes, expropriation, nationalization, coup d'état, martial law, revolution, civil strife damage, terrorism, war damage, kidnapping, crimes….**

GOVERNANCE & TRANSPARENCY MATTER IN FDI STRATEGY!



Three Sources of Political Risk

Direct «hard risks»	• **Risk materialization directly hurts the company:** Nationalization, expropriation and confiscation, contract repudiation, sham contracting, bribery and corruption, blocked funds, kidnapping, crimes
Indirect «surrounding risks»	• **Risk materialization stems from the hostile environment:** Revolution and civil unrest, martial law, terrorism, war damage, ideological and cultural shifts. Capital and dividend remittance constraints, ineffective legal and regulatory systems, non-compliance, strikes, currency inconvertibility, regional crisis and volatility spill-over
Collateral «soft risks»	• **Risk materialization is the byproduct of unfavorable interactions between power groups:** Legal and ethical risks, protectionism, fiscal uncertainty, wealth gaps, bureaucracy and weak institutions, pressure groups and hostile NGOs, ethnic/linguistic fragmentation

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WHERE DOES POLITICAL RISK COME FROM?

- Terrorism
- Ethnic/linguistic fragmentation
- Gap between socio-economic and political/institutional evolution
- Cultural fragmentation (riots, upheaval, government crises, corruption)
- Internal violence and power struggle (martial law, coup d'état, guerrilla warfare…)
- Rapid pace of urbanization coupled with religious fundamentalism
- Regional contamination

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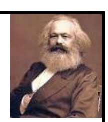
MARXIST APPROACH TO ECONOMIC DEVELOPMENT AND CLASS STRUGGLE



- The developing forces of production give rise to increasing conflict with the existing social relations of production = class struggle.
- The **state** does not represent the interests of `the people' or a common `general will'. Nor is it a force which stands above or beyond the clash of class interests.
- The state = Instrument of class rule, nothing but `a committee for managing the common affairs of the whole bourgeoisie'.
- Capitalism will inevitably lead to increasing class polarisation and class conflict.

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DANIEL BELL

Sociologist and professor emeritus at Harvard University.
Bell was among the original New York Intellectuals, a group of anti-Stalinist left-wing writers. Best known for his contributions to post-industrialism.
Masterworks: *The End of Ideology* (1960), *The Cultural Contradictions of Capitalism* (1976) and *The Coming of Post-Industrial Society* (1973)

The post-industrial society:

- Polarization and social tensions between work and consumption pressures: capitalism is inherently **instable**
- Centrality of the new science-based industries
- Rise of new technical elites and the advent of a new principle of stratification

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ULRICH BECK: "WORLD AT RISK" IN A MODERN SOCIETY

- Modernization challenges the institutions and structures of traditional societies in the name of individual freedom and autonomy.
- What began to emerge in the late 20th century was a radical shift in western societies from a culture where meaning and identity were grounded in loyalty to traditional institutions and structures to one in which meaning and identity are grounded in the self as the primary agent of meaning.
- The paradox in late modern society is that risk might be increasing due to technology, science and industrialism rather than being abated by scientific and technological progress.
- The **world risk society is** full of hazards and insecurities induced by modernization itself:

1. Globalization
2. Individualization
3. Gender Revolution
4. Underemployment
5. Global risks (ecological crisis and the crash of global financial markets)

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SAMUEL HUNTINGTON

Political order in changing societies

The Clash of Civilization

- http://markweatherall.wordpress.com/2009/10/12/political_order_in_changing/

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WHERE DOES POLITICAL TURMOIL COME FROM?

- Contrary to the expectations of modernization theory, **violence and instability stem from:**

1. **rapid social change**
2. **Centralized** decision-making system
3. mobilization of **new groups into politics**
4. **slow development of political institutions**.

- As societies modernize, they become more complex and disordered. If the process of **socio-economic** modernization is not matched by a process of **political and institutional** modernization with political institutions capable of managing the stress of modernization—the result is violence.

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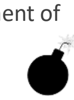
SAMUEL HUNTINGTON
ANALYZING THE ROOTS OF POLITICAL UPHEAVAL

- Primary problem of politics = **lag** in the development of **political institutions** behind socio- economic change.
- Instability = (rapid social change + rising mobilization of new groups into politics) **>** development of political institutions.



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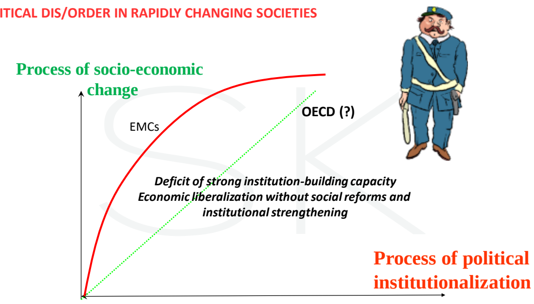
POLITICAL DIS/ORDER IN RAPIDLY CHANGING SOCIETIES



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A DEFICIT IN INSTITUTION-BUILDING ALWAYS LEADS TO SOCIAL UPHEAVAL

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HONG KONG = THE ROOT CAUSES OF RISING SOCIAL FRUSTRATION

MHB-Skema 2020 59

ECONOMIC GROWTH + POLITICAL MODERNIZATION IN CHINA?

- Shenzhen = spiritual home to economic reform in China?

PM Wen Jiabao: « *Political reform is a necessary companion to economic modernization: without the safeguard of political reform, the fruits of economic reform would be lost* » (August 2010)

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INSTITUTIONAL STRENGTHENING, ECONOMIC DEVELOPMENT AND POLITICAL STABILITY: CHALLENGING TRIANGLE!

▶ **Chile's President Bachelet:**

links between democratic strengthening, economic growth and social protection

▶ *« In Latin America , there are countries where people are uneasy about the process of economic liberalization, because structural economic reforms were not accompanied by the social policies that were necessary! The problem has not been with open economies per se but rather the lack of action in addressing poverty and social injustice »*

Interview by McKinsey Quarterly, 2007

WORLD BANK'S STRATEGY OF INSTITUTIONAL STRENGTHENING

"To achieve our goal of ending extreme poverty, we must focus on people living in countries that suffer from conflict and fragility.
Our new strategy aims to address the underlying causes of fragility and invest in the long-term development that helps create the conditions for peace and prosperity".

(APRIL 16, 2019 World Bank CEO Kristalina Georgieva)
https://www.worldbank.org/en/news/press-release/2019/04/16/world-bank-group-launches-worldwide-consultations-on-future-strategy-for-fragility-conflict-and-violence

TECHNIQUES TO ASSESS POLITICAL RISK

1. Economic intelligence: in-depth socio-political analysis
2. Checklist approach
   To examine key political factors that affect a country's risk: the **Prince Model**
3. Delphi technique
   - establish surveys
   - collect information and independent opinions
   - analyze results and make predictions
4. Ratings
5. Consultants on political risks

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

▶ MIG (UK)
▶ HISCOX
▶ PLATUS
▶ AON
▶ Global Risk Assessments
▶ EIU
▶ COFACE, OPIC & MIGA, EULER
▶ Howell International
▶ Control Risks Group: www.crg.com
▶ WMRC

▶ Frost & Sullivan
▶ US State Department + US CIA
▶ Marsh Crisis Consulting
▶ University of Maryland Center for Conflict Management
▶ Muir Analytics (Threat Watch, Threat Report, Threat Survey)
▶ NYA International

2. POLITICAL RISK ANALYSIS

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

- ideological (North Korea)
- charismatic (Cuba)
- economic/financial (Brunei)
- authoritarian populism (Thailand)
- ethnic (Ivory Coast, Ghana)
- religious (Iran)
- military (Burma)
- patron-client relationships (Togo)

3. POLITICAL RISK ANALYSIS: **PRINCE** MODEL

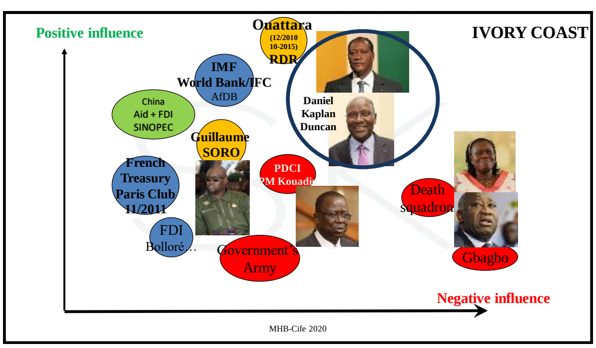
Frost & Sullivan: William D. Coplin and Michael K. O'Leary of the firm Political Risk Services.

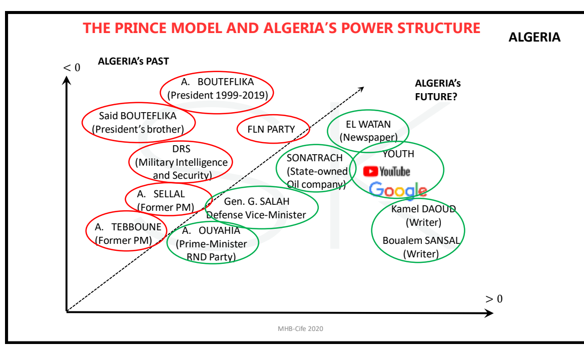
PRINCE = Probe, Interact, Calculate, and Execute

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

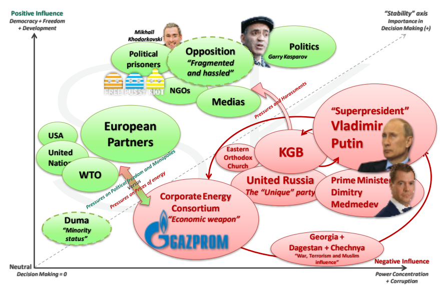
Political risk forecasting model to produce probability of loss from political instability by relating relative importance in decision-making and relative political orientation towards radical or incremental change (+/-)

DATA= https://www.cia.gov/library/publications/world-leaders-1/world-leaders-c/cote-divoire.html

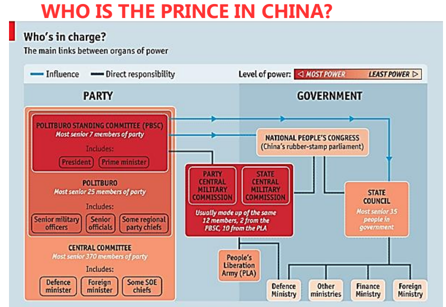




PRINCE MODEL APPLIED TO RUSSIA

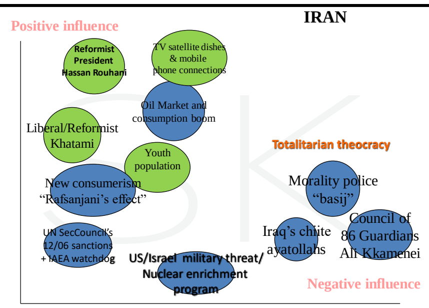


WHO IS THE PRINCE IN CHINA?



The Economist, 12/2012

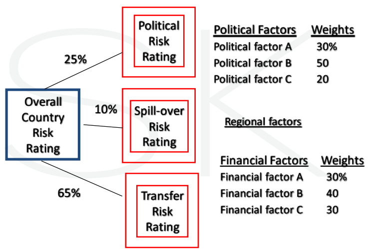
IRAN



4. QUANTIFYING COUNTRY RISK

- **Ratings and Rankings**:
- 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's website)*

QUANTIFYING COUNTRY POLITICAL RISK



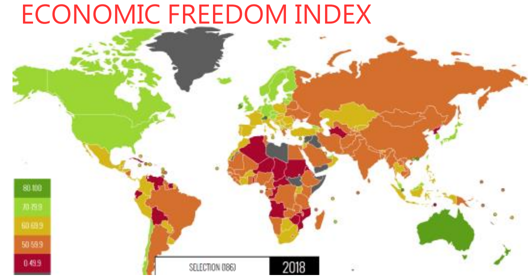
POLITICAL RISK INDICES

- Heritage Foundation
- Freedom House
- Cato Institute
- Fund for Peace
- Transparency International CPI
- PWCs: Opacity Index
- LB: Legsi
- Asiarisk
- Marsh
- World Bank (Governance)
- Euromoney (25%)
- Institutional Investor
- IMD
- ICRG-PRS
- MIG
- WMRC
- University of Maryland
- Ibrahim Index of Governance

CROSS-COUNTRY POLITICAL RISK MEASURE BY ICRG

Weights	ICRG's Political Risk Assessment Criteria
12	Government Stability
12	Socio-Economic conditions
12	Investment Profile
12	Internal Conflict
12	External Conflict
6	Corruption
6	Military in Politics
6	Religious Tensions
6	Law and Order
6	Ethnic Tensions
6	Democratic Accountability
4	Bureaucratic Quality
100	Total number of points for weighted influence

ECONOMIC FREEDOM INDEX



THE HERITAGE FOUNDATION: ECONOMIC FREEDOM INDEX

Q.3. How do you measure economic freedom?

We measure economic freedom based on 12 quantitative and qualitative factors, grouped into four broad categories, or pillars, of economic freedom:

1. Rule of Law (property rights, government integrity, judicial effectiveness)
2. Government Size (government spending, tax burden, fiscal health)
3. Regulatory Efficiency (business freedom, labor freedom, monetary freedom)
4. Open Markets (trade freedom, investment freedom, financial freedom)

Each of the twelve economic freedoms within these categories is graded on a scale of 0 to 100. A country's overall score is derived by averaging these twelve economic freedoms, with equal weight being given to each. More information on the grading and methodology can be found in the appendix.

INDEX OF ECONOMIC FREEDOM

Top 10 Countries

RANK	COUNTRY	OVERALL	CHANGE
1	Hong Kong	90.2	0.4
2	Singapore	88.8	0.2
3	New Zealand	84.2	0.5
4	Switzerland	81.7	0.2
5	Australia	80.9	-0.1
6	Ireland	80.4	3.7
7	Estonia	78.8	-0.3
8	United Kingdom	78.0	1.6
9	Canada	77.7	-0.8
10	United Arab Emirates	77.6	0.7

REPRESSED (49.9-40)

RANK	COUNTRY	OVERALL	CHANGE	RANK	COUNTRY	OVERALL	CHANGE
160	Niger	49.5	-1.3	171	Djibouti	45.1	-1.6
161	Sudan	49.4	+0.6	172	Algeria	44.7	-1.8
162	Chad	49.3	+0.3	173	Bolivia	44.1	-3.6
163	Central African Republic	49.2	-2.6	174	Zimbabwe	44.0	0.0
164	Angola	48.6	+0.1	175	Equatorial Guinea	42.0	-3.0
165	Ecuador	48.5	-0.8	176	Eritrea	41.7	-0.5
166	Suriname	48.1	+0.1	177	Republic of Congo	38.9	-1.1
167	Timor-Leste	48.1	+1.8	178	Cuba	31.9	-2.0
168	Togo	47.8	-5.4	179	Venezuela	25.2	-1.8
169	Turkmenistan	47.1	-0.3	180	North Korea	5.8	+0.9
170	Mozambique	46.3	-3.6				

FREEDOM HOUSE:

FREEDOM IN THE WORLD ANNUAL REPORT (1972-2015)

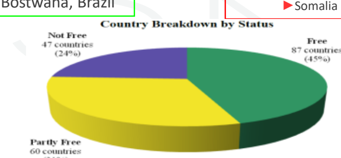
- Since 1972, Freedom House has published an annual assessment of the state of freedom in all countries in the world, based on a checklist of questions on political rights and civil liberties that are derived from the Universal Declaration of Human Rights. Each country is assigned a rating for PR and a rating for CL based on a scale of 1 (best) to 7 (worst).
- http://www.freedomhouse.org/ratings/index.htm

Free countries (87)

- Australia, Finland
- Malta, Slovenia
- Uruguay, Bulgaria
- Chile, Costa Rica
- Mauritius, Poland
- Indonesia, Benin
- Bostwana, Brazil

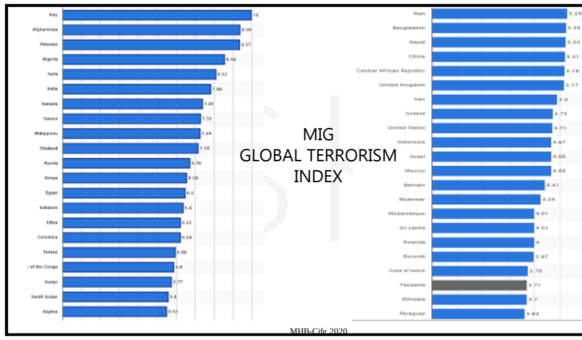
Not Free countries (47)

- Cameroon, Congo
- Haiti, Iran
- China, Vietnam
- North Korea, Burma
- Cuba, Saudi Arabia
- Syria, Turkménistan
- Libya, Sudan
- Somalia



MERCHANT INTERNATIONAL GROUP

- Founded in 1982, it specializes in strategic research and corporate intelligence, focusing on risks and threats that confront companies worldwide.
- MIG operates in over 100 countries.
- www.merchantinternational.com



POLITICAL TURMOIL AND CORRUPTION

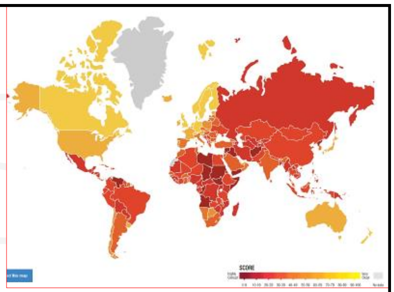
In 2018-19, public anger and legal action over corruption have toppled political leaders in Malaysia, Peru, Slovakia, South Africa, and other countries.
More than 10 percent of nations around the world have experienced corruption-fueled political change in the last five years (Carnegie, 2018).
In many countries, corruption has fueled terrorist recruitment and sparked violent insurgencies.
The World Bank estimates $1.5 trillion in bribes are paid every year, squandering business capital and stymying development.

FIGHTING CORRUPTION?

- United Nations Convention against Corruption: 10/2003 Resolution 58/4 -Entry into force: 12/2005
- The UN Convention is the only legally binding universal anti-corruption instrument. In 2019, 184 UN Member States are parties to the Convention (140 signatories!)
- 5 main areas: preventive measures, criminalization and law enforcement, international cooperation, asset recovery, and technical assistance and information exchange.
- Different forms of corruption: Bribery, trading in influence, abuse of functions, and various acts of corruption in the private sector.

TI WORLD MAP OF CORRUPTION

South Africa= 73
India = 78
China = 87
Brazil = 105
Russia = 138



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MEASURING CORRUPTION?

TRANSPARENCY INTERNATIONAL CPI

1	Denmark
2	New Zealand
3	Finland
3	Singapore
3	Sweden
3	Switzerland
7	Norway
8	Netherlands
9	Canada
9	Luxembourg
11	Germany
11	United Kingdom
13	Australia
14	Austria
14	Hong Kong
14	Iceland
17	Belgium
18	Estonia
18	Ireland
18	Japan
21	France

160	Zimbabwe
161	Cambodia
162	DR Congo
163	Haiti
164	Turkmenistan
165	Angola
166	Chad
167	Congo
168	Iraq
169	Venezuela
170	Burundi
171	Libya
172	Afghanistan
173	Equ. Guinea
174	Guinea Bissau
175	Sudan
176	N. Korea
177	Yemen
178	South Sudan
179	Syria
180	Somalia

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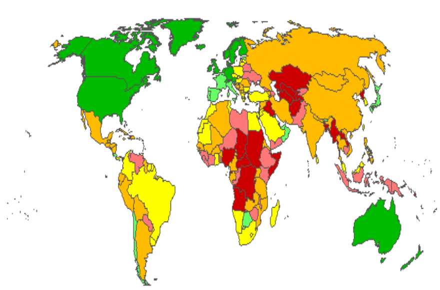
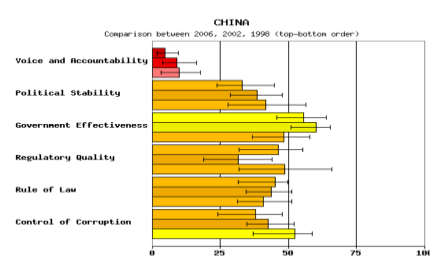
WORLD BANK'S WORLD MAP OF GOVERNANCE



Source: Kaufman, World Bank

WORLD BANK ASSESSMENT OF GOVERNANCE IN CHINA



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IBRAHIM INDEX OF GOVERNANCE IN AFRICA

The Index groups governance and political freedom indicators into four main categories:

1. Safety and Rule of Law,
2. Participation and Human Rights,
3. Sustainable Economic Opportunity,
4. and Human Development.

Source: http://www.moibrahimfoundation.org/en/section/the-ibrahim-index

IBRAHIM INDEX OF GOOD GOVERNANCE IN AFRICA

1	Mauritius	83,0	19	Mali	52,9	37	Nigeria	43,3
2	Seychelles	78,5	20	Mozambique	52,1	38	Liberia	43,2
3	Botswana	75,9	21	Burkina Faso	51,9	39	Togo	42,6
4	Cape Verde	75,5	22	Malawi	51,7	40	Niger	42,3
5	South Africa	71,5	23	Libya	51,5	41	Congo	42,0
6	Namibia	67,3	24	Uganda	50,8	42	Angola	39,3
7	Ghana	64,6	25	Swaziland	50,8	43	Guinea-Bissau	39,1
8	Tunisia	62,1	26	Kenya	50,5	44	Côte d'Ivoire	36,8
9	Egypt	60,5	27	Gabon	50,1	45	Guinea	35,6
10	Lesotho	60,1	28	Madagascar	48,7	46	Equatorial Guinea	34,7
11	São Tomé and Príncipe	58,2	29	Comoros	48,5	47	Sudan	32,9
12	Benin	56,6	30	Djibouti	48,5	48	Central African Republic	32,7
13	Morocco	56,6	31	Rwanda	47,2	49	Zimbabwe	32,7
14	Senegal	56,3	32	Sierra Leone	46,0	50	Eritrea	31,8
15	Algeria	55,2	33	Burundi	44,7	51	Congo, Democratic Rep.	31,1
16	Tanzania	55,0	34	Cameroon	44,2	52	Chad	28,8
17	Zambia	54,9	35	Ethiopia	43,5	53	Somalia	7,9
18	Gambia	53,0	36	Mauritania	43,4			

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COUNTRY RISK ANALYSIS

Michel-Henry BOUCHET

skema BUSINESS SCHOOL

Republic of Solvencia ©

Governance and the International Capital Markets

Casino BANK

SOLVENCIA's Eurobond Request

www.developingfinance.org

Author: **Dr. Michel-Henry BOUCHET**, Distinguished Finance Professor, Investment Fund Strategy Adviser-Global Finance SKEMA

Book: "**Country risk in an age of Globalization**": MH Bouchet, C Fishkin, A Goguel. Palgrave-MacMillan 2018

https://www.amazon.fr/Managing-Country-Risk-Age-Globalization/dp/3319897519/ref=sr_1_1?s=english-books&ie=UTF8&qid=1536225444&sr=1-1&keywords=country+risk+in+an+age+of+globalization

Country Risk Mooc : https://www.udemy.com/course/1426694/manage/curriculum/

Latest update: Q1 2020

SOLVENCIA ©

&

Country Risk Case Study

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SPRING 2020

Introduction

It was 9 o'clock yesterday morning, when your secretary passed an important message from Solvencia's Finance Minister, requesting an urgent meeting next week in Monaco. It was not too difficult for you to guess the purpose of the meeting given the country's plan to launch €800 million Eurobond on international capital markets, taking advantage of ultra-low rates of interest currently! Mr. Solvent, the finance minister, wants to get your assessment regarding market conditions for the bond floating, in order to compare your assessment with your competitors' offers in London, Zurich, and New York. The prospects of tighter monetary policy and higher interest rates in the OECD in 2021, coupled with market nervousness regarding developing countries' rising debt, however, make the request a formidable challenge!

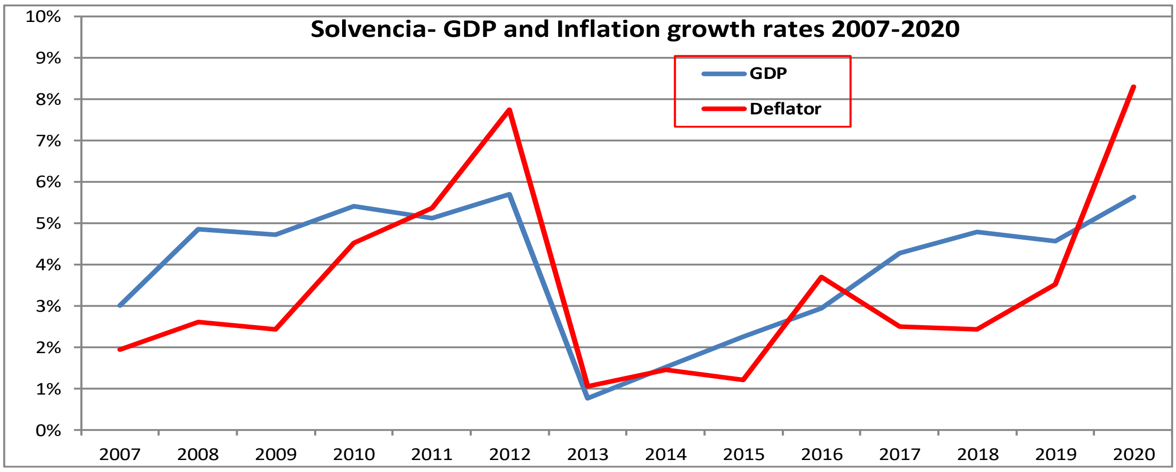
Solvencia's medium-term borrowing requirements are well known to the international financial community. This request thus does not come as a surprise. You are a young but promising investment banker who enhances his/her academic credentials thanks to CIFE's Master in Global Governance. You knew that Solvencia was about to approach investment banks in Europe. Your institution, **Casino Bank**, is a reputed player. Competition is fiercer than ever for bond syndication and placement. At stake is a substantial fee (and for you, a substantial bonus!). However, rumours regarding Solvencia's liquidity difficulties also come and go in the markets. The country is facing economic overheating, large external financing requirements, and upcoming financial problems, reportedly. Most importantly, weak governance and deep-seated corruption are a thorny issue!

Republic of Solvencia: Political Background

Solvencia is a country of roughly 13 million people. Its 2020 nominal GDP per capita of around US$4700 and US$8000 (in purchasing power parity) corresponds to a middle-income developing country. (Solvencia's GDP per capita thus fits in a group of countries like Guyana, Guatemala, El Salvador, Jamaica, Jordan, and Philippines, on the base of the UNDP HDI Index method). Solvencia's long struggle for independence ended in the mid-1970s. Gradual political reforms in the 1990s resulted in the establishment of a bicameral legislature in 2012. However, the political climate remains volatile. Political upheaval leads frequently to mass demonstrations followed by harsh repression. Since 2008, however, Solvencia was affected by the spill-over effect of the global financial crisis! In addition, Solvencia's governance improvement was questioned by strong pressure from the IFIs, notably the IMF and the World Bank. Rating agencies stressed that weak governance was a key impediment to sustainable development and to resumption of market access and development aid. Rating agencies are watching and stand ready to change their risk assessment of Solvencia. Moody's country rating currently is "Baa3" while Fitch rating stands at "BBB". Things do not seem to improve at the right pace, nevertheless. You get conflicting signals regarding Solvencial's commitment to structural economic and institutional reforms as well as more robust governance and better transparency!

Solvencia's overall economic conditions and policy outlook

Solvencia faces the challenges typical of developing countries – weak productivity, low competitiveness, and dependence on volatile commodity prices. In 2009-12, Solvencia experienced severe financial turbulences with large budget and current account deficits, following years of economic overheating characterized by high inflation. The spill-over effect of the global financial crisis was an aggravating variable. In addition, a severe drought depressed activity in the key agricultural sector and contributed to a protracted recession along with acute social problems. A sticky exchange rate in the initial period resulted in a sharp decline in external competitiveness, along with booming imports, little export dynamism, and a drop in official reserve assets, particularly in 2011-12, due to over-valued exchange rate. In 2013, Solvencia's government adopted an IMF-sponsored program and it implemented severe adjustment measures culminating with a sharp growth decline. Shrinking imports shifted the trade balance to a US$1 billion surplus, the first time in the decade.



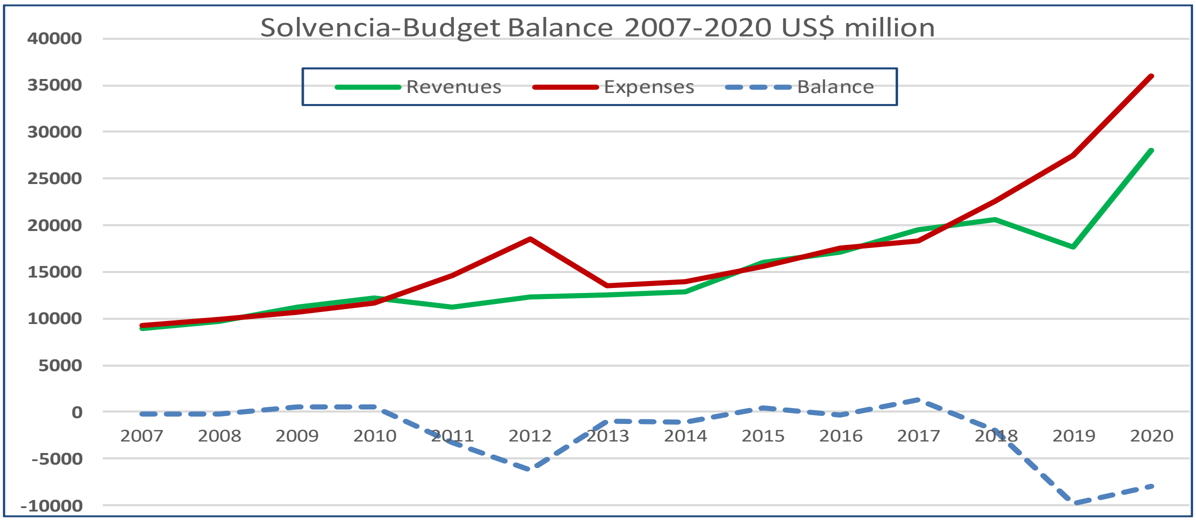
Clearly, Solvencia's government could postpone the economic adjustment for a while; it could not avoid it. The finance minister had to negotiate a structural adjustment program under the auspices of the IMF and the World Bank. The shock therapy was abrupt and it included the usual market-driven stabilization policy measures aimed at reducing domestic demand and restoring competitiveness: currency devaluation, cuts in public expenditures, openness to foreign direct investment, stimulation of private investment, and privatization. The monetary policy framework was strengthened and an inflation targeting system was introduced. A late but substantial real devaluation in 2014-15 boosted exports and the trade balance benefited from shrinking imports, though at the cost of an anaemic growth rate. One clear positive result has been to keep inflation under control. Overall, as much shock as therapy was provided.

In particular, notable progress was being made in areas such as trade liberalization and privatization. The trade openness ratio reached a level higher than 50% in 2012. The main challenge, clearly, was to further improve the competitiveness and flexibility of the economy. Solvencia's five-year plan (covering the period 2013-2017) was drawn up with these challenges in mind and with a view to articulate a strategy to accelerate the structural transformation of the economy towards one based on skill-intensive sectors. Priorities included addressing financial sector weaknesses, liberalizing the capital account, improving the regulatory framework, boosting human capital, and tackling labour market rigidities. The most notable result was a modest trade surplus in 2013-16 and the emergence of a budget surplus in 2015. But despite progress in raising living standards, unemployment remained stubbornly high. Official data shows that the unemployment rate remains broadly unchanged. However, unofficial estimates suggest that the rate is much higher and unabated. Underemployment is also a problem, particularly for the young population.

Following structural adjustment programs supported by the IMF, the World Bank, and the Paris Club, the currency is now convertible for current account transactions, and reforms of the financial sector have been implemented. The devaluation paved the way for the well-known "J-curve", i.e., growing imports in 2009-12 and again in 2015-20, due to unfavourable elasticities! On the positive side, exports increased and FDI picked up until 2016. Solvencia reported large foreign exchange inflows from the sale of a mobile telephone license and partial privatization of the state-owned telecommunications company **SolvaPhone**. Growth resumption only emerged gradually after several years of severe decline of real GDP. Favourable rainfall and export diversification led to reasonable growth thanks to good harvest conditions and improving terms of trade. Since 2016, however, Solvencia experienced again rising inflation, showing that stabilization was again off track. Economic growth recovery seems to be driven by large bank loans supported by global accommodative liquidity and low real rate policy of central banking authorities.

Inflation and Budget Deficit

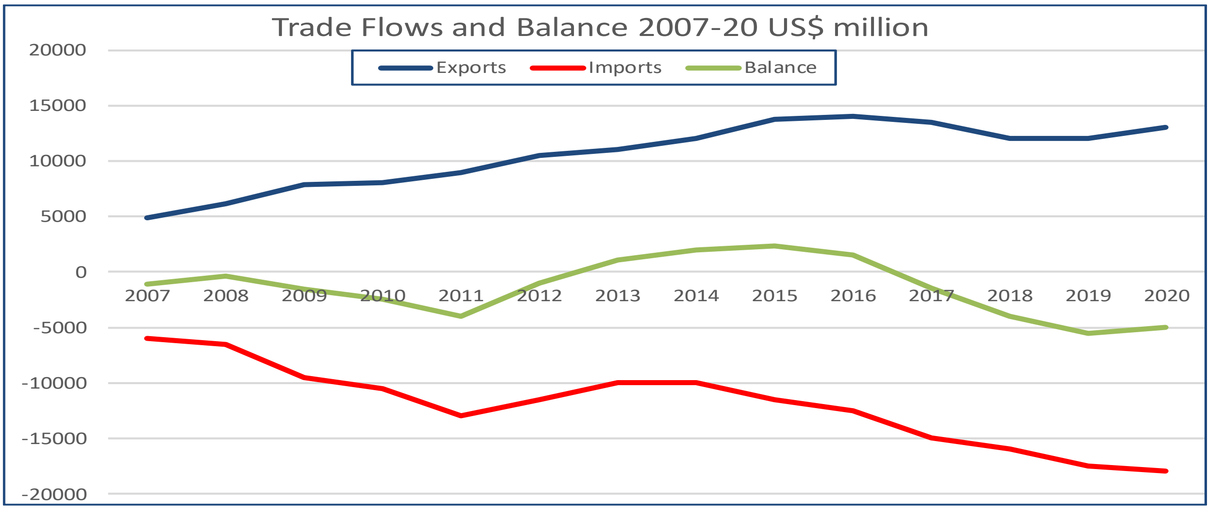
Inflation in Solvencia looks like a rollercoaster for the past decade (Exhibit 1). After rising inflation that reached an unsustainable peak in 2011-12, the government was able to drag down the inflation level to more reasonable levels. However, growing budget deficit and an accommodative monetary policy stimulated stubborn inflation during the 2019-20 period. Growing inflationary expectations stem from unchecked private and public demand. At the peak of the crisis, in 2011-12, the government budget deficit reached unsustainable levels. Solvencia returned to a similar situation in 2018-2020, illustrating the cost of populist policy measures taken by the government.



The structural adjustment program increased social and political volatility. Weak governance has fuelled mounting social frustration, demonstrations and a perverse cycle of repression and turmoil. Corruption has remained widespread! Dynamic privatization and severe cuts in government spending produced street demonstrations and political protests. The impact of economic adjustment could be seen in the 2013-2016 period, when Solvencia managed to stabilize its current account, improving its reserves/external debt ratio, and attracting significant foreign direct investment capital flows. The government also successfully stabilized inflation, while managing a better budget situation.

Solvencia's Balance of Payment Position

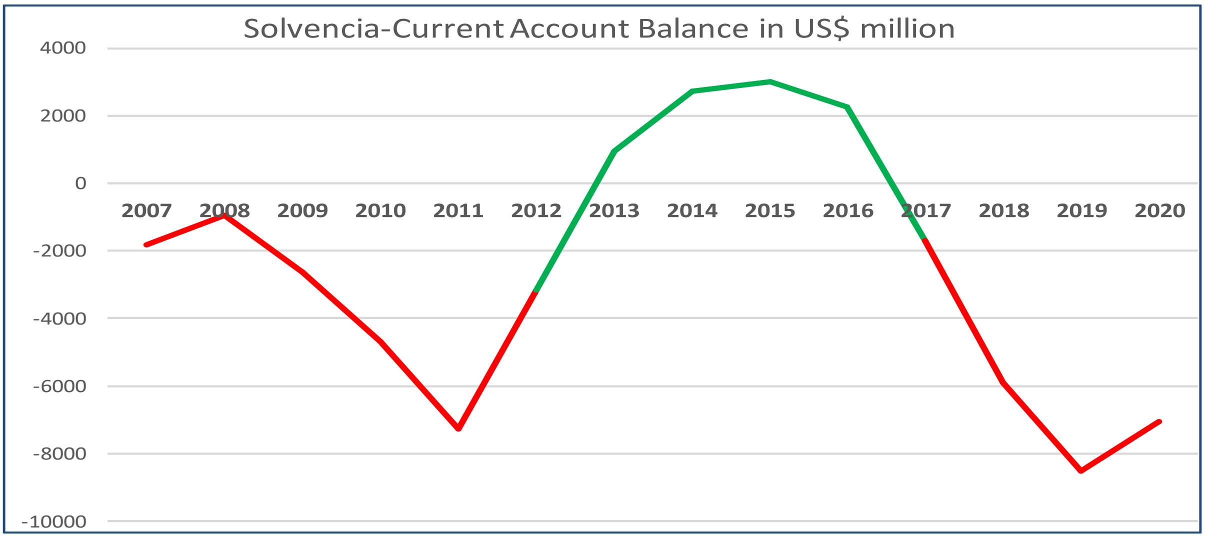
The current account during the period 2009-2012 was driven by the negative pattern of trade balance. Solvencia's trade balance became increasingly negative, mainly due to excessive growth in imports. In addition to the rise in oil prices, imports were boosted by strong demand for capital and related goods reflecting investment expenditure related to the industrial modernization program. In 2011-2013, trade balance generated a short-lived surplus, thanks to significant improvement in external competitiveness. But starting in 2017, trade balance returned to negative territory, as a result of declining export competitiveness. The drop in global oil prices since mid-2014 has been welcome news for Solvencia! Oil is the largest part of the country's imported commodities. The rise in the oil price in the global market, to around $105/barrel in 2012-13, was an important factor in the worsening trade deficit, though unchecked domestic consumption stems from the accommodative monetary and fiscal policy. The drop in oil prices between mid-2014 and mid-2019 tended to alleviate the pressure.



Balance of services, income and transfers showed a rising surplus starting in 2014-16, backed up by a substantial real depreciation of the exchange rate. No doubt that tourism, a major cash inflow source for Solvencia, benefitted from the large currency depreciation. Meanwhile, continued growth in the level of remittances has kept the transfers surplus steady. This constant inflow from one million expatriates (most of whom live in Europe) has been one of the main factors that has helped shrink the trade deficit in recent years.

The current account balance reached an unprecedented deficit of $ 7,3 billion in 2011, the equivalent of 14% of GDP, partly as a result of the global financial crisis and also of travel warning issued by the US and EU governments as a response to political instability and social upheaval. A couple of bomb threats in the country's capital city, ***Solven City,*** did not improve the investment climate. The main culprit for the rise in the deficit has been a combination of flat exports and booming imports. Since 2017, a large current account deficit surfaced again.

Debt is still a major financing source for Solvencia's current account deficit. During 2003-2007, commercial banks and capital markets were a primary source of external financing. The bond market was tapped in 2009 and 2010. The financial crisis led to a sharp reduction in international bank lending that was somewhat offset by official creditors, both bilateral and multilateral. The country had to use significant amount of official reserves to finance its external financing requirements. In 2020, bond issuing is to be the new ball game in Solven City's Finance Ministry!



The Eurobond Project Request: To float or not to float?

Solvencia, clearly, is not back on track. There is still a long way to go before domestic and foreign investors recover confidence. Rating agencies are prudent. Corruption and governance remain a genuine problem. Budget deficit is looming again. Long-term challenges include: servicing the external debt in view of the interest rate hike by the US Fed probably in 2020-21; modernizing the industrial sector; preparing the economy for freer trade with the EU and US; and improving education and attracting foreign investment (i.e., non-debt creating flows) to boost living standards and job prospects for Solvencia's youth. Two populist political parties call for debt default or debt restructuring!

Floating a Eurobond issue for Solvencia can be a major coup for your bank, but it can also become a nightmare should you be unable to place the paper in the market. Getting stuck with illiquid bond paper would be costly for your bank's portfolio, and for your so far promising career! Maturity, pricing, coupon and fees are one thing. Capital adequacy ratios, loan-loss provisions and default probability are another. As you have identified several conflicting risk indicators in Solvencia's economic and political situation, the first thing you need to do is to get the "story" of Solvencia right, i.e., you need to do some basic number crunching, particularly liquidity and solvency ratios.

Before calculating the key ratios, however, you need to understand where does the country come from regarding its growth track, what went wrong again in the 2017-2020 period, and why. You also need to understand the way the IMF's stabilization program achieved a turnaround in Solvencia's economy and whether this improvement is lasting or fragile. You need to check if the country is not falling back today in the same pitfalls as in 2009-2012. Then you must look at the scope for a resumption of sustainable development over the course of 2020 and beyond. The bond issue is a Yes/No decision though you can/should add a number of strings & whistles (issue tranches, collateral, currency switching, zero coupon bond, gradual repayment versus bullet payment, fixed/floating rate, conversion features…). Last but not least, you will call Solvencia's finance minister who is waiting in his Monaco junior suite.

COUNTRY RISK ANALYSIS

Republic of Solvencia and the International Capital Markets

MICHEL HENRY BOUCHET

Spring 2020

Annex

Background Information for Solvencia's Eurobond Request to CASINO BANK

For further information:

www.developingfinance.org

Annex

Background Information for Solvencia's Eurobond Request

to CASINO BANK

1. What is country risk all about?
2. What is a Eurobond ?
3. What are the key sources of country risk information a risk analyst can rely on ?
4. What are the key conditions that investment banks will/should consider before exploring the launching of a bond issue?
5. What are the key steps of a bond syndication process?
6. What are the underlying elements of a bond spread?
7. What are the main sources of country risk information a risk analyst can/should rely on?
8. What are the main risk parameters of sovereign risk?
9. What is the so-called "J-Curve impact" regarding the short-term balance of payment consequence of a currency devaluation?
10. How can a country manage to finance its current account deficit? In the capital account, what is the difference between non-debt creating flows and other capital flows?
11. What are the key liquidity and solvency ratios that any country risk analyst must consider?
12. What is The Paris Club? Methods and purposes?
13. What is the London Club? What is the IIF's role regarding country risk analysis

1. **What is country risk all about? (**Source: **Country risk in an age of Globalization,** Palgrave-MacMillan, 2018: Bouchet, Fishkin, Goguel)

Risk is a multi-faceted issue. It has to do with uncertainty, i.e., a deficit of information. Risk stems from a situation of uncertainty regarding the near or long term, where information about the situation's outcome is insufficient, lacking or simply wrong

Country risk analysis involves the assessment of a private or public foreign entity's ability **and** willingness to service its external obligations in full and in time (contractual, debt servicing, import payments, legal commitment…). It incorporates a forward-looking estimate of default probability.

Country risk includes several parameters:

- Economic risk
- Financial risk
- Foreign exchange risk
- Political risk
- Cultural environment risk
- Legal and contractual risk (repudiation, confiscation, bribes...)
- Regional contamination risk (spill-over effect/contagion), and
- Systemic risk (global crisis)

2. **What is a Eurobond?**

First of all, the prefix "Euro" has **nothing to do with the €** currency in the European economic community. A Eurobond is a bond issued and traded outside the country whose currency it is denominated in, and outside a single country's banking regulations. For instance, a Dollar-denominated bond issued on the London market is a Euro-dollar bond. This type of bonds is usually underwritten by a multinational syndicate of investment banks, therefore it can simultaneously be floated in various capital markets.

Eurobonds have a number of salient features.

- They are usually issued in bearer form, with yearly coupon payment.
- This type of bond also doesn't follow country issued domestic bond regulation (NY, London legislations).
- Another feature of Eurobonds, which give advantage to borrower, are less restrictive covenants and call provision features, even for short term bonds.

There are several types of Eurobond instruments. Most commonly issued bonds are in the form of long-term bonds as well as medium term notes, commercial papers and floating rate notes (FRN). As a result of this variety type of instruments, the term of Eurobond itself has got a new label, which is "International Securities". The most commonly currency used in Eurobond issuance is US$, accounted approximately 50% of total current outstanding Eurobonds.

Eurobonds also have secondary market trading, hence market liquidity. Usually, the market makers in Eurobond secondary market are the underwriters who sell the Eurobond in primary market. Since 1969, International Securities Market Association (ISMA) has performed a central role by providing global framework of industry-driven rules and recommendations which regulate and guide trading and settlement in this market.

3. What are the main underlying risks of a Eurobond issue:

Interest rate risk: The major risk faced by investor in bond market is interest rate risk. The change in current interest rate will affect the bond price, hence it will affect value of the investment. The sensitivity of the change in bond prices due to change in interest rate depend on various characteristics of issuance, such as coupon rate and the maturity period. The higher the coupon rate and the shorter maturities of the bond, the less sensitive price change due to change on the interest rate. But, this type of risk is not faced by held to maturity-investor, i.e., an investor who buys the bond and holds it until the last day. The issuer of the bond, especially floating-bonds issuer, also faces significant interest rate risk. Since the change of current interest rate will affect the benchmark rate, and finally will change the coupon rate that the issuer has to pay.

Exchange Rate Risk: currency mismatch: This type of risk is also a major risk faced by issuer and investor of Eurobond. Exchange rate risk refer to change in the exchange rate of issuer's and investor's currency to Eurobond denominated currency, that will affect return of the investor or the issuer's cost of borrowing. For example, imagine that a company in Japan which the revenue mainly generated in Yen, issued a Eurobond denominated in US$, and one of the investor of the Eurobond is a European investor. Therefore a change in exchange rate between US$/Yen and €/US$ will affect the cost of borrowing of the issuer and the rate of return for the investors.

Country Risk: This type of risk is also involved in Eurobond issuance. Country risk refers to any risk that exists with regard to transnational business. Sources of country risk could be varying. But basically, any volatility in economic, financial, and socio-political situation in a cross-border transaction can be a source of country risk. Related with Eurobond issuance, the risk is that the bond issuer is unable or unwilling to pay the principal or interest from the Eurobond due to specific and unexpected problems. Therefore, country risk analysis is an important pre-cautionary action before investing in Eurobond.

Default Risk: or often called credit risk is the risk that the issuer of Eurobonds be unable to pay timely coupon and principal payment, in full and on time! The rating agencies such as Moody's, Fitch and Standard and Poor are the major agencies that measure the default risk of issuer.

Liquidity Risk: The risk stemming from the lack of marketability of the Eurobond that cannot be bought or sold quickly enough to prevent or minimize a loss. The primary measure of this type of risk is the bid-ask spread quoted by the market. The wider the spread, the higher the liquidity risk faced by the investors.

"Risk of Risk": The risk faced by investors given the misunderstanding of the risk of the securities that they have invested. The main source of this risk is low understanding of the investors related with the risk-return characteristic of the issued securities, this could happen if the features of Eurobonds becoming more innovative and complex. In addition, unrealistic hypotheses (bell-shaped curve, thin tails, and Gaussian probability distribution) might add a model risk to a market risk! See Mandelbrot for further analysis of that biased assessment of market finance risk.

4. What are the key conditions investment banks will/should consider before exploring the launching of a bond issue:

Basically, the investment banks should carefully consider the risks described above before deciding to underwrite a Eurobond issuance. Country risk analysis should be the first priority to evaluate the underlying risk of Eurobond issuance. The country risk analysis involves qualitative as well as quantitative analysis of political, economy and other aspects of the country's issuer's creditworthiness. Qualitative analysis can be applied for political and governance issues of the country's issuer that will impact its ability to fulfill the commitment to pay coupon and principal of the Eurobonds. On the other hand, Quantitative analysis can be applied to macroeconomic, balance of payment and other economic features of the country's issuer. In the case that the Eurobond issuer is a private entity, microeconomic, sectoral as well as industry specific characteristics are also important factors in the Eurobond issuance. Finally, combination of all above-mentioned analysis will give the investment banks a framework and guidance to assess the short and long-term riskiness of Eurobond issuance.

5. How can a bond issue be syndicated:

Syndication refers to number of banks grouping together to make a loan to one borrower. There are 2 syndication's processes, the traditional one called "*European issue procedure*" which can be described in seven stages:

1. Preliminary negotiations and preparation
2. Legal clauses (pro rata, negative pledge…)
3. Preplacement
4. Fixing the final terms of the issue (pricing day)
5. Apportioning securities (offering day)
6. Placing the issue
7. Closing the issue (closing day)

The second syndication way is called "*Bought deal":* conditions are fixed by the lead manager and proposed to the issuer. This procedure is more rapid than the European procedure and the syndicates much smaller.

6. What are the underlying elements of a spread:

In the bond market, the spread reflects the additional required rate of return from the investors when shifting their investment from a risk-free or less risky instrument to more risky assets. Therefore, the term of spread reflects the risk premium of the investors. There are several types of spread definition that investors must know in bond market:

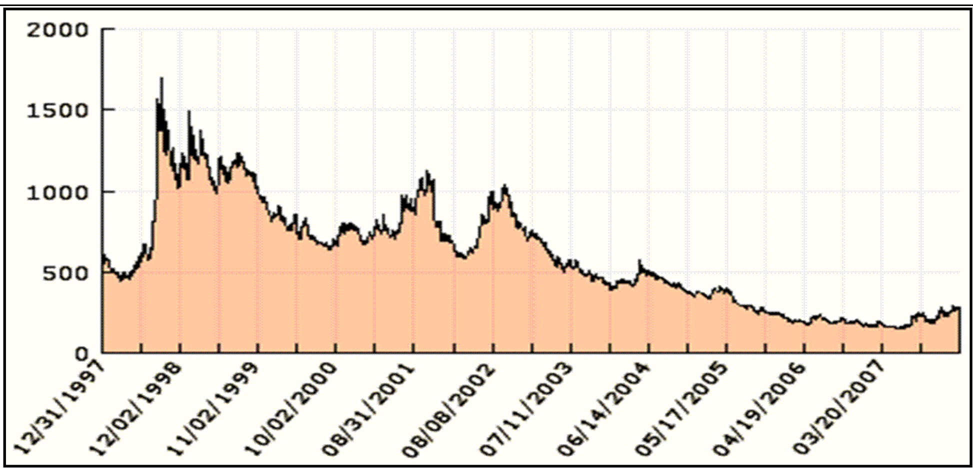
- <u>Quality Spread:</u> spread between different qualities of the credit ratings of the borrower. One can mention the difference between yield on a AAA credit rating company with the A credit rating company in a similar industry with same maturities.
- <u>Maturity Spread:</u> difference between yield of a similar credit rating borrower but with different maturities.
- <u>Intra-market Spread:</u> difference between yield of the bonds from different industries but with similar maturities and credit ratings and trading in same sector of bond market. One example is comparing yield between AAA ratings of a company in manufacturing industries with the company, which has same credit rating and maturities but operates in banking industry. Both bonds are traded in same bond market sector, i.e., corporate bond market

- Inter-market Spread: difference between yield on two sectors of bond market, that is, comparing a bond issued by the government's treasury which is being traded in treasury market securities with the bond issued by the corporate with similar maturities.
- Yield Spread: spread within a specific bond market that is attributable to differences between credit ratings (quality spread), maturities (maturity spread), and sectors within markets (intra-market spread).

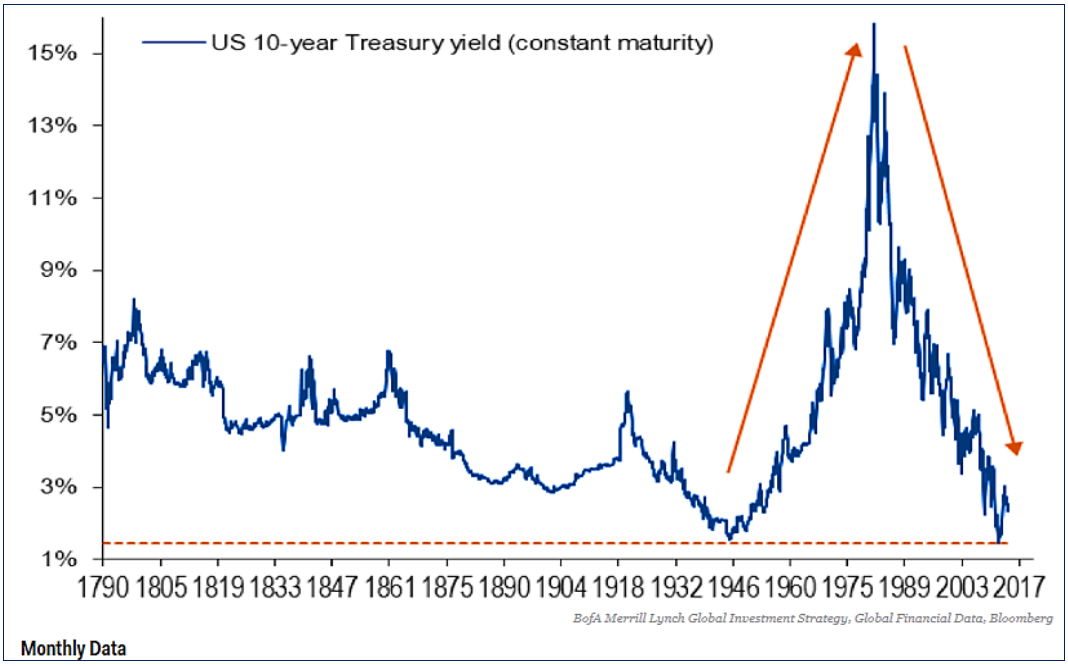
The definition of Eurobond spread which reflects the risk premium can be driven by two factors. First, if the Eurobond issuer is a government, the country risk analysis of the country's issuer is an important factor that determines the risk premium, and therefore the yield of the Eurobond. The yield of a Eurobond issued of a government, will be determined by the benchmark rate and risk premium. The benchmark rate is yield from the bond issued by a super-safe government or a country which holds a AAA credit rating (typically, an OECD country). Regarding current practices, many Eurobonds issued by a government use yield from the US treasuries which have same maturities as benchmark rate, because US treasury securities are still considered risk-free instruments.

Second, if the issuer is a private entity, the component of risk premium will be also determined by the risk analysis of the entity and the industry where it operates. So, total risk premium on the Eurobond issued by the private entity is the risk premium from country risk analysis where the entity operates, coupled with the risk premium from the analysis of entity credit riskiness as well as industry specific analysis where the entity operates.

Graph 1&2: Emerging Market Bonds (JP Morgan EMBI) Spread over US Treasuries



Source: CBonds

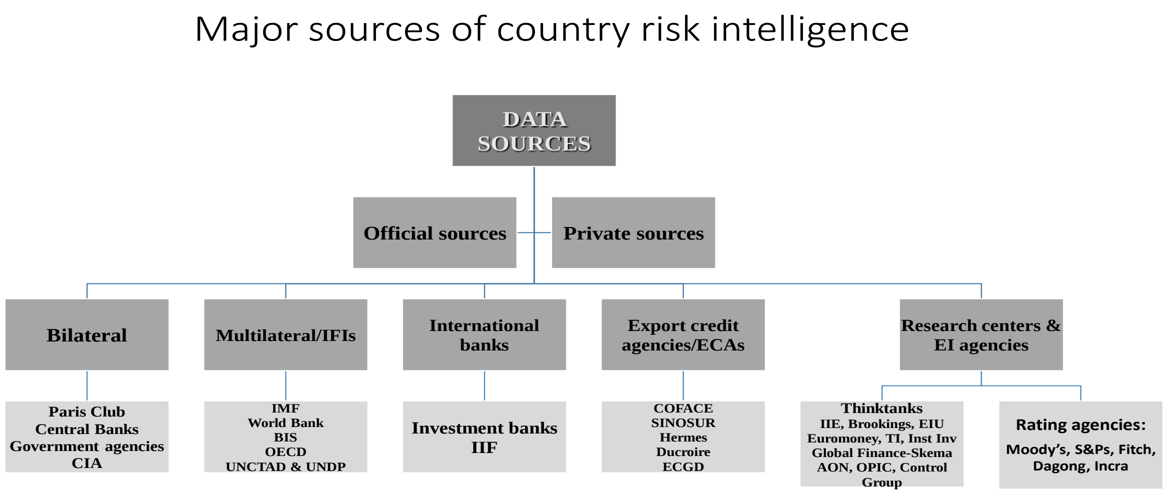


7. What are the key sources of country risk information a risk analyst can rely on:

Currently there are many institutions that provide country risk analysis data. Institutions like Standard & Poor's, Fitch, Moody's, DAGONG, INCRA, ICRG, TAC, Hermes, Euromoney, Coface and Economist Intelligence Unit issue regular monthly or quarterly country risk analysis.

Developing a reliable country risk analysis is much easier now compared to many years ago, given a wide range of publications and data for assessing country risk. An important source of country risk analysis is balance of payment and macroeconomics data from the country. One can find this data on the national bureau of statistics and central bank of the respected country. But before using this data, you have to analysis whether the government of the country tends to manipulate the data or not. A country with low governance and high corruption tends to manipulate those kinds of data for their own political purpose. In such a case, it is better to use the data from the international financial institutions such as IMF, World Bank, and Bank for International Settlements (BIS). An institution such as IMF, provides comprehensive financial data of a country in the International Financial Statistics monthly database. The IMF has also another database that can be accessed freely, which is World Economic Outlook (WEO) database that is updated periodically. The Bank for International Settlements (BIS) also provides important data such as international bank loans and deposits, the latter being a proxy for assessing capital flight. Useful trade and FDI data can be obtained from UNCTAD.

Graph 2: Data Sources Diagram for Country Risk Analysis



Political analysis, including governance and corruption issues, also plays an important factor in country risk analysis. Political analysis includes data on national institutions, governance and corruption, system of government, relationship between executive and legislative, as well as political parties and elections. This type of information can be gathered from independence political observers or institutions. Economist Intelligence Unit (EIU) provides informative sources for this kind of data, through EIU Country Profile. Governance. The level of corruption can be observed through Transparency International, the ICRG database, and the World Bank's governance database.

8. What are the risk parameters of a sovereign borrower?

There are several risk parameters that a country risk analyst must assess in measuring riskiness of a sovereign borrower. Macroeconomic indicators such as inflation, interest rate, exchange rate policy, and economic growth as well as independency of the central bank can develop important risk parameters from the macroeconomics side.

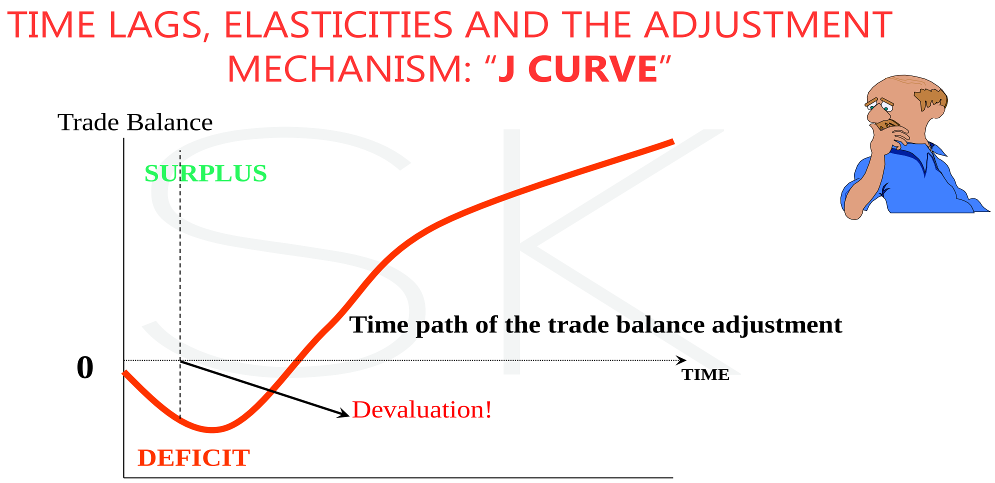
Balance of payment data also can be important risk parameters. This includes trade balance, current account deficit, capital account, and international reserve data. Various liquidity and solvency ratios can be developed from balance of payment data to assess country indebtedness and their ability to fulfill their financial commitment.

9. What is a J-Curve evolution in a current account balance?

The J-curve illustrates the shape of a country's trade balance following a devaluation. Trade elasticities are key parameters regarding the lag in the shift from a trade deficit to a sustainable surplus. A lower exchange rate initially means cheaper exports and more expensive imports, making the current account worse (a bigger deficit or smaller surplus).. After a while, though, the volume of exports will start to rise because of their lower price to foreign buyers, and domestic consumers will buy fewer of the costlier imports. Eventually, the trade balance will improve on what it was before the devaluation. If there is a currency appreciation there may be an inverted J-curve.

Following the depreciation/devaluation of the currency, the volume of imports and exports will remain on certain level due in part to pre-existing contracts for imported goods that have to be honored. However, the depreciation in the currency will cause the price of imports to rise and therefore total spending on imports will subsequently increase. This situation, coupled with the inertia of the external demand for exports and the domestic demand for imports, causes the initial worsening of the trade balance. But within around 18 months, a depreciation in the exchange rate can have the desired effect of improving the current account balance. Indeed, demand for exports gradually picks up while domestic consumers will switch their expenditure to domestic products and away from expensive imported goods and services. Equally, many foreign consumers may switch to purchasing cheaper products exported by the country that devaluates its currency, instead of their own domestically produced goods and services. This is represented on the diagram by the movement towards a trade surplus.

Picture 3: Evolution of Trade Balance – J Curve.



10. How does a country manage to finance its deficit? With sustainable long-term financing inflows or with volatile short-term finance?

The best way to financing the current account deficit is using sustainable long-term financing inflows rather than short-term financing. Mainly because long-term financing provides less volatility on balance of payment and therefore provides policy space for the government to perform consistent economic policies.

Long term financing in capital account can be separated into two main part, which are non debt-creating flows and long term debt-creating flows. Non-debt creating flows include portfolio and Foreign Direct Investment (FDI). This type of financing is the best way to finance current account deficit, since there is no obligation to pay interest and principal. It provides budget flexibility to the government to finance the economy. Long-term debt creating flows can be classified into three main sources,

1. Long-term debt from international financial institutions such as IMF, World Bank, regional development banks such as Asian Development Bank, or other multilateral creditors. Usually, debt from international financial institutions provides cheaper cost of fund and longer maturities, although with stricter conditionality than private institutions;
2. Long and medium-term loans from official bilateral creditors (i.e., governments of the Paris Club);
3. Long-term debt from private international institutions such as international commercial banks, mutual fund, and hedge funds. This type on debt could be a loan or Eurobond issued by the country's government.

11. **What are the key liquidity and solvency ratios that any country risk analyst must consider:**

Liquidity Risk ratios:

- Debt Service Ratio (Interest+Principal/Exports of goods and services): This ratio provides a good indicator to measure how a country can fulfill its debt obligation based on its ability to provide foreign exchange from export revenues. The higher the ratio, the riskier the country. The threshold usually used in this ratio is 33%
- Interest Ratio (Interest/Export): Provide an indicator to measure current proportion of total interest that a country has to pay in its total export revenues. The higher the ratio (above 25%), the riskier the country.
- Current Account Balance/GDP: Provide an indicator to measure whether the country lives beyond its means or not. The higher the deficit ratio, the riskier the country since it consumes more than its overall income.
- Reserve/Import ratio: This ratio is an important indicator, especially to measure the ability of a country to finance their import based on their current reserve. The lower the ratio, the riskier the country. Usually, if the ratio is below 6 months, it should be a warning indicator for the country risk analyst.
- Import/GDP ratio: Provide an indicator that show how import-dependent is the country's economy. It thus provides a measure of a country's dependency on foreign trade partners.
- Growth rate of exports/Average external interest rate: This ratio provides an important indicator to measure the ability of a country to provide timely interest payments for their external debt with increasing export revenues. It indicates whether the country's export growth rate can match the average interest rate on its external debt. It also measures the effectiveness of the debt-financed investment proceeds. The higher the ratio, the more dynamic the economy.

Solvency Risk ratios

- Debt/Export ratio: Is an indicator to measure total stock of debt compared to country's export. A ratio above 150% should be a warning indicator for a country risk analyst.
- Debt/GDP ratio: Is an indicator to measure indebtedness of a country, with comparing total debt of a country to total value of the economy, which represented by GDP. A ratio higher than 100% is a warning sign that a country is highly indebtedness. However much depends on the structure of the country's debt that is, its main creditors, the average maturity, interest rates floating or fixed, and more generally global market access.
- ST Debt/Reserves: Is an indicator to measure the ability of country's foreign reserves to service its short-term liabilities. The higher the ratio, the riskier a country.

12. **What is the Paris Club: http://www.clubdeparis.org/**

The Paris Club is a confidential ad-hoc forum of debt negotiations between OECD country creditors and their sovereign debtors. It only deals with official or officially-guaranteed credits (Coface, Hermes, ECGD, and US Eximbank). The first meeting with a debtor country was in 1956 when Argentina agreed to meet its public creditors in Paris. Since then, the Paris Club or ad hoc groups of Paris Club creditors have reached >430 agreements concerning 90 debtor countries. Since 1983, the total amount of debt covered in these agreements has been $585 billion.

The Paris Club has remained strictly informal: voluntary gathering of creditor countries willing to treat in a co-ordinated way the debt due to them by the developing countries. It can be described as a "non institution". The creditor countries (19 countries including Russia) meet 10 to 11 times a year, for negotiation sessions or to discuss among themselves the situation of the external debt of debtor countries or methodological issues on the debt of developing countries. These meetings are held in Paris. The Chairman is a senior official of the French Treasury. Deputies to the Chairman in the French Treasury serve as co-president and vice-president. The current Chairman is the head of the French Government Treasury.

A debtor country comes to the Paris Club for a negotiation when an appropriate programme is supported by the IMF and shows that the country is not able to meet its debt obligations and thus needs a new payment arrangement with its external creditors. Good governance is assumed to be a prerequisite!

13. What is the London Club: https://www.iif.com/

The London Club is an ad hoc forum for restructuring negotiations formed by private institutions. Each London Club is formed at the initiative of the debtor country and is dissolved when a restructuring agreement is signed. Ad hoc London Club "Advisory Committees" are chaired by a leading financial bank. Recently, Advisory Committees have included representatives from nonbank creditors (fund managers holding sovereign bonds). The first meeting of London Club took place in 1976 in response to Zaire's debt payment problem.

The Institute of International Finance, Inc. (IIF), is the global association of financial institutions. Created in 1983 in response to the international debt crisis, the IIF has evolved to meet the changing needs of the financial community. Members include most of the world's largest commercial banks and investment banks, as well as insurance companies and investment management firms.

Among the Institute's Associate members are MNCs, trading companies, ECAs, and multilateral agencies. The Institute has more than 450 members headquartered in more than 70 countries at end-2014. It provides members with in-depth country risk analysis of emerging market countries in Asia, Africa and the Middle East, as well as Eastern Europe and Latin America.