

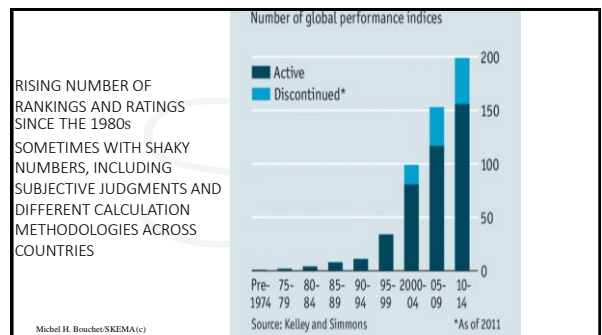


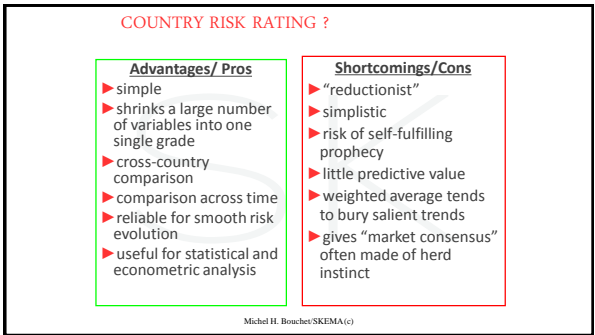
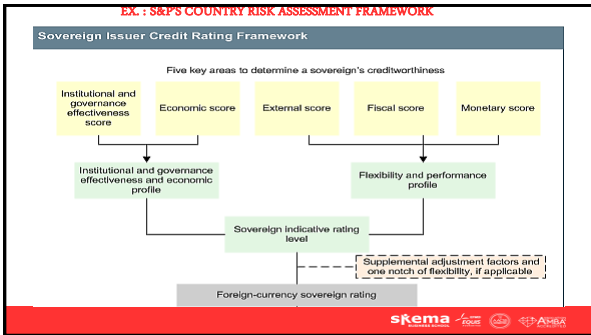
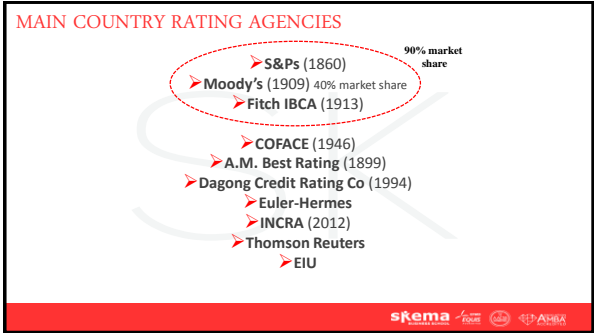
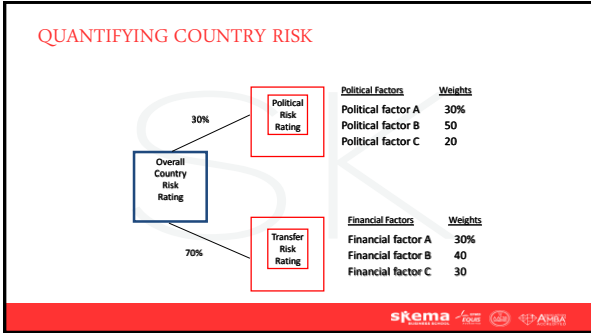
## 5 OBJECTIVES

1. Role of rating agencies
2. Looking at the pitfalls of rating agencies:  
Poor track record and shortsightedness
3. Rating methodology
4. Specific country risk ratings
5. Challenge of governance rating

## QUANTITATIVE APPROACH: RATING

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





**SHORTCOMINGS OF RATING AGENCIES?**

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

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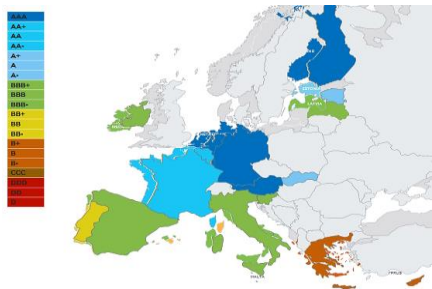
**THE OCDE IMPLEMENTS A RATING AND RANKING OF COUNTRY RISK FOR PROVIDING A LEVEL PLAYING FIELD TO EXPORT GUARANTEE COMPANIES WITHIN THE GROUP OF 34 DEVELOPED COUNTRIES AND FOR THE PURPOSE OF SETTING MINIMUM PREMIUM RATES FOR EXPORT CREDIT TRANSACTIONS**

SOURCE: [HTTP://WWW.OECD.ORG/TAD/XCRED/CRC.HTM](http://www.oecd.org/tad/xcred/crc.htm)

Country Risk Classifications of the Participants to the Arrangement on Officially Supported Export Credits  
Valid as of: 23 June 2018

Country Code (ISO Alpha 3)	Country Name <sup>(1)</sup>	Classification		Notes	
		Previous	Current		
01	ARG	Argentina	7	7	
02	ALB	Albania	6	6	
03	DZA	Algeria	4	4	
04	AND	Andorra	-	-	(R)
05	AGO	Angola	6	6	
06	ATG	Antigua and Barbuda	7	7	(R)
07	ARG	Argentina	6	6	
08	ARM	Armenia	6	6	
09	ATN	Aruba	4	4	
10	AUS	Australia	-	-	(R)
11	AUT	Austria	-	-	(R) (S)
12	AZE	Azerbaijan	5	5	
13	BEL	Belgium	3	3	
14	BHR	Bahrain	4	4	
15	BGD	Bangladesh	5	5	
16	BRB	Barbados	-	-	(S)
17	BEL	Belgium	6	6	
18	BEL	Belgium	-	-	(R) (S)
19	BEL	Belgium	7	7	
20	BEN	Benin	6	6	(R)
21	BTN	Bhutan	6	6	
22	BOL	Bolivia	5	5	
23	BHR	Bosnia and Herzegovina	7	7	
24	BRA	Brazil	2	2	
25	BRA	Brazil	5	5	
26	BRA	Brazil	6	6	(S)
27	BRA	Brazil	3	3	
28	BFA	Burkina Faso	7	7	(R)
29	BUR	Burundi	7	7	
30	CPV	Cabo Verde	6	6	
31	CHL	Chile	6	6	

**FITCH SOVEREIGN RATING SNAPSHOT 10-2013**



**RATING DOWNGRADES 10-2014**

<p><b>FITCH</b></p> <ul style="list-style-type: none"> <li>➤ Tunisia = BB</li> <li>➤ Egypt = B-</li> <li>➤ Greece = CCC</li> </ul>	<p><b>MOODY'S</b></p> <ul style="list-style-type: none"> <li>➤ USA = AAA</li> <li>➤ Egypt = Caa1</li> <li>➤ Tunisia = Ba3</li> <li>➤ Greece = Caa1</li> </ul>
<p><b>S&amp;Ps</b></p> <ul style="list-style-type: none"> <li>➤ USA = AA+</li> <li>➤ Egypt = B-</li> <li>➤ Tunisia = B-</li> <li>➤ Greece = B</li> </ul> <p><small>* selective default *</small></p>	<p><b>DAGONG</b></p> <ul style="list-style-type: none"> <li>➤ Tunisia = B-</li> <li>➤ Greece = CC</li> <li>➤ USA = A-</li> </ul>

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DAGONG 2017

- |                   |                 |
|-------------------|-----------------|
| ▶ Japan A-        | ▶ Argentina CC- |
| ▶ Spain BBB+      | ▶ Nigeria BB+   |
| ▶ Italy BBB-      | ▶ Venezuela BB- |
| ▶ Greece CC       | ▶ Turkey BB-    |
| ▶ Chile AA-       | ▶ Ecuador B-    |
| ▶ China AAA       | ▶ Malaysia A+   |
| ▶ France A+       | ▶ Thailand BBB- |
| ▶ Brazil A6       | ▶ Vietnam B+    |
| ▶ Germany AA+     | ▶ Morocco BBB-  |
| ▶ Russia A stable | ▶ Korea AA-     |
| ▶ USA A-          |                 |

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MOODY'S 15 TRIPLE-A RATING COUNTRIES

Sovereigns	Foreign Currency Debt	
Australia	Aaa	STA
Austria	Aaa	NEG
Canada	Aaa	STA
Denmark	Aaa	STA
Finland	Aaa	STA
Germany	Aaa	NEG
Isle of Man	Aaa	RUR-
Luxembourg	Aaa	NEG
Netherlands	Aaa	NEG
New Zealand	Aaa	STA
Norway	Aaa	STA
Singapore	Aaa	STA
Sweden	Aaa	STA
Switzerland	Aaa	STA
USA	Aaa	STA

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RATING = POOR EARLY WARNING SIGNAL?

1997 Asia risk ? « *It's like growth stocks... sovereign risk has never looked better!* »  
 • Institutional Investor (March 1997)

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

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

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ASIA-1998: LESSONS OF THE CRISIS

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

Fitch IBCA January 13, 1998

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**WAS THE 1998 ASIAN CRISIS ANTICIPATED BY RATING AGENCIES?**

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

**EUROMONEY'S RISK RATING**

*THE HIGHER THE SCORE, THE LARGER THE RISK*

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



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

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**RATING = POOR EARLY WARNING SIGNALS?**

**ENRON's collapse in December 2001**

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

Source: Credit-October 2006, Vol7, Issue 09

**RATING = POOR EARLY WARNING SIGNALS?**

- ▶ 2007-2008 US Subprime crisis: from Triple A rating of MBS (mortgage backed securities) to junk bonds
  - ▶ 06/2010: Dagong downgrades the US
- ▶ 08/2011: US downgrading to AA+: Political Risks, Rising Debt Burden
  - ▶ Fall 2011: Italy-Spain downgrading
  - ▶ 2012: Greece's multiple downgradings
  - ▶ October 2012: Spain downgrading by S&Ps
- ▶ November 2013: S&Ps downgrading of France: Political Risks, Rising Debt Burden

06/2013: US GOVERNMENT VERSUS S&P

- ▶ Civil lawsuit against Standard & Poor's: the US Department of Justice accuses the credit-rating agency to have defrauded federally insured financial institutions... The US complaint alleges that S&P's presented overly optimistic credit ratings as objective and independent when, in truth, S&P's downplayed and disregarded the true extent of credit risk...
- ▶ According to the plaintiff, Standard & Poor's catered rating favors in order to maintain and grow its market share and the fee income generated from structured debt ratings.

09/2013: S&P SUES US GOVERNMENT OVER ALLEGED RETALIATION FOR AAA CREDIT DOWNGRADE

- ▶ "Plaintiff [Justice Department] commenced this action in retaliation for S&P's exercise of their free speech rights with respect to the creditworthiness of the USA"



2011- 2017  
MOODY'S DOWNGRADES TUNISIA'S TO BAA3 NEGATIVE

- ▶ **January 2011:** Moody's Investors Service downgraded to Baa3 from Baa2 the local and foreign currency government bond ratings of the Tunisian government. The main drivers for the rating action were as follows:
  - (1) The country's instability due to the unexpected recent regime change, which resulted from the ongoing political crisis that first began as social unrest.
  - (2) The significant uncertainties surrounding both the economic and political outcomes.
  - (3) The ongoing unrest and the fluidity of the political situation which further endangers the country's future stability.
- ▶ **May 2013:** new downgrading to Ba2
- ▶ **October 2017:** B1 negative

COUNTRY RISK AND COMPETITIVENESS INDICES

- DBRS
- AM. Best rating services
- Coface
- SACE
- AT Kearney
- WEF
- IMD
- World Bank

<http://researchguides.library.vanderbilt.edu/c.php?g=68502&p=442929>

## DBRS'S SOVEREIGN RISK ASSESSMENT METHODOLOGY

DBRS's sovereign rating methodology groups risk factors into six categories, each of which contains a set of quantitative and qualitative considerations:

- (1) Fiscal management and policy
- (2) Debt and liquidity
- (3) Economic structure and performance
- (4) Monetary policy and financial stability
- (5) Balance of payments & exchange rate
- (6) Political environment

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## DBRS (CANADA'S RATING AGENCY SINCE 1976)

DBRS Sovereign Ratings		
	Long Term Foreign Currency	Long Term Local Currency
Austria	AAA	AAA
Canada	AAA	AAA
France	AAA	AAA
Germany	AAA	AAA
Netherlands	AAA	AAA
Switzerland	AAA	AAA
United Kingdom	AAA	AAA
Spain	AA	AA
Italy	AA (low) N	AA (low) N
Chile	A (high)	AA (low)
Ireland	A N	A N
Portugal	BBB (high) N	BBB (high) N
Mexico	BBB	BBB (high)
Brazil	BBB (low)	BBB (low)
Peru	BBB (low)	BBB (low)
Colombia	BBB (low)	BBB
India	BBB (low)	BBB (low)
Uruguay	BB P	BB P
Argentina	B (low) P	B (low) P

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### A.M. BEST RATING SERVICES

Country Risk Tier	Definition
CR1	Robust and transparent legal environment, legal system, architecture, institutional, administrative, financial system regulation with deep capital markets, inflation, insurance industry framework
CR2	Robust and transparent legal environment, legal system, architecture, institutional, sufficient financial system regulation, mature insurance industry framework
CR3	Developing legal environment, legal system, and business environment with developing capital markets, developing insurance regulatory structure
CR4	Weakly developed and transparent political, legal, and business environment, with underdeveloped capital markets, partial to no insurance regulatory structure
CR5	Unreliable and opaque political, legal, and business environment, with limited or no transparent capital markets, no insurance development and/or unreliable, repeat insurance industry

### BEST'S COUNTRY RISK REPORT

**Algeria**  
**CRT-5**  
August 22, 2018  
Region: Middle East & North Africa  
Country: Algeria  
Sub-Region: Middle East & North Africa  
Country Risk Category: **CR5 (Low)**

Country Risk Tier 5 (CR5) is the lowest level of Country Risk. It is assigned to countries with a high level of economic risk and very low levels of political and financial system risk. Algeria's high carbon-based economy is vulnerable to commodity price volatility and changes in global demand.

Algeria is a CRT-5 country with a high level of economic risk and very low levels of political and financial system risk. Algeria's high carbon-based economy is vulnerable to commodity price volatility and changes in global demand.

CR5 GDP growth rate is 2.0% in 2017. GDP growth is forecasted at 3.0% for 2018, driven by improving commodity prices and high government spending. Medium-term GDP growth forecasts range from 2.0% to 3.0%.

The map depicts countries in the region that A.M. Best evaluated for country risk. The report countries have risk levels ranging from CRT-3 to CRT-5.

**Regional Summary: Middle East & North Africa**

Higher global interest rates, particularly if interest rates increase faster than expected, create the potential for greater fiscal vulnerabilities and higher credit conditions. According to the IMF, GDP in the region has increased an average of 10% of GDP each year since 2010, owing to countries increasing large fiscal deficits through increased borrowing and slow-downs of fiscal buffers.

Economic growth for the region is estimated to increase in 2018 on strengthening global growth, a moderate rise in oil prices, easing fiscal conditions, reforms to promote non-oil sector growth, and growing infrastructure investment.

Fiscal consolidation and revenue generating programs implemented over the last few years continue, albeit at a slower pace. Revenue reduction is still the indicator of a value added (in January 2018) in Saudi Arabia and the United Arab Emirates, with other countries likely to implement similar measures by the end of the year. Improving the efficiency of public spending (in a bid to meet the government wage bill, for example) on the expenditure side is also a priority.

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## COFACE

155 countries

Country risk + Business climate ratings:

- ▶ Investment grade
- ▶ A1= steady economic and political situation
- ▶ A2= weak default probability
- ▶ A3= adverse circumstances may lead to worsening payment record
- ▶ A4= patchy payment record could be worsened by adverse economic/political developments
- ▶ Speculative grade:
- ▶ B= unsteady economic and political environment
- ▶ C= bad payment record
- ▶ D= high risk profile and very bad payment record

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7



ITALY'S ECA: SACE

Indicatori di rischio	OCSE	S&P's	Moody's	Fitch	
Rating	3/7	BBD+	BBD	BBD+	
<b>Indicatori di Business Climate</b>					
<i>Doing Business 2014</i>		42° su 189	39° su 183		
<i>Index of Economic Freedom 2014</i>		47° su 178	44° su 177		
<i>Corruption Perceptions Index 2013</i>		83° su 177	83° su 176		
<b>2011 2012 2013(o) 2014(p) 2015(p)</b>					
PIL (variazione % reale)	6,9	6,3	5,0	5,2	5,5
Inflazione media annua (%)	3,4	3,7	2,8	3,3	2,7
Saldo Bilancio pubblico/PIL (%)	2,0	2,2	0,9	0,4	0,2
<b>Bilancia dei pagamenti</b>					
Esportazioni (\$ mld)	46,3	46,2	41,8	44,0	47,6
Importazioni (\$ mld)	-37,0	-41,1	-42,2	-43,4	-46,0
Saldo transazioni correnti/PIL (%)	-1,9	-3,3	-4,9	-4,7	-4,3
Debito estero totale (\$ mld)	45,0	54,1	56,8	58,9	60,8
Debito estero totale/PIL (%)	25,5	27,1	27,5	27,6	26,8
Riserve valutarie lordi (\$ mld)	48,9	64,2	65,8	65,5	67,1
Riserve valutarie lordi (mesi import.)	13,5	15,9	15,8	15,3	14,8

Fonte: EIU, Giugno 2014

s: stime; p: previsioni

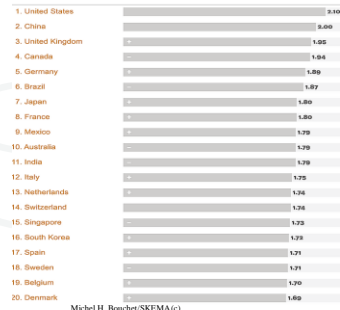
AT KEARNEY: THE FDI CONFIDENCE INDEX

- ▶ Constructed using primary data from a proprietary survey administered to senior executives of the world's 1000 largest corporations.
- ▶ 25-country survey is designed to gauge the likelihood of investment in specific markets in order to gain insights into likely trends in global FDI flows over the next one to three years.
- ▶ Index values are based on non-source country responses about various markets (eg: the index ranking for the United States reflects all non-US company responses about the US market)

▶ <http://www.countryrisk.com/guide/archive/000085.html>



AT KEARNEY  
FDI  
CONFIDENCE  
INDEX



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WORLD ECONOMIC FORUM:  
COMPETITIVENESS RANKING

- ▶ Growth prospects of 146 countries
- ▶ Countries are ranked by the Growth Competitiveness Index and the Microeconomic Competitiveness Index, which combined and encapsulate the relative strengths and weaknesses of growth
- ▶ **Hard + Soft DATA:** Public debt + REER + interest rates + inflation + savings rate + legal and regulatory framework + infrastructure & institutions + Health & Education....



**INDEX COMPONENTS:**

- The Global Competitiveness Report is backed up by the GCN's annual **Executive Opinion Survey (EOS)**. It captures the expert opinions of over 11,000 business leaders and entrepreneurs on:



Source: www.weforum.org



**COMPETITIVENESS INDEX  
DAVOS-WORLD ECONOMIC FORUM**

1	Switzerland	126	RCI
2	Singapore	127	Ethiopia
3	Finland	128	Liberia
4	Germany	129	Uganda
5	USA	130	Benin
6	Sweden	131	Zimbabwe
7	HongKong	132	Madagascar
8	Netherlands	133	Pakistan
9	Japan	134	Venezuela
10	UK	135	Mali
11	Norway	136	Malawi
12	Taiwan	137	Mozambique
13	Qatar	138	Timor Leste
14	Canada	139	Myanmar
15	Denmark	140	Burkina Faso
		141	Mauritania
		142	Angola
		143	Haiti
		144	Sierra Leone
		145	Yemen
		146	Burundi
		147	Guinea
		148	Chad

**France = 23**  
**China = 29**  
**South Afr = 53**  
**Brazil = 56**  
**India = 60**  
**Russia = 64**

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**IMD WORLD COMPETITIVENESS YEARBOOK**

- ▶ World Competitiveness Index : ability of nations to provide an environment that sustains the competitiveness of enterprises.
- ▶ Extensive coverage of 60 countries chosen because of their impact on the global economy and the availability of comparable international statistics.
- ▶ Over 300 competitiveness criteria are selected.

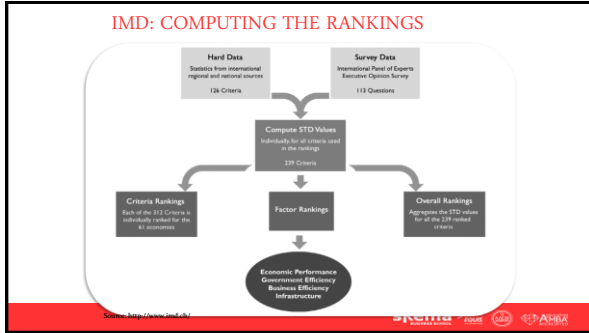


**IMD CRITERIA**

⇒ Over 300 competitiveness criteria are selected.

Economic Performance	(74 criteria)	Macro-economic evaluation of the domestic economy.
Government Efficiency	(84 criteria)	Extent to which government policies are conducive to competitiveness.
Business Efficiency	(66 criteria)	Extent to which enterprises are performing in an innovative, profitable and responsible manner.
Infrastructure	(90 criteria)	Extent to which basic, technological, scientific and human resources meet the needs of business.

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### IMD SCOREBOARD 60 COUNTRIES

Country	Score
1. China Hong Kong	78.00
2. Switzerland	76.00
3. Japan	75.00
4. USA	74.00
5. Sweden	73.00
6. Denmark	72.00
7. Ireland	71.00
8. Netherlands	70.00
9. France	69.00
10. Canada	68.00
11. Luxembourg	67.00
12. Singapore	66.00
13. Korea	65.00
14. Taiwan	64.00
15. UK	63.00
16. New Zealand	62.00
17. Austria	61.00
18. Israel	60.00
19. Portugal	59.00
20. Finland	58.00
21. Slovenia	57.00
22. Belgium	56.00
23. Czechia	55.00
24. Austria	54.00
25. China (Mainland)	53.00
26. Spain	52.00

France = 32

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