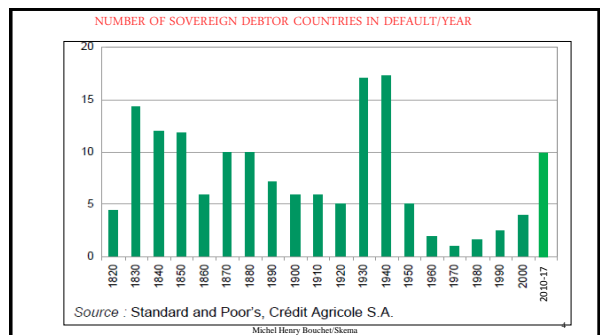
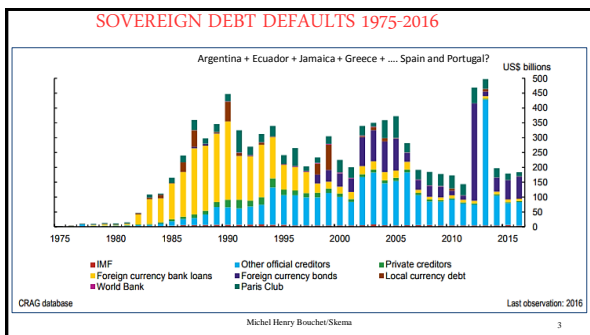
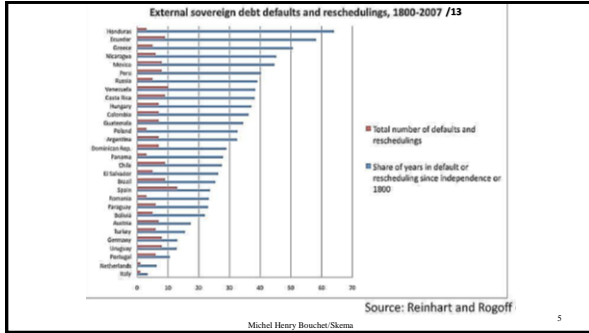


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**Country risk crisis:
In search of early warning indicators?**

Michel Henry Bouchet





Fitch-Rated Sovereign IDR Defaults (1995-2011)

Argentina: Defaulted on more than USD80 billion of sovereign foreign currency bonds in December 2001, most of which were held by non-residents. Debt default partially cured in 2005, but some holdout investors remained, constraining the rating to 'RD' until July 2010.

Dominican Republic: Distressed debt exchange in 2005 affected more than USD1.1 billion of eligible foreign currency-denominated bond debt.

Ecuador: Missed coupon payment on its 2012 global bonds followed by an announcement that the government would selectively default on all global bonds. The rating was lowered to 'RD' in December 2008.

Indonesia: Paris and London Club rescheduling operations in June 1998; further rescheduling in 2000 and 2002. Indonesia maintained payments on the single Fitch-rated sovereign bond outstanding at the time.

Moldova: USD75 million eurobond restructured in 2002, followed by a Paris Club deal.

Russian Federation: Exceptionally, Fitch dates sovereign default to August 1998. Although this was when the Russian Federation defaulted on its local currency debt, it began to incur arrears on foreign currency debt owed to the Paris Club official bilateral creditors very quickly afterwards. Defaults on foreign currency debt instruments held by private creditors occurred in 1999, although payments on Russian Federation eurobonds were maintained and honored.

Uruguay: Distressed debt exchange in March 2003 affecting more than USD6 billion of sovereign foreign currency debt, mostly held by non-residents.

Jamaica: Coercive debt exchange in February 2010 affected the country's domestic debt, which included foreign currency denominated instruments to which Fitch's foreign currency rating applied.

RD – Restricted default.

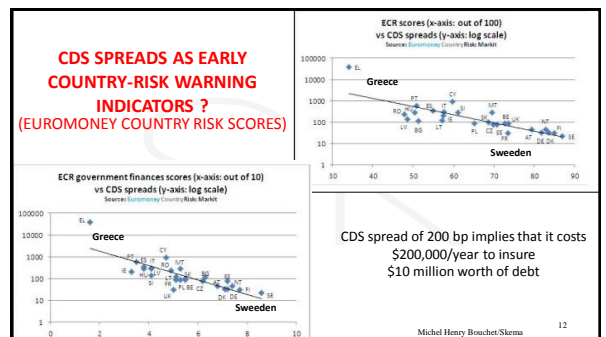
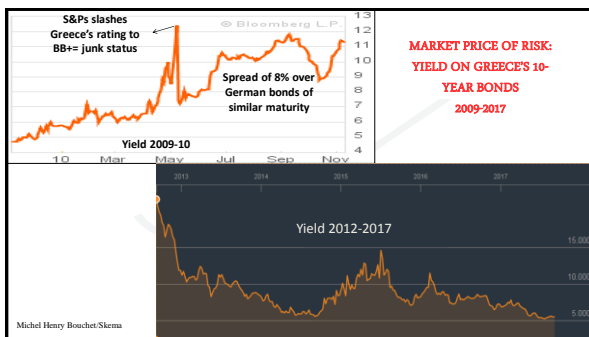
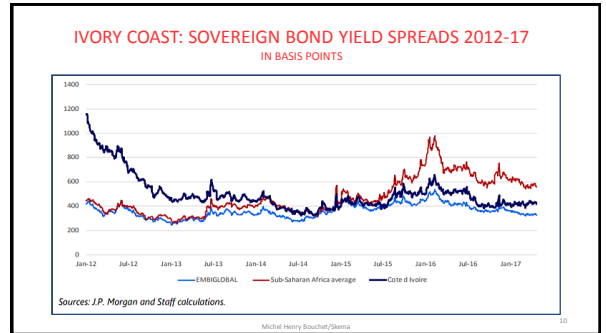
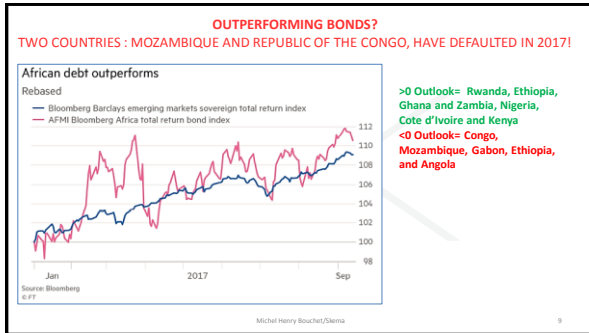
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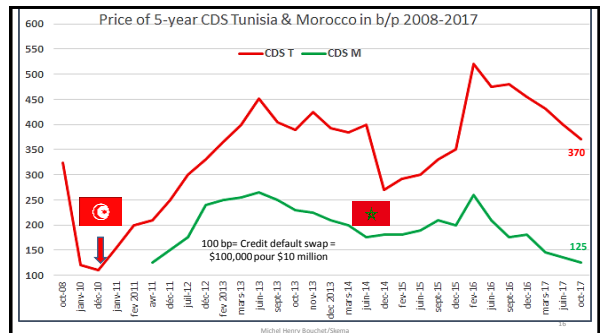
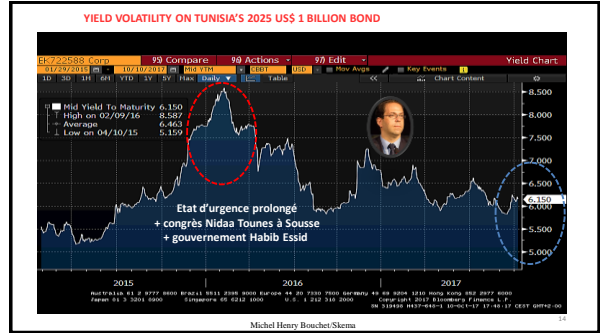
- ### LOOKING TOWARD EARLY WARNING SIGNALS OF UPCOMING FINANCIAL AND SOCIO-POLITICAL CRISIS?
- ▶ IMF reports?
 - ▶ Rating agencies?
 - ▶ CDS prices?
 - ▶ Stock market volatility
 - ▶ Spreads and yields?
 - ▶ Minsky's speculative bubbles and herd-instinct
 - ▶ B. Mandelbrot's fractal geometry
 - ▶ N. Taleb's Black Swans
 - ▶ D. Sornette's Dragon-Kings (extreme events)
 - ▶ Capital Flight?
- Michel Henry Bouchet/Skema

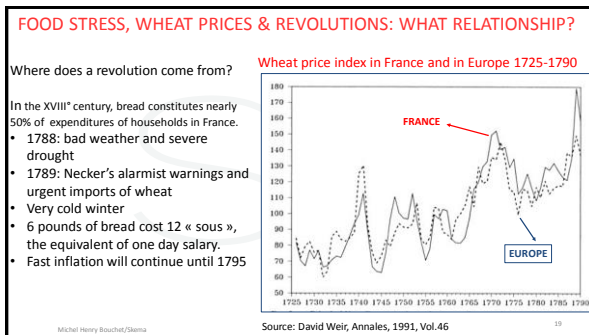
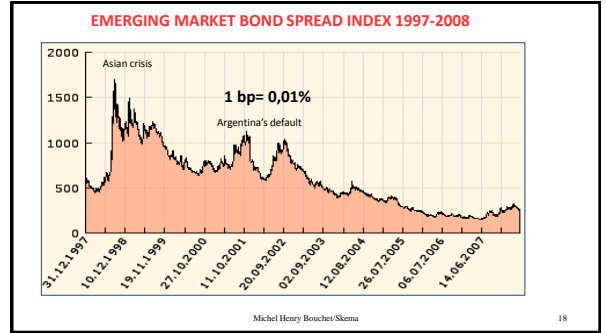
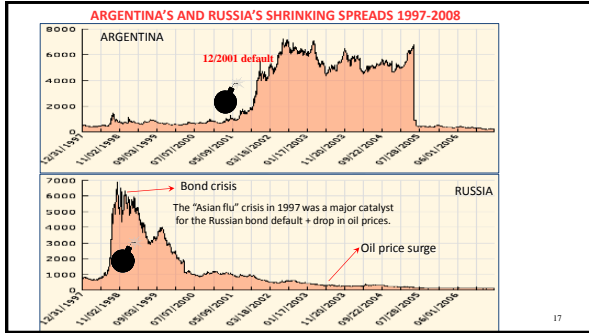
WAS THE 1998 ASIAN CRISIS ANTICIPATED BY RATING AGENCIES?

	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

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LOOKING FOR THE CANARI IN THE COAL MINE?

Clearly, looking for early warning indicators of upcoming country risk turmoil is challenging.
 Ratings and rankings, CDS, spread, volatility, interest rates, and debt ratios are **not** robust warning signals!
 One common sense solution is to watch how domestic economic agents in foreign countries manage their private assets. Indeed, households, companies, and private investors are « embedded » in their economic, institutional, and socio-political environment. They will always know more and better than you!
 Capital flight then is a good proxy for monitoring country risk development!

PUSH AND PULL FORCES OF CAPITAL FLIGHT

	Internal Push Forces/ Domestic factors	External Pull Forces/ Foreign factors
Socio-political instability	Political upheaval, nationalization, strikes, confiscation threats, capital controls, high and rising tax pressure	Socio-political stability, dynamic and sustainable development process
Institutional weaknesses	Banking system weakness, lack of trust in national financial institutions, volatile regulatory and legal framework, deposits withdrawals	Strongly capitalized global banks, dynamic offshore financial systems, tax havens, banking secrecy
Opacity and bad governance	Corruption and bribery, breach of contract, transfer and convertibility restrictions	Stable regulations, conducive legal framework, strong property rights

MEASURING CAPITAL FLIGHT

Definition	Methodology and Measure	Authors
1. Hot money : short-term volatile outflows	Balance of payments: errors and omissions	IMF
2. Hot money : short-term speculative and volatile capital flight	Balance of payments: short-term capital outflows + errors and omissions	Cuddington, J.
3. "Residual" measure: private residents' accumulation of foreign assets	Balance of payments identity= (Change in gross external debt + FDI flows) – (current account deficit + change in official reserve assets)	World Bank, Cline, W., Morgan Guaranty, Erbe, S., Lessard, D., Dooley, M. & Underwood, J.
4. "Assets" method: Direct approach	International Financial Statistics: change in the total assets of non-bank residents held at foreign banks.	IMF
5. Externally held claims with no reported capital return	Stock of claims on non-residents that do not generate reported investment income receipts	Dooley, M., Claessens, S.

CORRUPTION, AND HYDROCARBON AND MINING-BASED GROWTH

