

# SK

SKEMA BUSINESS SCHOOL  
Country Risk Assessment

*“Turning uncertainty into opportunity”*

Introduction Sophia Campus

Michel Henry Bouchet  
Global Finance –SKEMA

[www.developingfinance.org](http://www.developingfinance.org)

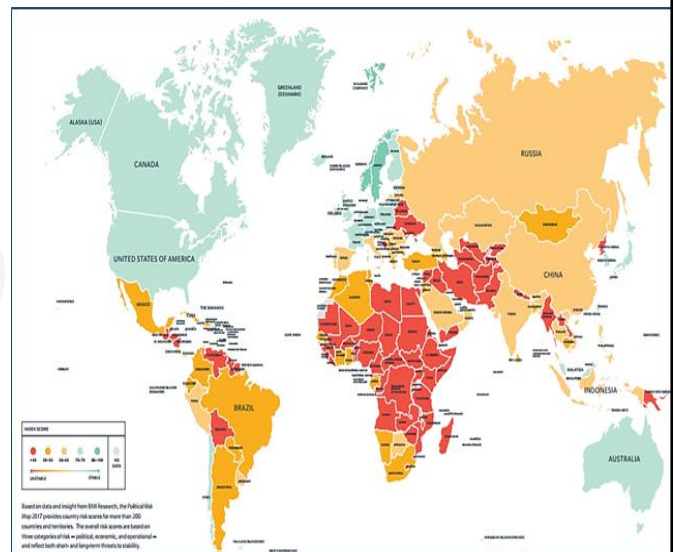


## WHY IS COUNTRY RISK ON THE FRONT BURNER IN FALL 2018?

- Political upheaval in Tunisia, Spain, Ukraine, Turkey, Brazil, Greece, Venezuela ....
- Debt default in Cuba?
- Geopolitical turmoil in North Korea
- European export headwinds from stronger €
- Soft/Hard landing in China? Bubble bursting?
- Upcoming rate hike = Looming bond crisis?
- Risk of currency crisis in EMCs + Capital flight

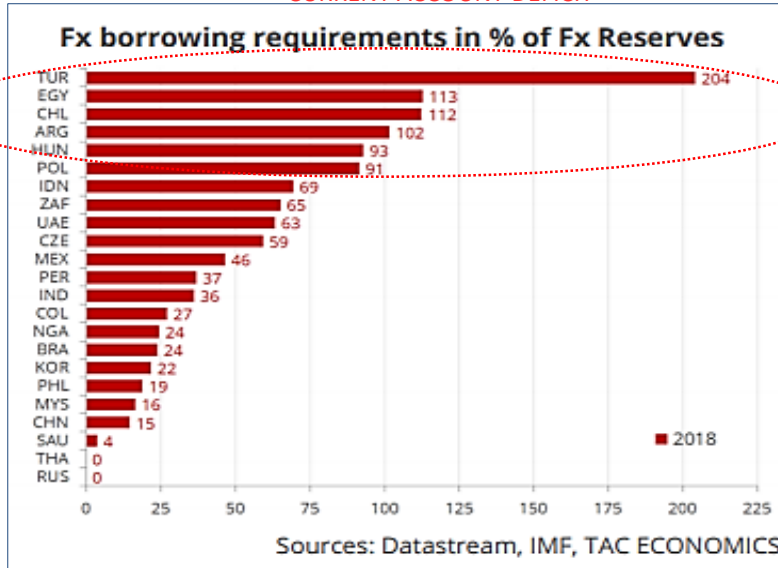
**Risk of spill-over is permanent!**

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**TURKEY'S VULNERABILITY AT END-2018=**

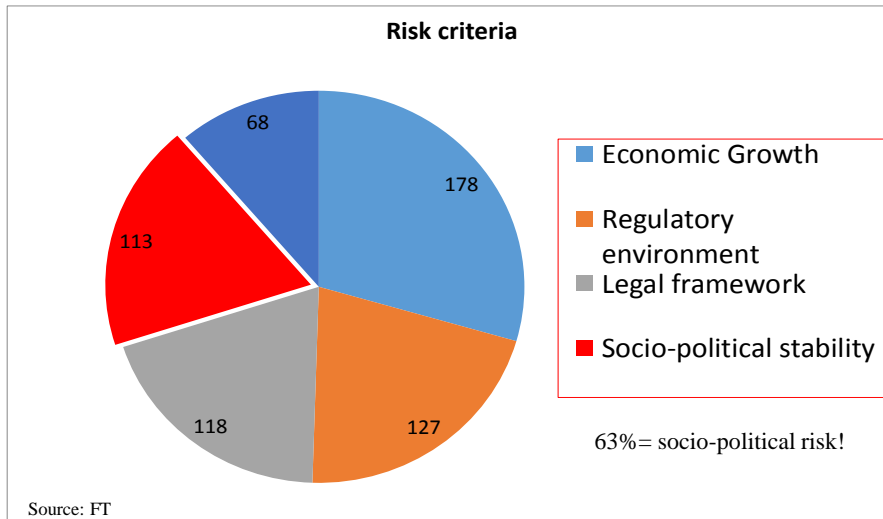
EXCESSIVE BORROWING REQUIREMENTS IN FOREIGN CURRENCY + LARGE ST DEBT TO BE ROLLED-OVER + LARGE AMORTIZATION ON LT EXTERNAL DEBT (\$170BN DUE FOR THE WHOLE YEAR 2018) + SUBSTANTIAL CURRENT ACCOUNT DEFICIT



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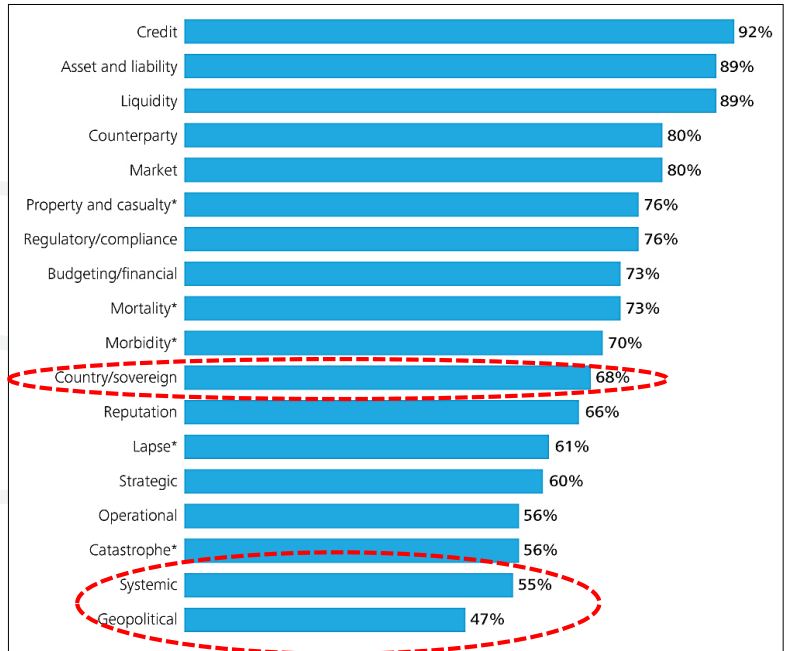
**THE BANKER GLOBAL RISK ASSET MANAGEMENT SURVEY=**

**WHERE DOES RISK COME FROM?**



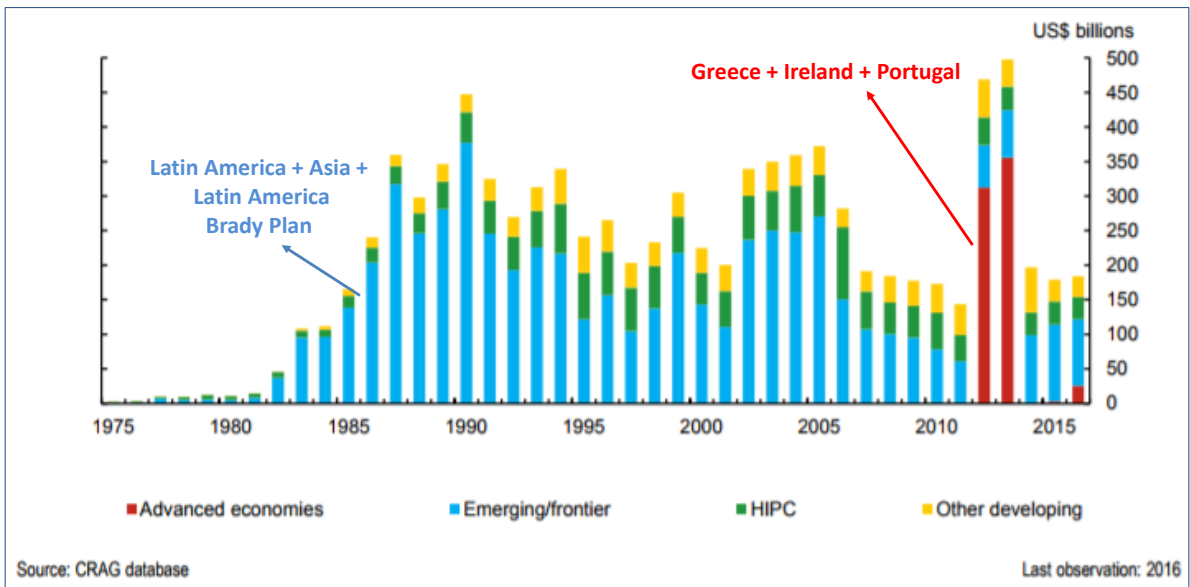
**DELOITTE'S SURVEY OF RISK MANAGEMENT:**

**« IS YOUR ORGANIZATION EFFECTIVE IN MANAGING RISKS? »**



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**SOVEREIGN DEBT IN DEFAULT, BY DEBTOR**



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## SOME OF THE BIGGEST SOVEREIGN DEFAULTS SINCE 2000:

1. **Argentina, \$82 billion, December 2001:** Insolvency cycles since 1827. New partial default in end-2014
2. **Ecuador, \$3.2 billion, December 2008:** Default on \$31 million interest payment, in the wake of Ecuador's 1999 default. In June 2014, \$2 b. of 10-year bonds in return to capital markets
3. **Jamaica, \$7.9 billion, February 2010:** Public debt as a share of GDP (both domestic and external) reached 130% in 2010.
4. **Greece, \$138 billion, March 2012:** (first sovereign default in the 4th century BC, by 10 Greek municipalities). Greece failed to record a budget surplus since 1973. **€110 billion** bailout from the European Union and IMF in May 2010 + **€86 billion** bail-out in mid-2015
5. Many defaults in EMCs in 2017-2018, including Mozambique and Congo

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## COUNTRY RISK SEMINAR

### ► Five key objectives:

1. **Identifying** the key components of country risk (economic, financial, socio-political, regional)
2. Grasping the new challenges of country risk in the global economy (**spill-over and contagion!**)
3. Identifying the **sources of information** and economic intelligence
4. Exploring the various techniques for **risk analysis** and **risk mitigation**
5. Focusing on both **EMCs ...** and **OECD**

### ► 7 academic tools

1. A Book (McMillan-Palgrave 2018)
2. 12 course sessions with lectures and debates
3. Students' group work: oral presentation of **breaking news**
4. **Solvencia Case study**
5. **Country Risk Research report**
6. A Mooc (15 videos + slides)
7. Background documents

<http://www.developingfinance>

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## WHAT IS RISK?

► “Risk means more things **can** happen than will happen.”

Elroy Dimson

Risk is always related to **uncertainty**, i.e.,  
a deficit of **information!**

“It is always wise to look ahead, but difficult to look further than you  
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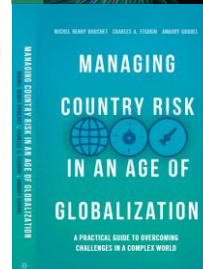
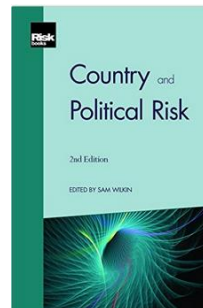
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OF AMBA  
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## ANALYSIS AND INFORMATION SOURCES

IMF, World Bank, IFC & MIGA  
UNCTAD & UNDP  
BIS, OECD, EBRD  
Coface, Euler-Hermes  
Moody's, S&P, Fitch  
Euromoney, Institutional Investor  
CIA & US State Dept, ICRG  
Transparency International  
Hiscox, AON, Control Group  
DEFI [www.developingfinance.org](http://www.developingfinance.org)



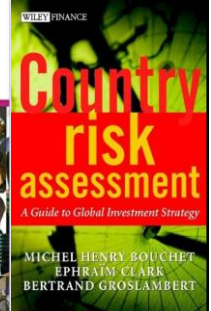
DEFI  
DEVELOPING FINANCE

OXFORD  
ECONOMICS

La globalisation

Introduction à l'économie  
du nouveau monde

Michel-Henry  
Bouchet



Control Risks

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Our knowledge serving your success

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## TEXTBOOKS & RESEARCH PAPERS

1. Bouchet, Goguel, Fishkin: **Country Risk Management**, Palgrave, 2018
2. Bouchet, Clark & Gros Lambert, « **Country risk assessment** », N.Y. Wiley
3. Bouchet, M & Gros Lambert, B: « **Governance & Country Risk** », in Governance and Risk in Global and Emerging Markets, Palgrave
4. Bouchet MH, « **In search of a country risk barometer?** », World Financial Review, Summer 2013
5. Bouchet MH: « **Capital Flight as early warning indicator of country risk** »: Oxford Economics-2015
6. Peter Bernstein, « **Against the gods- The history of Risk** », Wiley 1998
7. L. van Efferink, **Country risk analysis**, FMS, NIBESVV, Amsterdam

**ALL FILES on :** [www.developingfinance.org](http://www.developingfinance.org)

+ Skema Knowledge K2 + UDEMY MOOC

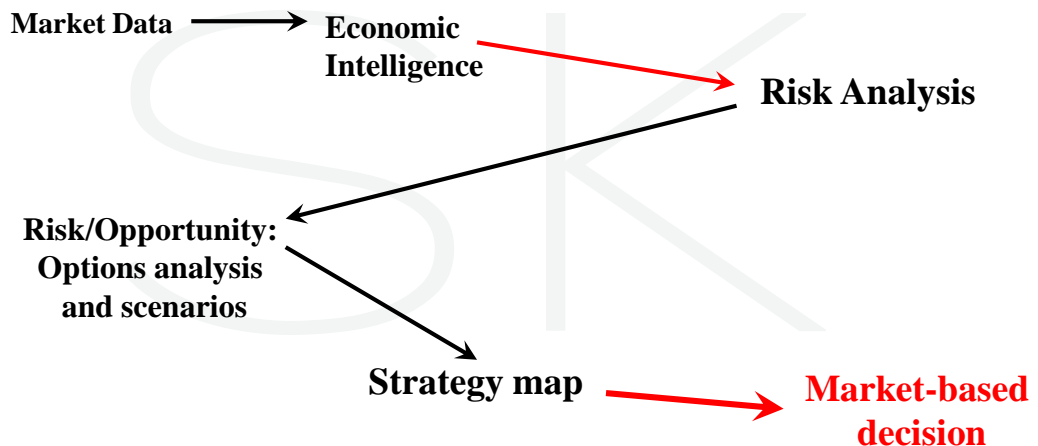
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## WHY DAILY REVIEWS OF COUNTRY RISK NEWS ARE SO IMPORTANT FOR THE SEASONED RISK ANALYST?



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- What we shall **not** do: learning a few techniques and using tools just for the sake of making abstract calculations!
- What we shall do : Using a wide range of methods of risk analysis to enhance the quality of economic intelligence
- Don't present breaking news but instead break the news down while keeping a close eye on the markets (FT, Reuters, Bloomberg, EIU, The Economist, CIA reports, IBRD news, IMF...)

Get access to key websites with reliable sources of risk information: Bloomberg, S&Ps, Moody's, CIA, BIS, IMF, WB, IIF, Paris Club, WEF, Coface, DEFI: [www.developingfinance.org](http://www.developingfinance.org)

## ORGANIZATION OF THE COURSE

10 groups of 3 students

- 10 sessions with *concise* “**Country Risk Hot Spots**” < 15 minute oral interventions focused on country risk topics: **what is on the front burner?** Random calls!
- Each group works on a specific **Country risk strategy report** (Word or PPT : to be submitted on final session) **25 slides or 12 pages**
- Case study: Solvencia

| COURSE ORGANIZATION FMI SOPHIA CAMPUS                              |   |   |   |  |   |
|--|---|---|---|--|---|
| MONDAY<br>SEPT 17  | MONDAY<br>SEPT 24   | THURSDAY<br>SEPT 27   | FRIDAY<br>SEPT 28   | TUESDAY<br>OCT 16  | THURSDAY<br>OCT 18  |
| <b>SESSION 1</b><br><br>Introduction:<br>What is Risk?<br><br>Quiz | <b>SESSION 3</b><br><br>Group 1<br>BOP<br>Liquidity<br>Solvency | <b>SESSION 5</b><br><br>Group 3<br>Debt restructuring<br>analysis | <b>SESSION 7</b><br><br>Group 5<br>Political Risk<br>PRINCE MODEL     | <b>SESSION 9</b><br><br>Group 7<br>Political Risk                            | <b>SESSION 11</b><br><br>Group 9<br>Capital Flight                                |
| <b>SESSION 2</b><br>What is<br>Country Risk?                       | <b>SESSION 4</b><br>Group 2<br>Debt Analysis                    | <b>SESSION 6</b><br>Group 4<br>Ratings &<br>rankings              | <b>SESSION 8</b><br>Group 6<br>Assessing Governance<br>And corruption | <b>SESSION 10</b><br>Group 8<br>Assessing<br>Governance in<br>OECD countries | <b>SESSION 12</b><br>Group 10<br>Assessing<br>Governance<br>Wrap up!<br>SOLVENCIA |
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## COUNTRY RISK STRATEGY REPORT - METHODOLOGY:

- 1. WHERE?** In which **country**?
- 2. WHAT?** Define your “**risk exposure**” : *MNC, FDI, investment fund, banking? Lending, investing, trading, exporting?*
- 3. WHEN?** Time horizon
  - Specify the main **types of risks** (economic or socio-political, financial, labor costs, infrastructure, institutions...)
  - Identify a wide range of information sources
  - Think “global” : never lose sight of the global environment (regional contamination and spill-over effects)
  - Work burden sharing in each team
  - Conclude with specific strategy decisions

## COUNTRY RISK STRATEGY REPORT - METHODOLOGY:

A **Country Risk Report** is NOT a Country report

Aim 1: Students propose a solution to implement a specific country risk strategy.

Aim 2: The report is focused on a specific risk exposure in a foreign country (investing, lending, advising, exporting, or importing)

Aim 3: Identify the main country risk features and the range of hedging options (including not investing or not lending!)

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## COUNTRY RISK RESEARCH TOPICS ?

1. Portfolio investment in Vietnam: the HCMV stock market
2. Venezuela's bond yields
3. Secondary market trading in West Africa?
4. CDS : Brazil versus Lebanon
5. Greece: real estate investment bonanza?
6. Cocoa market : Ghana-Ivory Coast-Malaysia
7. Tunisia's debt structure vs Morocco
8. Political risk turmoil in Brazil
9. Spain-Portugal: tourism investment target?
10. FDI project: China versus Cambodia/Bangladesh/Vietnam

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## COUNTRY RISK RESEARCH PROJECT?


« Success » or « horror » stories in country risk

11. Suez in Argentina pre- and post peso devaluation
12. SIEMENS in China
13. Total's strategy in Angola
14. Oil companies in Chad
15. LVMH in China (Yuan?)
16. Repsol in Argentina and Bolivia (nationalization)
17. Lafarge-Holcim in North Korea between 2008 and 2017 (Sangwon Cement)

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GETTING READY FOR  
SEASONED COUNTRY  
RISK ANALYSIS!

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|   |              |
|---|--------------|
| <b>COUNTRY RISK ANALYSIS</b><br>Republic of Solvencia and the International Capital Markets |              |
| MICHEL HENRY BOUCHET  | <b>Annex</b> |
| <b>Background Information for Solvencia's Eurobond Request to CASINO BANK</b>               |              |
|         |              |
| For further information:  |              |
| <a href="http://www.developingfinance.org">www.developingfinance.org</a>                    |              |

| Fall 2016                          |   | Source: Solvencia National Statistics Agency SNSA - October 2016 |        |        |         |         |         |        |         |         |         |         |         |         |         |
|------------------------------------|---|--|--------|--------|---------|---------|---------|--------|---------|---------|---------|---------|---------|---------|---------|
| COUNTRY RISK ANALYSIS              |   | SOLVENCIA  |        |        |         |         |         |        |         |         |         |         |         |         |         |
| A                                  | DOMESTIC ECONOMY                        | 2003   | 2004   | 2005   | 2006    | 2007    | 2008    | 2009   | 2010    | 2011    | 2012    | 2013    | 2014    | 2015    | 2016    |
| DOMESTIC ECONOMY (constant prices) |   |  |        |        |         |         |         |        |         |         |         |         |         |         |         |
|                                    | Real GDP (local currency billion)       | 5 055  | 5 300  | 5 785  | 6 350   | 7 000   | 7 150   | 7 100  | 7 300   | 7 600   | 7 855   | 8 250   | 8 750   | 9 350   | 9 250   |
|                                    | Nominal GDP (local currency billion)    | 51 125   | 53 000 | 57 000 | 63 000  | 72 000  | 85 000  | 88 000 | 91 000  | 96 000  | 103 000 | 116 000 | 130 000 | 148 000 | 170 000 |
|                                    | GDP deflator % change                   | 5,00%  | 3,67%  | 7,55%  | 10,53%  | 14,29%  | 18,06%  | 3,53%  | 3,41%   | 5,49%   | 7,29%   | 12,62%  | 12,07%  | 13,85%  | 14,86%  |
|                                    | Nominal GDP (\$ billion)                | 51,13  | 51,21  | 52,05  | 54,55   | 51,80   | 50,00   | 49,44  | 49,19   | 49,23   | 50,74   | 57,00   | 63,73   | 72,20   | 68,00   |
|                                    | Nominal GDP per capita \$               | 8 521  | 8 351  | 8 323  | 8 550   | 7 960   | 7 533   | 7 317  | 7 151   | 7 031   | 7 118   | 7 863   | 8 643   | 9 628   | 8 917   |
|                                    | Exchange Rate                           | 1 000  | 1 035  | 1 095  | 1 155   | 1 390   | 1 700   | 1 780  | 1 850   | 1 950   | 2030    | 2035    | 2040    | 2050    | 2500    |
|                                    | Rate of ER depreciation                 |  |        |        |         |         |         |        |         |         |         |         |         |         |         |
| B                                  | 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  | 14 000  | 13 500  | 12 000  | 13 650  | 15 000  |
|                                    | Merchandise imports                     | -6 012   | -6 562 | -9 487 | -10 555 | -13 000 | -11 550 | -9 960 | -10 730 | -13 500 | -14 500 | -15 000 | -16 000 | -17 500 | -14 250 |
|                                    | 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   | 1 500   | 1 850   |
|                                    | Interest receipts                       | 124  | 120    | 317    | 486     | 145     | 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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**PROGRAM**  
**10 SESSIONS**


**D1 S1/S2= Introduction**  
**Country risk assessment**





**D2 S3/S4= BOP**  
**BOP Analysis (Greece vs Spain)**

**D3 S5/S6= Liquidity/solvency**  
**SOLVENCIA**

**D4 S7/S8 = Political risk**  
**PRINCE MODEL**

**D5 S9/10 = Risk analysis methods**  
**Ratings**  
**Wrap up: SOLVENCIA**



## GRADING SYSTEM



- ✓ CR Oral Presentations and participation = 20%  
(random calls + debates)
- ✓ Solvencia Case study= 20%
- ✓ Research projects = 25%
- ✓ Final exam = 35%

Σ 100% !

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## ORGANIZATION

- ▶ ✉ Michelhenry.bouchet@skema.edu
- ▶ Appointments ☎ 0493954596
- 1. Urgency 1: ☎ 0033-658176702
- 2. Urgency 2: ☎ 0034-633335422
- 3. Urgency 3: ☎ 00216-21016000
- ▶ Course slides on Skema-K2
  - ▶ **Web site of Global Finance Center:**  
<https://www.developingfinance.org>

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# COUNTRY RISK QUIZ TIME!



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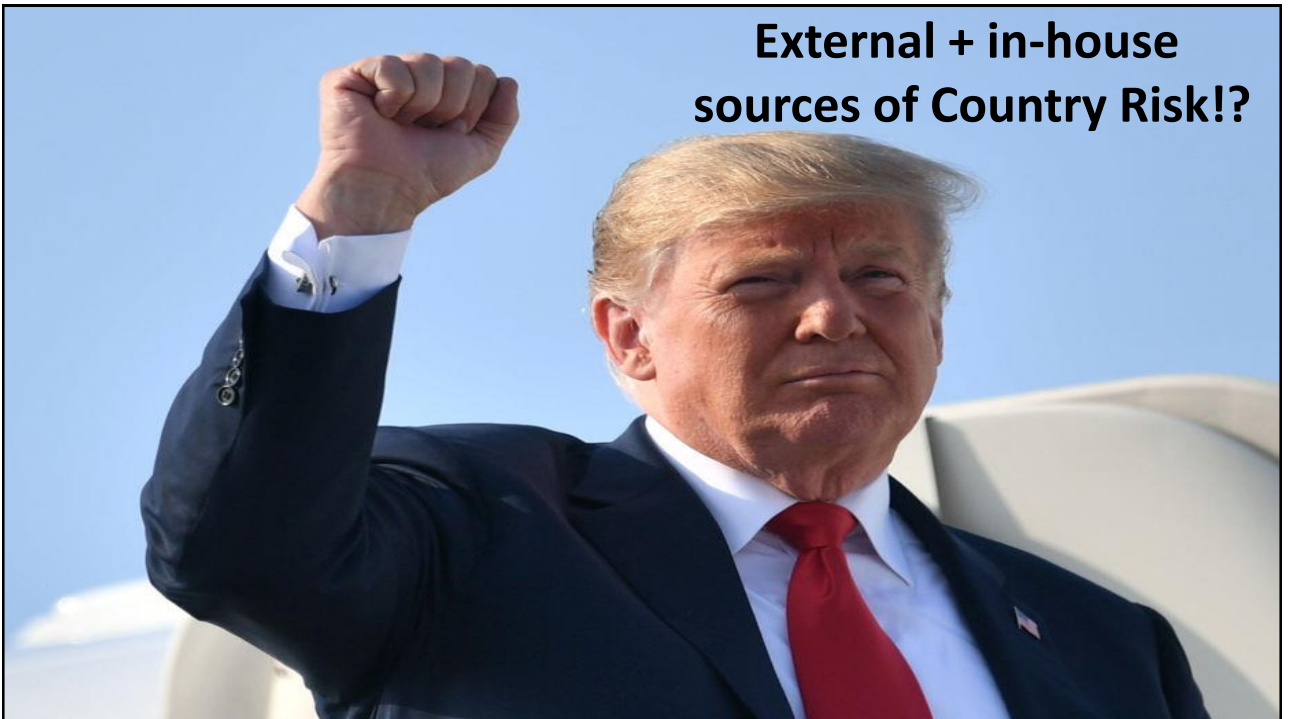
Introduction Paris Campus

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Global Finance –SKEMA

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**External + in-house  
sources of Country Risk!?**



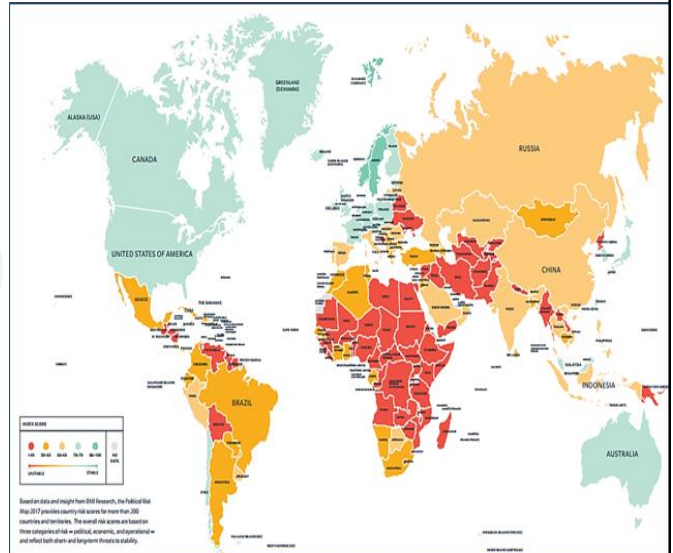


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- Debt default in Cuba?
- Trade protectionism US-China
- European export headwinds from stronger €
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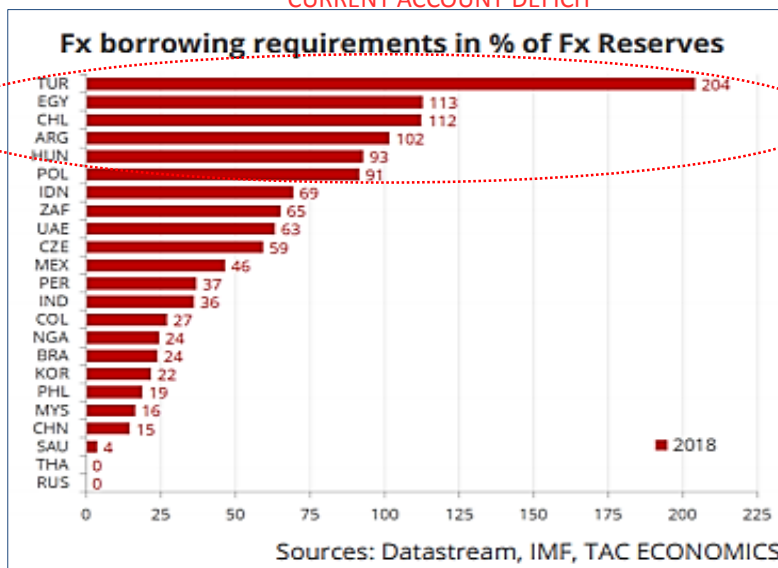
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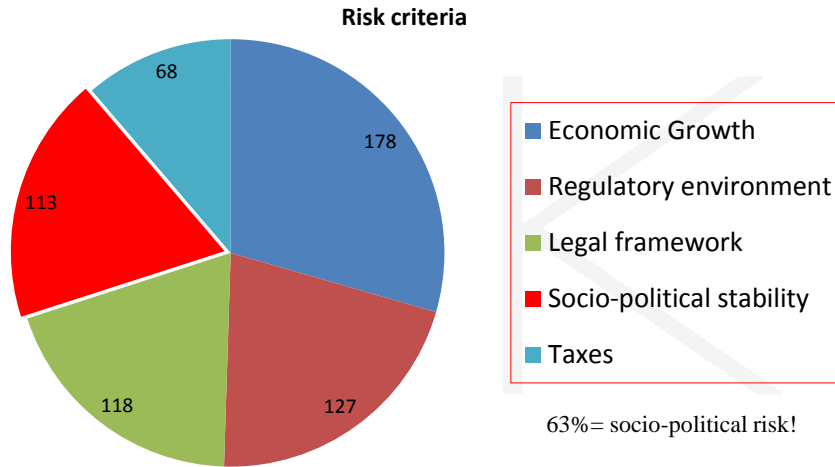
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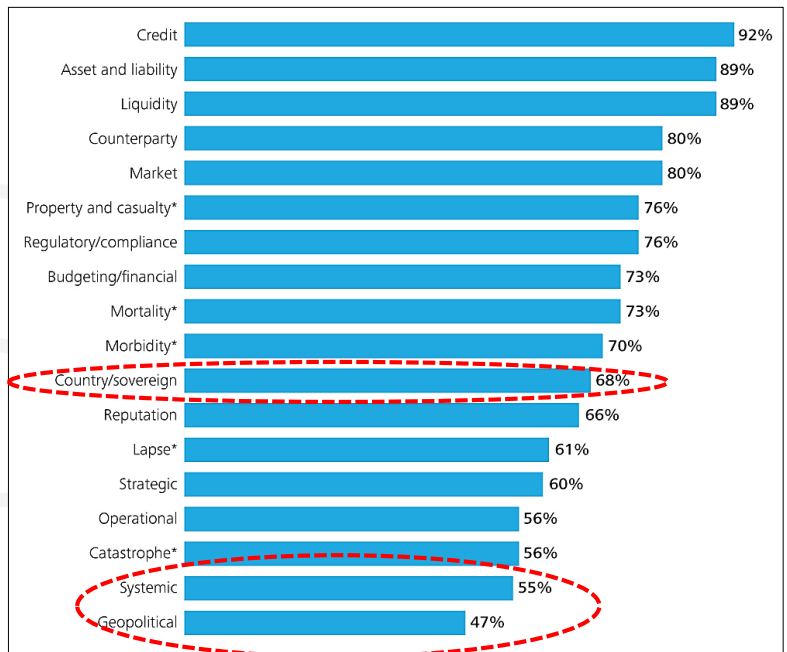


Source: FT



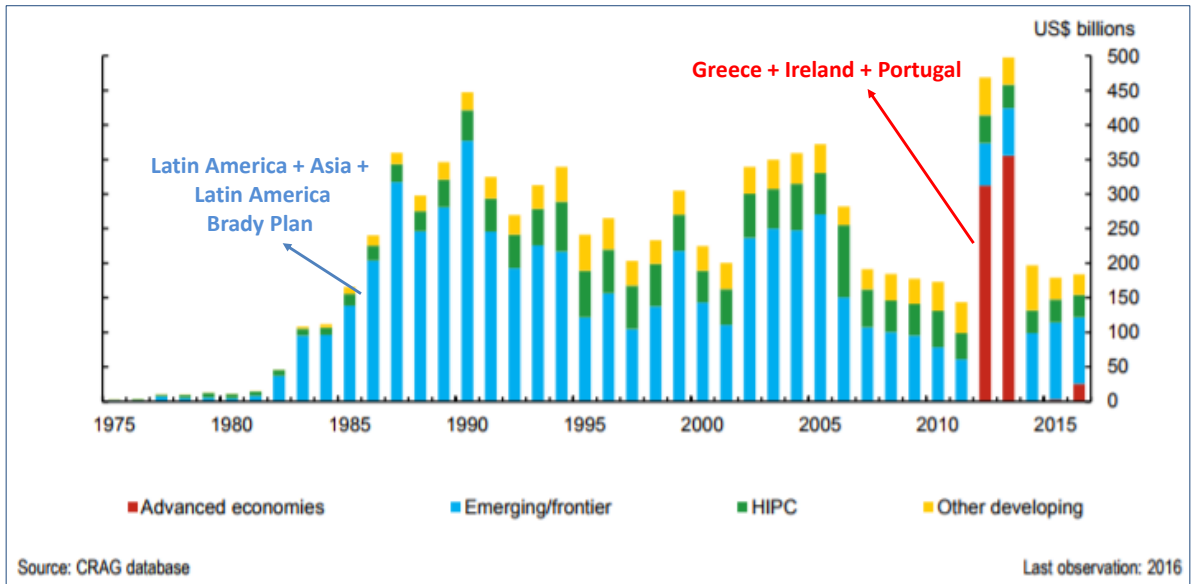
DELOITTE'S SURVEY OF RISK  
MANAGEMENT:

« IS YOUR  
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5. Many defaults in EMCs in 2017-2018, including Mozambique and Congo, and Cuba in 2019?

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## CHINA'S LOCAL CURRENCY CORPORATE BOND MARKET

### Yields near 7% flag danger for corporate refinancing

■ China AA- Corporate Bond Yield



Source: ChinaBond

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### Just Off Peak

Banks' lending to other financial firms drops to one-year low

■ Chinese banks' claims on other financial firms



Source: Bloomberg, PBOC

Bloomberg

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2. Grasping the new challenges of country risk in the global economy (**spill-over and contagion!**)
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### ► 4 Academic tools

#### ME

1. A Book (McMillan-Palgrave 2018)
2. 8 course sessions with lectures and debates
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4. Background documents

#### ME & YOU

1. Students' group work: oral presentation of **breaking news**
2. **Solvencia Case study**
3. **Country Risk Research report**
4. **SOLVENCIA**

<http://www.developingfinance>

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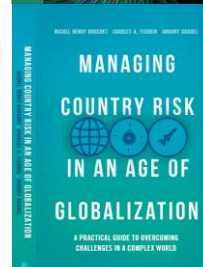
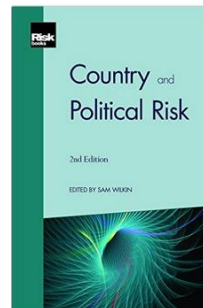
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## ANALYSIS AND INFORMATION SOURCES

IMF, World Bank, IFC & MIGA  
UNCTAD & UNDP  
BIS, OECD, EBRD  
Coface, Euler-Hermes  
Moody's, S&P, Fitch  
Euromoney, Institutional Investor  
CIA & US State Dept, ICRG  
Transparency International  
Hiscox, AON, Control Group  
DEFI [www.developingfinance.org](http://www.developingfinance.org)



DEFI  
DEVELOPING FINANCE

La globalisation

Introduction à l'économie  
du nouveau monde

Michel-Henry  
Bouchet

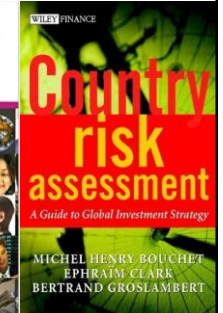


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## TEXTBOOKS & RESEARCH PAPERS

1. Bouchet, Goguel, Fishkin: **Country Risk Management**, Palgrave, 2018
2. Bouchet, Clark & Gros Lambert, « **Country risk assessment** », N.Y. Wiley
3. Bouchet, M & Gros Lambert, B: « **Governance & Country Risk** », in Governance and Risk in Global and Emerging Markets, Palgrave
4. Bouchet MH, « **In search of a country risk barometer?** », World Financial Review, Summer 2013
5. Bouchet MH: « **Capital Flight as early warning indicator of country risk** »: Oxford Economics-2015
6. Peter Bernstein, « **Against the gods- The history of Risk** », Wiley 1998
7. L. van Efferink, **Country risk analysis**, FMS, NIBESVV, Amsterdam

**ALL FILES on :** [www.developingfinance.org](http://www.developingfinance.org)

+ Skema Knowledge K2

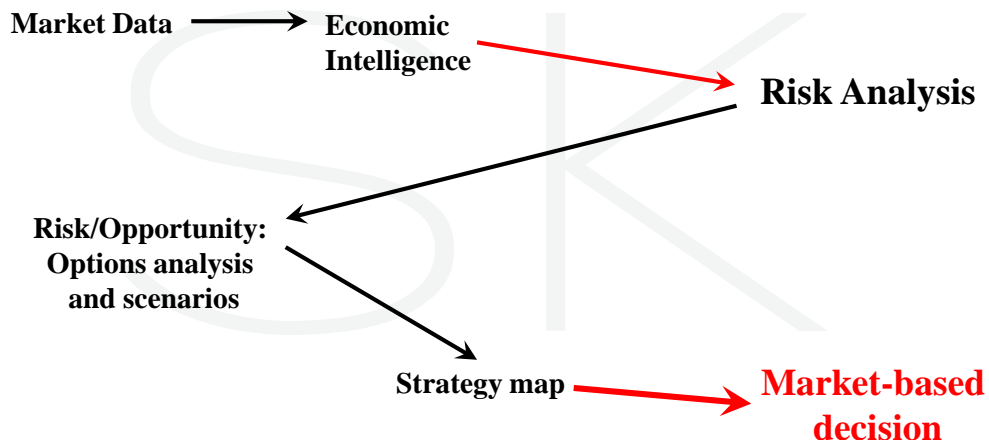
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## WHY DAILY REVIEWS OF COUNTRY RISK NEWS ARE SO IMPORTANT FOR THE SEASONED RISK ANALYST?



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- What we shall **not** do: learning a few techniques and using tools just for the sake of making abstract calculations!
- What we shall do : Using a wide range of methods of risk analysis to enhance the quality of economic intelligence
- Don't present breaking news but instead, break the news down while keeping a close eye on the markets (FT, Reuters, Bloomberg, EIU, The Economist, CIA reports, IBRD news, IMF...)
- Get access to key websites with reliable sources of risk information: S&Ps, Moody's, CIA, BIS, IMF, WB, IIF, Paris Club, Coface, DEFI: [www.developingfinance.org](http://www.developingfinance.org)

## ORGANIZATION OF THE COURSE: 8 SESSIONS

9 groups of 3-4 students

- 8 sessions with *concise* “**Country Risk Hot Spots**” < 15 minute oral interventions focused on country risk topics: **what is on the front burner?** Random calls!
- Each group works on a specific **Country risk strategy report** (Word or PPT : to be submitted on last session)  
**25 slides or 12-15 pages**
- Case study: Solvencia
- MOOC

| COURSE ORGANIZATION FMI PARIS CAMPUS                               |   |   |   |  |   |
|--|---|---|---|--|---|
| TUESDAY<br>OCT 2   | WEDNESDAY<br>OCT 3  | THURSDAY<br>OCT 4   | FRIDAY<br>OCT 5   | TUESDAY-<br>WEDNESDAY<br>OCT 9-10                                      | THURSDAY-FRIDAY<br>OCT 11-12                        |
| <b>SESSION 1</b><br><br>Introduction:<br>What is Risk?<br><br>Quiz | <b>SESSION 2</b><br><br>Group 1<br>BOP<br>Liquidity<br>Solvency | <b>SESSION 3</b><br><br>Group 3<br>Debt restructuring<br>analysis | <b>SESSION 4</b><br><br>Group 5<br>Political Risk<br>PRINCE MODEL | <b>SESSION 5-6</b><br><br>Group 6-7<br>Political Risk<br>& Wealth Gaps | <b>SESSION 7-8</b><br><br>Group 8<br>Capital Flight |
| What is<br>Country Risk?   | Group 2<br>Debt Analysis  | Group 4<br>Ratings &<br>rankings                                  | Assessing Governance<br>& corruption                              | Assessing<br>Governance  | Wrap up!<br>SOLVENCIA                               |

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## COUNTRY RISK STRATEGY REPORT - METHODOLOGY:

A **Country Risk Report** is NOT a Country report

Aim 1: Students propose a solution to implement a specific country risk strategy.

Aim 2: The report is focused on a specific risk exposure in a foreign country (investing, lending, advising, exporting, or importing)

Aim 3: Identify the main country risk features and the range of hedging options (including **not** investing or not lending!)

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## COUNTRY RISK STRATEGY REPORT - METHODOLOGY:

- 1. WHERE?** In which **country**?
- 2. WHAT?** Define your “**risk exposure**” : *MNC, FDI, investment fund, banking? Lending, investing, trading, exporting?*
- 3. WHEN?** **Time horizon**
  - Specify the main **types of risks** (economic or socio-political, financial, labor costs, infrastructure, institutions...)
  - Identify a wide range of information sources
  - Think “global” : never lose sight of the global environment (regional contamination and spill-over effects)
  - Work burden sharing in each team

## COUNTRY RISK RESEARCH TOPICS ?

1. Portfolio investment in Vietnam: the HCMV stock market
2. Venezuela's bond yields
3. Secondary market trading in West Africa?
4. CDS : Brazil versus Lebanon
5. Greece: real estate investment bonanza?
6. Cocoa market : Ghana-Ivory Coast-Malaysia
7. Tunisia's debt structure vs Morocco
8. Political risk turmoil in Brazil
9. Spain-Portugal: tourism investment target?
10. FDI project: China versus Cambodia/Bangladesh/Vietnam

## COUNTRY RISK RESEARCH PROJECT?


« Success » or « horror » stories in country risk

11. Suez in Argentina pre- and post peso devaluation
12. SIEMENS in China
13. Total's strategy in Angola
14. Oil companies in Chad
15. LVMH in China (Yuan?)
16. Repsol in Argentina and Bolivia (nationalization)
17. Lafarge-Holcim in North Korea between 2008 and 2017 (Sangwon Cement)

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GETTING READY FOR  
SEASONED COUNTRY  
RISK ANALYSIS!

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|  |  |
|--|--|
| COUNTRY RISK ANALYSIS ¶<br>Republic of Solvencia and the International Capital Markets ¶ |  |
| ¶  | MICHEL HENRY BOUCHET ¶   |
| ¶  | <b>Annex ¶</b>   |
| Background Information for Solvencia's Eurobond Request to CASINO BANK ¶                 |  |
| ¶  |                      |
| ¶  | ¶  |
| ¶  | For further information: ¶<br><a href="http://www.developingfinance.org">www.developingfinance.org</a> ¶ |

| Fall 2016                               |                                  | Source: Solvencia National Statistics Agency SNSA - October 2016 |        |        |         |         |         |        |         |         |         |         |         |         |         |
|---|----------------------------------|--|--------|--------|---------|---------|---------|--------|---------|---------|---------|---------|---------|---------|---------|
| COUNTRY RISK ANALYSIS                   |                                  | SOLVENCIA  |        |        |         |         |         |        |         |         |         |         |         |         |         |
| A                                       | DOMESTIC ECONOMY                 | 2003   | 2004   | 2005   | 2006    | 2007    | 2008    | 2009   | 2010    | 2011    | 2012    | 2013    | 2014    | 2015    | 2016    |
| DOMESTIC ECONOMY (constant prices)      |                                  |  |        |        |         |         |         |        |         |         |         |         |         |         |         |
| Real GDP (local currency billion)       |                                  | 5 055  | 5 300  | 5 785  | 6 350   | 7 000   | 7 150   | 7 100  | 7 300   | 7 600   | 7 855   | 8 250   | 8 750   | 9 350   | 9 250   |
| Nominal GDP (local currency billion)    |                                  | 51 125   | 53 000 | 57 000 | 63 000  | 72 000  | 85 000  | 88 000 | 91 000  | 96 000  | 103 000 | 116 000 | 130 000 | 148 000 | 170 000 |
| GDP deflator % change                   |                                  | 5,00%  | 3,67%  | 7,55%  | 10,53%  | 14,29%  | 18,06%  | 3,53%  | 3,41%   | 5,49%   | 7,29%   | 12,62%  | 12,07%  | 13,85%  | 14,86%  |
| Nominal GDP (\$ billion)                |                                  | 51,13  | 51,21  | 52,05  | 54,55   | 51,80   | 50,00   | 49,44  | 49,19   | 49,23   | 50,74   | 57,00   | 63,73   | 72,20   | 68,00   |
| Nominal GDP per capita \$               |                                  | 8 521  | 8 351  | 8 323  | 8 550   | 7 960   | 7 533   | 7 317  | 7 151   | 7 031   | 7 118   | 7 863   | 8 643   | 9 628   | 8 917   |
| Exchange Rate                           |                                  | 1 000  | 1 035  | 1 095  | 1 155   | 1 390   | 1 700   | 1 780  | 1 850   | 1 950   | 2030    | 2035    | 2040    | 2050    | 2500    |
| Rate of ER depreciation                 |                                  |  |        |        |         |         |         |        |         |         |         |         |         |         |         |
| B                                       | 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  | 14 000  | 13 500  | 12 000  | 13 650  | 15 000  |
| Merchandise imports                     |                                  | -6 012   | -6 562 | -9 487 | -10 555 | -13 000 | -11 550 | -9 960 | -10 730 | -13 500 | -14 500 | -15 000 | -16 000 | -17 500 | -14 250 |
| 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   | 1 500   | 1 850   |
| Interest receipts                       |                                  | 124  | 120    | 317    | 486     | 145     | 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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D5 S9/10-12 =  
Risk analysis methods  
Ratings  
Wrap up: SOLVENCIA

D4 S7/S8 =  
Political risk  
PRINCE MODEL

D3 S5/S6 =  
Liquidity/solvency  
SOLVENCIA

D2 S3/S4 = BOP  
BOP Analysis (Greece vs Spain)

D1 S1/S2 = Introduction  
Country risk assessment

## GRADING SYSTEM

- ✓ CR Oral Presentations and participation = 20%  
(random calls + debates)
- ✓ Solvencia Case study= 20%
- ✓ Research projects = 25%
- ✓ Final exam = 35%

Σ 100% !

## ORGANIZATION

- ▶ ✉ Michelhenry.bouchet@skema.edu
- ▶ Appointments ☎ 0493954596
- 1. Urgency 1: ☎ 0033-658176702
- 2. Urgency 2: ☎ 0034-633335422
- 3. Urgency 3: ☎ 00216-21016000

▶ Course slides on Skema-K2

- ▶ **Web site of Global Finance Center:**

<https://www.developingfinance.org>

[Country Risk in the Age of Global Turbulences](https://www.udemy.com/course/country-risk-in-the-age-of-global-turbulences/)

<https://www.udemy.com/course/country-risk-in-the-age-of-global-turbulences/learn/v4/overview>

# COUNTRY RISK QUIZ TIME!



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# SK

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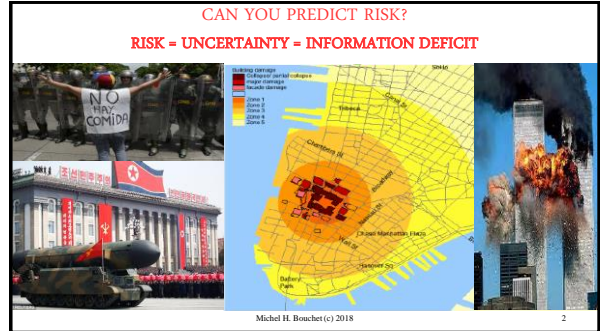
## What is Risk all about?

"Converting risks into springboards of success"  
Michel Henry Bouchet

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### CAN YOU PREDICT RISK?

**RISK = UNCERTAINTY = INFORMATION DEFICIT**






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### WHAT IS RISK?

- ▶ Risk stems from all the negative consequences of the unknown
- ▶ "Risk means more things can happen than will happen." Elroy Dimson
- ▶ "Risk" derives from the early Italian *risicare* = "to dare": risk is a choice rather than a fate.

Peter L. Bernstein- *Against the Gods: The Remarkable Story of Risk*




**Risk is always related to Uncertainty!**

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### WHAT IS RISK ABOUT?

- ▶ Risk stems from all the uncertainty regarding current or future situations, where information about the situation's outcome is insufficient, lacking or simply wrong

- Information availability = measure of risk (BOP, debt data, governance, corruption...)
- Information scarcity = taking action might produce negative and costly consequences (investigation time, transaction cost, delays...)

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### RISK & UNCERTAINTY

► **Frank Knight:** 1921 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

► **Harry Markowitz:** 1959: Risk = probability of loss = historical volatility in returns as measured by standard deviation or Beta. But risk diversification and tolerance also matter!

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

► **Ulrich Beck:** 2010: « Global risk society where current decisions and technological developments trigger long-term global impact » (warming, terrorism, pollution, financial deregulation...)

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| Strong Uncertainty   | Weak Uncertainty   | Ambiguity   | Complexity   |
|--|--|---|--|
| <p><b>1. Substantive uncertainty</b> = Lack of all the information necessary to make decisions with certain outcomes</p> <p><b>2. Fundamental uncertainty</b> = List of possible events is not predetermined or knowable ex ante, as the future is yet to be created</p> <p><b>3. Procedural uncertainty</b> = Lack of complete knowledge on the part of the economic agents about the very structure of the problem they face given the available information</p> | <p><b>Risk</b> = Decision-makers use homogenous data for additive and <b>fully reliable</b> probability distributions to measure uncertainty</p> <p>Individuals can act on the basis of a probability that is objective (any reasonable person would agree on it) and known.</p> | <p><b>Unforeseen contingencies and « Judgmental uncertainty »</b> = How specifying which of a set of distributions is appropriate in a given situation?</p> <p>High ambiguity even with ample quantity of information due to <b>conflicting opinion and evidence</b>, or poor understanding of the causal process</p> | <p>Individuals are exposed to the occurrence of <b>unexpected events</b> with wide range of ramifications and risk of spill-over effects</p> |

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### ILLUSTRATION OF COUNTRY RISK EXAMPLES OF EVENT UNCERTAINTY

| Country Risk-Event     | Strong uncertainty ?                              | Weak & measurable uncertainty ?                | Ambiguity ?                       | Complexity ?                   |
|------------------------|---|--|-----------------------------------|--------------------------------|
| Economic events        | FDI decision in the UK post-Brexit                | Exchange rate depreciation                     | Inflation decrease                | Sharp fall in commodity prices |
| Socio-political events | Revolution, strikes and coup d'état               | New market-oriented and probusiness government | High rate of electoral abstention | Upcoming elections             |
| Financial events       | Nationalization of banking system                 | Interest rate increase                         | Over-valuation of tech companies  | Abrupt external debt default   |
| Spill-over events      | Regional crisis, contamination and capital flight | US economic recession                          | USD appreciation                  | Regional crisis contamination  |

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**RISK HAS TO DO WITH UNCERTAINTY REGARDING THE FUTURE, HENCE THE NEED OF TACKLING FUTURE PROSPECTS!**

« Ancient times » = circular time.. until the Middle Age

XV° century Renaissance = « Modern time » = merchant time = linear time of economic & financial transactions!

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## THE DISCOVERY OF THE MEASURE OF RISK




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## THE « DISCOVERY » OF RISK




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**NICOLAS DE CONDORCET:** 1765: PROBABILITY DISTRIBUTION AND STATISTICS (BEGINNING OF BIG DATA?)




**Robert Brown:** Scottish botanist: in 1827, while examining grains of pollen suspended in water under a microscope, Brown observed minute particles ejected from the pollen grains, **executing a continuous jittery motion**



**Jules Regnault** (1863): « Le calcul des chances » : random walk model of stock price variations (good/bad speculation)



**Louis Bachelier** (1900): **stock price forecasting** is impossible due to endless number of influences though it is possible to study **probability distribution of price variations** (sigma) = volatility risk



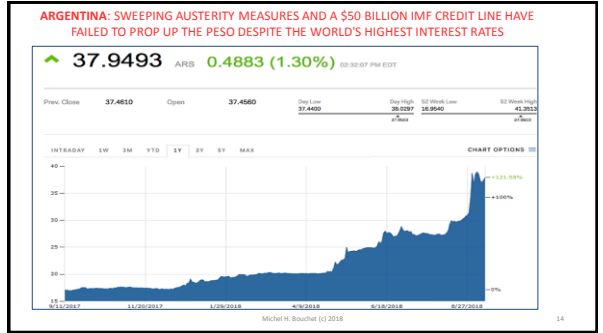
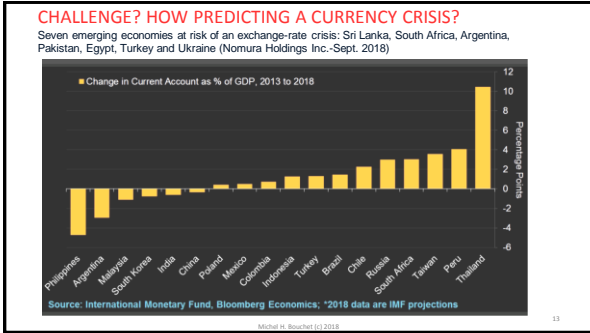
**Alfred Cowles** (1933): forecasting stock market prices is impossible (large gap between actual stock prices and professional forecasting)

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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?

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### CHALLENGE? HOW PREDICTING A CURRENCY CRISIS?

**Liquidity indicators**

- ▶ Foreign-exchange reserves
- ▶ interest rates
- ▶ import cover
- ▶ debt servicing ratio

➤ **Socio-political and behavioral indicators**

- Socio-political turmoil
- Capital flight
- Bank run : number of customers withdraw their deposits simultaneously due to concerns about banking solvency

**Solvency and structural indicators**

- ▶ debt levels (Debt/GDP, Debt/X, ST Debt/R)
- ▶ Worsening terms of trade
- ▶ Productivity's protracted weakness

➤ **Exogenous and global indicators**

- Systemic crisis
- Regional contagion
- Commodity prices
- Interest rate differentials
- \$/€ Exchange rate volatility

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### BUT NOW HOW TACKLING AN « ABNORMAL » RISK? LARGE, ABRUPT, AND OUTSIDE THE STANDARD TOOLKIT OF RISK INDICATORS?

**Gradual trend of mounting riskiness**

- ▶ Liquidity indicators
- ▶ Solvency ratios
- ▶ Ratings and rankings
- ▶ Surveys and polls
- ▶ Behavioral change
- ▶ Growth slowdown

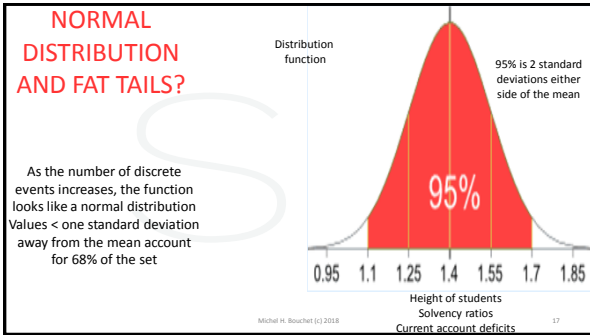
= « Gaussian law »

**Abrupt turmoil and crisis**

- ▶ War
- ▶ Coup d'état and Revolution
- ▶ Commodity crisis
- ▶ Exchange rate devaluation
- ▶ Bank run
- ▶ Debt crisis and default
- ▶ Nationalization & confiscation

= « fat tails and black swans »

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### BLACK SWANS AND DRAGON KINGS

- **Nassim Taleb's Black Swans:** Major catastrophes are just events that started small and did not stop growing to develop into extreme sizes. These events are **unpredictable!** Black Swans are quantified by heavy-tailed distributions of event sizes ("fat tails" in Gaussian distributions). These outliers are anomalies with an abnormal distance from other values in a random sample from a population.

- **Sornette's Dragon Kings:** Very large in impact and born out of unique origins: non-linear systems. These **extreme events** are generated by herd-instinct, feedbacks, and unsustainable super-exponential acceleration before collapse. DKs are beyond the extrapolation of the fat tail distribution of the rest of the population. Their occurrences can be **diagnosed ex-ante**, bringing back responsibility and accountability.

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### POWER LAWS AND EXTREME RISKS?

**Power law probability distributions** = Functional relationship between 2 quantities, where a relative change in one quantity results in a proportional relative change in the other quantity, independent of the initial size of those quantities: one quantity varies as a power of another.

- Considering the area of a square in terms of the length of its side, if the length is doubled, the area is multiplied by a factor of four!
- Car exhaust is distributed according to a power-law among cars : very few cars contribute to most contamination
- Wealth gap and Pareto distribution: The net worth of Americans is distributed according to a power law with an exponent of 2 (the average income hides fat-tails!)
- Power-law distributions are plotted on doubly logarithmic axes, which emphasizes the upper tail region ("extreme events")
- Log-log plot and power-law graph of cumulative distribution of ranking of popularity: right= long tail and left= the few that dominate, also known as the 80-20 rule

Income

Population cumulative distribution

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### HOW DOES A GLOBAL BANK LIKE SOCIETE GENERALE MEASURE THE RISK OF « BLACK SWANS »?

SG Swan Chart

Mexico and trade wars (10%)

China tariff sanction (20%)

Sharp increase in bond yields (25%)

Political uncertainty (e.g. 30%)

More cyber (10%)

Significant fiscal deterioration & fast track reform (5%)

Downside risks to the growth outlook

Upside risks to the growth outlook

The y-axis gives an indication of how probable we consider a risk factor to be. The size of the swans gives an indication of how important the impact of that event materializing would be in terms of its upside or downside shock to the outlook.

Source: SG Credit Asset Research/Economics

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## CONCLUSION

- Transforming information into economic intelligence =  
Best risk mitigation strategy!

## BETTER OFF IN TUNISIA OR IN ALGERIA?



## TUNISIA

- GDP Per capita = \$10500
- HDI= 97
- Life expectancy f = 77
- Infant mortality= 13/1000
- Gender inequality: 0,28
- Doing Business= **88**
- Corruption = 74



## ALGERIA

- GDP Per capita=13500
- HDI= 83
- Life expectancy f= 75
- Infant mortality= 22/1000
- Gender inequality: 0,43
- Doing Business= **166**
- Corruption = **112**

## MOROCCO



- GDP per capita ppp= \$7200
- HDI = 123
- Life expectancy= 74
- CPI corruption= 81
- Gender inequality = **0,49**
- Infant mortality= **23,7/1000**
- Doing Business = **68**
- FDI= **Tunisia \* 2**

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**A glance at academic approaches to risk:  
from Keynes to Stiglitz**  
Michel Henry Bouchet

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**Market**



**State**



↓

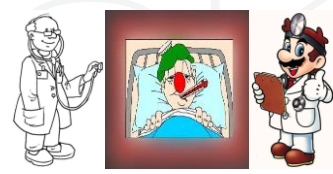
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GLOBAL RISKS - A POLARIZED DEBATE

|   | Positive sum game > 0<br>"win-win"   | Distorted growth process<br>Zero-sum game  |
|---|--|--|
| <b>Neo-classical economists</b>                     | Adam Smith, David Ricardo, Benjamin Constant, Frédéric Bastiat, Friedrich Hayek  | Karl Marx, F. Engels, Léonine, Rosa Luxembourge  |
| <b>Contemporary economists</b>                      | Kenneth Arrow, Milton Friedman, Walter Rostow, Robert Lucas, Jagdish Bhagwati, Anne Krueger, Stanley Fisher, Rüdiger Dornbusch, Alan Greenspan, Kenneth Rogoff | Paul Prebisch, Hans Singer, Paul Baran, Paul Sweezy, Aglietti Emmanuel, Harry Magdoff, Immanuel Wallerstein, Samir Amin, Gunther Frank, P. Krugman, J. Sachs, J. Stiglitz, Michel Aglietta, Thomas Piketty, MH. Bouchet, James Galbraith |
| <b>Social scientists</b>                            | 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  |
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GLOBAL CRISIS - **CONFLICTING DIAGNOSIS -**  
**CONFLICTING CRISIS MANAGEMENT STRATEGY -** DIFFERENT POLICY TOOL-KIT !



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### 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

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### A glance at modern approaches to risk and uncertainty

1. P. Krugman
2. J. Stiglitz
3. Hyman Minsky
4. B. Mandelbrot
5. T. Piketty

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### 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

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### Financial Globalization and Country Risk?

#### TWO SCHOOLS OF THOUGHT

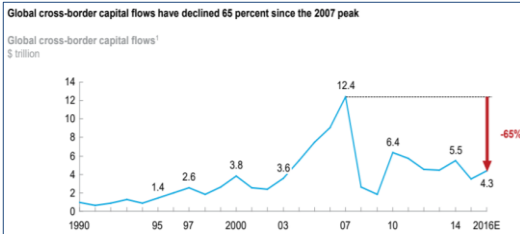
► 1- Stiglitz, Sachs, Eichengreen, Krugman, Rodrik... Financial and capital account liberalization = capital flow volatility + financial crises = capital controls + Tobin taxes + pressure to promote **finance sustainability** (Environmental + social concerns-IFC)

► 2. Quinn, Edwards, Edison, Greenspan, Fischer, Summers...  
► Fruitful openness to global capital flows = higher capital efficiency North-South + technology spillover + financial market liberalization + FDI =  $\Delta$  GDP

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

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



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](http://www.nytimes.com/2007/05/14/opinion/14krugman.html?_r=1&ref=paulkrugman)

PAUL KRUGMAN: THE "WAY FORWARD"?

- ▶ **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 banking crisis because no bank can convert all its assets into cash on short notice;
2. a currency crisis because panicked investors were trying to convert baht or rupiah into dollars.
3. a governance crisis

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

- ▶ There was 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?**

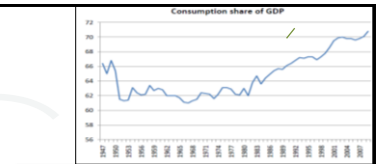
- ▶ Neoliberal agenda's 4 key features:
  1. Increased competition (opening up of domestic markets)
  2. Deregulation (interest and exchange rates)
  3. Capital account liberalization
  4. Smaller role for the state (privatization and fiscal austerity)

**Do austerity 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



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### 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.

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### 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.

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### 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

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### 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.

### HYMAN MINSKY

(1919-1996)



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### 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!

### MINSKY : WEALTH EFFECT AND DEBT CRISIS?

- ▶ Prolonged economic stability encourages deregulation + financial innovation + debt accumulation = higher leverage, leading to liquidity and solvency 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>

### THOMAS PIKETTY:

#### INCOME INEQUALITY AND WEALTH DISTRIBUTION IN XXI<sup>o</sup> 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 wealth stock relative to the income generated ( $K=5x Y$ )

### CONCLUSION

- ▶ 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!

# GLOBALIZATION: A POLARIZED DEBATE THE “ANTI-MARKET GLOBALIZATION” SIDE

## 2. THE NEO-KEYNESIANS

Michel Henry Bouchet

[www.developingfinance.org](http://www.developingfinance.org)

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# SK



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



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## GLOBALIZATION = A POLARIZED DEBATE

|   | <b>Positive sum game &gt; 0<br/>"win-win"</b>  | <b>Distorted growth process<br/>Zero-sum game</b>  |
|---|--|--|
| <b>Neo-classical economists</b>                     | Adam Smith, David Ricardo, Benjamin Constant, Frédéric Bastiat, Friedrich Hayek  | Karl Marx, F. Engels, Lénine, Rosa Luxembourg  |
| <b>Contemporary economists</b>                      | Kenneth Arrow, Milton Friedman, Walter Rostow, Robert Lucas, Jagdish Bhagwati, Anne Krueger, Stanley Fisher, Rüdiger Dornbusch, Alan Greenspan, Kenneth Rogoff | Paul Prebisch, Hans Singer, Paul Baran, Paul Sweezy, Arghiri Emmanuel, Harry Magdoff, Immanuel Wallerstein, Samir Amin, Gunther Franck<br>P. Krugman, J. Sachs, J. Stiglitz, Michel Aglietta, Thomas Piketty, MH. Bouchet, James Galbraith |
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## THE « OFF MAIN-STREAM » DISSIDENDS (Keynesian tradition)

1. P. Krugman
2. J. Stiglitz
3. J. Sachs
4. James Galbraith
5. Hyman Minski
6. B. Mandelbrot
7. The « French School »



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## THE « DISSIDENTS » ARE NEO-KEYNESIANS

- ☞ For short hand, they 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)
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## FINANCIAL GLOBALIZATION AND ECONOMIC GROWTH? TWO SCHOOLS OF THOUGHT

☞ 1- **Stiglitz, Sachs, 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. **Greenspan, Fischer, Summers...**  
☞ Openness to global capital flows = higher capital efficiency North-South + technology spillover + financial market liberalization + FDI =  $\Delta$  GDP

Prasad-Rogoff IMF-Harvard 2006

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## ☞ TWO-FOLD EMANCIPATION

(Bouchet-Pearson, Paris 2006)

- **1960s: Economic system from Political system** (MNCs, trade openness, privatization, economic liberalization, deregulation...)
- **1980s-90s: Financial system from Economic system** (global investment funds, offshore centers, derivatives...) The financial system cut loose from its economic base, hence dwarfing it

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## HA-JOON CHANG: STRATEGIC TRADE PROTECTIONISM TO PROTECT INFANT INDUSTRY IN EMCS

Globalization is too important to be left to free-trade economists' policy advice!

Japan, the US and the UK have based their economic take-off on trade protectionism

- ☞ **In the UK:** 1721: average industrial tariff rate of 40-50 per cent, compared with 20 per cent and 10 per cent in France and Germany respectively. Britain moved to free trade only in the 1860s
- ☞ **In the US:** 1789: protective tariffs, subsidies, import liberalisation of industrial inputs, patents for inventions and support of development of the banking system. Following the Anglo-American war in 1812, the US started shifting to a protectionist policy; by the 1820s, its average industrial tariff had risen to 40 per cent. By the 1830s, America's average industrial tariff rate was the highest in the world and, except for a few brief periods, remained so until WWII, at which point its manufacturing supremacy was absolute

[http://www.prospect-magazine.co.uk/article\\_details.php?id=9653](http://www.prospect-magazine.co.uk/article_details.php?id=9653)

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## PAUL KRUGMAN'S VIEW ON GLOBALIZATION

Ph.D. in 1977 from MIT.

Council of Economic Advisors (1982)

John Bates Clark Medal (1991)

Nobel Prize 2008. NY Times columnist. Currently at Princeton.



“**New trade theory**“ deals with the consequences of increasing returns, preference for diversity in consumption, and imperfect trade competition.

Ricardo and Heckscher-Ohlin theories emphasize trade based on the comparative advantage of countries with different characteristics (agriculture/industry productivity). But an ever larger share of trade occurs between countries with similar characteristics. Krugman argues that trade is welfare enhancing because the scale of production can increase, hence reducing costs and prices.

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## KRUGMAN AND INTERNATIONAL TRADE

- ☞ Challenge: **consumers** prefer a diverse choice of brands, but **production** favors economies of scale.
- ☞ In each country, consumers have a preference for variety but there is a tradeoff between variety and cost: consumers want variety but since there are economies of scale – a firm’s unit costs fall as it produces more – more variety means higher prices. Preferences for diversity push in the direction of wider choice, economies of scale push in the direction of less.
- ☞ Trade, largely shaped by economies of scale, remains beneficial, even between similar countries: it permits firms to save on costs by producing at a larger, more efficient scale: it increases the range of brands available and sharpens the competition between firms.
- ☞ Economies of scale in production and a preference for diversity in consumption lead each country to specialize in producing a few brands of any given type of product, instead of specializing in different types of products.

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## 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!**
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### **Krugman’s view on Asia’s 1997-98 economic crisis**

- IMF’s shortsighted approach to the crisis:
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The result was a combined crisis:

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## **IMF DECLARATIONS ON THE EVE OF THE ASIAN CRISIS (04/1997)**

***« Directors welcomed Korea's continued impressive macroeconomic performance [and] praised the authorities for their enviable fiscal record »***

***« Directors strongly praised Thailand's remarkable economic performance and the authorities' consistent record of sound macroeconomic policies »***

IMF, 1997 annual report

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

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

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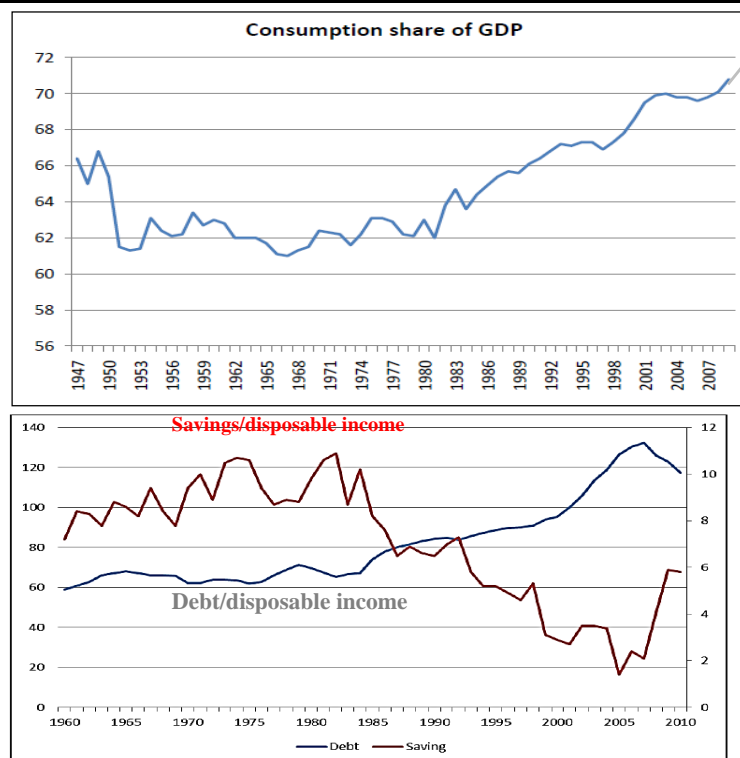
## KRUGMAN ON GLOBALIZATION AFTER THE CRISIS

6 minutes on Globalization

<http://www.youtube.com/watch?v=VJiQsgikZeM>

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



Stiglitz, Rajan, Krugman 2011-12 NIPA, Flow of Funds; authors' calculations

### *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)
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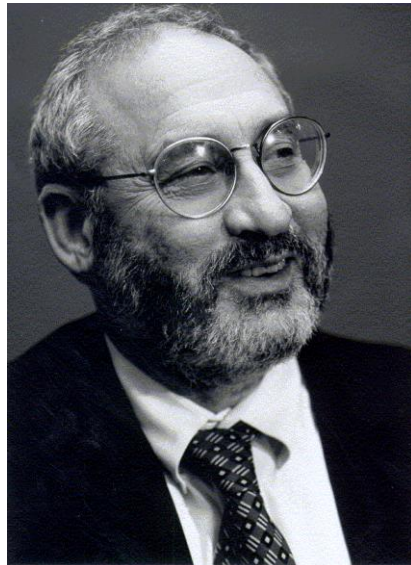
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4. Decreasing debt does not boost growth!



Source: IM Finance & Development, June 2016

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## JOSEPH STIGLITZ'S VIEWS



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### WHAT IS ASYMMETRY OF INFORMATION?

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## APPLE, GOOGLE AND STIGLITZ: THE PROBLEM OF MULTINATIONAL CORPORATE TAX AVOIDANCE

- ☞ Globalization has made us increasingly interdependent.
- ☞ MNCs are the big beneficiaries of globalisation. **Multinationals** have learned how to exploit globalization in every sense of the term – including exploiting the tax loopholes that allow them to evade their global social responsibilities. Big corporates are gaming one nation's taxpayers against another's.
- ☞ It is time the international community faced the reality: we have an unmanageable, unfair, distortionary **global tax regime**. It is a tax system that is pivotal in creating the increasing inequality that marks most advanced countries today!

☞ <http://www.guardian.co.uk/commentisfree/2013/may/27/globalisation-is-about-taxes-too>

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## 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.

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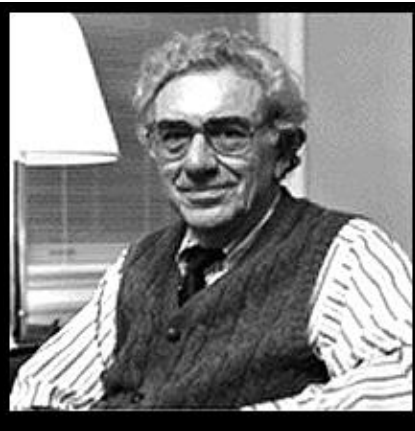
## THOMAS FRIEDMAN:

*GLOBALIZATION, THE LEXUS AND THE OLIVE TREE (2000)*

- ☞ He dramatizes the conflict of "the Lexus and the olive tree" – the tension between the globalization system and ancient forces of culture, geography, tradition, and community.
- ☞ He also details the powerful backlash that globalization produces among those who feel brutalized by it
- ☞ Against the « Washington consensus »: the « golden straitjacket » sums up today's neoliberal orthodoxy : countries should privatise state-owned enterprises, maintain low inflation, reduce the size of government, balance the budget, liberalise trade, deregulate foreign investment and capital markets, make the currency convertible, reduce corruption and privatise pensions.
- ☞ All this leads to volatility, social disruption, crises, regional and global recession

[http://www.columbia.edu/cu/news/vforum/03/globalization\\_inequality/index.html](http://www.columbia.edu/cu/news/vforum/03/globalization_inequality/index.html)

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## HYMAN MINSKY

(1919-1996)



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## MINSKY AND THE *RECURRING* FRAGILITY OF FINANCIAL STRUCTURES

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

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## MINSKY WEALTH EFFECT AND DEBT CRISIS?

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

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## 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.

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## 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 baby steps. Despite increasing empirical evidence that concentration and volatility better characterize market reality, the reliance on the bell-shaped curve still prevail
- ☞ 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

(Mis)Behavior of Markets

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## THE « FRENCH SCHOOL »

☞ **F. Braudel**

☞ **R. Aron**

☞ **M. Foucault**

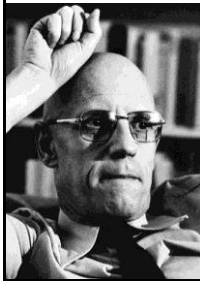
☞ **P. Bourdieu**

☞ **C.A. Michalet**

☞ **B. Stiegler**

☞ <http://www.youtube.com/watch?v=Z3UwC5omnce>

☞ **T. Piketty**



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### THOMAS PIKETTY: INCOME INEQUALITY AND WEALTH DISTRIBUTION IN XXI<sup>o</sup> 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 wealth stock relative to the income generated ( $K= 5x Y$ )

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# SK

SKEMA BUSINESS SCHOOL

## What is Country Risk all about?

Michel Henry Bouchet

skema EQUIS ACCREDITED AACSB ACCREDITED AMBA ACCREDITED

### «YESTERDAY'S» COUNTRY RISK

- ▶ Traditional definition of cross-border financial risk:  
**Assessment of a foreign entity's ability and willingness to meet its external obligations in full and on time**
- ▶ Foreign entity? Private firm, country government, bank, supplier, client, partner..
- ▶ Country risk is composed of a complex combination of **political, financial and macro-economic risk**

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

Operational definition:  
Set of interdependent economic, financial and socio-political factors, specific for a particular country in the global economy, which can affect both domestic and foreign economic agents, relating to savings, investment, and credit transactions.

- ▶ Domestic agents? Private firms, households, banks, merchants, exporters and importers, students...
  - ▶ Country risk is composed of a complex combination of **political, financial and macro-economic risk that must be assessed in the globalized system**

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### WHAT COUNTRY RISK IS NOT

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

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### COUNTRY RISK IN THE AGE OF DONALD TRUMP

**Direct «hard risks»**

- Risk materialization directly hurts US business: outbreak of a military conflict between North Korea and the United States; sharp rise in interest rates and fall in bond prices; stock market crash; sharp weakening of USD; protracted renegotiation of NAFTA ; mounting trade and geopolitical tensions with China

**Indirect «surrounding risks»**

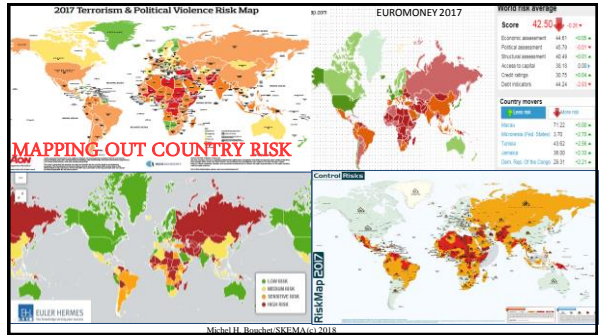
- Risk materialization stems from a more hostile environment: protracted stalemate between White House and Congress regarding budgetary policy; ongoing saber-rattling with North Korea; trade retaliation by Mexico and Canada; regional crisis in the Western Hemisphere

**Collateral «soft risks»**


- Risk materialization as byproduct of unfavorable interactions between power groups: impeachment of Donald Trump; global protectionism, fiscal uncertainty, mounting wealth gap, pressure groups and hostile NGOs



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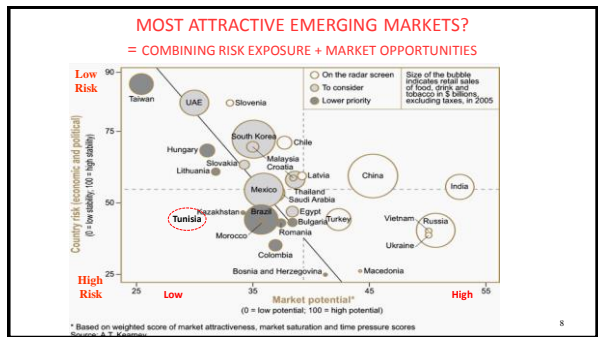
### TACKLING COUNTRY RISK

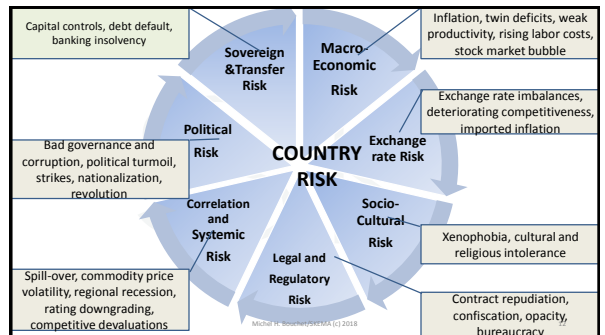
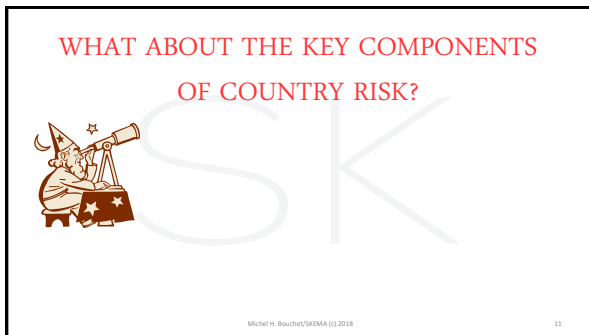
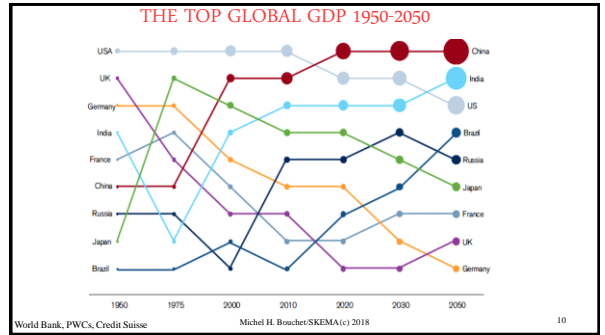
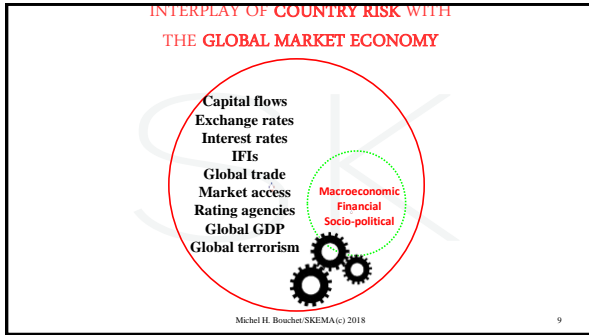


## COUNTRY + RISK

- **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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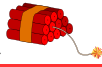






### MAIN COMPONENTS OF GLOBAL RISK

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

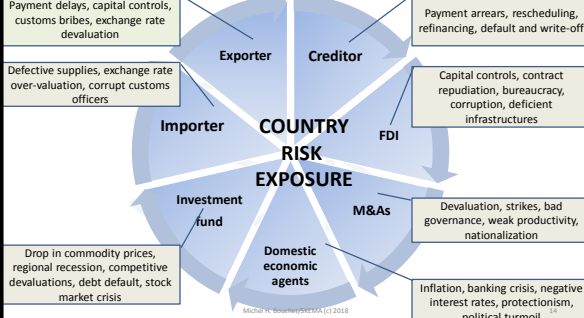
Quantifiable but ultimately judgmental

Subjective, insurable and diversifiable



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### COUNTRY RISK EXPOSURE







- Exporter:** Payment delays, capital controls, customs bribes, exchange rate devaluation
- Creditor:** Payment arrears, rescheduling, refinancing, default and write-off
- FDI:** Capital controls, contract repudiation, bureaucracy, corruption, weak infrastructures
- M&As:** Devaluation, strikes, bad governance, weak productivity, nationalization
- Domestic economic agents:** Inflation, banking crisis, negative interest rates, protectionism, political turmoil
- Investment fund:** Drop in commodity prices, regional recession, competitive devaluations, debt default, stock market crisis
- Importer:** Defective supplies, exchange rate over-valuation, corrupt customs officers

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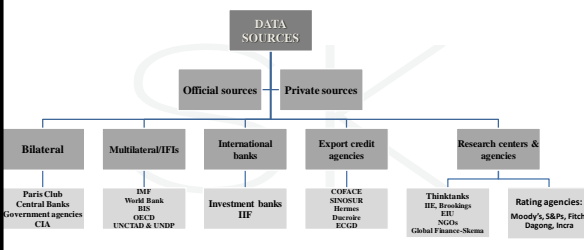
### COUNTRY RISK ASSESSMENT

Reliable and updated information  
= Economic intelligence

▶ Robust risk analysis

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### MAJOR SOURCES OF COUNTRY RISK INTELLIGENCE



- DATA SOURCES**
  - Official sources**
    - Bilateral:** Paris Club, Central Banks, Government agencies, CIA
    - Multilateral/IFIs:** IMF, World Bank, BIS, OECD, UNCTAD & UNDP
    - International banks:** Investment banks, IIF
    - Export credit agencies:** COFACE, SINOSURE, Hermes, Deutsche, ECGI
  - Private sources**
    - Research centers & agencies:** Thinktanks (IIE, Brookings, EIU, NGOs, Global Finance-Skema), Rating agencies (Moody's, S&P, Fitch, Dun & Bradstreet)

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#### 4 MAIN APPROACHES TO COUNTRY RISK ASSESSMENT

1. **Qualitative approach:** financial, macroeconomic, legal, regulatory and political parameters
2. **External debt analysis:** Balance of payments + liquidity and solvency
3. **Quantitative approach :** rating and scoring
4. **Econometric approach** and modelization



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# SK

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## Global risk and the mounting wealth gap

Michel Henry Bouchet



**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



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## 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)

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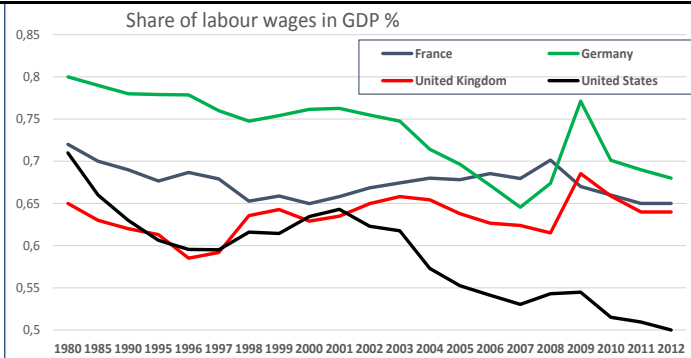


## FACT: INCOME UNEQUALITY IS NOT A MONOPOLY OF DEVELOPING COUNTRIES!

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.

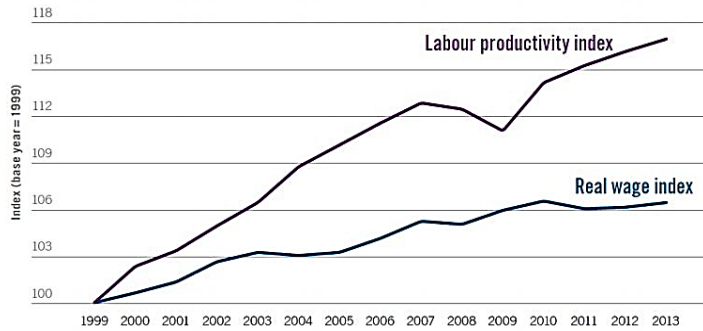
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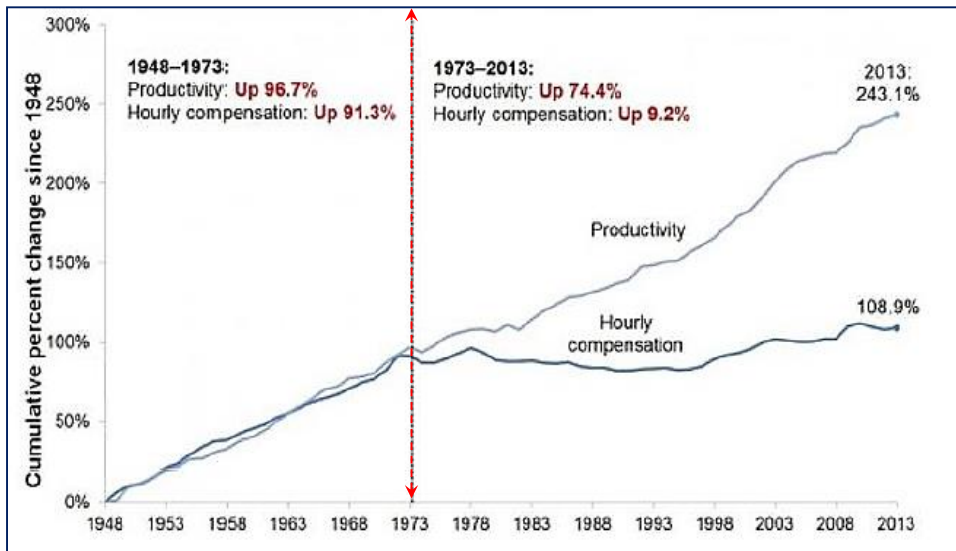
FALLING SHARE OF  
WORK SALARY IN  
GLOBAL VALUE  
ADDED  
1980-2015

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

Source: OECD data



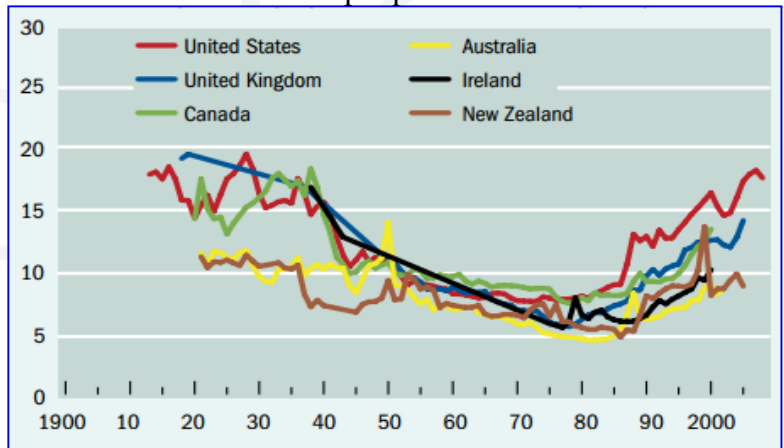
THE RACE BETWEEN WAGES AND PRODUCTIVITY IN THE US  
(AND MOST OECD COUNTRIES!)



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

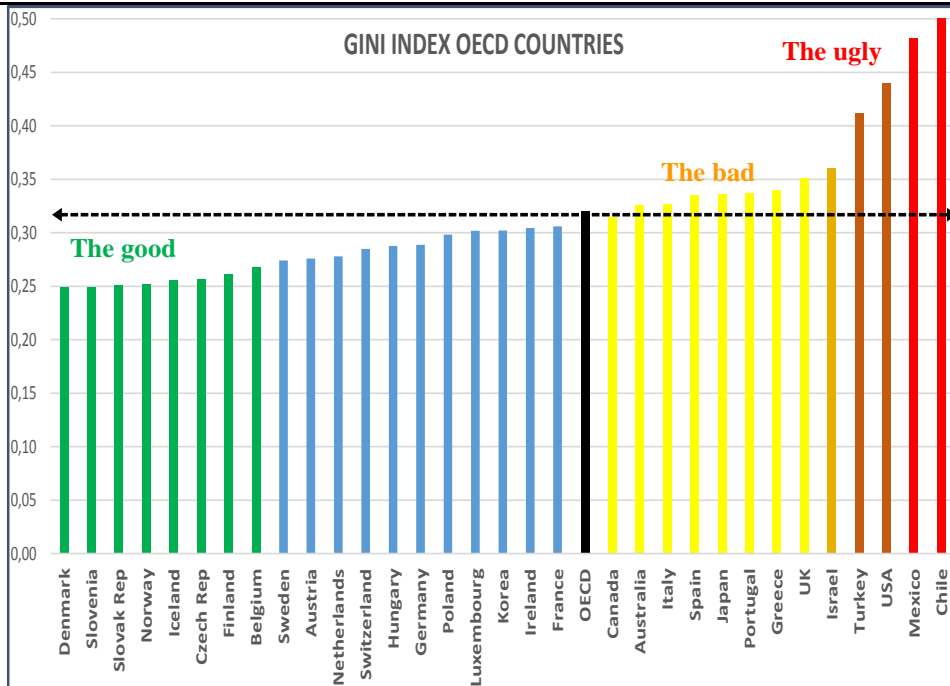
Share in income distribution  
of top 1 percent



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

Source: IMF

GINI INDEX OECD COUNTRIES



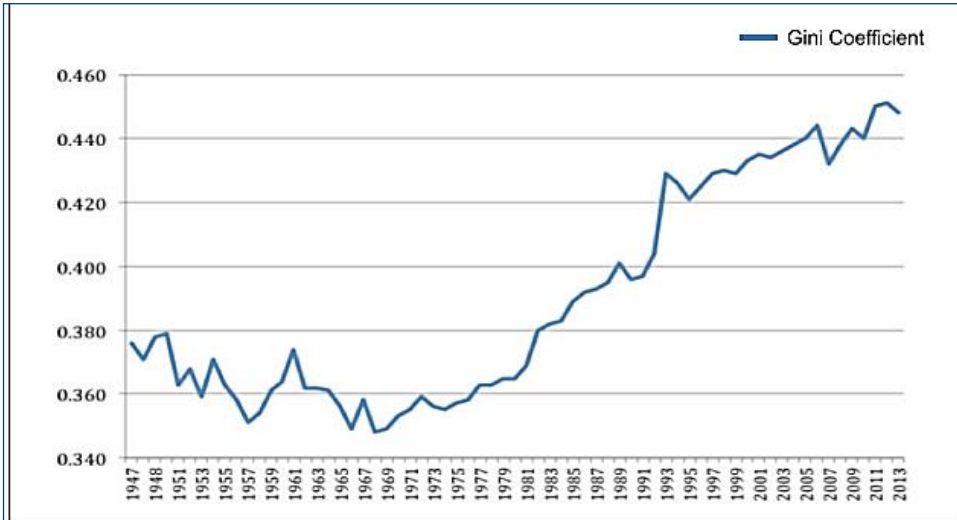
OECD 2016

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### US FAMILIES' INCOME DISTRIBUTION GAP

GINI INDEX 1947-2015

= RISING INEQUALITY + SHRINKING MIDDLE-CLASS

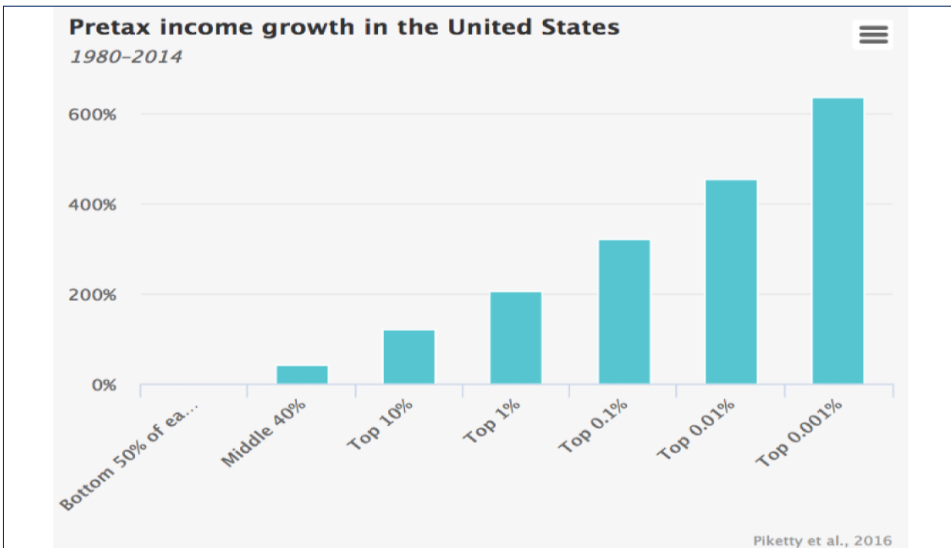


Source: U.S. Census Bureau, *Historical Income, Families*

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### 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.

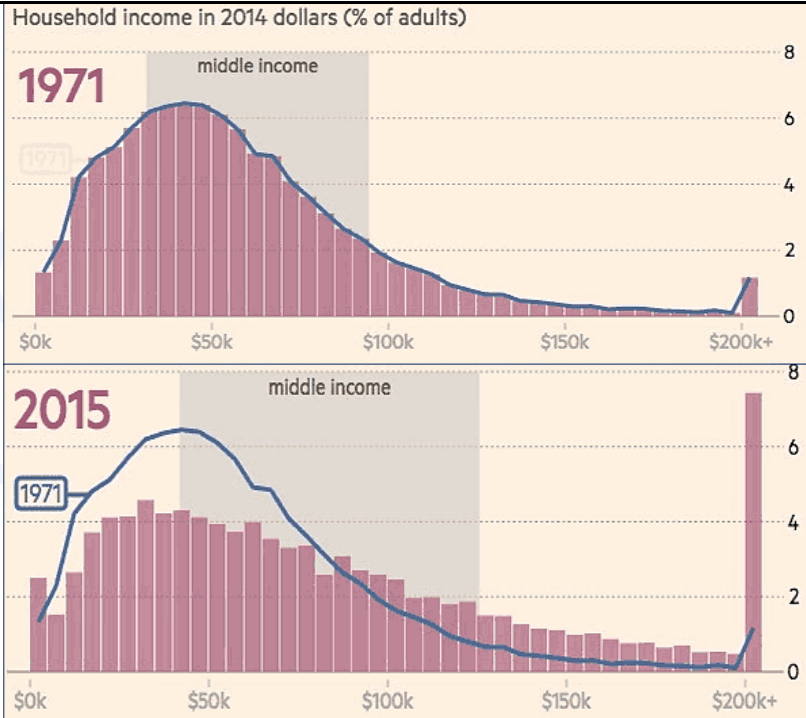


SOURCE: Chicago Booth

Piketty et al., 2016

BUSINESS INSIDER

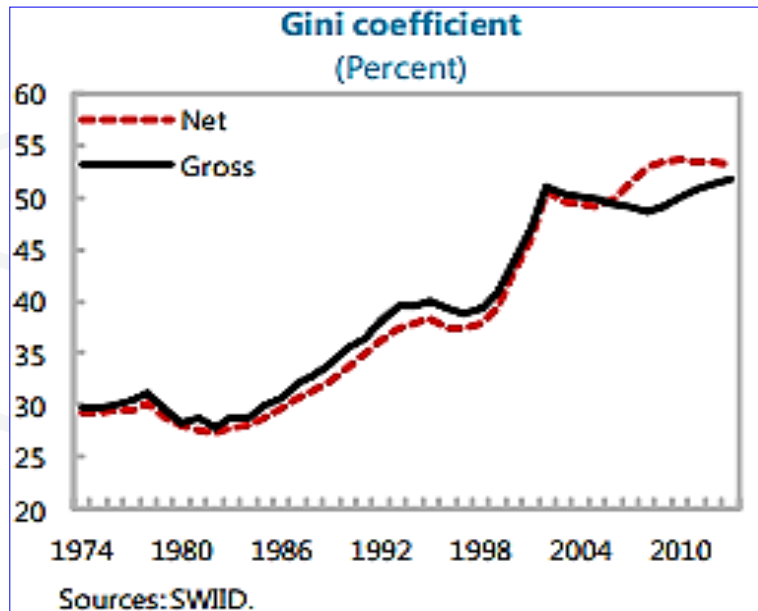
**THE SHIFT IN  
US INCOME  
DISTRIBUTION  
1971-2015**



Source: Pew Research Center 12/15

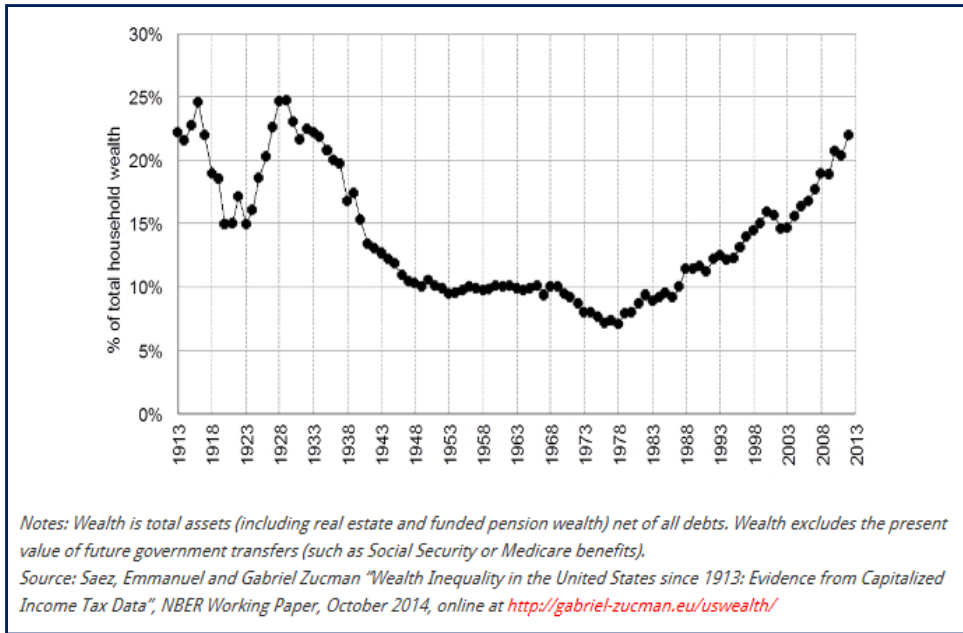
**CHINA'S RISING WEALTH GAP**

Gini coefficient reaches 0,5



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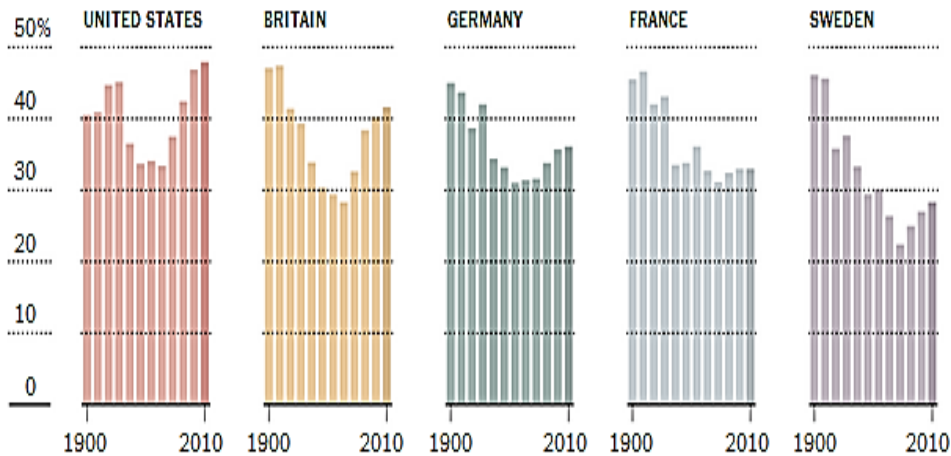
**US WEALTH ACCUMULATION: TOP 0,1% 1913-2013 = 22%**



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

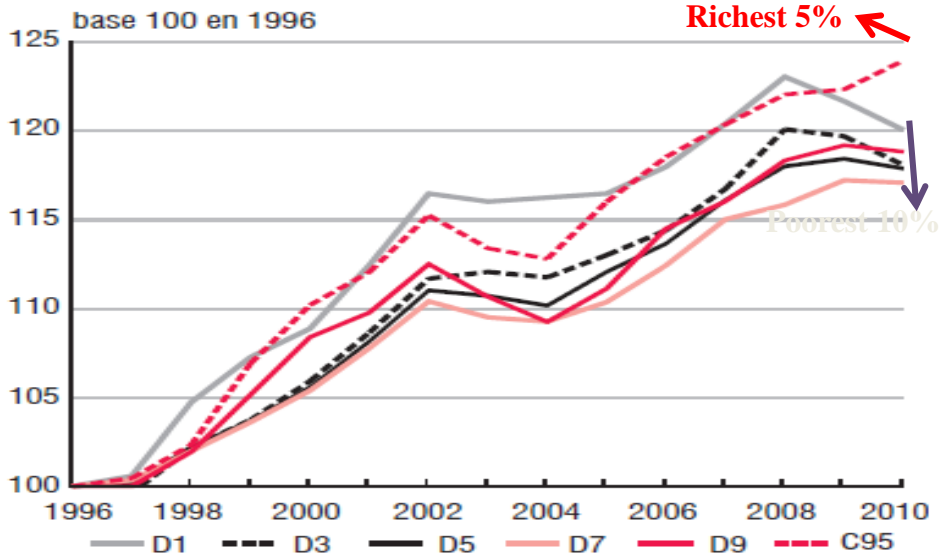
**Share of total income of the richest 10 percent**



Source: T. Picketty 2014

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



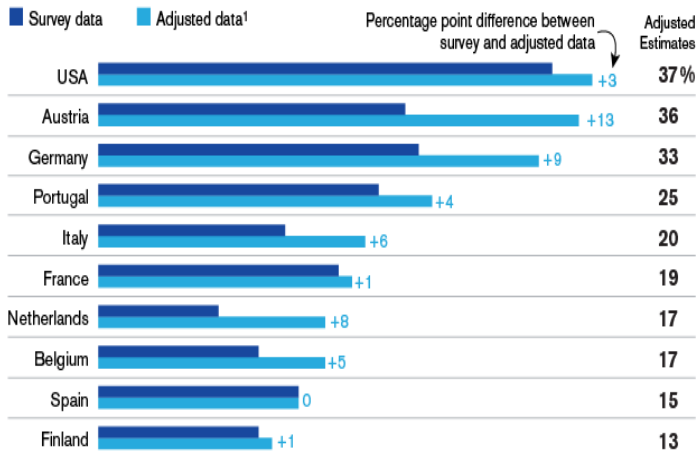
INSEE 09/2012

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**How Rich are the Top 1 Percent, Really?**

The wealth held by the top 1 percent of households is probably underestimated, according to an ECB paper that offers an adjusted estimate relying partly on Forbes Billionaires data.

Percentage of a nation's wealth held by the top 1 percent of households<sup>1</sup>



1 - One adjustment by Philip Vermeulan using a regression method and Forbes Billionaires data  
Source: Philip Vermeulan at European Central Bank

Bloomberg Visual Data

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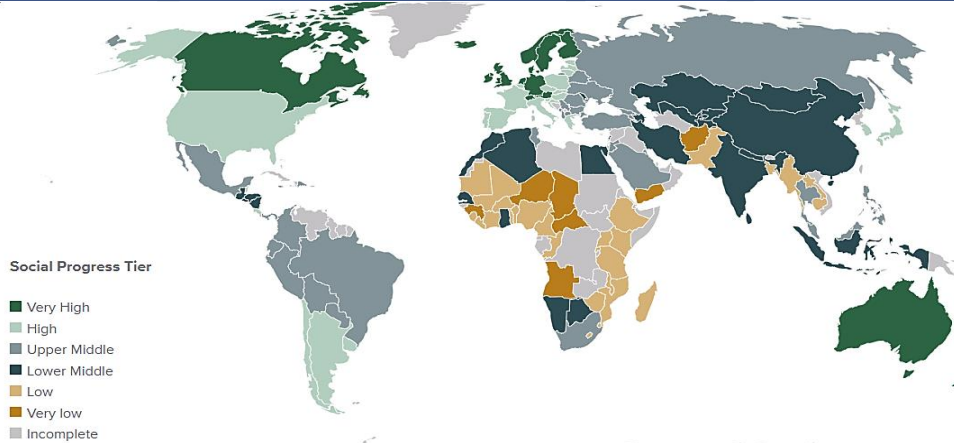
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## MEASURING SOCIO-ECONOMIC PROGRESS ACROSS TIME AND ACROSS COUNTRIES?



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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 choice + political choice)

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Country Risk Economic Intelligence and Information Sources  
Michel Henry Bouchet

skema

COUNTRY RISK ASSESSMENT

Economic intelligence + reliable and updated information sources  
=  
**robust risk analysis**

skema

**KEY INFORMATION SOURCES**

- IMF, World Bank, IFC & MIGA
- UNCTAD & UNDP
- BIS, OECD, EBRD
- Coface, Euler-Hermes
- Moody's, S&P, Fitch
- Euromoney, Institutional Investor
- CIA & US State Dept
- Transparency International
- Hiscox, AON, Control Group
- DEFI [www.developingfinance.org](http://www.developingfinance.org)

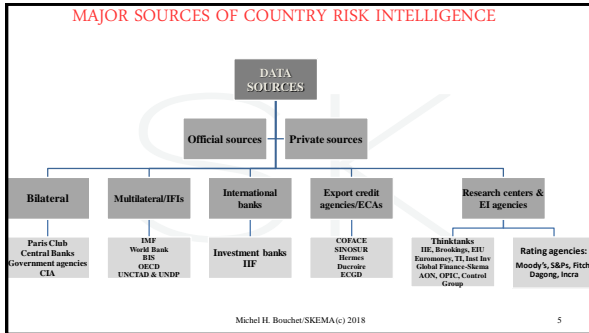
skema

**ECONOMIC INTELLIGENCE =**  
TRANSFORMING INFORMATION INTO RISK STRATEGY

Macro-Eco Structures (1960-70) | Debt & BoP (1980) | Banking & Finance (1990) | Governance (2000) | Regulation & Leverage (2008) | Shadow Economy, Capital Flight, Corruption (2010-18)

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4



### 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 OPIIC)
2. Research institutes (IEE, 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, Inkra)

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- ### 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](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

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IMF AS SOURCE OF MACRO-ECONOMIC INFORMATION

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

|                        | Ecuador |         |         |         |         |         |         |         |         |         |         |         |         |         |
|------------------------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
|                        | 2008    | 2009    | 2010    | 2011    | 2012    | 2013    | 2014    | 2015    | 2016    | 2017    | 2018    | 2019    | 2020    | 2021    |
| <b>Current account</b> | 1,716   | 309     | -1,586  | -483    | -568    | -567    | -2,247  | -2,289  | -978    | -874    | -549    | 196     | 196     | -484    |
| Exports                | 1,549   | 161     | -1,394  | -89     | -95     | -93     | -1,208  | -1,201  | 158     | 30      | 78      | 1,208   | 1,208   | -25     |
| Imports                | 16,483  | 16,462  | 18,117  | 20,802  | 20,806  | 20,804  | 20,806  | 20,806  | 20,806  | 20,806  | 20,806  | 20,806  | 20,806  | 20,806  |
| G.O.                   | 11,773  | 4,262   | 6,973   | 12,946  | 12,946  | 12,946  | 12,946  | 12,946  | 12,946  | 12,946  | 12,946  | 12,946  | 12,946  | 12,946  |
| Non-G.O.               | 2,740   | 1,467   | 8,644   | 10,177  | 11,175  | 11,175  | 11,175  | 11,175  | 11,175  | 11,175  | 11,175  | 11,175  | 11,175  | 11,175  |
| Invisibles (+/-)       | -17,022 | -16,241 | -16,561 | -16,285 | -16,561 | -16,561 | -16,561 | -16,561 | -16,561 | -16,561 | -16,561 | -16,561 | -16,561 | -16,561 |
| G.O.                   | -1,308  | -1,238  | -4,663  | -5,867  | -5,461  | -5,167  | -4,467  | -3,969  | -2,96   | -1,976  | -1,706  | -1,064  | -1,064  | -4,28   |
| Non-G.O.               | -14,714 | -14,999 | -11,898 | -10,418 | -10,999 | -10,999 | -10,999 | -10,999 | -10,999 | -10,999 | -10,999 | -10,999 | -10,999 | -10,999 |
| Services (+/-)         | -1,883  | -1,238  | -1,364  | -1,623  | -1,686  | -1,674  | -1,776  | -1,766  | -1,689  | -1,689  | -1,640  | -1,640  | -1,640  | -1,289  |
| Travelers (+/-)        | 1,123   | 2,722   | 2,461   | 2,222   | 2,489   | 2,244   | 2,278   | 2,238   | 2,246   | 2,291   | 2,425   | 2,278   | 2,278   | 2,723   |

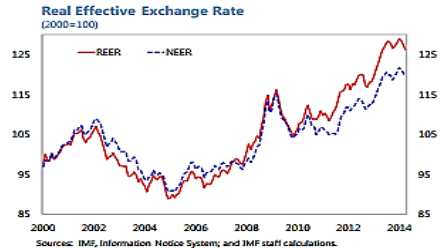
  

**China: Selected Economic Indicators**

|  | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|--|------|------|------|------|------|------|------|------|------|------|------|
| <b>NATIONAL ACCOUNTS</b>                 |      |      |      |      |      |      |      |      |      |      |      |
| Real GDP (base=2012)                     | 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  | 8.3  | 8.4  | 8.6  | 8.0  | 7.4  | 7.1  | 6.6  | 6.3  |      |
| Investment                               | 7.1  | 9.1  | 7.1  | 6.1  | 6.3  | 6.2  | 5.5  | 6.0  | 6.0  | 5.8  | 5.8  |
| Fixed                                    | 9.0  | 9.1  | 6.8  | 6.2  | 6.7  | 6.2  | 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 | -0.1 | -0.1 | -0.2 | -0.2 | -0.2 | -0.1 | -0.1 |
| Total capital formation (percent of GDP) | 47.2 | 47.3 | 46.8 | 44.1 | 44.2 | 43.7 | 42.9 | 42.4 | 42.0 | 41.7 | 41.4 |
| Open national saving (percent of GDP)    | 49.7 | 48.8 | 49.0 | 47.2 | 45.9 | 45.1 | 44.3 | 43.8 | 42.3 | 42.1 | 41.8 |



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



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THE IMF'S WEO



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

STRICTLY CONFIDENTIAL  
UNTIL RELEASED

Less Even Expansion, Rising Trade Tensions

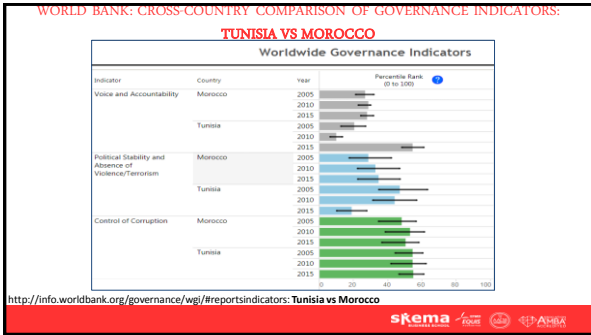
- Global growth is projected to reach 2.9 percent in 2018 and 2019, in line with the forecast of the April 2018 World Economic Outlook (WEO), but the expansion is becoming less even, and risks to the outlook are mounting. The rate of expansion appears to have peaked in some major economies and growth 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.

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WORLD BANK AS SOURCE OF RISK INFORMATION

|   |   |
|---|---|
| <p><b>Global Development Finance (annual)</b></p> <ul style="list-style-type: none"> <li>▶ Vol. 1 = Global tables</li> <li>Total debt stock and flows of EMCs broken down by creditors &amp; maturities</li> <li>▶ Vol. 2 = country tables</li> <li>Total debt and debt servicing payments</li> </ul> | <p><b>Country economic reports</b></p> <ul style="list-style-type: none"> <li>▶ Structural indicators</li> <li>▶ Economic policy issues</li> <li>▶ WB project lending</li> <li>▶ Debt sustainability analysis</li> <li>▶ Governance analysis</li> </ul> |
|---|---|

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**BIS AS SOURCE OF FINANCIAL RISK INFORMATION**

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

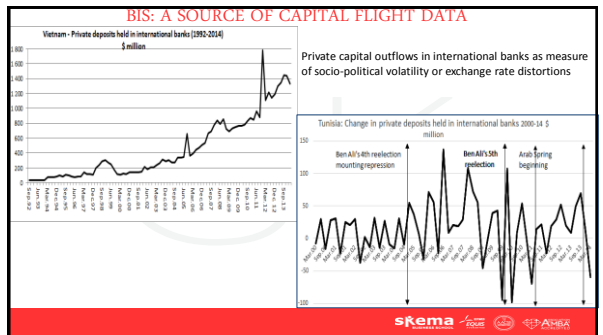
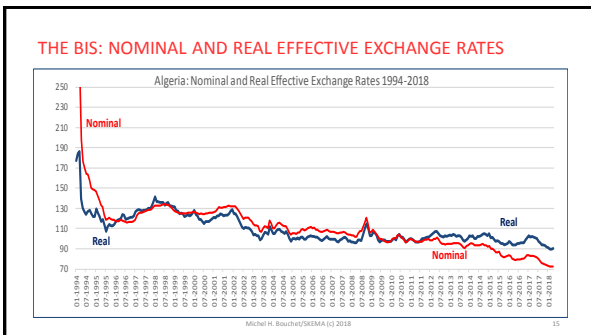
**Global tables**

- 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

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### 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%



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### PARIS CLUB AS 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.



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### 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".

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### THE PARIS CLUB IN 2018

#### 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             |

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**TOTAL CLAIMS OF PARIS CLUB MEMBERS ON EMERGING MARKET COUNTRIES AS OF JANUARY 1, 2017**

Créances au 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  |
|--------------------|--------------|---------------|--------|
| Albanaisien        | 1            | 1 250         | 1 251  |
| Algérie du Sud     | 766          | 173           | 939    |
| Albanie            | 495          | 23            | 517    |
| Algérie            | 520          | 2             | 522    |
| Angola             | 451          | 653           | 1 104  |
| 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     |
| Bielorussie        | 26           | 6 359         | 6 385  |
| Bolivie            | 105          | 2             | 106    |
| Bosnie-Herzégovine | 250          | 374           | 624    |
| Botswana           | 19           | -             | 19     |
| Bulgarie           | 188          | 74            | 262    |
| Burkina Faso       | 140          | 0             | 140    |
| Burundi            | -            | -             | -      |
| Caméroun           | 915          | 1 399         | 2 314  |
| Canada             | 537          | 24            | 562    |
| Cap Vert           | 111          | 47            | 158    |
| Chili              | 90           | -             | 90     |
| Chine              | 14 710       | 1 030         | 15 740 |

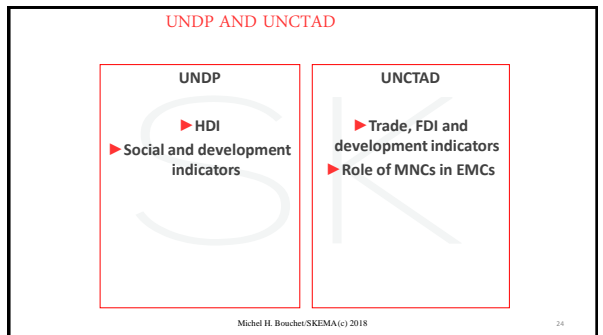
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**PARIS CLUB DEBT RESTRUCTURING TERMS**

| Restructuring Terms | Eligibility                                 | Rescheduling term (T/Grace)   | Debt Reduction Terms  |                                  | Debt Conversion  |
|---------------------|---|-------------------------------|---|----------------------------------|--|
|                     |   |                               | ODA   | Non ODA                          |  |
| Houston 09/90       | GDP per capita < \$2995 and debt/GDP > 50 % | ODA: 20/10<br>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<br>Non ODA: up to 20% of the outstanding amount or 15-30 million SDR |
| Toronto 10/88       | Poorest countries                           | ODA: 25/14<br>Non ODA: 14/8   |   | 33,33%                           |  |
| London, 12/91       | 23 countries                                | ODA: 30/12<br>Non ODA: 23/6   |   | 50%                              |  |
| Naples 12/94        | Poorest countries                           | ODA: 25/14<br>Non ODA: 14/8   |   | 67%                              |  |
| Lyon 11/96          | Poorest countries                           | ODA: 40/16<br>Non ODA: 23/6   |   | 80%                              |  |
| Cologne 11/99       | 41 HIPC                                     | ODA: 40/16<br>Non ODA: 23/6   |   | 90%                              |  |

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- 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 conditional 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.
- skema | foun | abn | ASBIA



|    |                |     |                |
|----|----------------|-----|----------------|
| 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 |

**UNDP**  
**HUMAN DEVELOPMENT INDEX**

Often rich countries with poor!

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**CIA**

▶ The World FactBook  
▶ [https://www.cia.gov/library/publications/the-world-factbook/wfbExt/regio\\_nur.html](https://www.cia.gov/library/publications/the-world-factbook/wfbExt/regio_nur.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.

| RANK | COUNTRY        | GDP (PURCHASING POWER PARITY) | DATE OF INFORMATION |
|------|----------------|-------------------------------|---------------------|
| 1    | CHINA          | \$21,140,000,000,000          | 2014 EST.           |
| 2    | EUROPEAN UNION | \$19,970,000,000,000          | 2014 EST.           |
| 3    | UNITED STATES  | \$18,560,000,000,000          | 2014 EST.           |
| 4    | INDIA          | \$8,721,000,000,000           | 2014 EST.           |
| 5    | JAPAN          | \$4,932,000,000,000           | 2014 EST.           |
| 6    | GERMANY        | \$3,979,000,000,000           | 2014 EST.           |
| 7    | RUSSIA         | \$3,745,000,000,000           | 2014 EST.           |
| 8    | BRAZIL         | \$3,081,000,000,000           | 2014 EST.           |
| 9    | INDONESIA      | \$3,028,000,000,000           | 2014 EST.           |
| 10   | UNITED KINGDOM | \$2,788,000,000,000           | 2014 EST.           |

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- 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
  - ▶ Insurance companies: AON
- skema | AON | ABIA

- 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
- skema | AON | ABIA



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

Rating Distribution of Sovereign Issuers on Selected Dates

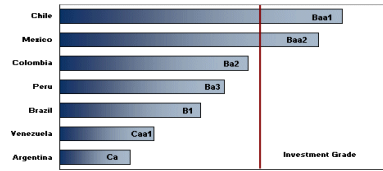
| Rating            | 1983 | 1990 | 1995 | 2000 | 2005 | 2010 | 2011 | 2012 |
|-------------------|------|------|------|------|------|------|------|------|
| Aaa               | 79%  | 33%  | 16%  | 12%  | 19%  | 15%  | 14%  | 13%  |
| Aa                | 21%  | 28%  | 25%  | 15%  | 7%   | 15%  | 11%  | 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

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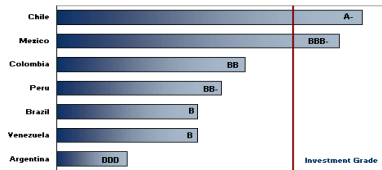
MOODY'S INVESTORS SERVICE LONG-TERM FOREIGN CURRENCY RATINGS



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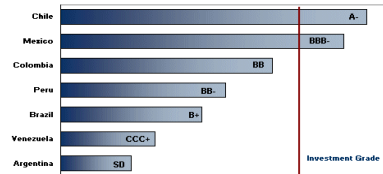
FITCH IBCA, DUFF AND PHELPS LONG-TERM FOREIGN CURRENCY RATINGS



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STANDARD AND POOR'S LONG-TERM FOREIGN CURRENCY RATINGS



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

Sovereign Risk Indicators: Economic Data

| LTC rating | Nominal GDP (Bn. LC) | Nominal GDP (Bn. US\$) | Real GDP per capita (US\$) | Real GDP growth (%) | Real GDP growth investment (%) | Real GDP investment / GDP (%) | Savings / GDP (%) | Exports / GDP (%) | Unemployment rate (% of work force) | Real GDP |       |
|------------|----------------------|------------------------|----------------------------|---------------------|--------------------------------|-------------------------------|-------------------|-------------------|-------------------------------------|----------|-------|
|            |                      |                        |                            |                     |                                |                               |                   |                   |                                     | 2016e    | 2016e |
| AA         | 789                  | 209                    | 71,687                     | 2.0                 | (2.0)                          | N/A                           | N/A               | N/A               | 69.1                                | 3.0      |       |
| B+         | 1,523                | 12                     | 4,216                      | 3.2                 | 3.4                            | 6.0                           | 27.9              | 15.6              | 26.5                                | 17.1     |       |
| BBB        | 7                    | 3                      | 36,861                     | 1.8                 | 0.8                            | 30.6                          | N/A               | N/A               | N/A                                 | 1.7      |       |
| B          | 14,387               | 95                     | 3,718                      | 1.3                 | (1.2)                          | 0.4                           | 28.4              | 16.0              | 36.9                                | 30.0     |       |
| B-         | 8,809                | 147                    | 12,550                     | (1.8)               | (2.8)                          | (0.3)                         | 17.4              | 14.6              | 14.1                                | 8.9      |       |
| BBB+       | 8                    | 3                      | 14,238                     | 0.4                 | (0.7)                          | 1.1                           | 23.3              | 21.8              | 71.0                                | 7.5      |       |
| AAA        | 1,035                | 1,205                  | 49,934                     | 2.7                 | 1.3                            | (3.0)                         | 25.7              | 21.2              | 18.8                                | 5.9      |       |
| AA+        | 300                  | 389                    | 45,125                     | 1.4                 | 0.9                            | 2.8                           | 33.4              | 33.4              | 13.2                                | 6.2      |       |
| BB+        | 59                   | 59                     | 3,402                      | (3.0)               | (4.6)                          | 4.3                           | 28.9              | 33.0              | 39.1                                | 15.5     |       |
| BBB-       | 9                    | 9                      | 22,764                     | 0.2                 | (1.1)                          | (7.1)                         | 36.2              | 35.5              | 38.4                                | 14.6     |       |
| BB-        | 12                   | 31                     | 22,039                     | 2.0                 | (1.0)                          | 3.0                           | 25.1              | 19.2              | 71.9                                | 2.4      |       |
| BB-        | 17,296               | 220                    | 1,350                      | 7.1                 | 6.3                            | 8.0                           | 28.4              | 31.1              | 19.3                                | 3.5      |       |
| B-         | 9                    | 4                      | 15,790                     | 1.8                 | 0.7                            | 2.1                           | 12.8              | 1.9               | 36.8                                | 11.5     |       |
| B-         | 908,942              | 45                     | 4,772                      | (2.7)               | (2.7)                          | (2.7)                         | 32.4              | 28.6              | 53.8                                | 1.0      |       |
| AA         | 420                  | 407                    | 41,418                     | 1.3                 | 0.7                            | 3.5                           | 23.9              | 23.6              | 85.3                                | 8.1      |       |
| CC         | 3                    | 2                      | 4,582                      | (1.6)               | (4.1)                          | (1.4)                         | 28.9              | 16.3              | 80.1                                | 11.7     |       |
| AA+        | 6                    | 6                      | 30,689                     | 2.0                 | 2.1                            | (1.0)                         | 11.9              | 21.7              | 49.3                                | 6.8      |       |
| BB         | 248                  | 26                     | 3,206                      | 4.1                 | 2.5                            | 4.1                           | 19.2              | 13.8              | 30.9                                | 4.0      |       |

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THE INSTITUTE OF INTERNATIONAL FINANCE (IIF)



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   |
|--------------------------------------|--------|--------|--------|--------|
| <b>Capital Inflows</b>               |        |        |        |        |
| <b>Total Inflows, Net</b>            | 1,262  | 1,188  | 1,072  | 1,164  |
| <b>Private Inflows, Net</b>          | 1,232  | 1,156  | 1,032  | 1,112  |
| 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     | 52     |
| International Financial Institutions | 5      | -3     | 19     | 27     |
| Bilateral Creditors                  | 31     | 35     | 28     | 25     |
| <b>Capital Outflows</b>              |        |        |        |        |
| <b>Total Outflows, Net</b>           | -1,292 | -1,360 | -1,348 | -1,332 |
| Private Outflows, Net                | -946   | -625   | -981   | -950   |
| Equity Investment Abroad, Net        | 564    | -403   | -368   | -381   |
| Resident Lending/Other, Net          | -614   | -422   | -613   | -570   |
| Reserves (= Increase)                | -352   | -534   | -367   | -388   |
| <b>Memor:</b>                        |        |        |        |        |
| Net Errors and Omissions             | -246   | -65    | 0      | 0      |
| Current Account Balance              | 276    | 236    | 262    | 174    |

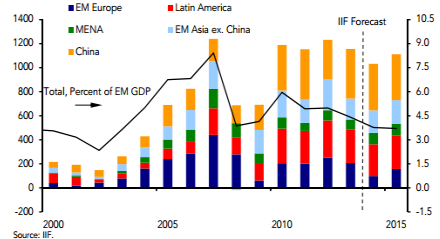
Source: IIF



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.

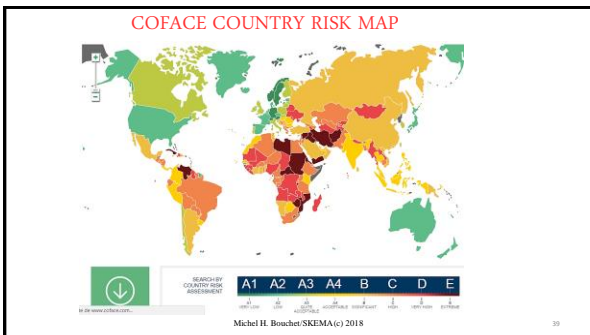





**COFACE**

- ▶ 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](http://www.coface.org)



**BRAZIL 2017 COFACE'S MACRO-ECONOMIC PROSPECTS**

POPULATION  
204.459 MILLION

GDP PER CAPITA  
\$ 669 US\$

**C**  
COUNTRY RISK ASSESSMENT

**A4**  
BUSINESS CLIMATE

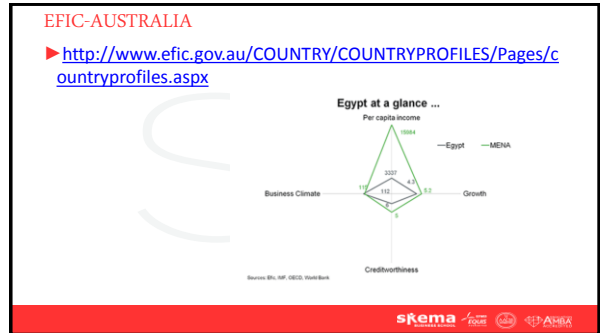
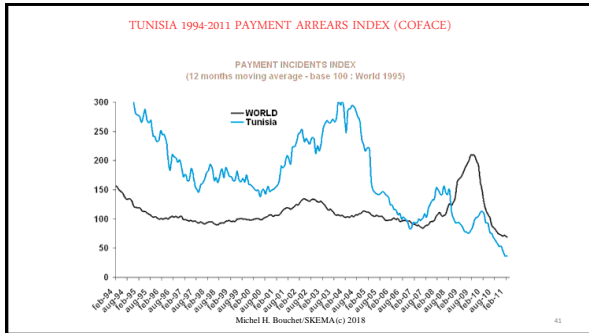
**D**  
COMMERCE COUNTRY

**A**  
COMMERCE COUNTRY

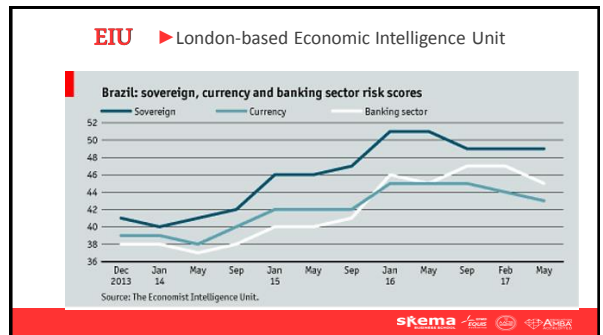
**MAJOR MACRO ECONOMIC INDICATORS**

|                                 | 2014 | 2015  | 2016(i) | 2017(i) |
|---------------------------------|------|-------|---------|---------|
| GDP growth (%)                  | 0.5  | -3.8  | -3.6    | 0.4     |
| Inflation (yearly average) (%)  | 6.3  | 9.0   | 9.7     | 4.4     |
| Budget balance (% GDP)          | -6.6 | -10.3 | -9.8    | -9.1    |
| Current account balance (% GDP) | -4.2 | -3.3  | -1.3    | -1.4    |
| Public debt (% GDP)             | 62.3 | 72.6  | 78.3    | 81.2    |

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- ### 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.
- skema | EIU | ABB | ASBIA



**EIU** ▶ London-based Economic Intelligence Unit

July 31st 2017 Print | Email | Share

### Overview

#### Brazil: risk assessment

| Country risk | Corruption risk | Business environment risk | Political risk | Economic investment risk | Country risk |
|--------------|-----------------|---------------------------|----------------|--------------------------|--------------|
| BB           | BB              | BB                        | BB             | BB                       | BB           |

Mean Brazil local equivalent: PwC Brazil Impact, published 07 May 2017, 21st 2017.

These ratings are derived from the ratings report published above, which was produced outside the European Union, and therefore are not issued by the European Commission and credit ratings agency status is not regulated in accordance with Regulation (EU) No 1060/2009 of the European Parliament and of the Council on credit rating agencies, as amended. This report and the ratings, therefore, are not subject 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, governmentality 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 R\$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 its policy rates rise. Brazil has a large reserves cushion.

**skema**   

|  |   |   |
|--|---|---|
| <p><b>Business Environment Risk Intelligence (BERI)</b> 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 handful of experts with a diplomatic or political science background. Governance quality is included into political risk analysis along with government effectiveness and social indicators.</p> <p><a href="http://berl.com">berl.com</a></p>              | <p><b>Political Risk Services</b> The PRS analyses covers a handful countries and are updated on a quarterly basis. <b>International Country Risk Guide</b> measures and tracks corruption perception in government, law and order, corruption risk, as well as the quality of bureaucracy. These measures stem from the subjective assessment of experts around the world.</p> <p><a href="http://prsgroup.com">http://prsgroup.com</a></p>  | <p>Thanks to its unique policy dialogue with more than 100 countries, the <b>World Bank</b> has developed a comprehensive database of composite governance indicators, measuring perceptions of voice and accountability, political stability, government effectiveness, regulatory quality, risk of law, and corruption.</p> <p><a href="http://www.worldbank.org/wbi/governance/">www.worldbank.org/wbi/governance/</a></p>   |
| <p>The <b>London-based Economist Intelligence Unit (EIU)</b> provides a comprehensive 6-year forecasting country risk analysis on more than 100 EMAs, on a quarterly basis. The EIU method flows from expert's surveys to a series of 77 predetermined qualitative and quantitative questions.</p> <p><a href="http://eiu.com">http://eiu.com</a></p>  | <p>To look upon governance and corruption, Moody's takes into consideration the structure 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 such of these factors upon business prospects.</p> <p><a href="http://moody.com">http://moody.com</a></p>   | <p><b>Standard and Poor's</b> rating approach is both quantitative and qualitative. It is based on checklist of 19 categories, including governance and political risk. The political risk factors gauge the impact of politics on economic conditions, as well as the quality of government and the degree of government support in the population. S&amp;P assigns short term and long term ratings.</p> <p><a href="http://standardandpoors.com">http://standardandpoors.com</a></p> |
| <p><b>Euromoney</b> 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 (best) to 100 (best).</p> <p><a href="http://www.euromoney.com">www.euromoney.com</a></p> | <p><b>Institutional Investor's</b> 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 (low chance of default).</p> <p><a href="http://www.institutinvestor.com">www.institutinvestor.com</a></p> | <p><b>Transparency International</b>, 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 NGOs, domestic and foreign corporations, investors, and business contacts.</p> <p><a href="http://www.transparency.org">www.transparency.org</a></p>  |

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|  |   |   |
|--|---|---|
| <p><b>Heritage Foundation</b> established since 1965, in partnership with the WES, 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.</p> <p><a href="http://www.heritage.org">www.heritage.org</a></p>   | <p><b>ProctorKhanh's Openly Quality Index</b> 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 transparency 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.</p> <p><a href="http://www.qualityindex.com">www.qualityindex.com</a></p> | <p>The <b>Institute for Management Development's World Competitiveness Report</b> analyses 49 industrialized and emerging economies around the world based on a far-reaching survey since 1989. By 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.</p> <p><a href="http://www.imd.ch">www.imd.ch</a></p> |
| <p><b>Freedom House</b> 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).</p> <p><a href="http://www.freedomhouse.org/corruption-index.html">www.freedomhouse.org/corruption-index.html</a></p> | <p>The <b>Political and Economic Stability Index of Edmund Byrne and Francis</b> measures relative stability in around 20 EMAs by integrating political science theories with financial market developments. The monthly evaluation uses both quantitative and qualitative criteria, including institutional efficiency, political legitimacy, economic performance, and government effectiveness.</p> <p><a href="http://www.pesti.com">www.pesti.com</a></p>  | <p><b>Political and Economic Risk Consultancy (PERC)</b> 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 executives bring in to obtain their perceptions of corruption, value quality, intellectual property rights (risk) and other systemic shortcomings.</p> <p><a href="http://www.pesti.com">www.pesti.com</a></p>                               |

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**Country Risk and the Balance of Payments I**  
Current account  
Michel Henry Bouchet




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► **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!

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**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

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**BALANCE OF PAYMENTS AND EXTERNAL DEBT**

| Balance of Payments   | Assets & Liabilities   |
|---|--|
| <p><b>Change in flows</b></p> <p>Double-entry accounting system</p> <p>► Receipts = <b>Inflows</b><br/>(exports GS + capital)</p> <p>► Debits = <b>Outflows</b><br/>(Imports, interest and debt payments)</p> | <p><b>External Debt and Reserves</b></p> <p>► <b>Change in stocks</b></p> <p>Δ+ Reserve Assets<br/>Debt repayment</p> <p>Δ- Reserves<br/>Δ+ Debt Stock</p> |

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THE BALANCE IS ALWAYS BALANCED!



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

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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 resident in the country in which they are located even if their shares are actually owned by foreign residents.
- IFIs are always foreign residents
- Tourists and students are foreign residents if they stay in the reporting country < 1 year

skema | ABB | ABN AMRO | AXA | BNP PARIBAS | CREDIT AGRICOLE | HSBC | JPMORGAN CHASE & CO. | NBS | PNC | RABOBANK | UBS | WELLS FARGO

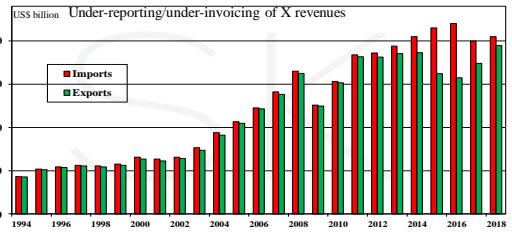
BALANCE OF PAYMENTS ACCURACY ?



- ▶ Data collection and methodological errors
- ▶ Inconsistencies in the time of recording and valuation or 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!

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THE WORLD "MISSING" EXPORTS  
A « *black hole* »  
>US\$300 b



Source: IMF-2018

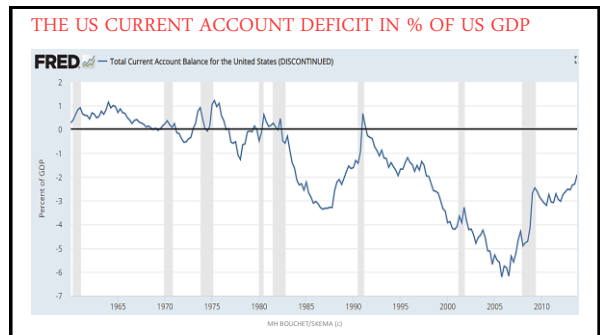
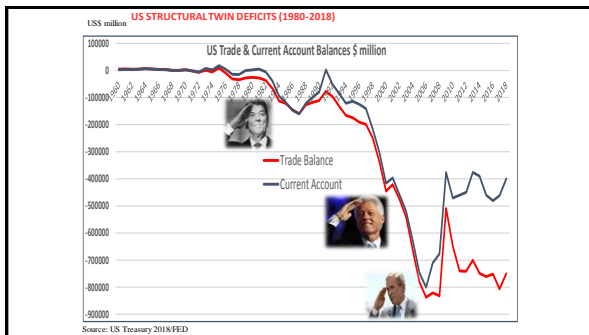
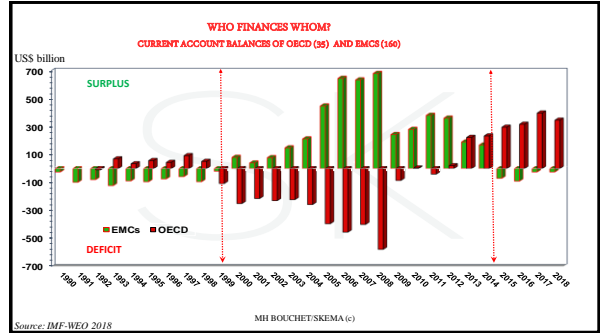
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**INTERPRETING THE BALANCE OF PAYMENTS**

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, trade barriers, deflation...)



**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 =  $\Delta$  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  
 $Y = C + I + G + X - M - T + (KM - K \text{ flight})$   
 Savings = Y - C  
 $(S - I) + (T - G) = (X - M) + (KM - K \text{ flight})$   
 Savings      Fiscal balance      Trade balance      Net capital inflows

**BOOSTING SAVINGS TO FINANCE INVESTMENT WITHOUT EXTERNAL DEFICIT?**

- if  $S > I \Rightarrow X > M$
- ▶ a trade imbalance is always rooted in low savings and excessive domestic spending (absorption)
  - ▶ It requires macroeconomic correction (interest rate hike, devaluation,  $\uparrow$  taxation, credit reduction,  $\uparrow$  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**

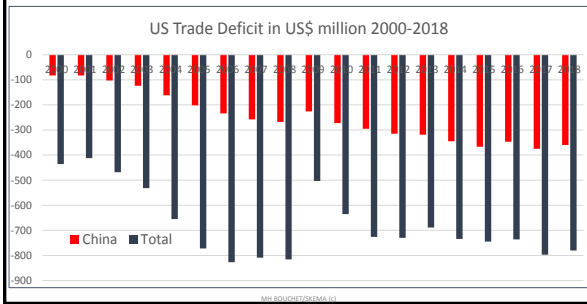


### 1. The trade balance comprises

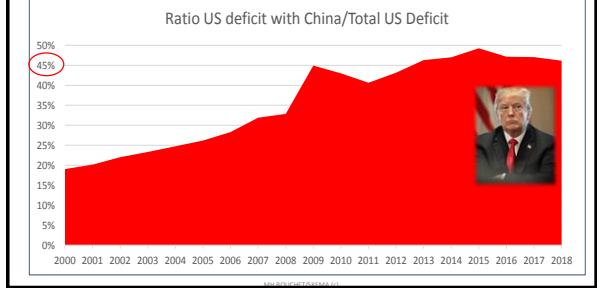


- 1. Merchandise exports:** all movable goods such as equipment, cars, textile, appliances, etc.
- 2. Imports are recorded "free on board" (f.o.b.):** services (freight, insurance, shipping and handling performed on goods up to the customs frontier of the economy from which the goods are exported), are **not** included in the trade balance.

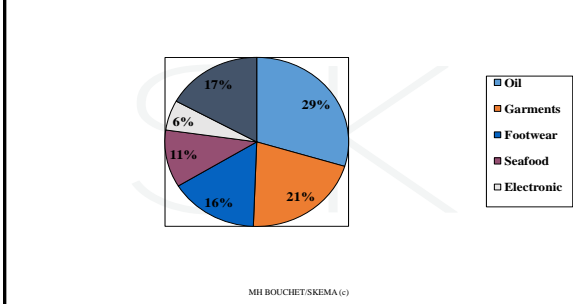
**BLAMING CHINA?**



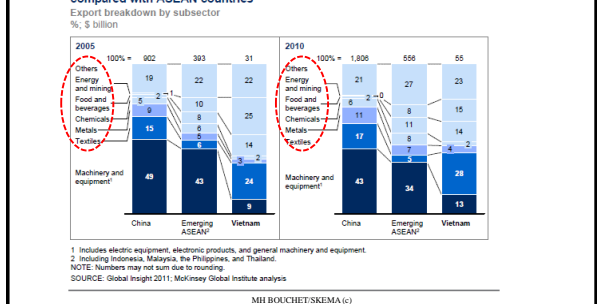
**BLAMING CHINA??**

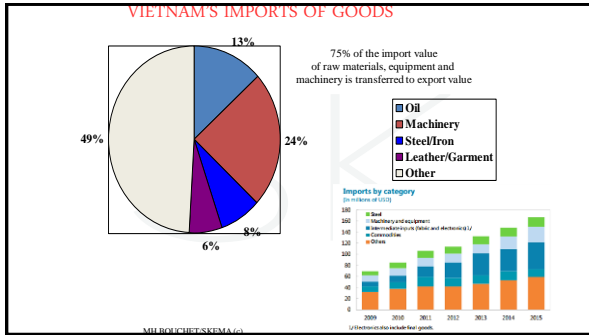


**VIETNAM'S EXPORTS OF GOODS**



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





### 2. Non-financial services =

**Freight, insurance, passenger services, tourism, and travel.**

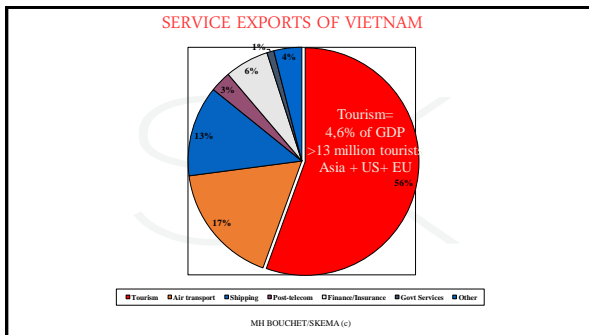
The transportation of persons represents the largest component of passenger services.

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

Freight refers mainly to the carriage or transport of goods between national economies.

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.

srema



### 3. Financial services: =

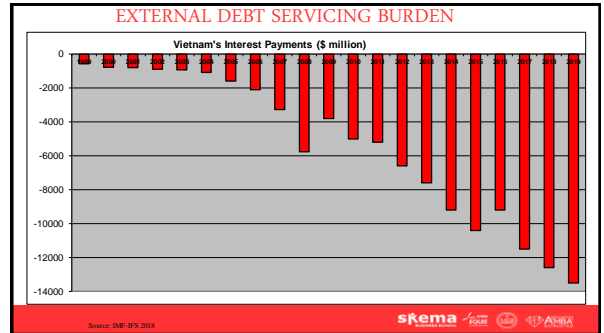
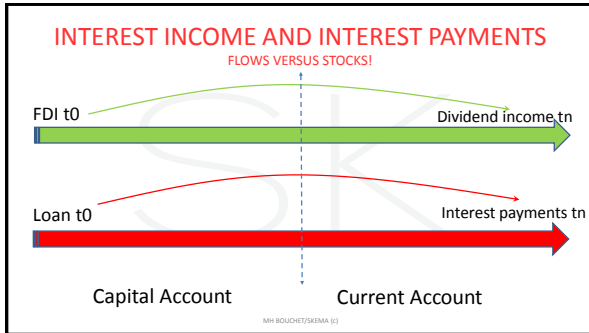
**Investment income and interest payments**

**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

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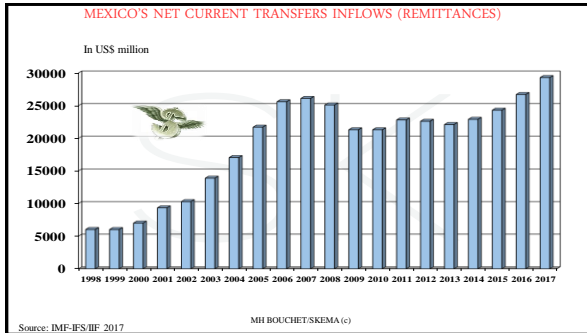
#### 4. Private and official unrequited transfers

**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

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#### REMITTANCES BETWEEN LATIN AMERICA AND THE US?

- ▶ = 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>

**SK**  
SKEMA BUSINESS SCHOOL

**The Balance of Payments II**  
Current account deficit adjustment

Michel Henry Bouchet

skema



HELLO SKEMA FMI! HELP!  
Calculate the trade balance, the current account, and the CA/GDP ratio asap!

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

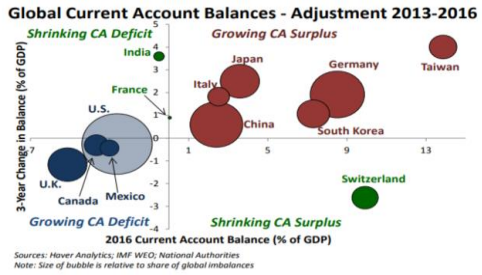
**THE CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS**

*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**

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**ADJUSTING CURRENT ACCOUNT IMBALANCES?**



**POLICY TOOLS TO FIGHT A BOP DEFICIT?**



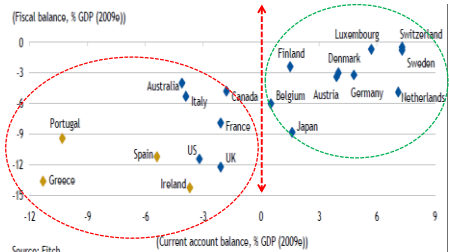
► Reducing absorption and boosting income with:

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 CURRENT ACCOUNT**

- 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 economic 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 CURRENT ACCOUNT**

**▶ 3. Government restrictions**

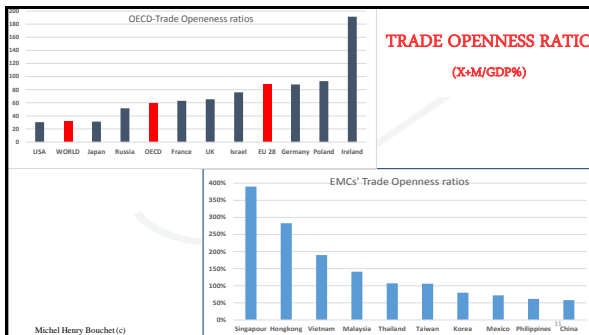
- Import tariff (tax on imported goods)
  - increases prices & lowers demand on imported goods
  - increases current account of the country
  - US tariffs on apparel and farm products
  - "banana war": exports from European former colonies (Africa-Caribbean-Pacific): USA entitled to impose US\$191 million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



**FACTORS AFFECTING 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, thus decreasing demand for the good
  - assumes 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



**1. CORRECTING A TRADE DEFICIT?**

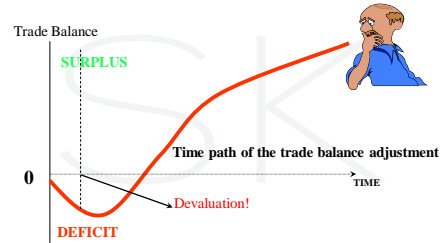
**▶ Impact of domestic currency devaluation**

- 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?

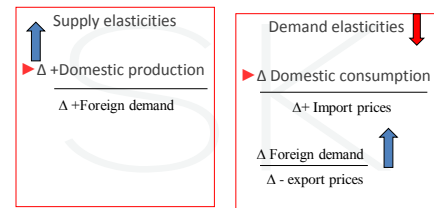
- ▶ **Import demand elasticity** to prices =  $\frac{\Delta MD}{\Delta P\$} < 0$
- ▶ **Export elasticity** to exchange rate change =  $\frac{\Delta X}{\Delta P\$} > 0$
- ▶ **Supply elasticity** to increased export demand =  $\frac{\Delta S}{\Delta XD} > 0$ ?

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



### 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

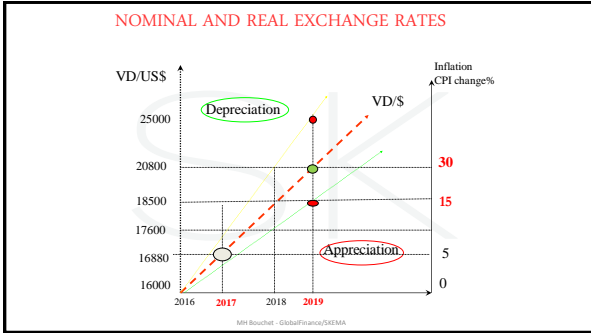
- ▶ The RER is the product of the nominal exchange rate between two currencies and the ratio of prices

$$RER = NR \times \frac{P_X}{P_Y}$$

If the €/S 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**

$$RER \text{ €/\$} = 1,5 * (2,5/3,7)$$

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



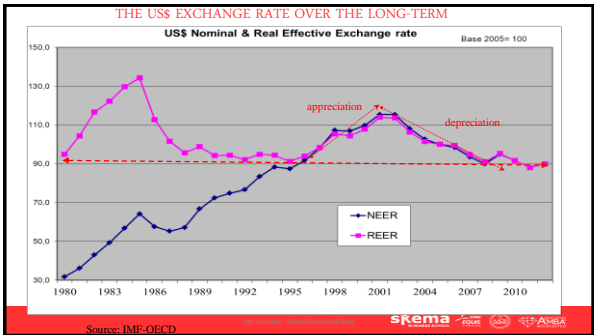
### MEASURING COUNTRY COMPETITIVENESS?

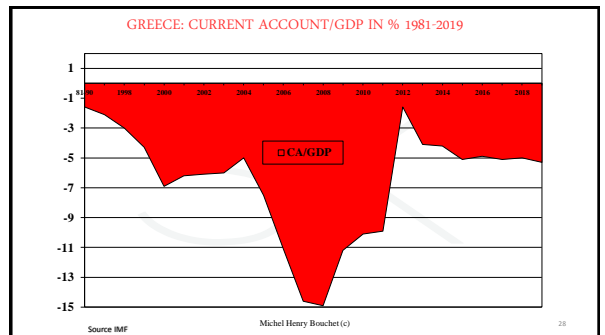
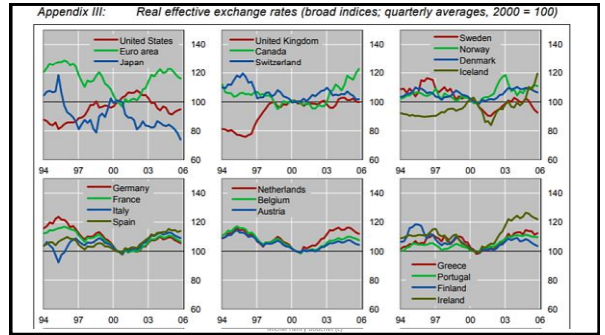
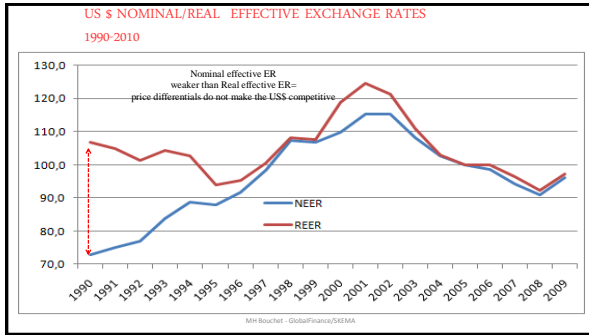
#### NOMINAL AND REAL EFFECTIVE EXCHANGE RATES

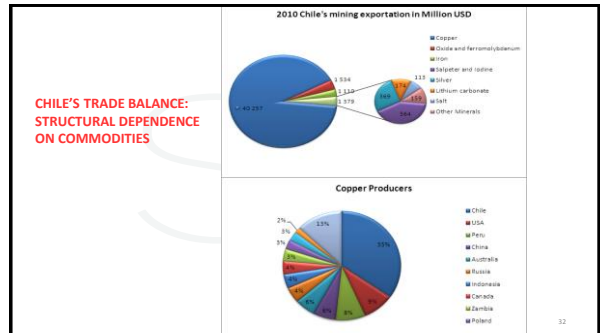
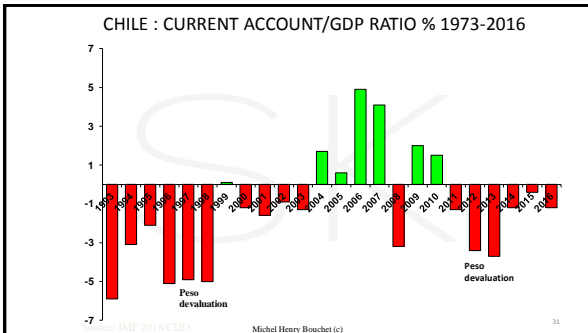
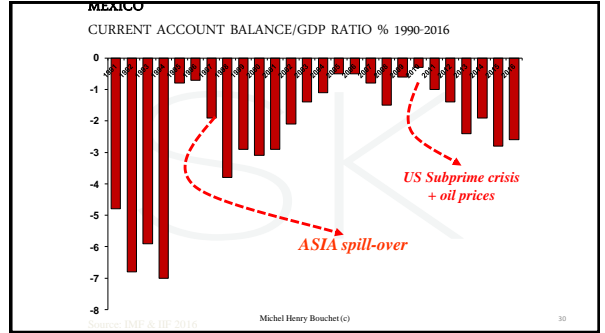
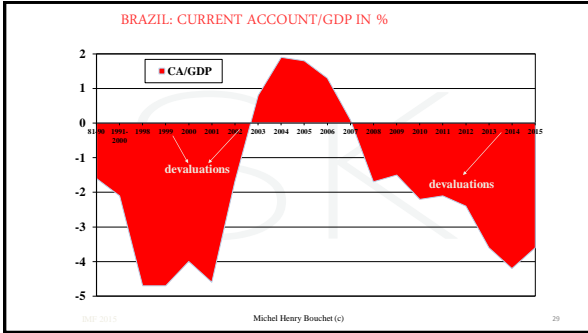
- ▶ **Nominal EERs**= geometric weighted averages of bilateral exchange rates (weighted by trading shares)
- ▶ **Real EERs** = weighted averages of bilateral exchange rates adjusted by **relative prices**.

### 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)









## 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!

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## 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

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## US CURRENT ACCOUNT, IMPORT PRICES AND DOLLAR EXCHANGE RATE

- Weaker \$ = Lower US demand?
- ▶ 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

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## 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.

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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](http://www.digitaleconomist.com/bop_4020.html)  
Michel Henry Bouchet (c)

**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.

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THE US CURRENT ACCOUNT DEFICIT DILEMMA

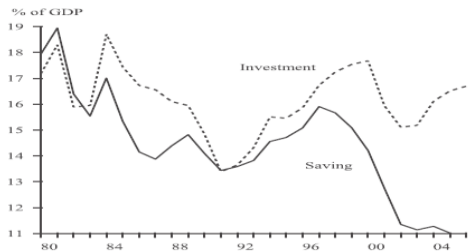
- ▶ Shrinking the deficit requires a weaker \$
- ▶ Financing the deficit requires a strong \$ by attracting US\$2 billion/day foreign capital inflows



Michel Henry Bouchet (c)

INVESTMENT > SAVINGS = US BOP DEFICIT

Saving and investment rates



FRBSF March 2007





### FINANCING THE US CA DEFICIT?

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

Record US CA deficit in 2003-2008 >7% of GDP  
and 5% of GDP in 2009-2017

- ▶ 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?**

# SK

SKEMA BUSINESS SCHOOL

## The Balance of Payments III

### Capital Account

Michel-Henry BOUCHET



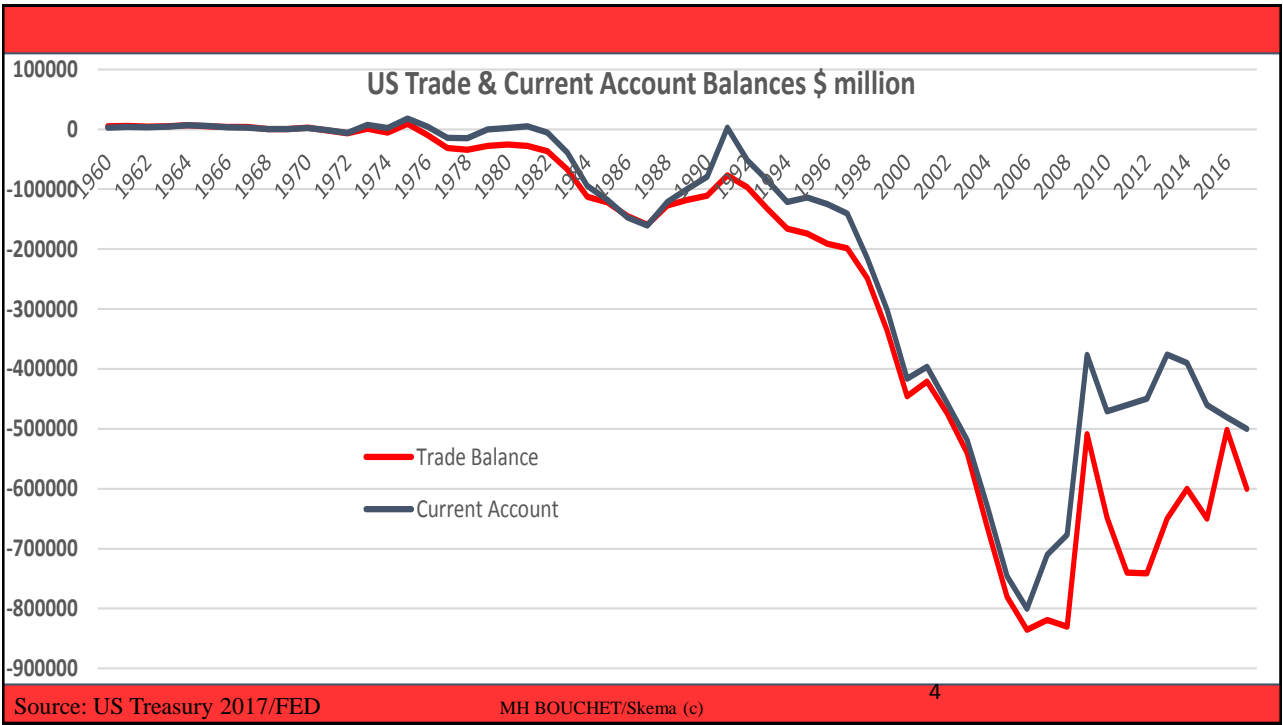
MH BOUCHET/Skema (c)

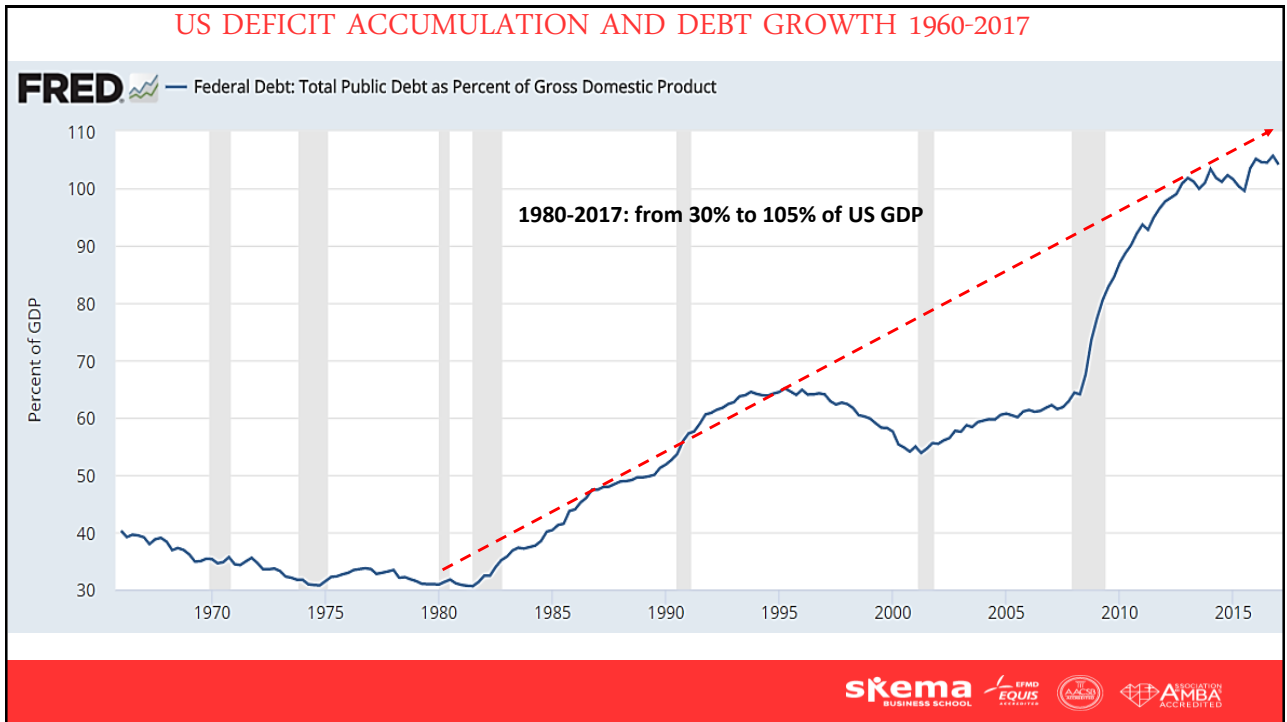


Hello SKEMA FMI! HELP!  
Calculate the trade balance, the current account, and the CA/GDP ratio asap!

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

MH BOUCHET/Skema (c)





## ▶ Capital account

- Reflects changes in country's ownership of 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...)

## THE CAPITAL ACCOUNT

**From less liquid items  
to more liquid items!**



### Capital account

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



## TABLE OF USES AND SOURCES

### USES (outflows)

1. Imports of goods
2. Imports of services
3. Interest payments
4. Principal debt payments
5. ST capital outflows
6. E&Os

### SOURCES (inflows)

1. Exports of goods
2. Exports of services
3. Transfers & Remittances
4. Dividends
5. FDI
6. ST and LT K inflows
7. Debt cancellation
8. Arrears

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## 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

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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)

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

## 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!

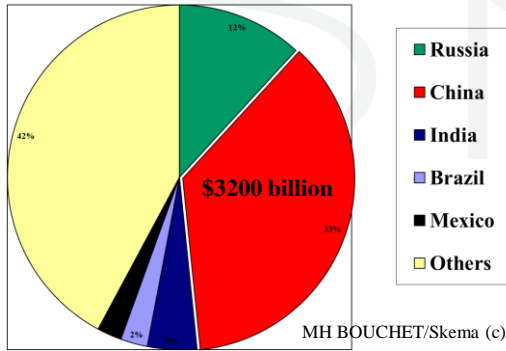
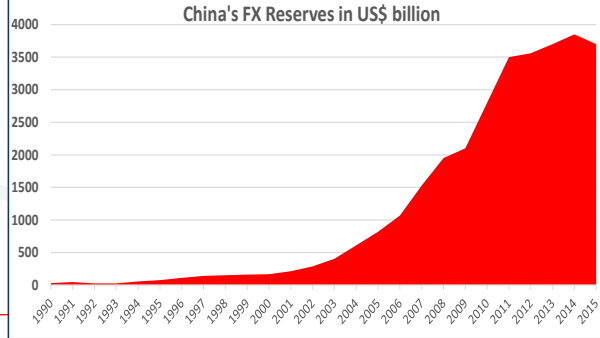
FX RESERVES AS  
BUFFER OF LIQUIDITY  
CRISIS

|             | 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*

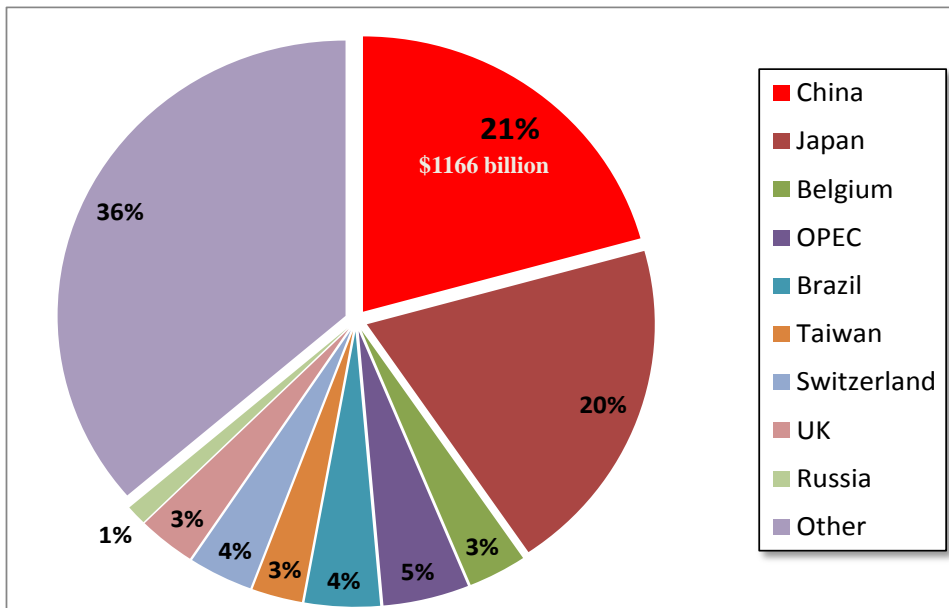
*Sources: National Authorities; World Bank; International Monetary Fund; Haver Analytics*

THE RISE IN  
CHINA'S HARD  
CURRENCY  
RESERVES



Σ world reserves 2017=  
\$11,500 billion

CHINA = > 1/5 OF FOREIGN HOLDING OF US DEBT IN 2017



US Treasury

MH BOUCHET/Skema (c)

#### 4. Net errors and omissions

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

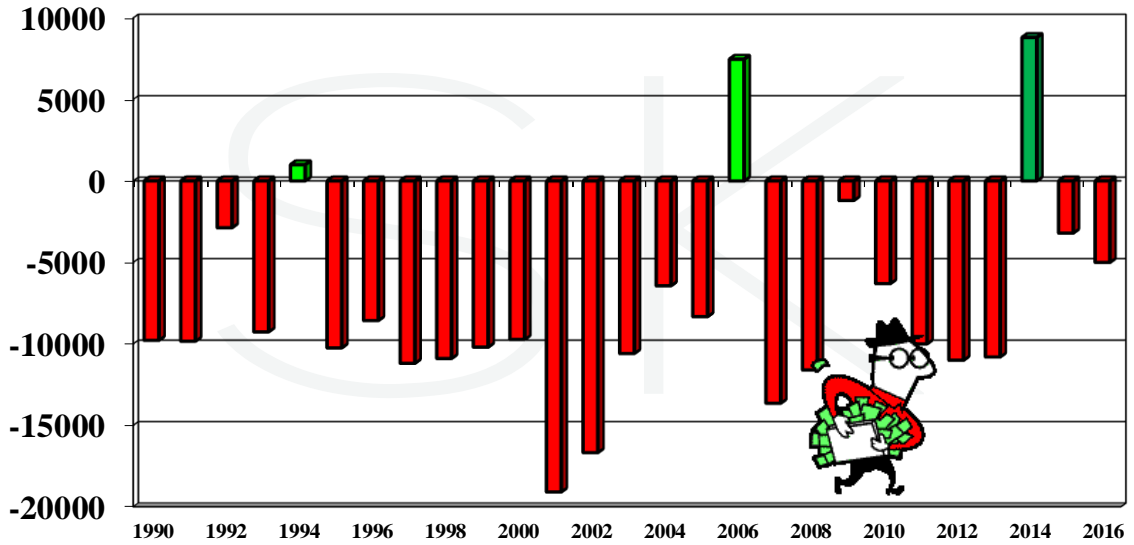
Other sources of E&Os:

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

#### NET ERRORS AND OMISSIONS ?

- ▶ An examination of the size and direction of NE&Os may shed some 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)**



Source: BIS

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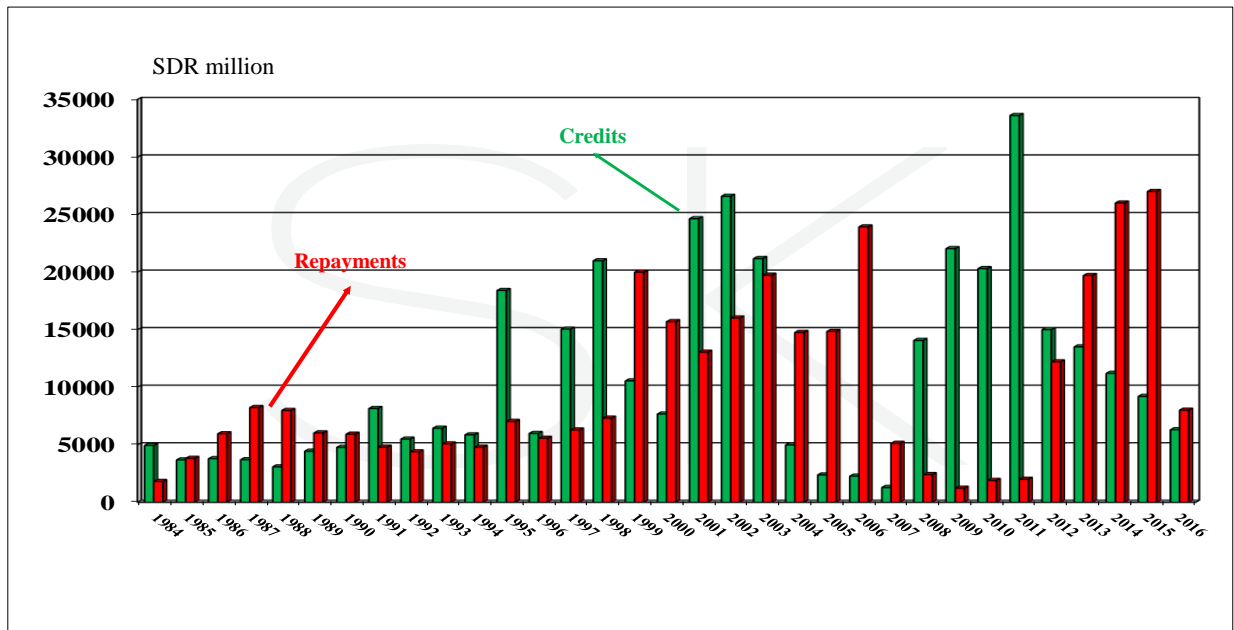
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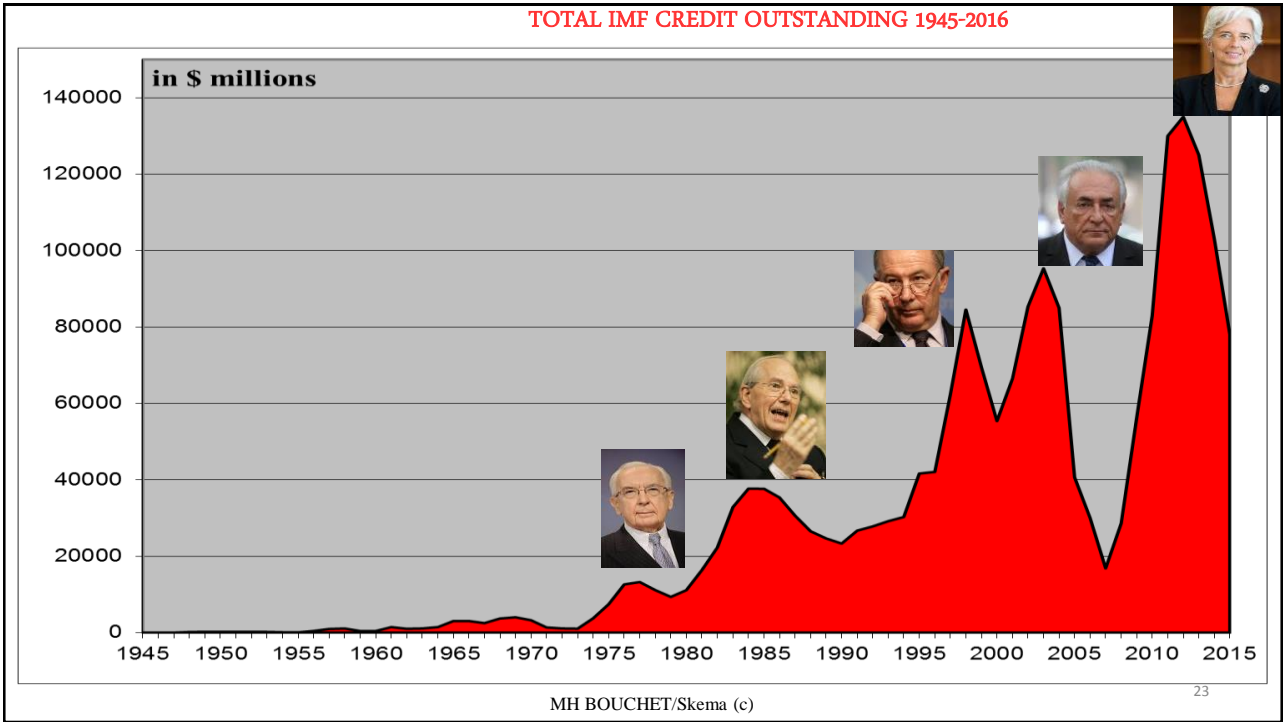
## 6. EXCEPTIONAL FINANCING



- 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 1984-2017










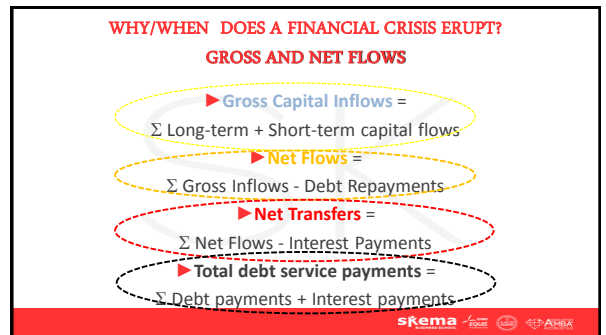
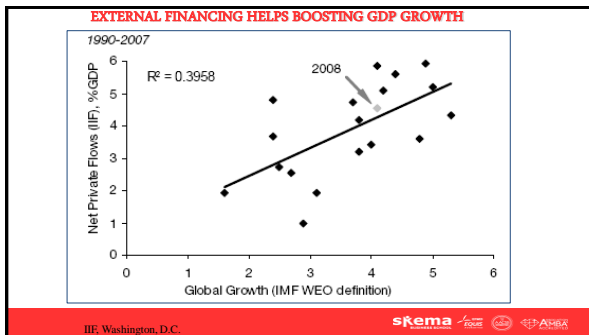
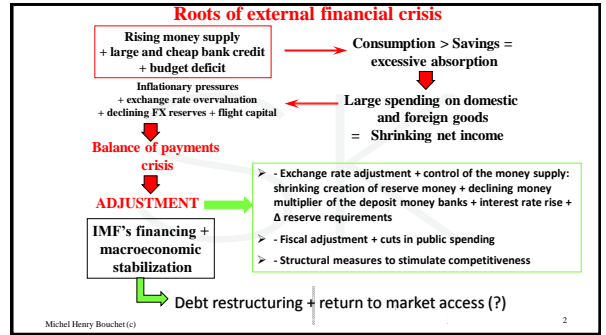
| Table1 Joint BIS-IMF-OECD-World Bank Statistics on External Debt (mill. US\$) |        |        |        |        |        | Table1 Joint BIS-IMF-OECD-World Bank Statistics on External Debt (mill. US\$) |        |        |        |        |        |
|---|--------|--------|--------|--------|--------|---|--------|--------|--------|--------|--------|
| Data are in millions  |        |        |        |        |        | Data are in millions  |        |        |        |        |        |
|   | 2016Q2 | 2016Q3 | 2016Q4 | 2017Q1 | 2017Q2 |   | 2016Q2 | 2016Q3 | 2016Q4 | 2017Q1 | 2017Q2 |
| <b>A1. Loans and other credits (Debt of)</b>                                  |        |        |        |        |        | <b>A1. Loans and other credits (Debt of)</b>                                  |        |        |        |        |        |
| 01_Cross-border loans, by BIS reporting banks                                 | 10,063 | 10,556 | 10,600 | ..     | ..     | 01_Cross-border loans, by BIS reporting banks                                 | 2,726  | 2,894  | 2,830  | ..     | ..     |
| 02_o/w to nonbanks  | 6,666  | 7,064  | 7,144  | ..     | ..     | 02_o/w to nonbanks  | 1,656  | 1,862  | 1,871  | ..     | ..     |
| 03_Official bilateral loans, total  | ..     | ..     | ..     | ..     | ..     | 03_Official bilateral loans, total  | ..     | ..     | ..     | ..     | ..     |
| 04_o/w aid loans  | ..     | ..     | ..     | ..     | ..     | 04_o/w aid loans  | ..     | ..     | ..     | ..     | ..     |
| 05_o/w other  | ..     | ..     | ..     | ..     | ..     | 05_o/w other  | ..     | ..     | ..     | ..     | ..     |
| 06_Multilateral loans, total  | 8,299  | 8,516  | 8,215  | 8,335  | 0      | 06_Multilateral loans, total  | 6,772  | 6,676  | 6,860  | 6,839  | 1,902  |
| 07_o/w IMF  | 0      | 0      | 0      | 0      | 0      | 07_o/w IMF  | 1,721  | 1,700  | 1,620  | 1,619  | 1,902  |
| 08_o/w other institutions   | 8,299  | 8,516  | 8,215  | 8,335  | ..     | 08_o/w other institutions   | 5,052  | 4,976  | 5,240  | 5,221  | ..     |
| 09_Insured export credit, Berne Union   | 7,200  | 7,272  | 6,599  | ..     | ..     | 09_Insured export credit, Berne Union   | 2,841  | 2,686  | 2,572  | ..     | ..     |
| 10_o/w short term   | 4,601  | 4,775  | 4,310  | ..     | ..     | 10_o/w short term   | 2,137  | 2,004  | 1,914  | ..     | ..     |
| 11_SDR allocations  | 785    | 784    | 755    | 762    | 781    | 11_SDR allocations  | 382    | 381    | 367    | 370    | 380    |
| <b>A2. Loans and other credits (Debt due within a year)</b>                   |        |        |        |        |        | <b>A2. Loans and other credits (Debt due within a year)</b>                   |        |        |        |        |        |
| 12_Liabilities to BIS banks (cons.), short term                               | 2,792  | 2,929  | 2,948  | ..     | ..     | 12_Liabilities to BIS banks (cons.), short term                               | 528    | 585    | 584    | ..     | ..     |
| 13_Multilateral loans, IMF, short term  | ..     | ..     | ..     | ..     | ..     | 13_Multilateral loans, IMF, short term  | 149    | 231    | 328    | 448    | 531    |
| <b>B1. Debt securities (All maturities)</b>                                   |        |        |        |        |        | <b>B1. Debt securities (All maturities)</b>                                   |        |        |        |        |        |
| 14_Debt securities held by nonresidents                                       | 5,761  | ..     | ..     | ..     | ..     | 14_Debt securities held by nonresidents                                       | 3,458  | ..     | ..     | ..     | ..     |
| <b>B2. Debt securities (short term, original maturity)</b>                    |        |        |        |        |        | <b>B2. Debt securities (short term, original maturity)</b>                    |        |        |        |        |        |
| 15_Debt securities held by nonresidents                                       | 97     | ..     | ..     | ..     | ..     | 15_Debt securities held by nonresidents                                       | 24     | ..     | ..     | ..     | ..     |
| <b>C. Supplementary information on debt (liabilities)</b>                     |        |        |        |        |        | <b>C. Supplementary information on debt (liabilities)</b>                     |        |        |        |        |        |
| 16_International debt securities, all maturities                              | 8,029  | 8,044  | 8,197  | 8,234  | ..     | 16_International debt securities, all maturities                              | 4,924  | 5,459  | 5,182  | 6,246  | ..     |
| 17_o/w issued by nonbanks   | 7,728  | 7,744  | 7,897  | 7,935  | ..     | 17_o/w issued by nonbanks   | 4,924  | 5,459  | 5,182  | 6,246  | ..     |
| 18_International debt securities, short term                                  | 555    | 558    | 527    | 535    | ..     | 18_International debt securities, short term                                  | 500    | 599    | 586    | 589    | ..     |
| 19_o/w issued by nonbanks   | 555    | 558    | 527    | 535    | ..     | 19_o/w issued by nonbanks   | 500    | 599    | 586    | 589    | ..     |
| 20_Paris Club claims (ODA)  | ..     | ..     | 4,479  | ..     | ..     | 20_Paris Club claims (ODA)  | ..     | ..     | 2,608  | ..     | ..     |
| 21_Paris Club claims (non ODA)  | ..     | ..     | 270    | ..     | ..     | 21_Paris Club claims (non ODA)  | ..     | ..     | 856    | 24     | ..     |
| 22_Liabilities to BIS banks, locational, total                                | 13,990 | 14,548 | 12,089 | ..     | ..     | 22_Liabilities to BIS banks, locational, total                                | 3,661  | 3,767  | 3,317  | ..     | ..     |

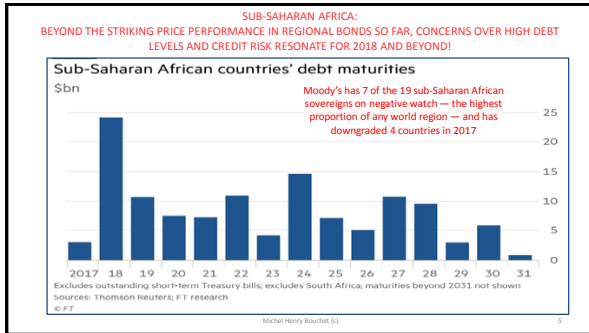
**SK**  
SKEMA BUSINESS SCHOOL

**The Balance of Payments IV**  
**External debt analysis**  
Michel Henry Bouchet



skema    





**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

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**Emerging Market Economies: Capital Flows**  
\$ billion

|                                      | 2012  | 2013  | 2014  | 2015  |
|--------------------------------------|-------|-------|-------|-------|
| <b>Capital Inflows</b>               |       |       |       |       |
| <i>Total Inflows, Net</i>            | 1269  | 1188  | 1079  | 1164  |
| <b>Private Inflows, Net</b>          | 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   |
| <b>Official Inflows, Net</b>         | 37    | 32    | 47    | 53    |
| International Financial Institutions | 5     | -3    | 19    | 27    |
| Bilateral Creditors                  | 31    | 35    | 28    | 26    |
| <b>Capital Outflows</b>              |       |       |       |       |
| <i>Total Outflows, Net</i>           | -1292 | -1360 | -1348 | -1332 |
| Private Outflows, Net                | -946  | -825  | -981  | -950  |
| Equity Investment Abroad, Net        | -352  | -403  | -368  | -281  |
| Resident Lending/Other, Net          | -614  | -422  | -613  | -670  |
| Reserves (= Increase)                | -352  | -534  | -367  | -388  |
| <b>Memo:</b>                         |       |       |       |       |
| <i>Net Errors and Omissions</i>      | -246  | -65   | 0     | 0     |
| <i>Current Account Balance</i>       | 278   | 236   | 262   | 174   |

Source: IIF  
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**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

+ LI Capital Inflows

- Debt Servicing Payments

+/- ST Capital Flows

+/- Reserve Variation

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**EXTERNAL DEBT ANALYSIS:  
THE DUAL FACE OF COUNTRY RISK**

| <b>Liquidity Risk</b>  | <b>Solvency Risk</b>   |
|--|--|
| <ul style="list-style-type: none"> <li>▶ Debt Service Ratio: (P+I/X)</li> <li>▶ Interest Ratio (I/X)</li> <li>▶ Current account/GDP</li> <li>▶ Growth rate of exports/ Average external interest rate</li> </ul> | <ul style="list-style-type: none"> <li>▶ Debt/Export ratio</li> <li>▶ Debt/GDP ratio</li> <li>▶ Debt/Reserves</li> <li>▶ ST Debt/Total Debt</li> <li>▶ ST Debt/Reserves</li> <li>▶ Reserve/Import ratio</li> </ul> |

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**LIQUIDITY AND SOLVENCY THRESHOLDS**

**Stock variables**

- ▶ **Solvency** = Debt/GDP < 100%
- Debt/Exports < 150%
- Reserves/months of Imports > 6 months

**Flow variables**

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

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**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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**EXTERNAL DEBT ANALYSIS II**

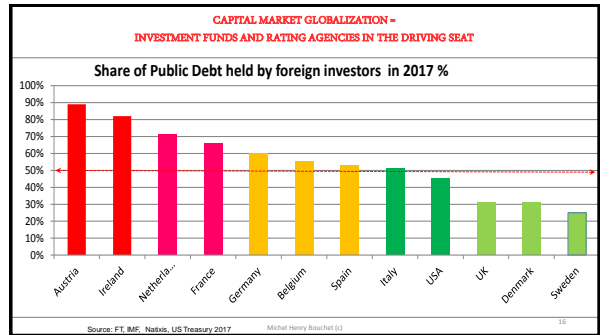
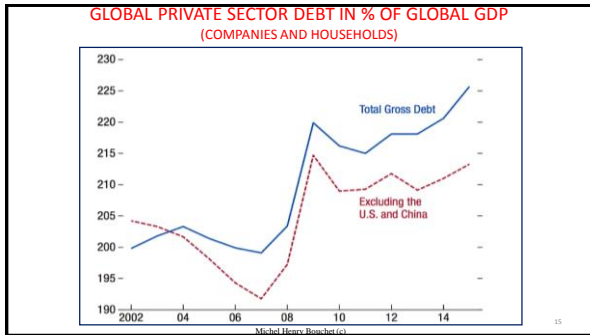
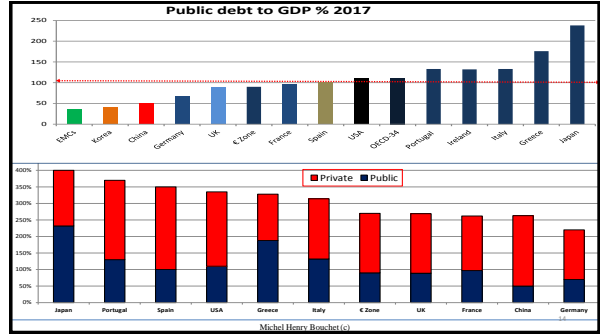
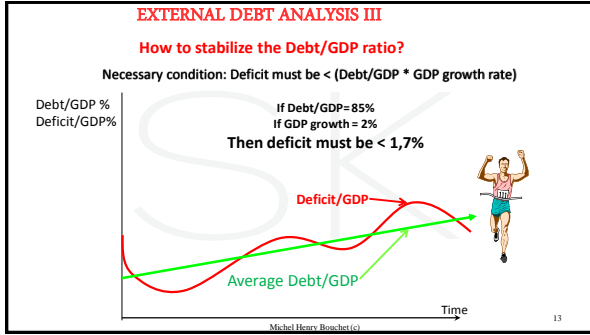
**r = average rate of interest and g = average GDP growth rate**

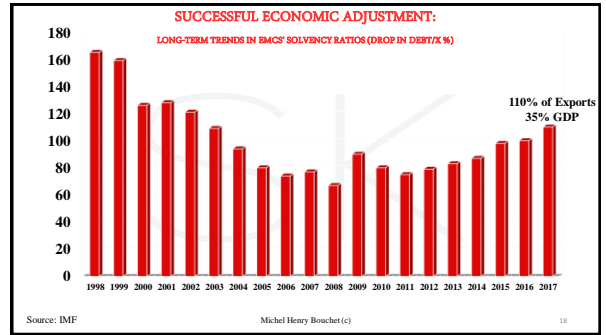
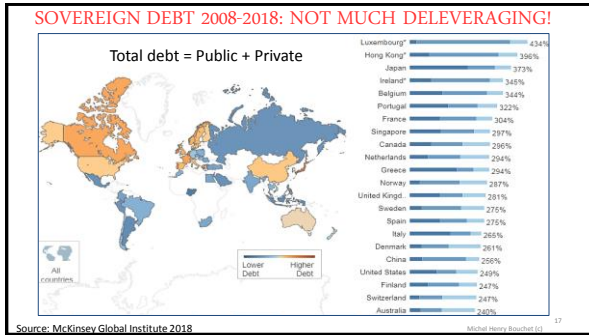
- ▶  $DEBT_t = DEBT_{t-1} * (1+r)$  - Primary Budget Balance
- ▶  $GDP_t = GDP_{t-1} * (1+g)$
- ▶  $\frac{DEBT_t}{GDP_t} = \frac{DEBT_{t-1} * (1+r)}{GDP_{t-1} * (1+g)}$  - Primary Budget Balance / GDP

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

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

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### TWO COUNTRIES = TWO DEBT TRAJECTORIES

**Solencia**  
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

Source: Michel Henry Bouchet (c)

### EXTERNAL FINANCING PROFILES IN 2017-18

| RATIOS       | VIETNAM | GABON | ECUADOR |
|--------------|---------|-------|---------|
| 1. CA/GDP    | +2%     | -9%   | -3%     |
| 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     |

Source: Michel Henry Bouchet (c)

**DEBT DATA?**

- ▶ [http://www.bis.org/statistics/annex\\_map.htm](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>

Table 1 Joint BIS-IMF-CEIC World Bank Statistics on External Debt (mill. US\$)

|   | 2003  | 2004  | 2005  | 2006  | 2007  | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|-------|-------|-------|-------|-------|------|------|------|------|------|------|------|------|------|
| A1. Loans and other credits (Direct 1/)               | 6,289 | 6,748 | 6,582 | 6,152 | 6,474 |      |      |      |      |      |      |      |      |      |
| A2. Government loans, by BIS reporting status         | 6,289 | 6,748 | 6,582 | 6,152 | 6,474 |      |      |      |      |      |      |      |      |      |
| A3. Official bilateral loans, total                   |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| A4. A/FM and loans                                    |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| A5. A/FM other  |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| A6. Multilateral loans, total                         | 6,709 | 7,119 | 7,000 |       |       |      |      |      |      |      |      |      |      |      |
| A7. A/FM IMF  | 0     | 0     |       |       |       |      |      |      |      |      |      |      |      |      |
| A8. A/FM other institutions                           | 6,709 | 7,119 | 7,000 |       |       |      |      |      |      |      |      |      |      |      |
| A9. External export credits, State Union              | 7,607 | 7,215 | 7,600 | 7,464 | 7,019 |      |      |      |      |      |      |      |      |      |
| A10. A/FM short term                                  | 6,610 | 6,884 | 6,880 | 6,601 | 6,484 |      |      |      |      |      |      |      |      |      |
| A11. A/FM long term                                   | 774   | 736   | 720   | 720   | 720   |      |      |      |      |      |      |      |      |      |
| B1. Loans and other credits (Direct 2/ within a year) |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B2. A/FM short term                                   | 6,474 | 6,841 | 6,448 | 6,074 | 6,417 |      |      |      |      |      |      |      |      |      |
| B3. A/FM long term                                    |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B4. A/FM other  |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B5. A/FM other  |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B6. A/FM other  |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B7. A/FM other  |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B8. A/FM other  |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B9. A/FM other  |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B10. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B11. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B12. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B13. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B14. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B15. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B16. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B17. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B18. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B19. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B20. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B21. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B22. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B23. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B24. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B25. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B26. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B27. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B28. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B29. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B30. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B31. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B32. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B33. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B34. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B35. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B36. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B37. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B38. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B39. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B40. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B41. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B42. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B43. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B44. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B45. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B46. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B47. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B48. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B49. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B50. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B51. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B52. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B53. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B54. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B55. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B56. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B57. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B58. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B59. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B60. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B61. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B62. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B63. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B64. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B65. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B66. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B67. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B68. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B69. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B70. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B71. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B72. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B73. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B74. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B75. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B76. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B77. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B78. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B79. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B80. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B81. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B82. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B83. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B84. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B85. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B86. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B87. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B88. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B89. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B90. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B91. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B92. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B93. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B94. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B95. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B96. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B97. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B98. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B99. A/FM other                                       |       |       |       |       |       |      |      |      |      |      |      |      |      |      |
| B100. A/FM other                                      |       |       |       |       |       |      |      |      |      |      |      |      |      |      |



**Solvencia - case study**

| BALANCE OF PAYMENTS (€ million)         | 2003   | 2004   | 2005   | 2006   | 2007   | 2008    | 2009   | 2010    | 2011    | 2012    | 2013    | 2014    | 2015    | 2016    |
|---|--------|--------|--------|--------|--------|---------|--------|---------|---------|---------|---------|---------|---------|---------|
| Trade Balance                           | -113   | -41    | -137   | -238   | -430   | -1,055  | 1,040  | 1,210   | 300     | -500    | -1,300  | -4,800  | -3,800  | 15      |
| Merchandise exports                     | 4,800  | 6,100  | 7,000  | 8,000  | 9,000  | 10,000  | 11,000 | 12,000  | 13,000  | 14,000  | 15,000  | 16,000  | 17,000  | 18,000  |
| Merchandise imports                     | -4,913 | -6,141 | -7,137 | -8,238 | -9,430 | -11,050 | -9,760 | -10,790 | -12,700 | -14,000 | -16,300 | -20,800 | -17,800 | -17,985 |
| Balance on Services, Income & Transfers | -550   | -520   | -1,000 | -2,200 | -3,200 | -2,100  | -750   | 800     | 400     | 400     | -500    | -1,800  | -3,000  | -1,200  |
| Services & income receipts              | 800    | 1,000  | 1,500  | 1,800  | 2,200  | 2,500   | 2,700  | 2,800   | 2,900   | 3,000   | 3,100   | 3,200   | 3,300   | 3,400   |
| Services & income payments              | -1,350 | -1,520 | -2,500 | -4,000 | -5,400 | -4,600  | -3,000 | -3,600  | -2,500  | -2,600  | -3,600  | -5,000  | -4,300  | -4,600  |
| Spots of services                       | 100    | 120    | 150    | 180    | 200    | 220     | 240    | 260     | 280     | 300     | 320     | 340     | 360     | 380     |
| Interest receipts                       | 100    | 120    | 150    | 180    | 200    | 220     | 240    | 260     | 280     | 300     | 320     | 340     | 360     | 380     |
| Other services & income receipts        | 0      | 0      | 0      |        |        |         |        |         |         |         |         |         |         |         |

# SK

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## Country risk and Debt Crisis I

Michel Henry Bouchet



### BIBLIOGRAPHY

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- ▶ Bouchet, Guilhon: Intelligence Economique et Gestion des Risques (Paris: Pearson)
- ▶ Reinhart C., Rogoff K.: This time it's different (Princeton, 2009)
- ▶ Paris Club 2018
- ▶ IIF 2018
- ▶ IMF yearly report and WEO 2018
- ▶ US Treasury and US FFIEC 2018
- ▶ BIS reports 2018
- ▶ C-Bonds website

## EXTERNAL DEBT ANALYSIS

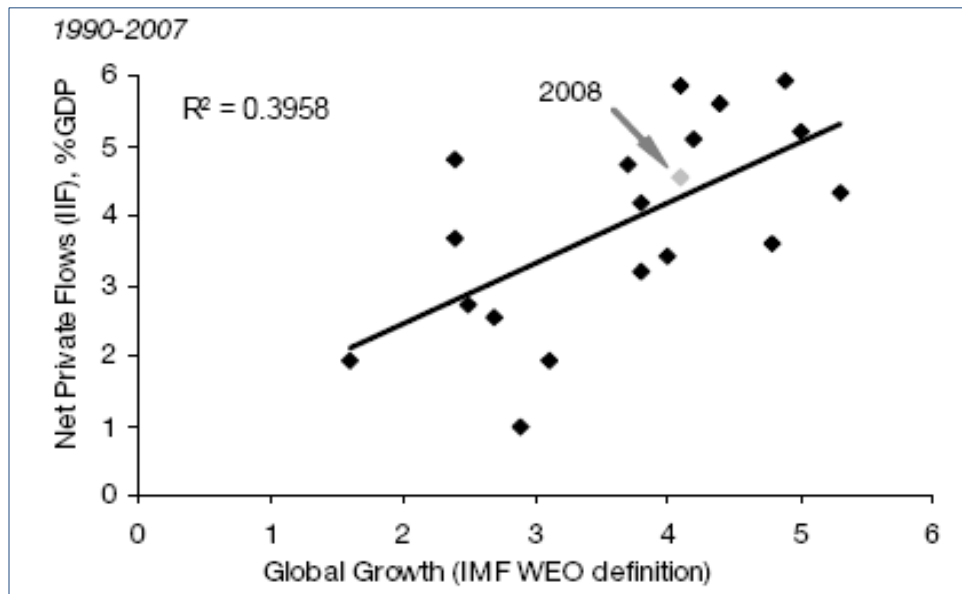
### 4 Objectives:

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

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## EXTERNAL FINANCING HELPS BOOSTING GDP GROWTH



IIF, Washington, D.C.

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## Roots of external financial crisis

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

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

**Consumption > Savings =  
excessive absorption**

**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 +  $\Delta$  reserve requirements
- Fiscal adjustment + cuts in public spending
- Structural measures to stimulate competitiveness



**Debt restructuring + return to market access (?)** <sup>5</sup>

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## DOMESTIC AND EXTERNAL FINANCIAL EQUILIBRIUM

What is disposable income?

$Y = \text{gross income} - \text{imports \& taxation}$

$$Y = C + I + G + X - M - T + (KM - K \text{ flight})$$

$$\text{Savings} = Y - C$$

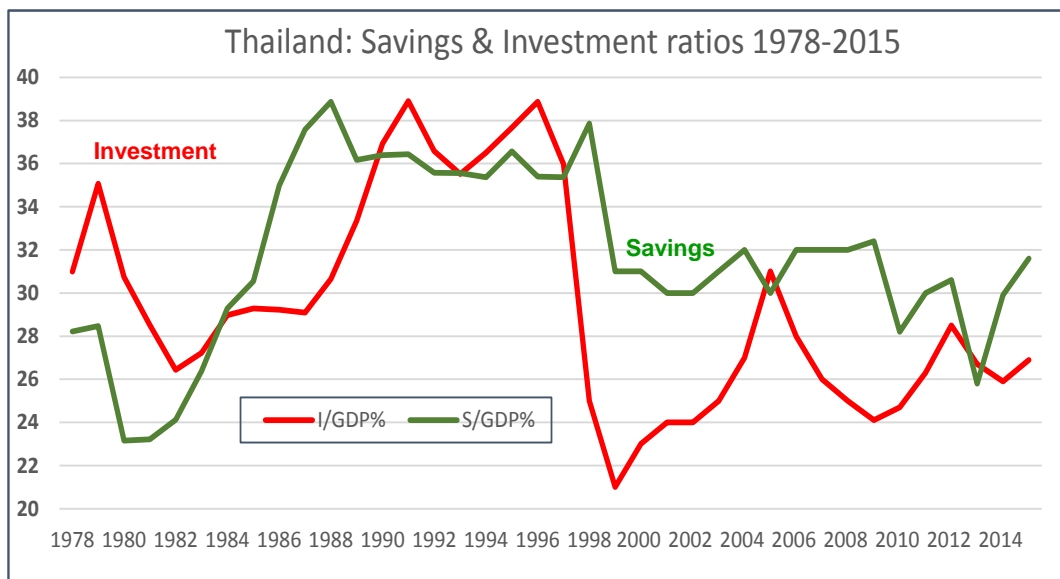
$$\underbrace{(S - I)}_{\text{Net savings}} + \underbrace{(T - G)}_{\text{Fiscal balance}} = \underbrace{(X - M)}_{\text{Trade balance}} + \underbrace{(KM - KX)}_{\text{Net capital inflows}}$$

## BOOSTING SAVINGS TO FINANCE INVESTMENT WITHOUT EXTERNAL DEFICIT

if  $S < I \Rightarrow X < M$

- ▶ a **trade imbalance** is always rooted in low savings and excessive domestic spending (absorption).
- ▶ It requires macroeconomic correction (interest rate hike, devaluation,  $\uparrow$  taxation, credit reduction,  $\uparrow$  reserve requirements...)

### THE LONG-TERM DYNAMICS OF INVESTMENT AND NATIONAL SAVINGS

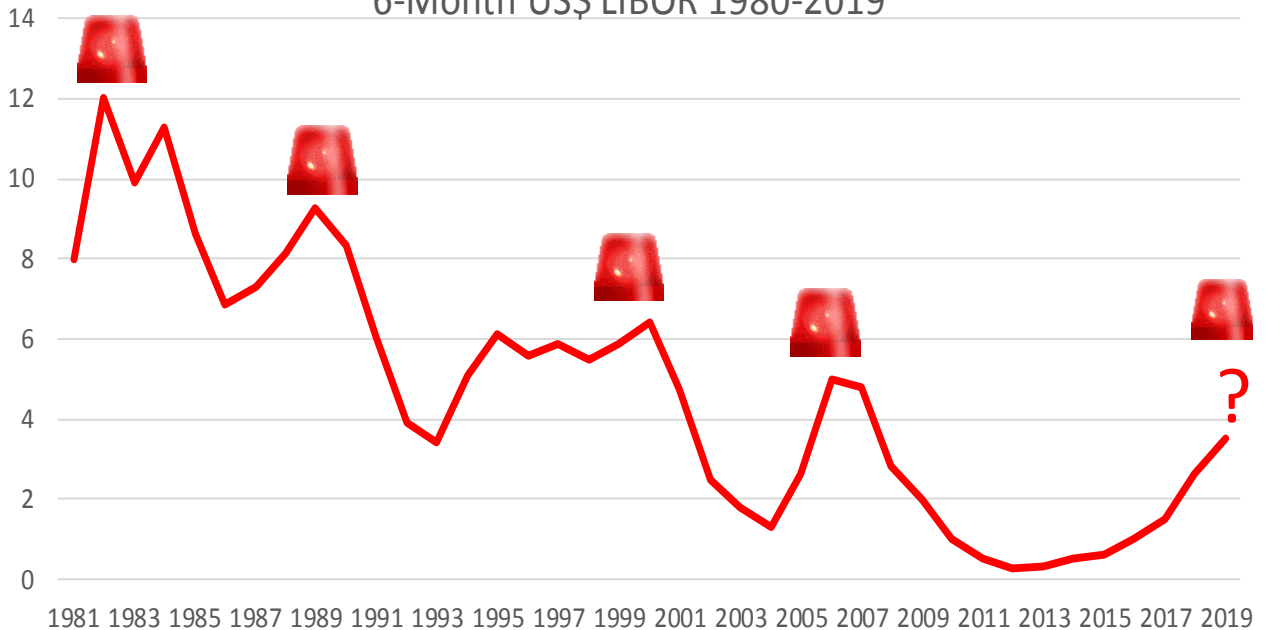


## THE CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS

- 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**



## 6-Month US\$ LIBOR 1980-2019



*From less liquid items to more liquid items!*

### 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)**



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WHY/WHEN DOES A FINANCIAL CRISIS ERUPT?

## GROSS AND NET FLOWS

▶ **Gross Capital Inflows** =

$\Sigma$  Long-term + Short-term capital flows

▶ **Net Flows** =

$\Sigma$  Gross Inflows - Debt Repayments

▶ **Net Transfers** =

$\Sigma$  Net Flows - Interest Payments

▶ **Total debt service payments** =

$\Sigma$  Debt payments + Interest payments

## 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

## TABLE OF USES AND SOURCES

### USES (outflows)

1. Imports of goods
2. Imports of services
3. Interest payments
4. Principal debt payments
5. ST capital outflows
6. E&Os

### SOURCES (inflows)

1. Exports of goods
2. Exports of services
3. Transfers & Remittances
4. Dividends
5. FDI
6. ST and LT K inflows
7. Debt cancellation
8. Arrears



**Hello SKEMA FMI!  
HELP!**

|  | 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                                 |       |       |
| <b>Note: Country GDP: 15000 (end-2017)</b>       |       |       |
| <b>Official Reserve Assets ( end-2015): 5500</b> |       |       |
| <b>External Debt Stock (end-2015)</b>            |       | 17000 |

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**Hello SKEMA FMI!  
HELP!**

|                               | 2016        | 2017         |
|-------------------------------|-------------|--------------|
| Exports of Goods              | <b>5550</b> | <b>4150</b>  |
| Imports of Goods              | -4650       | -5250        |
| Trade balance                 | <b>900</b>  | <b>-1100</b> |
| Service Income (net)          | 625         | 500          |
| Interest Payments             | -1750       | -1855        |
| Official unrequited transfers | 300         | 125          |
| Private unrequited transfers  | 125         | 100          |
| Current account               | <b>200</b>  | <b>-2230</b> |
| 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             | <b>-600</b> | <b>3030</b>  |
|                               | 0           | 0            |

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**Hello SKEMA FMI!  
HELP!**



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

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## EXTERNAL DEBT ANALYSIS

**FLOWS:** Balance of payments analysis and capital flight

- ▶ Liquidity
- ▶ 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, maturity)
- ▶ Solvency ratios
- ▶ London Club debt : secondary market discounts
- ▶ Spread/margin over US T Bills and CDS

## EXTERNAL DEBT ANALYSIS

**FLOWS:** Balance of payments analysis and capital flight

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➔ 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

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## RISK MANAGEMENT AND BOP ANALYSIS

|       |  |
|-------|--|
| +     | Export of goods f.o.b.                     |
| -     | Imports of goods f.o.b.                    |
| =     | <b>Trade balance</b>                       |
| +/-   | Exports/Imports of non-financial services  |
| -     | Interest payments                          |
| +     | Investment income (dividends) credit/debit |
| + (-) | Private/Official unrequited transfers      |
| =     | <b>Current account balance</b>             |
| +/-   | <b>FDI</b>                                 |
| +/-   | <b>Portfolio capital Flows</b>             |
| +     | <b>LT Capital Inflows</b>                  |
| -     | <b>Debt Servicing Payments</b>             |
| +/-   | <b>ST Capital Flows</b>                    |
| +/-   | <b>Reserve Variation</b>                   |

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## EXTERNAL DEBT ANALYSIS:

## THE DUAL FACE OF COUNTRY RISK

**Liquidity Risk**

- ▶ Debt Service Ratio:  
( $P+I/X$ )
- ▶ Interest Ratio ( $I/X$ )
- ▶ Current account/GDP
- ▶ Growth rate of  
exports/ Average  
external interest rate

**Solvency Risk**

- ▶ Debt/Export ratio
- ▶ Debt/GDP ratio
- ▶ Debt/Reserves
- ▶ ST Debt/Total Debt
- ▶ ST Debt/Reserves
- ▶ Reserve/Import ratio

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## 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)

## 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    |
|----------------------------|-------|-------------------------------|-----------------|----------------|-----------|
| <b>1. Real Economy</b>     |       |                               |                 |                |           |
| "+, -, 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  |
| <b>2. External Finance</b> |       |                               |                 |                |           |
| "+, -, 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       |
| <b>3. Spill-over</b>       |       |                               |                 |                |           |
| only > 0                   | 13    | Trade openness ratio - %      | performance     | quarterly      | WB        |
| only > 0                   | 14    | Capital Flight / Reserves - % | capital flight  | quarterly      | BIS       |
| <b>4. Risk Ratings</b>     |       |                               |                 |                |           |
| 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 Develop Index           | governance      | annual         | UNDP      |
| only > 0                   | 19    | Doing Business index          | performance     | annual         | WB        |

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## 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*

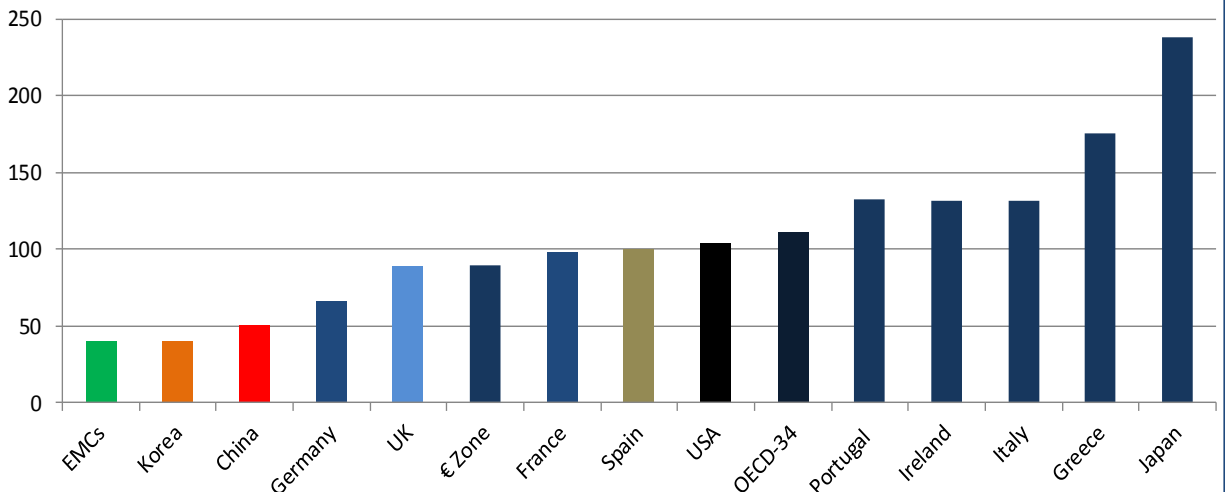
*Sources: National Authorities; World Bank; International Monetary Fund; Haver Analytics*

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## PUBLIC DEBT IN 2018-19: STILL UNDER CONTROL?

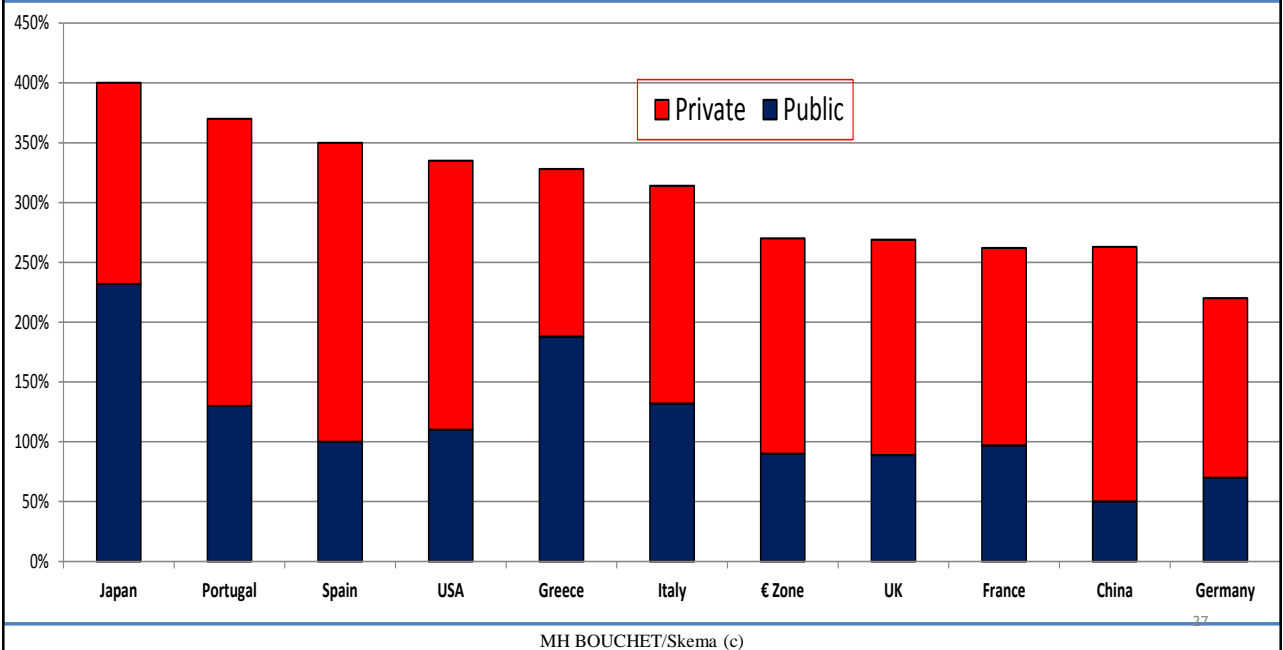
### Public debt to GDP % 2018



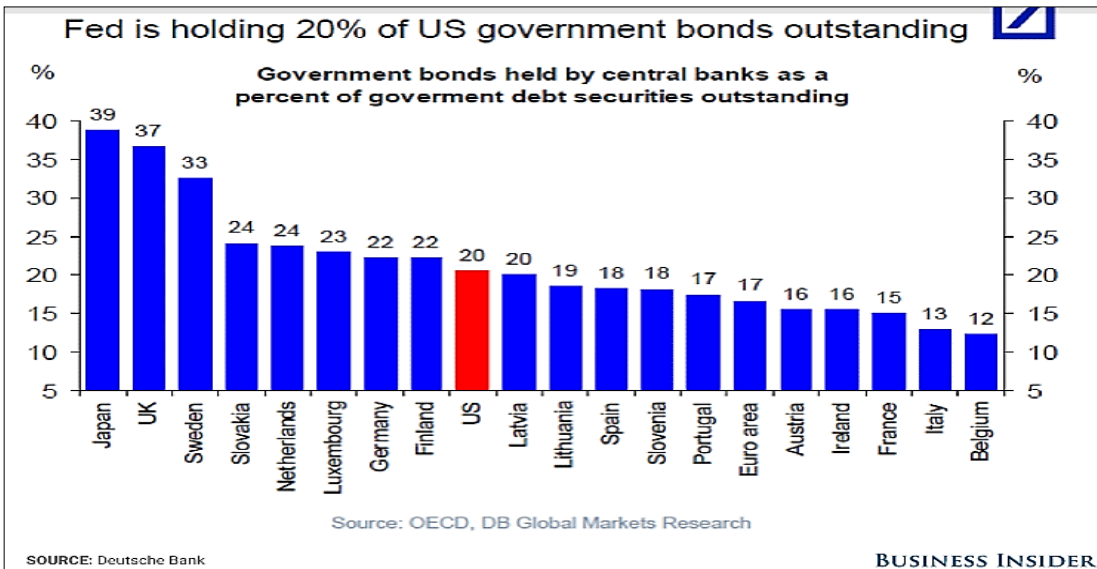
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## OVERALL NATIONAL DEBT BURDENS



## CENTRAL BANKS' ACCOMODATIVE MONETARY POLICY AND SOVEREIGN DEBT



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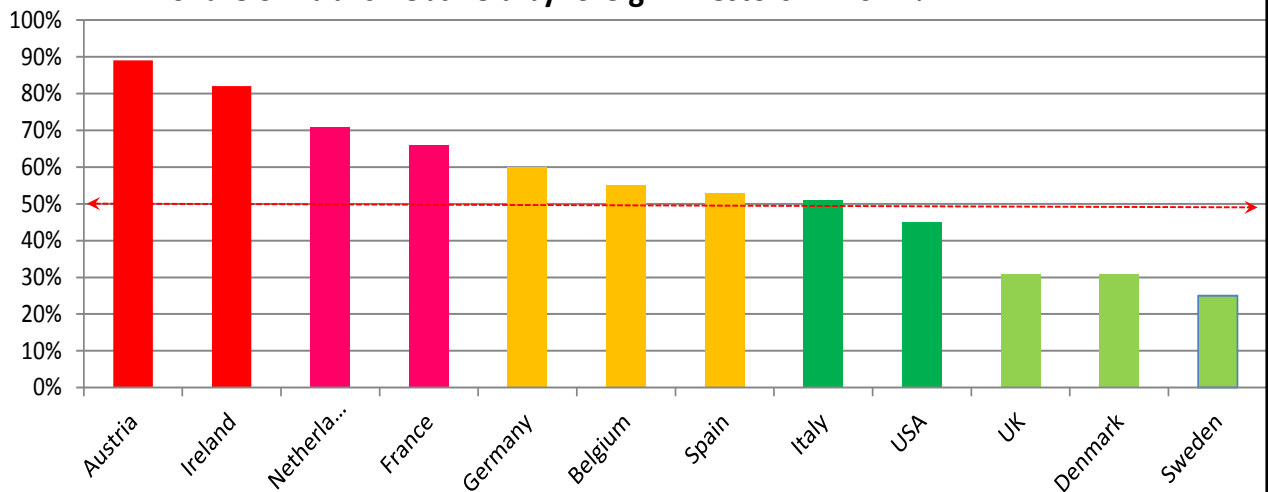
### GLOBAL PRIVATE SECTOR DEBT IN % OF GLOBAL GDP (COMPANIES AND HOUSEHOLDS)



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

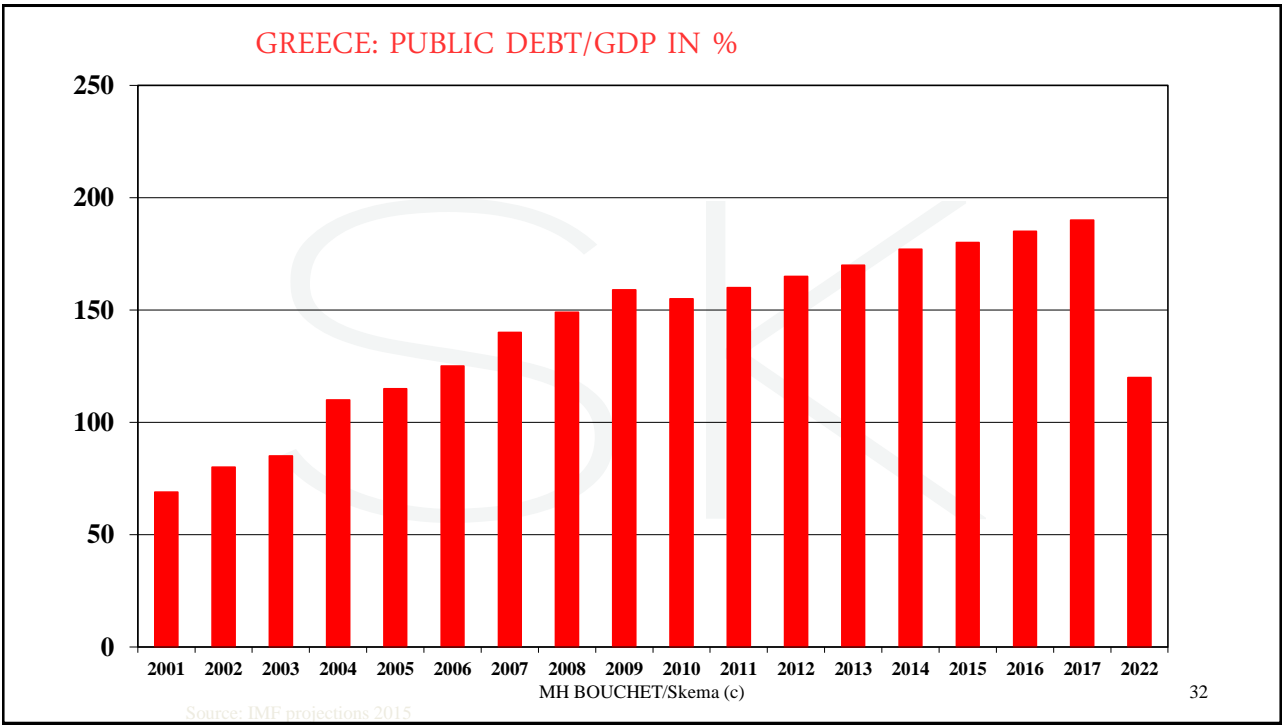
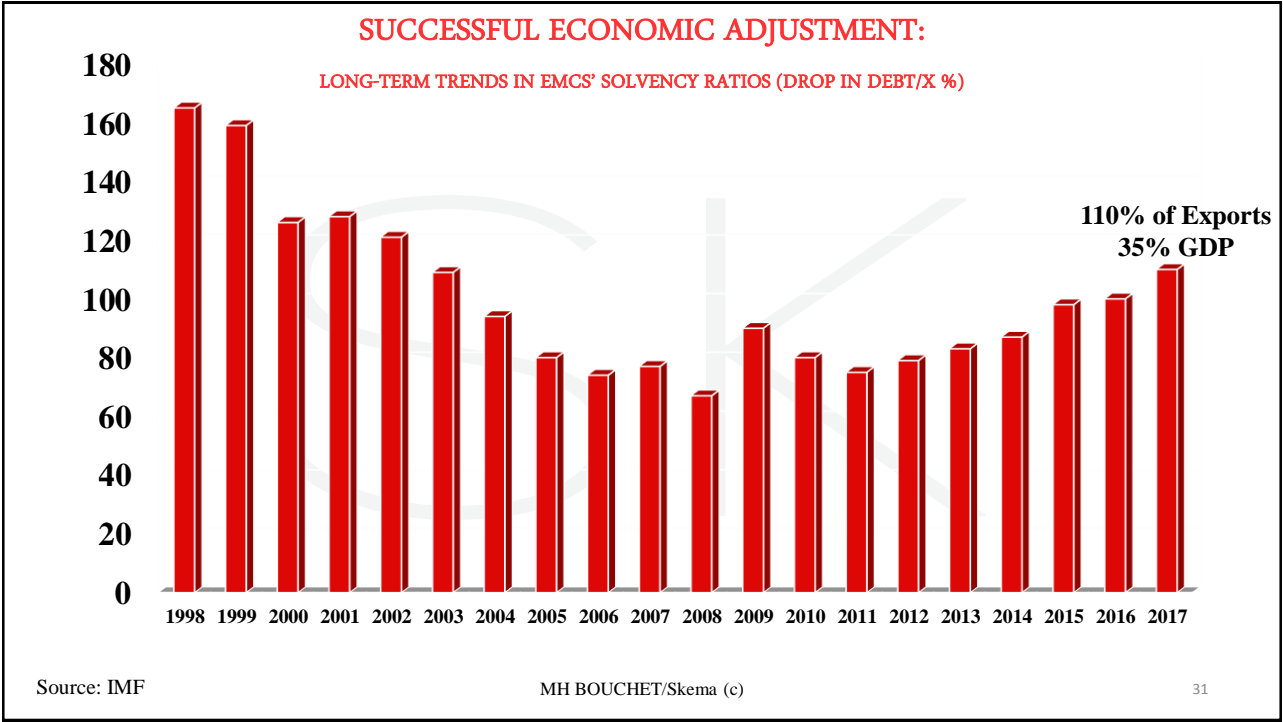
#### Share of Public Debt held by foreign investors in 2017 %

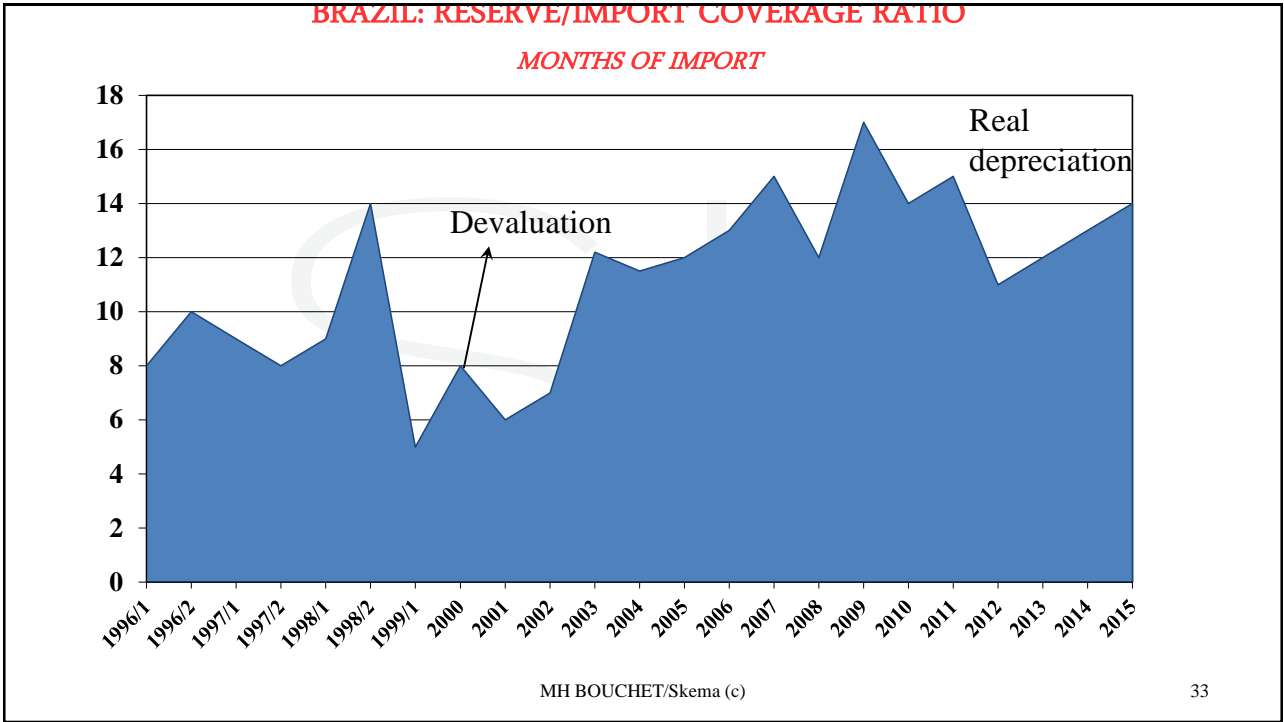


Source: FT, IMF, Natixis, US Treasury 2017

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### EXTERNAL FINANCING PROFILES IN 2017-18

| RATIOS       | VIETNAM | GABON | ECUADOR |
|--------------|---------|-------|---------|
| 1. CA/GDP    | +2%     | -9%   | -3%     |
| 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://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  | 2016Q1 | 2016Q2 | 2016Q3 | 2016Q4 | 2016Q1 |
|---|--------|--------|--------|--------|--------|
| <b>A1. Loans and other credits (Debt of)</b>                |        |        |        |        |        |
| <b>01_Cross-border loans, by BIS reporting banks</b>        | 8,289  | 8,768  | 8,882  | 9,126  | 8,614  |
| <b>02___o/w to nonbanks</b>                                 | 6,868  | 6,040  | 6,236  | 6,068  | 6,344  |
| <b>03_Official bilateral loans, total</b>                   | --     | --     | --     | --     | --     |
| <b>04___o/w aid loans</b>                                   | --     | --     | --     | --     | --     |
| <b>05___o/w other</b>                                       | --     | --     | --     | --     | --     |
| <b>06_Multilateral loans, total</b>                         | 8,798  | 7,113  | 7,286  | --     | --     |
| <b>07___o/w IMF</b>   | 0      | 0      | 0      | --     | --     |
| <b>08___o/w other institutions</b>                          | 8,798  | 7,113  | 7,286  | 7,621  | 7,726  |
| <b>09_Insured export credit, Berne Union</b>                | 7,807  | 7,721  | 7,650  | 7,144  | 7,173  |
| <b>10___o/w short term</b>                                  | 4,613  | 4,684  | 4,690  | 4,421  | 4,484  |
| <b>11_SDR allocations</b>                                   | 774    | 790    | 788    | 778    | 781    |
| <b>A2. Loans and other credits (Debt due within a year)</b> |        |        |        |        |        |
| <b>12_Liabilities to BIS banks (cons.), short term</b>      | 2,874  | 2,901  | 2,429  | 2,379  | 2,617  |
| <b>13_Multilateral loans, IMF, short term</b>               | --     | --     | --     | --     | --     |
| <b>B1. Debt securities (All maturities)</b>                 |        |        |        |        |        |
| <b>14_Debt securities held by nonresidents</b>              | --     | 6,442  | --     | --     | --     |
| <b>B2. Debt securities (short term, original maturity)</b>  |        |        |        |        |        |
| <b>15_Debt securities held by nonresidents</b>              | --     | 132    | --     | --     | --     |
| <b>C. Supplementary information on debt (liabilities)</b>   |        |        |        |        |        |
| <b>16_International debt securities, all maturities</b>     | 8,864  | 7,863  | 8,120  | 8,007  | 8,102  |
| <b>17___o/w issued by nonbanks</b>                          | 8,664  | 7,862  | 7,820  | 7,738  | 7,802  |
| <b>18_International debt securities, short term</b>         | 84     | 66     | 66     | 64     | 0      |
| <b>19___o/w issued by nonbanks</b>                          | 64     | 66     | 66     | 64     | 0      |
| <b>20_Paris Club claims (ODA)</b>                           | --     | --     | --     | --     | --     |
| <b>21_Paris Club claims (non ODA)</b>                       | --     | --     | --     | --     | --     |
| <b>22_Liabilities to BIS banks, locational, total</b>       | 12,929 | 12,632 | 12,676 | 12,784 | 13,237 |
| <b>23_Liabilities to BIS banks, consolidated, total</b>     | 10,894 | 10,909 | 10,668 | 10,783 | 11,184 |
| <b>D. Memorandum items: selected foreign assets</b>         |        |        |        |        |        |
| <b>24_International reserves (excluding gold)</b>           | 17,864 | 18,762 | 21,680 | 22,264 | 24,327 |
| <b>25___o/w SDR holdings</b>                                | 770    | 786    | 773    | 783    | 778    |
| <b>26_Portfolio investment assets</b>                       | --     | --     | --     | --     | --     |
| <b>27_Cross-border deposits with BIS rep. banks</b>         | 4,888  | 6,767  | 6,071  | 5,372  | 6,787  |
| <b>28___o/w deposits from nonbanks</b>                      | 2,804  | 2,688  | 2,472  | 2,333  | 2,484  |

## 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



## EXTERNAL DEBT ANALYSIS II

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

▶  $DEBT_t = DEBT_{t-1} * (1+r) - \text{Primary Budget Balance}$

▶  $GDP_t = GDP_{t-1} * (1 + g)$

▶  $\frac{DEBT_t}{GDP_t} = \frac{DEBT_{t-1} * (1+r) - \text{Primary Budget Balance}}{GDP_{t-1} * (1+g)}$

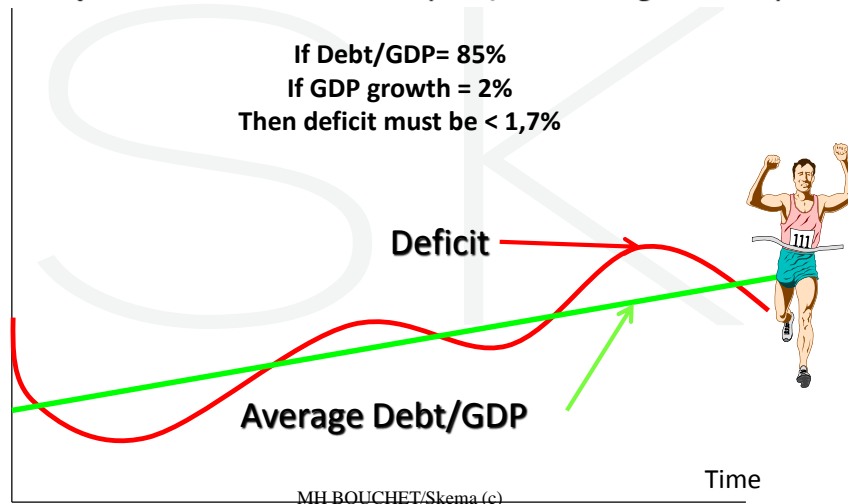
$\frac{DEBT}{GDP_t} = \frac{DEBT}{GDP_{t-1}} * \frac{1+r}{1+g} - \frac{\text{Primary Budget Balance}}{GDP}$

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

$$DEBT_t = DEBT_{t-1} + DEF_{t-1} \quad DEF = d * Y_t \quad \Delta Y_t = Y_{t-1} (1+g)$$

$$\frac{DEBT_t}{Y_t} = \frac{DEBT_{t-1}}{Y_t} + \frac{d * Y_{t-1}}{Y_t}$$

$$\begin{aligned} \frac{DEBT_t}{Y_t} &= \frac{DEBT_{t-1}}{Y_{t-1}} * \frac{Y_{t-1}}{Y_t} + \frac{d}{1+g} \\ &= \left( \frac{1}{1+g} \right) * \frac{DEBT_{t-1}}{Y_{t-1}} + \frac{d}{1+g} = \frac{d/1+g}{1 - (1/1+g)} = \frac{d}{g} \end{aligned}$$


So, if  $DEBT/Y < 120\%$ ,  $DEF$  should be  $< 3\%$  for a  $2,5\%$  GDP growth rate





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**Country risk, Financial crisis, and Debt Restructuring :**  
**Paris & London Clubs**  
 Michel Henry Bouchet

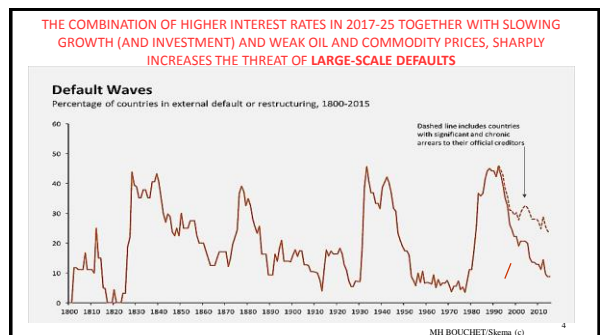
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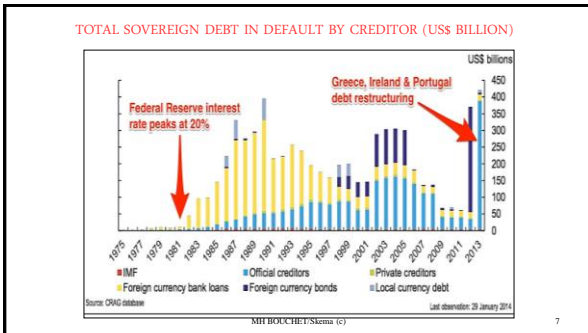
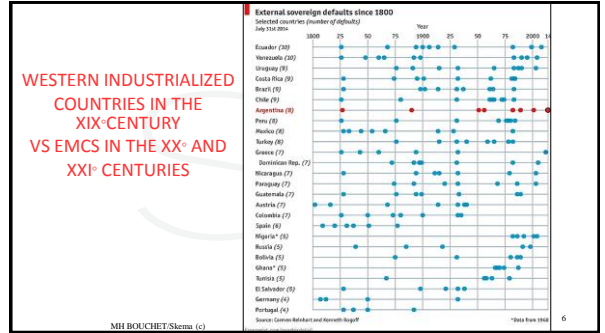
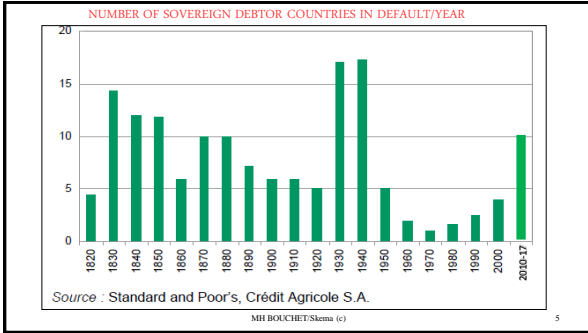



IMF  
 2 COUNTRY RISK  
 TRAJECTORIES IN 2018?

|                           |  VIETNAM |  PHILIPPINES |
|---------------------------|---|---|
| Current Account/GDP       |   |   |
| Debt/GDP                  |   |   |
| Debt/Exports              |   |   |
| Reserves/Imports (months) |   |   |

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**Fitch-Rated Sovereign IDR Defaults (1995-2011)**

**Argentina:** Defaulted on more than USD40 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 USD5 billion of sovereign foreign currency debt, mostly held by non-residents.

**Jamaica:** A 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.

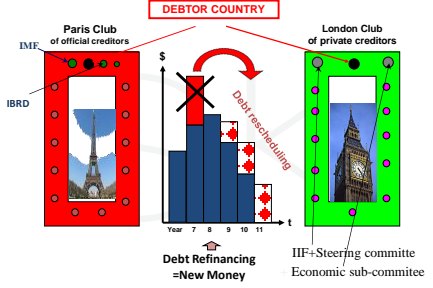
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### WHO's WHO?

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

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**DEBTOR COUNTRY**

Debt Refinancing = New Money

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## ▶ 1. The Paris Club



<http://www.clubdeparis.org/sections/donnees-chiffres/chiffres-cles>

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### 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             |

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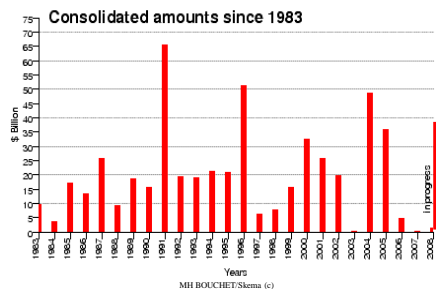
## PARIS CLUB DEBT RESTRUCTURING

- ▶ **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

## PARIS CLUB CONSOLIDATED DEBT AMOUNTS IN US\$ BILLION

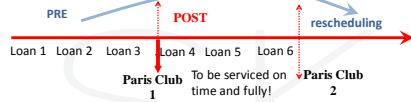


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## THE FOUR KEY RULES OF THE PARIS CLUB

1. **Consensus** : no decision can be taken within the Paris Club if it is not the result of a consensus among the participating creditor countries.
2. **Conditionality** : debt treatments are applied only for countries that need a rescheduling and that implement reforms to resolve their payment difficulties. In practice conditionality is provided by the existence of an appropriate programme supported by the IMF, which demonstrates the need for debt relief.
3. **Solidarity** : Creditors agree to implement the terms agreed in the context of the Paris Club.
4. The Paris Club preserves the **comparability of treatment** between different creditors, as the debtor country cannot grant to another creditor a treatment less favourable for the debtor than the consensus reached in the Paris Club.

### 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

### PARIS CLUB DEBT RESTRUCTURING

#### ▶ From debt rescheduling to debt reduction and debt conversion

- ▶ 09/1990: Houston terms: debt service rescheduling (15/8) for countries with GDP per capita <\$1345
- ▶ Toronto 1988 : 33% debt reduction: Menu approach
- ▶ 12/1991: « London terms » for 23 poorest countries: 50% reduction of eligible debt payments or consolidated debt in NPV, with promise of considering « stock reduction »
- ▶ Naples 1994 67% NPV (flow rescheduling) for EMCs with per capita GDP<US\$500 and D/X ratio >350%
- ▶ Lyon 1996 HIPC 80% debt stock rescheduling
- ▶ Cologne June 1999: debt stock reduction up to 80%

### « LONDON TERMS » DEBT RESTRUCTURING

“London Terms”: 12/1991: Paris Club creditors agreed to implement a new treatment on the debt of the poorest countries to raise the level of debt cancellation from the 33.33% as defined in Toronto terms to 50%.  
23 countries benefited from London terms until mid-1990s, when these terms were replaced by Naples terms.

London terms included the possibility for creditor countries to conduct, on a bilateral and voluntary basis, debt swaps with the debtor country.

These swap operations in principle could be carried out without limit on official development aid loans, and up to 20% of the outstanding amount or 15 up to 30 million SDR for non-ODA credits.

### PARIS CLUB DEBT RESTRUCTURING UNDER THE « LONDON TERMS »

- ▶ Non-ODA credits cancelled to a 50% level through one of the four following options:
  1. - "debt reduction option": 50% of the claims treated cancelled (after possible topping-up), the outstanding part being rescheduled at the appropriate market rate (23 years repayment period including 6-year grace and progressive payments).
  2. - "debt service reduction option": claims rescheduled at a reduced interest rate (23 years repayment period with progressive payments).
  3. - "moratorium interest capitalization option": claims rescheduled at a reduced interest rate (23-year repayment period including 6-year grace and progressive payments).
  4. - "commercial option": claims restructured at the appropriate market rate over a longer period (25-year repayment period including 14-year grace): non-concessional option.
- ▶ ODA credits rescheduled at an interest rate at least as favorable as the original concessional interest rate applying to these loans (30-year repayment period including 12-year grace and progressive repayment).

### VIETNAM AND THE PARIS CLUB 12/93

- ▶ Amounts treated = \$544 million
- ▶ Repayment profile treatment = London terms (50% debt cancellation)
- ▶ Cutoff date= January 01, 1990
- ▶ Participating creditors: AUSTRALIA , AUSTRIA , BELGIUM , DENMARK , FRANCE , GERMANY , ITALY , NETHERLANDS , NORWAY , UNITED KINGDOM , UNITED STATES OF AMERICA
- ▶ Observers: JAPAN , SPAIN , SWEDEN , Asian Development Bank , IMF , OECD , UNCTAD , World Bank

### CÔTE D'IVOIRE DEBT RELIEF AGREEMENT 11/2011

- ▶ Paris Club external debt relief following the approval by the IMF of a new 3-year arrangement under the Extended Credit Facility on November 4, 2011.
- ▶ “Cologne terms” for implementation of the HIPC initiative debt relief = 80%
- ▶ On an exceptional basis, considering the Republic of Côte d'Ivoire's limited capacity of payment, creditors have agreed to defer and reschedule over a ten-year period the repayment of maturities due on **short term and post-cut off date debts**; and, over an eight-year period the arrears on those claims. They also agreed to defer all the interest due on the amounts treated.
- ▶ These measures are expected to reduce the debt service (including the arrears) due to Paris Club creditors between 1st July 2011 and 30 June 2014 by more than **78%** which corresponds to \$1822 million, of which \$397 million cancelled.

## The London Club of debt restructuring

MH BOUCHETS



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### DEBT RESTRUCTURING OF LONDON CLUB DEBT

- ▶ Commercial banks' claims on EMCs and OECD countries
- ▶ Debt renegotiation workouts

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.
- ▶ Advisory Committees have included representatives from nonbank creditors (fund managers holding sovereign bonds)
- ▶ The IIF plays a key role in London Club meetings



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WHAT IS THE « LONDON CLUB »?

- ▶ *ad hoc* forum for restructuring negotiations.
- ▶ Each London Club is formed at the initiative of the debtor country
- ▶ London Club "Advisory Committees" are chaired by a leading financial firm with representatives from a cross-section of international banks
- ▶ Meetings in London, New York, Paris, and other financial centers.
- ▶ IIF + Economic Subcommittee = macroeconomic, BOP analysis and debt sustainability reports to the Advisory Committees

Source: IIF



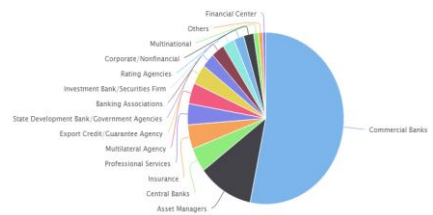
WHAT IS THE IIF?

- ▶ 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**.



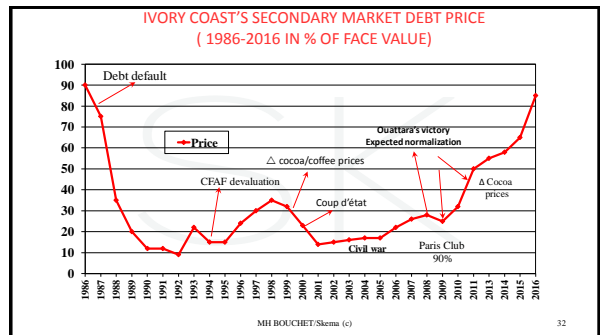
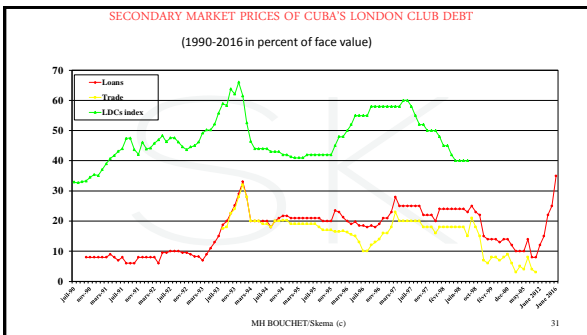
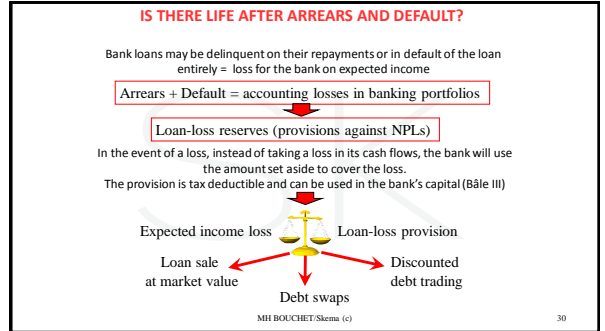
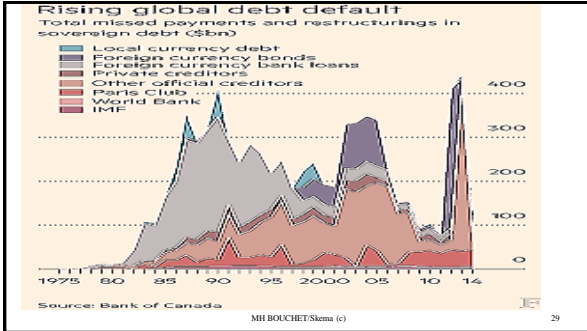
THE IIF= A GLOBAL BANKING UNION

IIF Member Breakdown



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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 | COUNTRY / ISSUE                     | Low Price | High Price |
|--|-----------|------------|-------------------------------------|-----------|------------|
| <b>Africa Hyper-Exotica</b>                        |           |            | <b>Eastern Europe Hyper-Exotica</b> |           |            |
| Anglia / Trade                                     | 50.000%   | 55.000%    | Azerbaijan / Trade                  | 18.000%   | 23.000%    |
| Anglia / Loans                                     | 55.000%   | 59.000%    | Bosnia / Trade                      | 36.000%   | 41.000%    |
| Cameroon / Trade (non-HPC)                         | 14.000%   | 20.000%    | Georgia / Trade                     | 11.000%   | 15.000%    |
| Congo / Trade (non-HPC)                            | 22.000%   | 24.000%    | Serbia / Trade                      | 44.000%   | 54.000%    |
| DR Congo / Loans, Trade (non-HPC)                  | 16.000%   | 20.000%    | Turkmenistan / Trade                | 23.000%   | 33.000%    |
| Ghana / Trade (non-HPC)                            | 78.000%   | 82.000%    | Ukraine / Trade                     | 18.000%   | 25.000%    |
| Kenya / Trade                                      | 39.000%   | 49.000%    | Uzbekistan / Trade                  | 20.000%   | 24.000%    |
| Mozambique / Trade (non-HPC)                       | 28.000%   | 28.000%    | <b>Midwest East Hyper-Exotica</b>   |           |            |
| Senegal / Loans, Trade (non-HPC)                   | 22.000%   | 14.000%    | Egypt / Trade                       | 45.000%   | 75.000%    |
| Surin / Loans (non-HPC)                            | 11.000%   | 14.000%    | Iraq / Paris Club                   | 84.000%   | 89.000%    |
| Tanzania / Loans, Trade (non-HPC)                  | 10.000%   | 13.000%    | Iraq / Bonds                        | 91.000%   | 92.000%    |
| Uganda / Trade (non-HPC)                           | 14.000%   | 16.000%    | Libya / Trade                       | 25.000%   | 35.000%    |
| Zambia / Loans, Trade (non-HPC)                    | 13.000%   | 20.000%    | Syria / Trade                       | 6.000%    | 11.000%    |
| Zimbabwe / Trade                                   | 1.000%    | 4.000%     | <b>Asia Hyper-Exotica</b>           |           |            |
| <b>Latin America &amp; Caribbean Hyper-Exotica</b> |           |            | North Korea / Loans, Certificates   |           |            |
| Cuba / Trade                                       | 2.000%    | 4.000%     |                                     | 9.000%    | 12.000%    |
| Cuba / Loans                                       | 5.000%    | 10.000%    |                                     |           |            |
| Suriname / Loans, Trade                            | 14.000%   | 18.000%    |                                     |           |            |

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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

# SK

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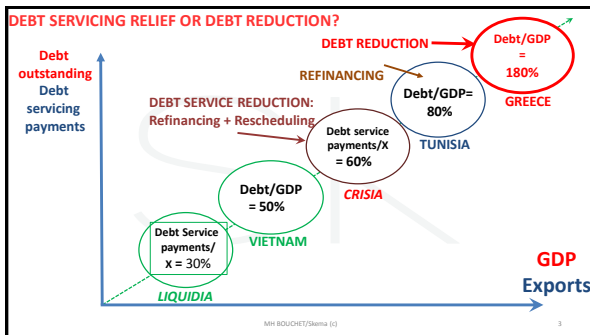
## Country risk and External Debt Restructuring

Michel Henry Bouchet

skema

Hello SKEMA FM!! HELP!  
I need to know asap the international bank debt of two countries:  
**Argentina & Spain**

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### MENU-BASED DEBT RESTRUCTURING

#### THE BRADY PLAN AND BEYOND

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### THE 1989-2017 BRADY PLAN 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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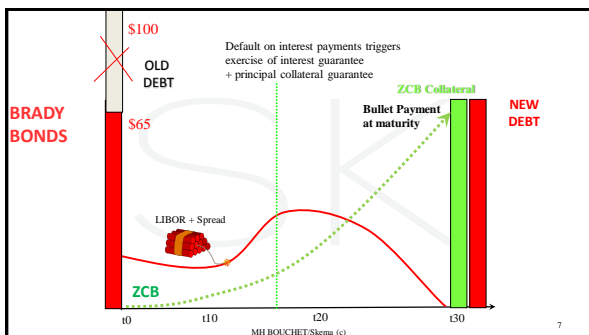
### THE BRADY PLAN IN ACTION

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

A pie chart illustrating the composition of debt. A green section represents 'BONDS SENIOR DEBT' at 65%. A red section represents 'LOANS' at 35%. A dashed line indicates a '35% haircut' on the loans portion.

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 arrear*  
 = \$850 million  
 ▶ 30-year bonds with 50% discount + par bonds + buyback at 44%

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

**SNAPSHOT AT VIETNAM'S GOVERNMENT SECURITIES**

| Issuer               | Coupon | Maturity | Series | Rtg | Freq | Mtg       | Type | Contry | 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 | 189R   | 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  | 03/12/20 | US     | NR  | S/A  | CALL/SINK | VN   | USD    | N.A.     |     |    |
| 8)VIETNAM-PAR        | 4.000  | 03/12/20 | 309R   | B+  | S/A  | CALL/SINK | VN   | USD    | 75.0000  |     |    |
| 9)VIETNAM-DISC       | FLOAT  | 03/13/20 | 309R   | B+  | S/A  | BULLET    | VN   | USD    | 84.0000  |     |    |
| 10)VIETNAM-DISC      | FLOAT  | 03/13/20 | US     | NR  | S/A  | BULLET    | VN   | USD    | N.A.     |     |    |
| 11)VIETNAM-DOT 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 (AS OF 10-2017)**

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

| Field  | Value                    | Field               | Value                      |
|--|--------------------------|---------------------|----------------------------|
| Issuer   | SOCIALIST REP OF VIETNAM | ID Number           | TT209548                   |
| Industry   | Sovereign                | ISIN                | XS069034824                |
| Security Information   |                          | Page 1/11           | Security Description: Bond |
| PAR Int  | Euro-Dollar              | Brady               |                            |
| Country  | VN                       | Currency            | USD                        |
| Rank   | Secured                  | Series              | 30YR                       |
| Coupon   | 2.350000                 | Type                | Floating                   |
| Formula  | S/A US LIBOR +81.2500    | Composite           | 88                         |
| Day Int  | ACT/360                  | Issuance & Trading  |                            |
| Maturity   | 03/13/2028               | Aggregated Amount   | Issued/Out                 |
| ISIN   | XS069034824              | USD                 | 24,552.00 (8) /            |
| ISIN   | XS069034824              | USD                 | 24,552.00 (8)              |
| Calc Type  | (575)BRADY-FLT REG VLD   | Min Piece/Increment | 1,000.00 / 1,000.00        |
| Pricing Date   | 03/12/1998               | Par Amount          | 1,000.00                   |
| Interest Accrual Date  | 03/12/1998               | Book Runner         |                            |
| List Settle Date   | 03/12/1998               | Exchange            | LUXEMBOURG                 |
| List Coupon Date   | 03/13/1998               |                     |                            |
| CPI RATE-6MO USLIBIDR +81.25BP. PRIN SEC D BY U.S. 30YR ZERO'S. 6MO ROLLING INT CRT. |                          |                     |                            |

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.

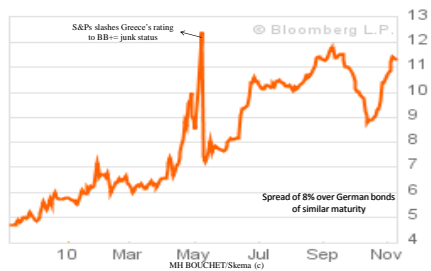
Calculation: IIF & <http://www.vaxe.org/index.php?q=node/6818>

CHALLENGES OF THE GREEK DEBT RESTRUCTURING WORKOUT 2011-17

- ▶ 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

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

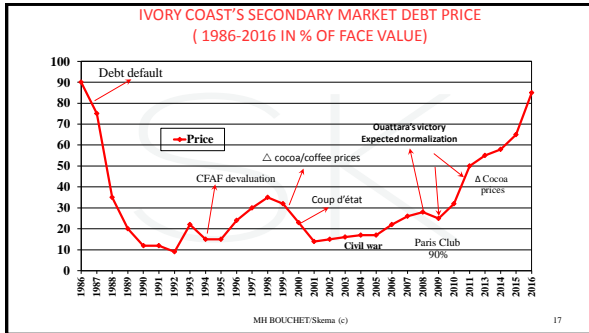
2009-2010



15

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.
- ▶ 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"



### UKRAINE'S DEBT RESTRUCTURING

09/2015

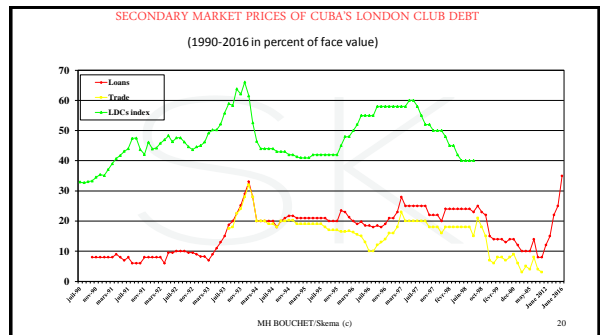
- ▶ 20% write off on \$18 billion of bonds, condition for the IMF to press ahead with 4-year \$40 billion package
- ▶ Main creditors: PTG Pactual, T Rowe Price, TCW, Franklin Templeton...
- ▶ Inclusion of GDP-linked instrument
- ▶ Between 2021-40 investors will receive up to 40% of the value of economic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

skema

### 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  |

skema



**HYPER-EXOTIC DEBT PRICES**

- |  |   |
|--|---|
| <ul style="list-style-type: none"> <li>▶ Myanmar 20%</li> <li>▶ Cambodia 20%</li> <li>▶ Mongolia 22%</li> <li>▶ North Korea 10%</li> </ul>   | <ul style="list-style-type: none"> <li>▶ Irak Bonds 90%</li> <li>▶ Libya 25-35%</li> <li>▶ Syria 6-11%</li> <li>▶ Yemen 30%</li> </ul>  |
| <ul style="list-style-type: none"> <li>▶ Argentina (2033 bonds)= 62% following ruling by NY court in 11/2012)</li> <li>▶ Cuba Loans 10-35%</li> <li>▶ Cuba Trade 15%</li> <li>▶ Albania 36%</li> <li>▶ Bosnia 36%</li> <li>▶ Serbia 44%</li> </ul> | <ul style="list-style-type: none"> <li>▶ Angola 60%</li> <li>▶ Ethiopia 60%</li> <li>▶ Senegal 35%</li> <li>▶ Sudan 11-14%</li> <li>▶ Uganda 14-16%</li> <li>▶ Zimbabwe 1-4%</li> </ul> |

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**EMCS SECONDARY MARKET DEBT PRICES**

| COUNTRY / ISSUE                                    | Low Price | High Price | COUNTRY / ISSUE                     | Low Price | High Price |
|--|-----------|------------|-------------------------------------|-----------|------------|
| <b>Africa Hyper-Exotica</b>                        |           |            | <b>Eastern Europe Hyper-Exotica</b> |           |            |
| Anglia / Trade                                     | 50.000%   | 55.000%    | Azerbaijan / Trade                  | 18.000%   | 23.000%    |
| Anglia / Loans                                     | 55.000%   | 59.000%    | Bosnia / Trade                      | 36.000%   | 41.000%    |
| Cameroon / Trade (non-HPC)                         | 14.000%   | 20.000%    | Georgia / Trade                     | 11.000%   | 15.000%    |
| Congo / Trade (non-HPC)                            | 22.000%   | 24.000%    | Serbia / Trade                      | 44.000%   | 54.000%    |
| DR Congo / Loans, Trade (non-HPC)                  | 16.000%   | 20.000%    | Turkmenistan / Trade                | 23.000%   | 33.000%    |
| Ghana / Trade (non-HPC)                            | 78.000%   | 81.000%    | Ukraine / Trade                     | 18.000%   | 25.000%    |
| Kenya / Trade                                      | 39.000%   | 49.000%    | Uzbekistan / Trade                  | 20.000%   | 24.000%    |
| Mozambique / Trade (non-HPC)                       | 28.000%   | 28.000%    | <b>Midwest East Hyper-Exotica</b>   |           |            |
| Senegal / Loans, Trade (non-HPC)                   | 12.000%   | 14.000%    | Egypt Trade                         | 45.000%   | 75.000%    |
| Sudan / Loans (non-HPC)                            | 11.000%   | 14.000%    | Iraq / Paris Club                   | 84.000%   | 89.000%    |
| Tanzania / Loans, Trade (non-HPC)                  | 10.000%   | 13.000%    | Iraq / Bonds                        | 91.000%   | 92.000%    |
| Uganda / Trade (non-HPC)                           | 14.000%   | 16.000%    | Libya / Trade                       | 25.000%   | 35.000%    |
| Zambia / Loans, Trade (non-HPC)                    | 13.000%   | 20.000%    | Syria / Trade                       | 6.000%    | 11.000%    |
| Zimbabwe / Trade                                   | 1.000%    | 4.000%     | <b>Asia Hyper-Exotica</b>           |           |            |
| <b>Latin America &amp; Caribbean Hyper-Exotica</b> |           |            | North Korea / Loans, Certificates   |           |            |
| Cuba / Trade                                       | 2.000%    | 4.000%     |                                     | 22.000%   | 30.000%    |
| Cuba / Loans                                       | 5.000%    | 10.000%    |                                     | 9.000%    | 12.000%    |
| Suriname / Loans, Trade                            | 14.000%   | 18.000%    |                                     |           |            |

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**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

skema 

**Debt trading and EMTA**

EMTA

400 Lexington Avenue  
Suite 5300  
New York, NY 10174  
646 676 4293

Contact: Jonathan Murno  
EMTA  
[jmurno@emta.org](mailto:jmurno@emta.org)

**For Immediate Release**

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

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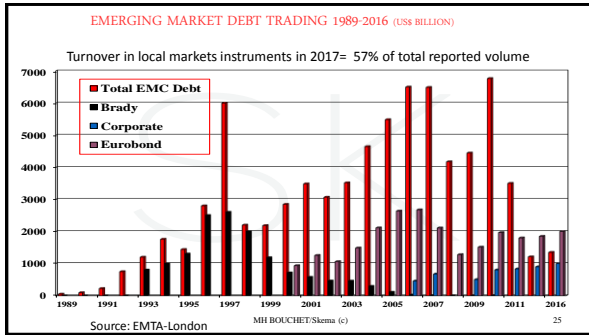
*Volumes Decline 17% on Year-on-Year Basis*

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**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.

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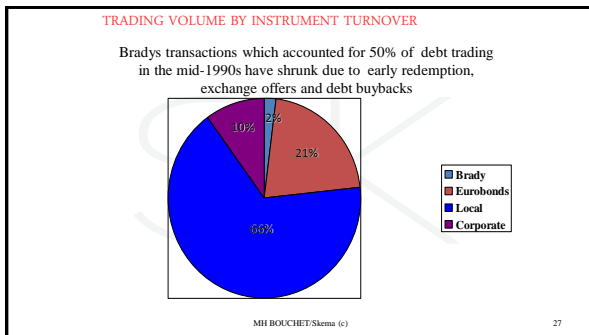


**WHO'S WHO IN HIGHLY DISCOUNTED AND EXOTIC DEBT TRADING?**

- Trading:** FH International (Eric Herman), Omni Bridgeway (Amsterdam, Geneva, Singapore, London, Guernesey), MarketAxess, Société Générale, BNP, Lazard Brothers
- 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)
- 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), Greyclock Capital (Venezuela).

MH BOUCHET/Slema (c)

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**THE EVOLVING STRUCTURE IN THE SECONDARY DEBT MARKET**

**MARKET SHARE COMPARISON**

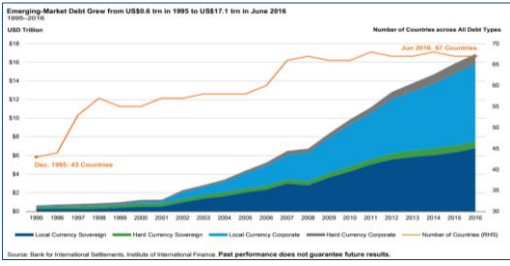
|                      | 2005 | 1997 |
|----------------------|------|------|
| Eurobonds            | 48%  | 23%  |
| Local Instruments    | 47%  | 25%  |
| Options and Warrants | 2%   | 6%   |
| Brady Bonds          | 2%   | 41%  |
| Loans                | >1%  | 5%   |

Source: EMTA

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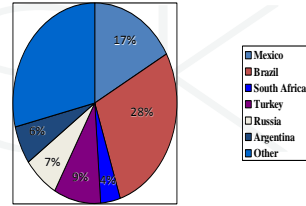
EMERGING MARKET LOCAL CURRENCY BONDS 1995-2017



MH BOUCHET/Srema (c)

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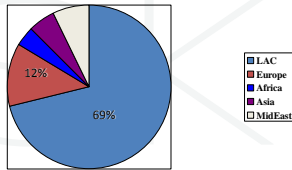
TRADING VOLUME BY COUNTRY (EMTA)



MH BOUCHET/Srema (c)

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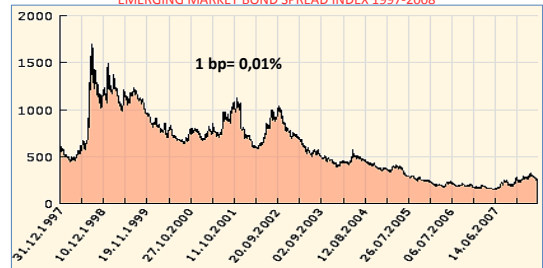
TRADING VOLUME BY REGION



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



srema

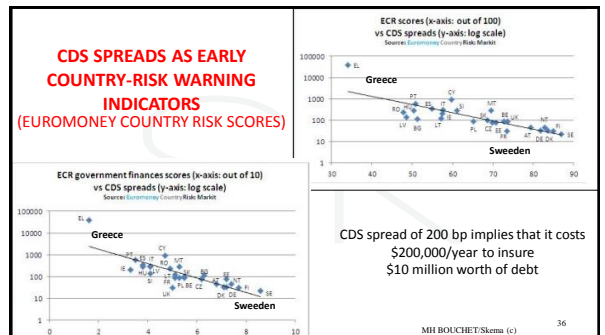


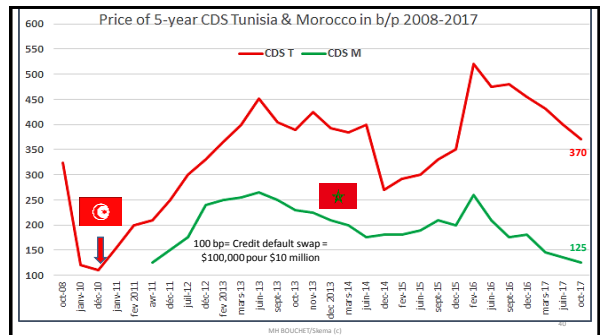
### CDS IN 2016-17?

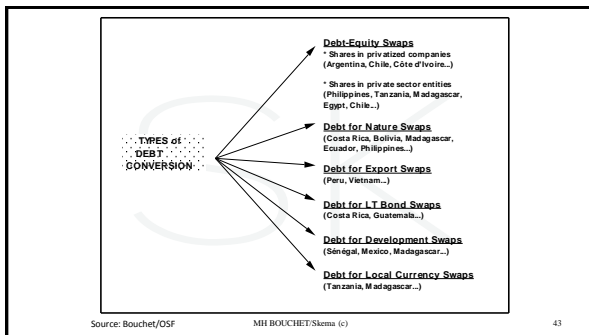
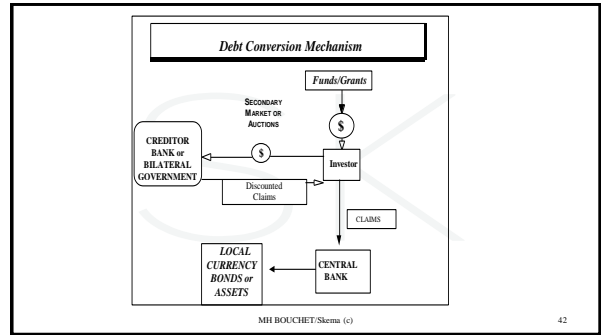
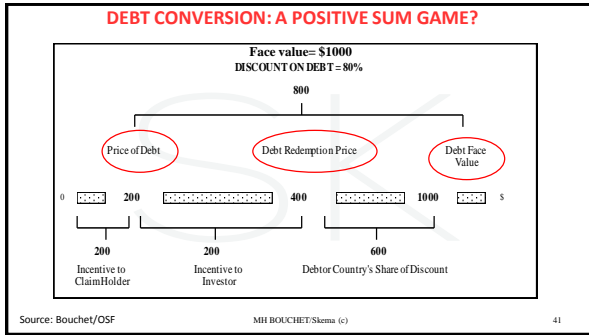
Nigeria CDS spread of 590 bp implies that it costs \$590,000/year to insure \$10 million worth of debt

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### 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

# SK

SKEMA BUSINESS SCHOOL

## Political Risk Analysis

-|-

Michel Henry Bouchet



### COUNTRY RISK AND POLITICAL RISK ASSESSMENT

- ▶ **A reminder: Sovereign 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!

Whereas political uncertainty refers to instability and threats in the socio-political system, **political risk** is the unexpected unfavorable consequences of the arbitrary exercise of power by a government and its ramifications at home and abroad, as well as by non-governmental actors

## WHAT IS « GOOD GOVERNANCE »?

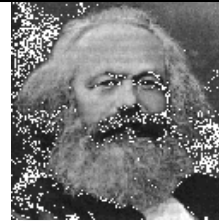
XIV<sup>o</sup> century Sienna: the allegory of **Good Government** =  
Balance between Wisdom, Justice, Strength, Prudence, and Peace



Michel Henry Bouchet -

3

## 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, hence 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 is essentially an instrument of class rule. The state in capitalist society is a bourgeois state: it is nothing but 'a committee for managing the common affairs of the whole bourgeoisie'.

Capitalism will inevitably lead to increasing class polarisation and class conflict.

## DANIEL BELL

- ▶ **One of the most important cultural critics of the postwar era** : 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

## ULRICH BECK: "WORLD AT RISK"

- ▶ 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 the locus of meaning 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 in fact be increasing due to technology, science and industrialism rather than being abated by scientific and technological progress. This is the **world risk society** 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,)

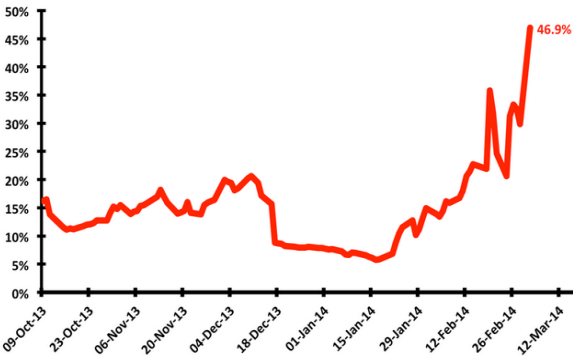
**RANKING OF TOP RISKS REPORTED BY FTSE 100 FIRMS** (FT JULY 2017)



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**YIELD ON 6-MONTH UKRAINE GOVERNMENT BOND**



**UKRAINE:**

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



Michel Henry Bouchet -

**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

8

## THE COST OF GLOBAL POLITICAL RISK

### The Annual Economic Impact Of Global Violence

Economic impact of violence/conflict to the world economy (in trillion U.S. dollars)



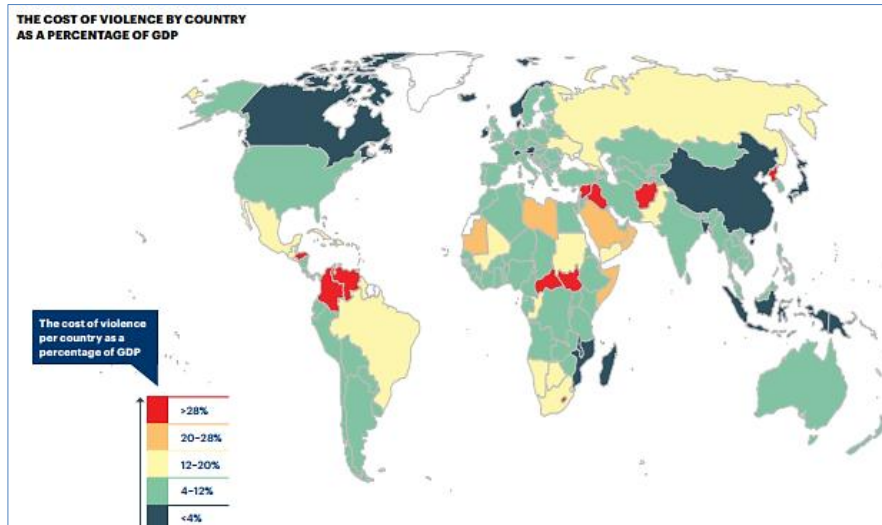
<https://www.statista.com/chart/3948/the-annual-economic-impact-of-global-violence/>

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## THE COST OF VIOLENCE IN % OF GDP

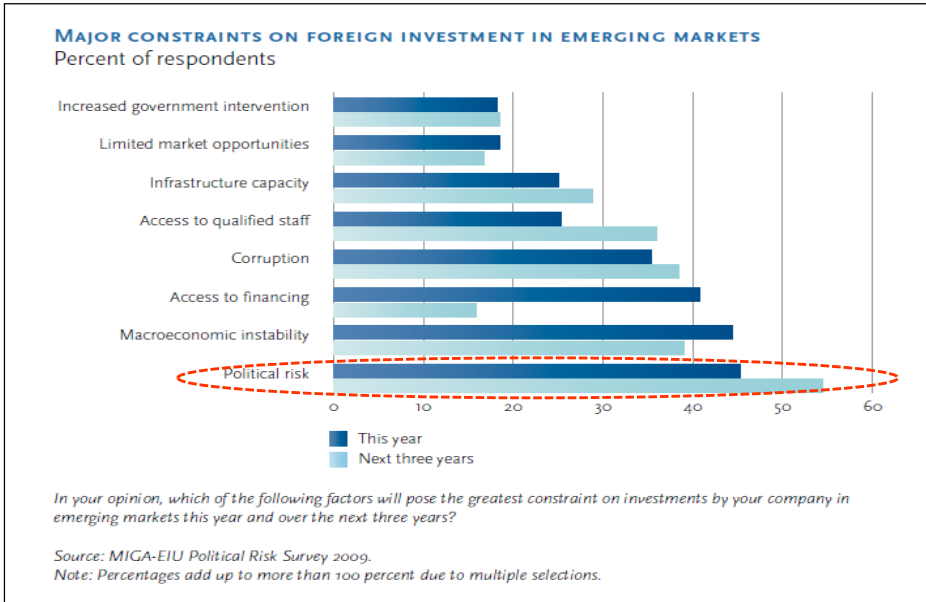
(WORLD ECON FORUM: THE ECONOMIC VALUE OF PEACE REPORT )



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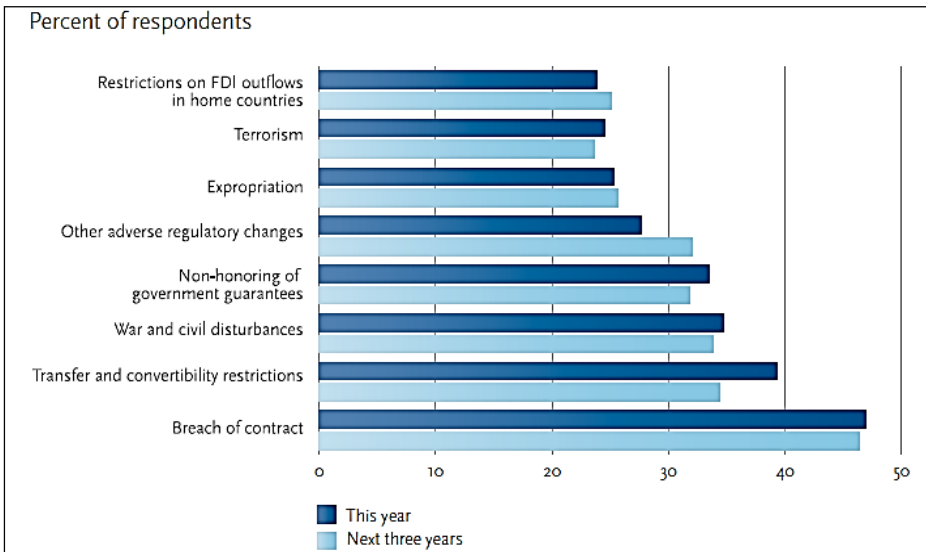
## MIGA: THE KEY CHALLENGE OF POLITICAL RISK



Michel Henry Bouchet -

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## MIGA: TYPES OF POLITICAL RISK OF HIGHER CONCERN TO MNCs IN EMCS

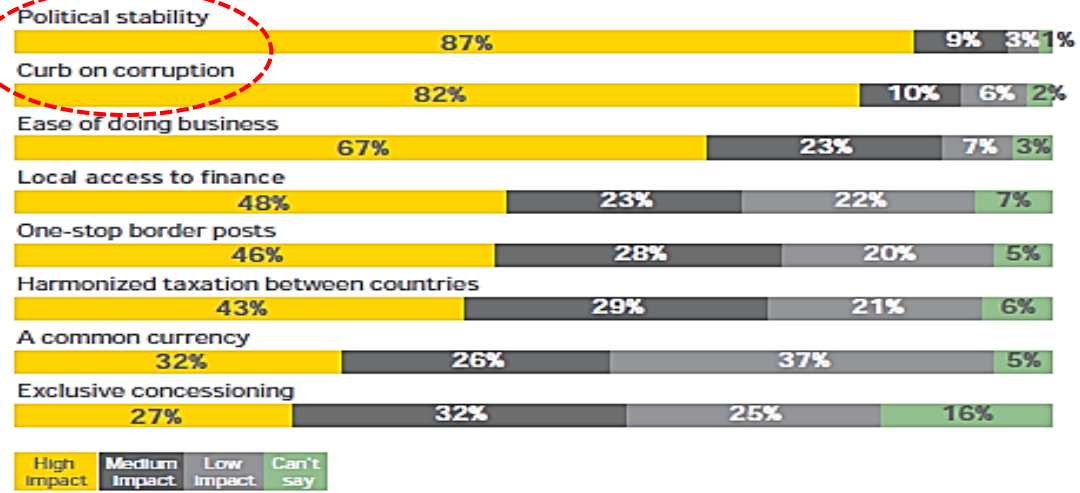


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## BOOSTING FDI IN AFRICA?

What impact would the following changes have on Africa attractiveness?



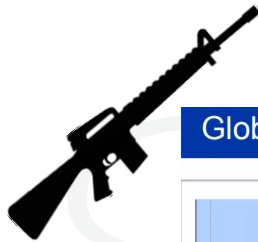
Source: Ernst & Young's 2012 Africa attractiveness survey. Total respondents: 505.

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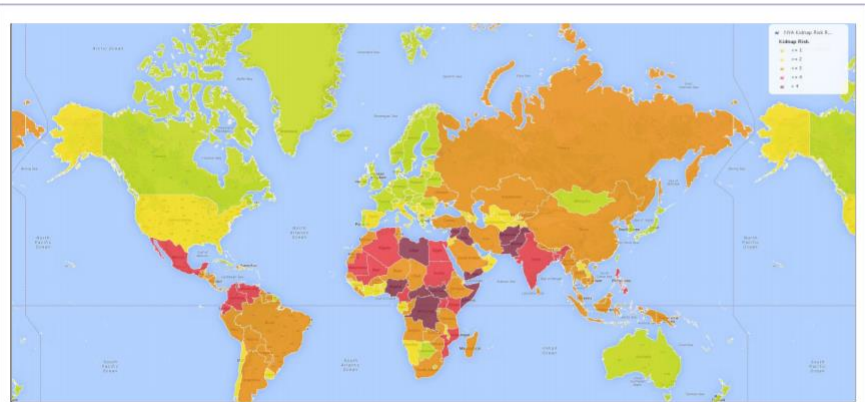
13

## TOP TEN KIDNAP RANKING 1992-2017

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



### Global Kidnap Review 2016



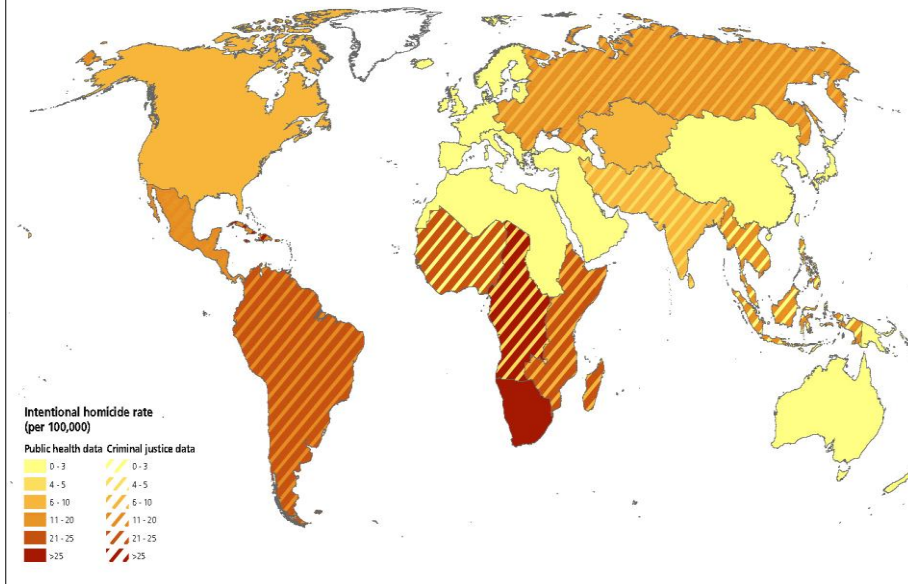
: >7,770 kidnaps for ransom!

Source: Hiscox Group/FT

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NYA International

Intentional homicide rate by sub-region and for two sources, latest available year



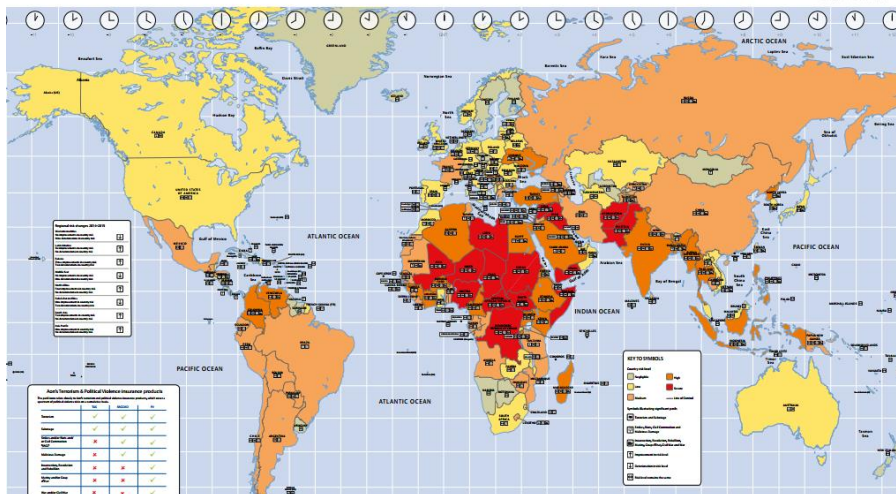
[HTTP://WWW.UNODC.ORG/UNODC/INDEX.HTML?REF=MENU TOP](http://www.unodc.org/unodc/index.html?ref=menutop)

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

#### 2015 Terrorism & Political Violence Risk Map

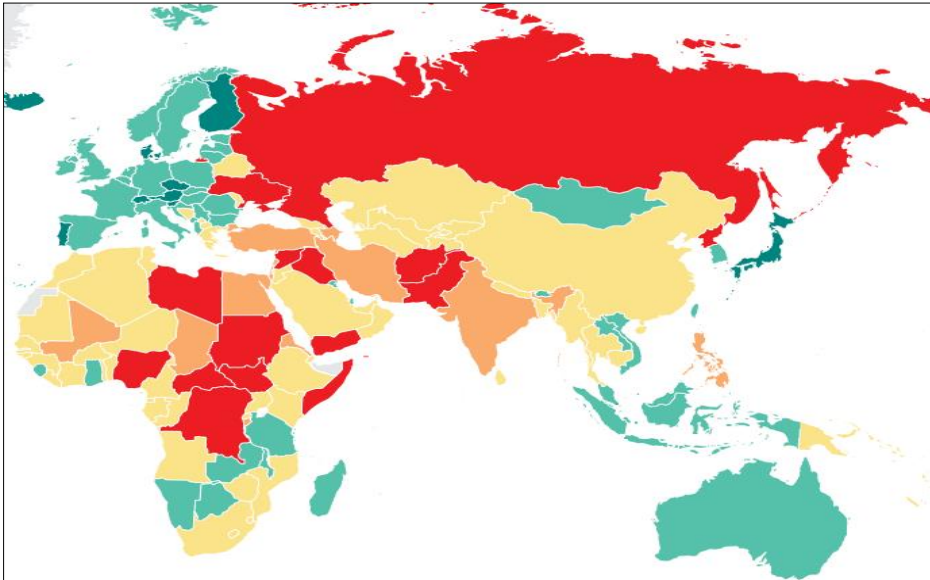


<http://www.aon.com/terrorismmap/2013-Terrorism-Map-14-05-2013.pdf>

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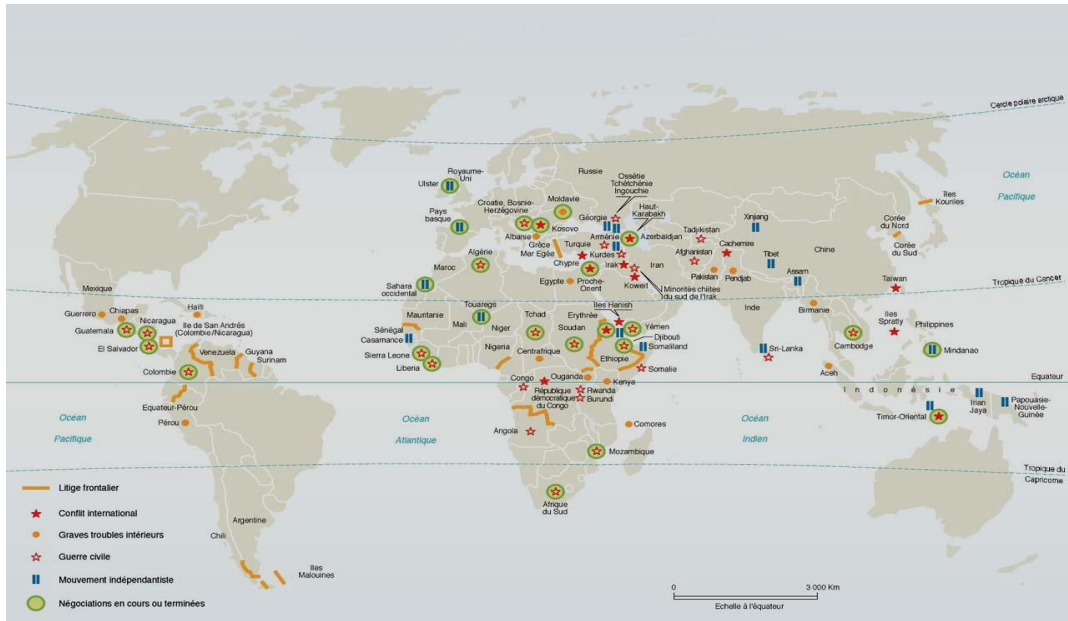
16

### PEACE AND SECURITY INDEX



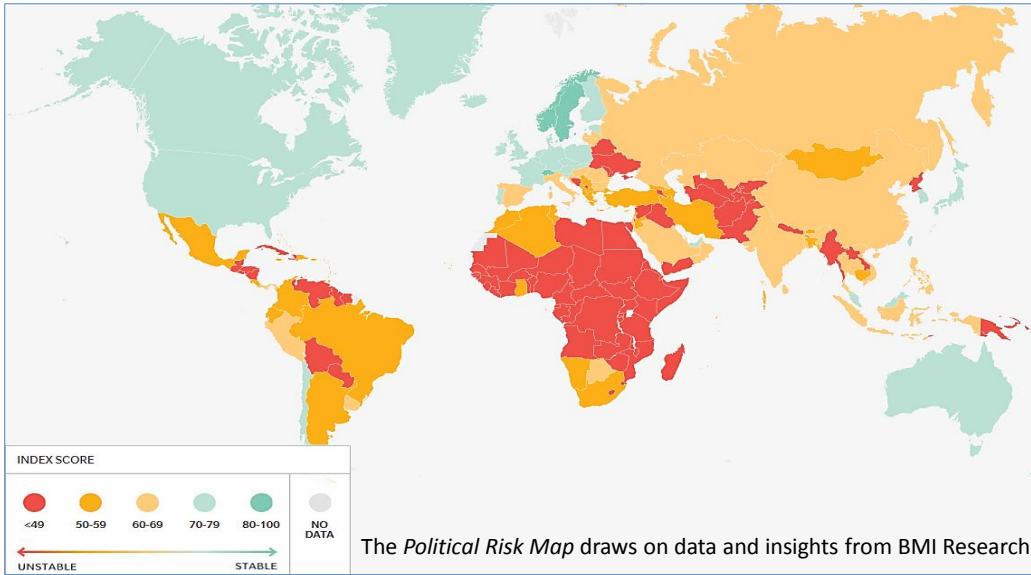
[http://www.visionofhumanity.org/sites/default/files/Global%20Peace%20Index%20Report%202016\\_0.pdf](http://www.visionofhumanity.org/sites/default/files/Global%20Peace%20Index%20Report%202016_0.pdf)  
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### Wars and armed conflicts all over the world



Michel Henry Bouchet -

# MARSH POLITICAL RISK MAP



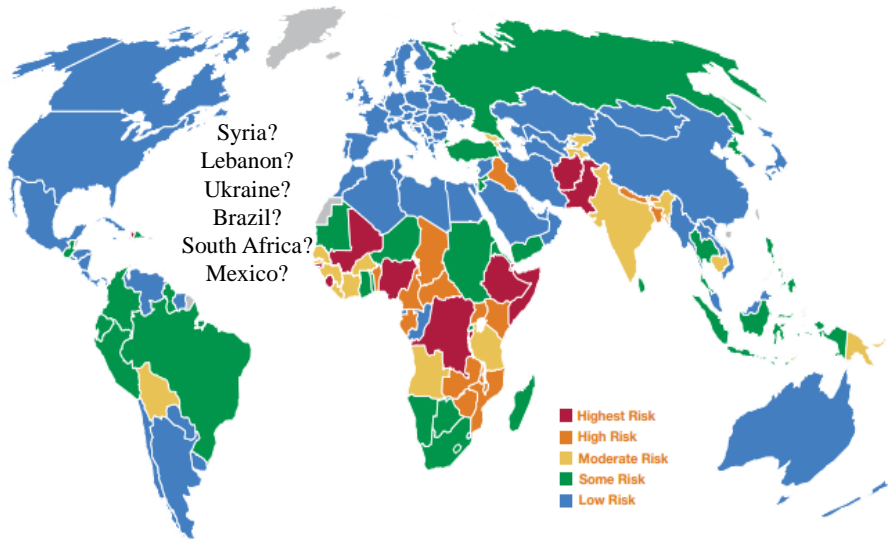
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## BLINDNESS? RISK OF FUTURE POLITICAL CRISIS 2010-12

SOURCE: UNIVERSITY OF MARYLAND CENTER FOR CONFLICT MANAGEMENT

Figure 2.1 Risk of Future Instability, 2010-2012



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## POLITICAL RISK ASSESSMENT IN THE GLOBAL FIRM

- ▶ **Origins?** Political risk stems from the overall **uncertainty** related to the exercise of power by a foreign government and its ramifications, as well as by non-governmental actors in the country.
- ▶ **Impact?** Arbitrary political decisions, conditions, and events in a country will affect the business climate in such a way that investors, exporters or creditors will confront losses.

## 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
  - 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

## SAMUEL HUNTINGTON



*Political order in changing societies*  
*The Clash of Civilization*

• [http://markweatherall.wordpress.com/2009/10/12/political\\_order\\_in\\_changing/](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.

**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.

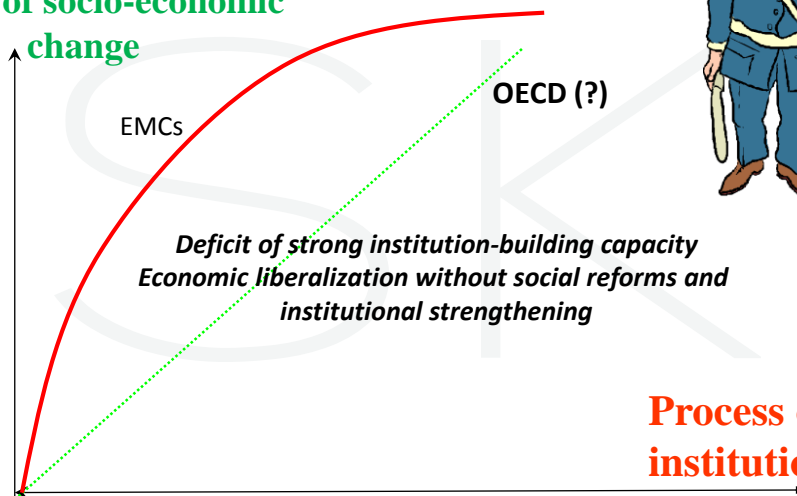


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**POLITICAL DIS/ORDER IN RAPIDLY CHANGING SOCIETIES**

**Process of socio-economic change**

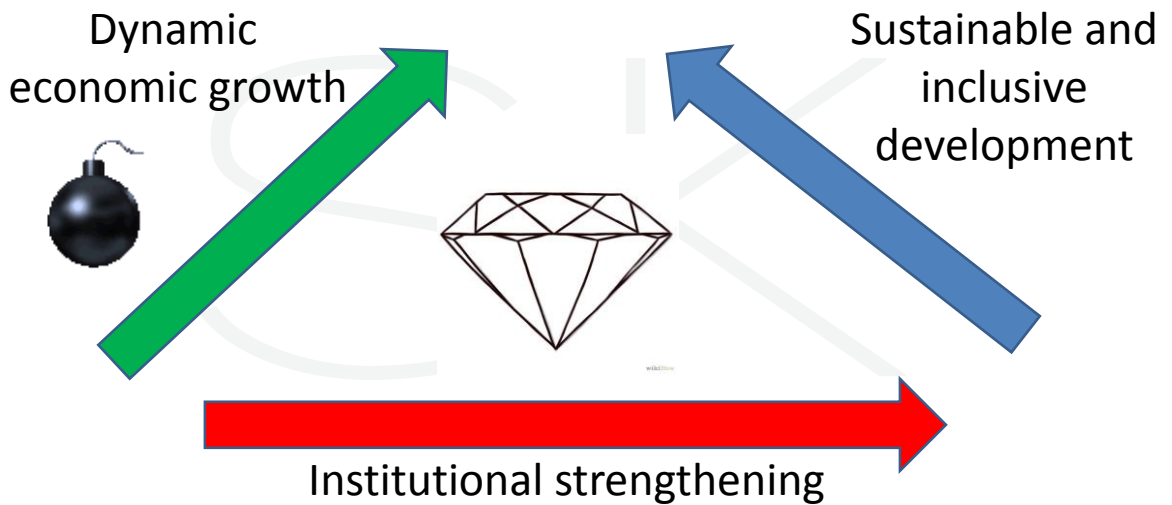


**Process of political institutionalization**

### A DEFICIT IN INSTITUTION-BUILDING ALWAYS LEADS TO SOCIAL UPHEAVAL



### THE REQUIRED POLITICAL STABILITY TRIANGLE



## 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)

## 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***

**SK**  
SKEMA BUSINESS SCHOOL  
**Political Risk Analysis**  
-II-  
Michel Henry Bouchet

skema

## 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

skema

### 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



skema

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

- |  |  |
|--|--|
| <ul style="list-style-type: none"> <li>▶ MIG (UK)</li> <li>▶ HISCOX</li> <li>▶ PLATUS</li> <li>▶ AON</li> <li>▶ Global Risk Assessments               <ul style="list-style-type: none"> <li>▶ EIU</li> </ul> </li> <li>▶ COFACE, OPIC &amp; MIGA, EULER</li> <li>▶ Howell International</li> <li>▶ Control Risks Group:<br/><a href="http://www.crg.com">www.crg.com</a></li> <li>▶ WMRC</li> </ul> | <ul style="list-style-type: none"> <li>▶ Frost &amp; Sullivan</li> <li>▶ US State Department + US CIA</li> <li>▶ Marsh Crisis Consulting</li> <li>▶ University of Maryland Center for Conflict Management</li> <li>▶ Muir Analytics (Threat Watch, Threat Report, Threat Survey)</li> <li>▶ NYA International</li> </ul> |
|--|--|

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2. POLITICAL RISK ANALYSIS

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

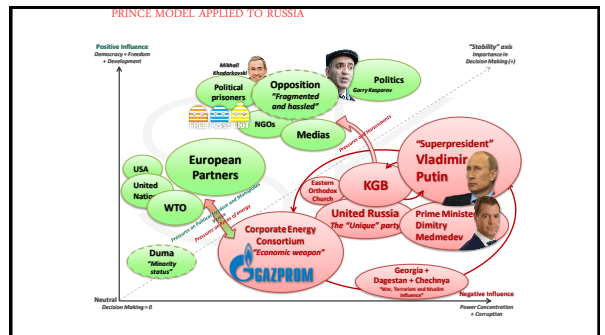
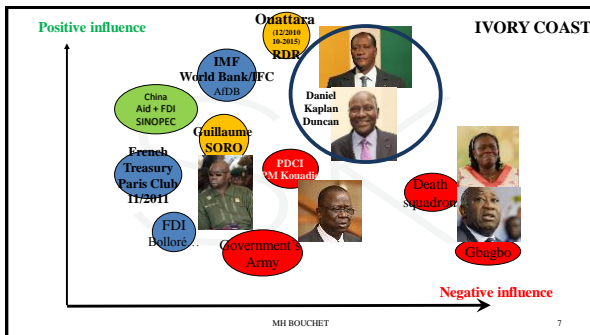
- ▶ ideological (North Korea)
- ▶ charismatic (Cuba)
- ▶ economic/financial (Brunei)
- ▶ authoritarian populism (Thailand)
- ▶ ethnic (Ivory Coast, Ghana)
- ▶ religious (Iran)
- ▶ military (Burma)
- ▶ patron-client relationships (Togo)

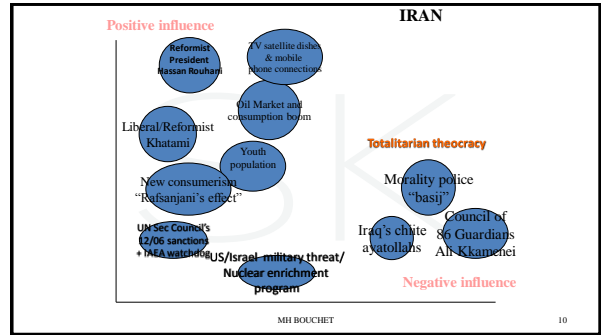
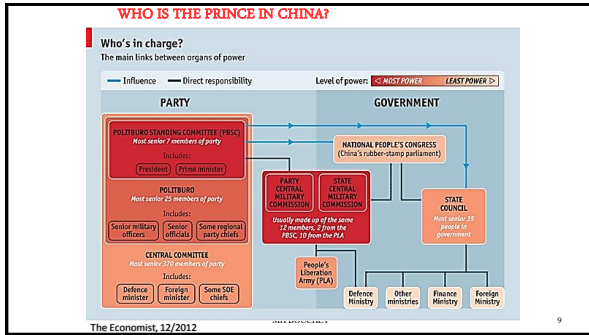
3. POLITICAL RISK ANALYSIS: **PRINCE** MODEL

**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 (+/-)





#### 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](http://www.useit.com) Jakob Nielsen's website)

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#### QUANTIFYING COUNTRY POLITICAL RISK

Overall Country Risk Rating = 25% Political Risk Rating + 10% Spill-over Risk Rating + 65% Transfer Risk Rating

| 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%     |

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### POLITICAL RISK INDICES

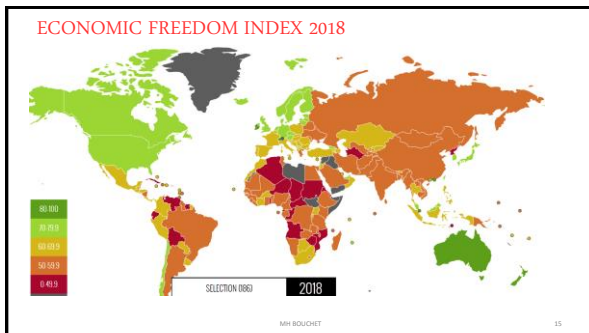
- ▶ Heritage Foundation
- ▶ Freedom House
- ▶ Cato Institute
- ▶ Transparency International CPI
- ▶ PWCs: Opacity Index
- ▶ LB: Legsi
- ▶ Asiarisk
- ▶ Marsh
- ▶ World Bank (Governance)
- ▶ Euromoney (25%)
- ▶ Institutional Investor
- ▶ IMD
- ▶ ICRG-PRS
- ▶ MIG
- ▶ WMRC
- ▶ University of Maryland
- ▶ Ibrahim Index of Governance

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### 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                                 |
| <b>100</b> | <b>Total number of points for weighted influence</b> |

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### THE HERITAGE FOUNDATION: ECONOMIC FREEDOM INDEX 2018

**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.

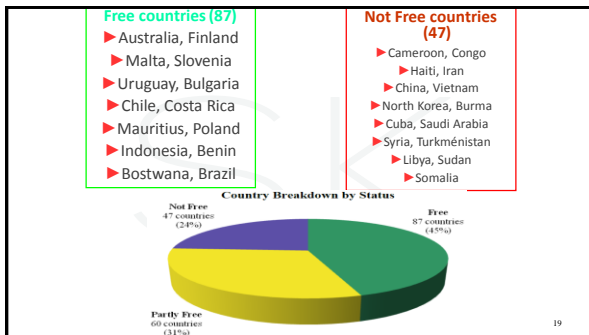
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**INDEX OF ECONOMIC FREEDOM 2018**

| Top 10 Countries |                      |                | REPRESSED (49.9-40) |                          |                |
|------------------|----------------------|----------------|---------------------|--------------------------|----------------|
| RANK             | COUNTRY              | OVERALL CHANGE | RANK                | COUNTRY                  | OVERALL CHANGE |
| 1                | Hong Kong            | 90.2 0.4 ▲     | 160                 | Niger                    | 49.5 -1.3 ▼    |
| 2                | Singapore            | 88.8 0.2 ▲     | 181                 | Sudan                    | 49.4 +0.6 ▲    |
| 3                | New Zealand          | 84.2 0.5 ▲     | 182                 | Chad                     | 49.3 +0.3 ▲    |
| 4                | Switzerland          | 81.7 0.2 ▲     | 183                 | Central African Republic | 49.2 -2.6 ▼    |
| 5                | Australia            | 80.9 -0.1 ▼    | 184                 | Angola                   | 48.6 +0.1 ▲    |
| 6                | Ireland              | 80.4 3.7 ▲     | 185                 | Ecuador                  | 48.5 -0.8 ▼    |
| 7                | Estonia              | 78.8 -0.3 ▼    | 186                 | Suriname                 | 48.1 +0.1 ▲    |
| 8                | United Kingdom       | 78.0 1.6 ▲     | 187                 | Timor-Leste              | 48.1 +1.8 ▲    |
| 9                | Canada               | 77.7 -0.8 ▼    | 188                 | Togo                     | 47.8 -5.4 ▼    |
| 10               | United Arab Emirates | 77.6 0.7 ▲     | 189                 | Turkmenistan             | 47.1 -0.3 ▼    |
|                  |                      |                | 170                 | Mozambique               | 46.3 -3.6 ▼    |
|                  |                      |                | 171                 | Djibouti                 | 45.1 -1.6 ▼    |
|                  |                      |                | 172                 | Algeria                  | 44.7 -1.8 ▼    |
|                  |                      |                | 173                 | Bolivia                  | 44.1 -3.6 ▼    |
|                  |                      |                | 174                 | Zimbabwe                 | 44.0 0.0 —     |
|                  |                      |                | 175                 | Equatorial Guinea        | 42.0 -3.0 ▼    |
|                  |                      |                | 176                 | Eritrea                  | 41.7 -0.5 ▼    |
|                  |                      |                | 177                 | Republic of Congo        | 38.9 -1.1 ▼    |
|                  |                      |                | 178                 | Cuba                     | 31.9 -2.0 ▼    |
|                  |                      |                | 179                 | Venezuela                | 25.2 -1.8 ▼    |
|                  |                      |                | 180                 | North Korea              | 5.8 +0.9 ▲     |

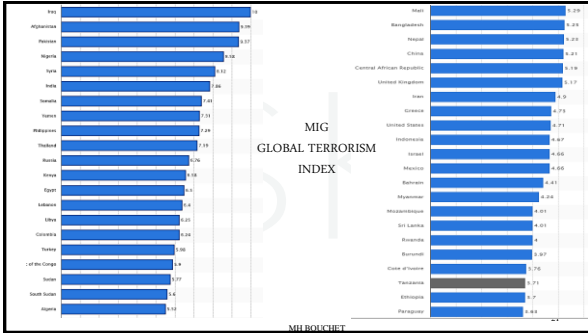
**FREEDOM HOUSE:**  
FREEDOM IN THE WORLD ANNUAL REPORT (1972-2015)

- ▶ 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>



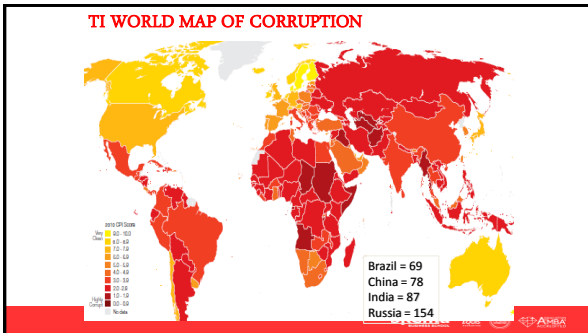
**MERCHANT INTERNATIONAL GROUP**

- ▶ 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](http://www.merchantinternational.com)



**POLITICAL TURMOIL AND CORRUPTION**

In 2018, 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.

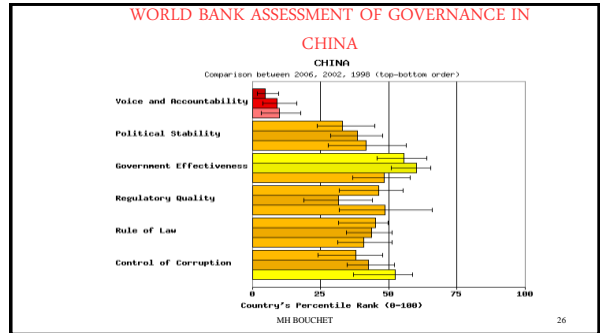


**MEASURING CORRUPTION?**  
TRANSPARENCY INTERNATIONAL CPI

|    |             |     |                   |
|----|-------------|-----|-------------------|
| 1  | New Zealand | 162 | Guinea-Bissau     |
| 2  | Denmark     | 162 | Kyrgyzstan        |
| 3  | Singapore   | 162 | Venezuela         |
| 3  | Sweden      | 168 | Burundi           |
| 5  | Switzerland | 168 | Equatorial Guinea |
| 6  | Finland     | 168 | Guinea            |
| 6  | Netherlands | 168 | Haiti             |
| 8  | Australia   | 168 | Iran              |
| 8  | Canada      | 168 | Turkmenistan      |
| 8  | Iceland     | 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           |

France = 22  
Brazil = 72  
China = 80  
India = 94  
Russia = 133

**STOP CORRUPTION**



### 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.mohammedibrahimfoundation.org/en/section/the-ibrahim-index>

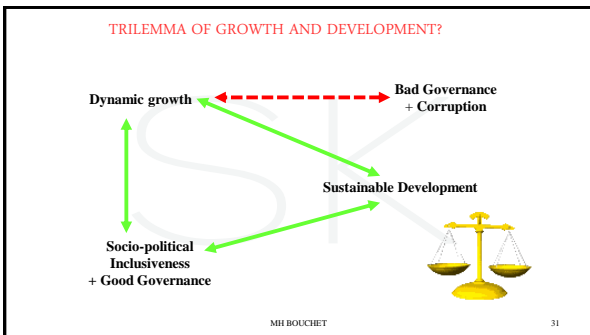
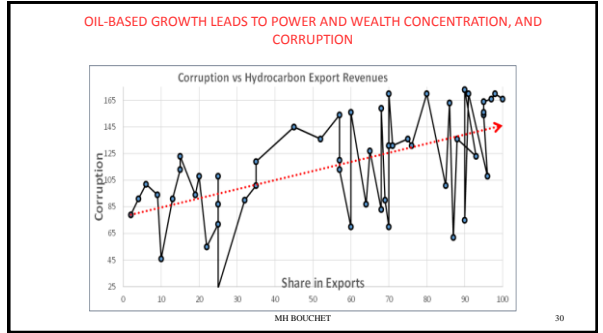
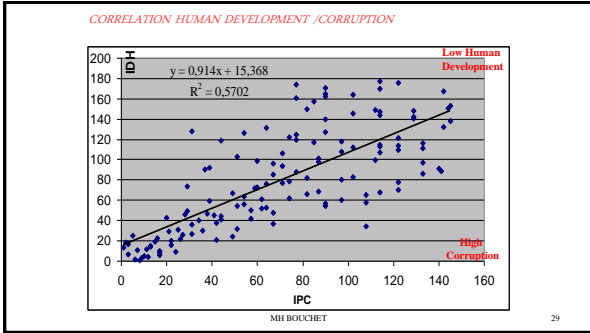
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### IBRAHIM INDEX OF GOOD GOVERNANCE IN AFRICA

|                          |      |                 |      |                             |      |
|--------------------------|------|-----------------|------|-----------------------------|------|
| 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                  | 64.4 | 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                    | 33.9 |
| 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     | 44.3 | 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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**DEVELOPMENT = ECONOMIC GROWTH + KEY CONDITIONS THAT MAKE IT SUSTAINABLE!**

|                 | CHILE    | COSTA RICA | RUSSIA   | GABON    |
|-----------------|----------|------------|----------|----------|
| GDP/per capita  | \$15,000 | \$11,000   | \$15,000 | \$14,000 |
| Life Expectancy | 79       | 80         | 67       | 61       |
| HDI Rank        | 40       | 62         | 55       | 106      |

|                 | ARMENIA | SRI LANKA | CONGO  | ANGOLA |
|-----------------|---------|-----------|--------|--------|
| GDP per capita  | \$5000  | \$5000    | \$5000 | \$5000 |
| Life expectancy | 74      | 75        | 57     | 51     |
| HDI Rank        | 87      | 97        | 142    | 148    |

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### BETTER OFF IN TUNISIA OR IN ALGERIA ?

| TUNISIA   | ALGERIA   |
|---|---|
| <ul style="list-style-type: none"> <li>▶ GDP Per capita = \$10500</li> <li>▶ HDI= 97</li> <li>▶ Life expectancy f = 77</li> <li>▶ Infant mortality= 13</li> <li>▶ Gender inequality: 0,28</li> <li>▶ Doing Business= 77</li> <li>▶ Corruption = 75</li> </ul> | <ul style="list-style-type: none"> <li>▶ GDP Per capita=13500</li> <li>▶ HDI= 83</li> <li>▶ Life expectancy= 75</li> <li>▶ Infant mortality= 22/1000</li> <li>▶ Gender inequality: 0,43</li> <li>▶ Doing Business= 156</li> <li>▶ Corruption = 108</li> </ul> |

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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 democracy**
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 environment, hence a positive impact on sustainable growth!**

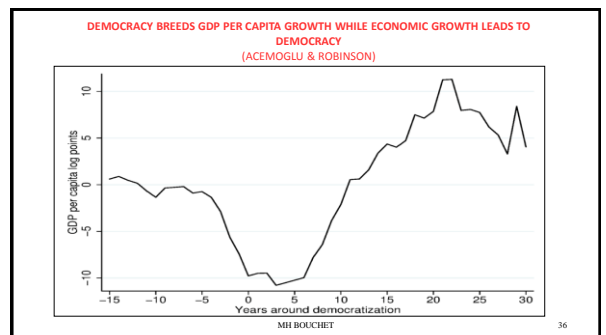
Since 1980, of the 124 EMCs that have managed to sustain a 5% growth rate for a full decade, 52 % were democracies. What matters is not the implementation of key reforms for growth and development.

Feng, Y. Cambridge, 1997- Przeworski, A/ NYU- Ruchir Sharma 09/2012 34

### HOW MOVING FROM GROWTH TO SUSTAINABLE AND INCLUSIVE DEVELOPMENT?

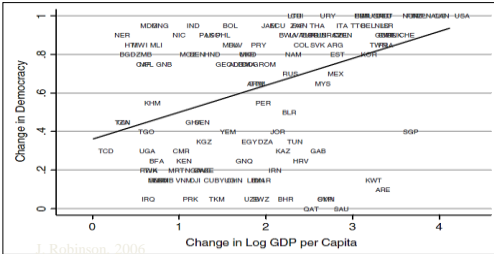
| Assumption n°1  | Assumption n°2  |
|---|---|
| <ul style="list-style-type: none"> <li>▶ Primacy of <b>human capital for both growth and democratization</b>: human and social capital shape both institutional and productive capacities of a society.</li> <li>▶ Growth in <b>income and human capital</b> causes institutional improvement with better political institutions even with pro-market dictators: <b>policy choices matter</b> while institutional quality rises as a country grows richer.</li> <li>▶ Economic growth and human capital accumulation cause institutional improvement, rather than the other way around</li> </ul> | <ul style="list-style-type: none"> <li>▶ Democracy and other checks on government are the <b>key mechanisms for securing property rights and boosting growth</b></li> <li>▶ <b>Good and stable institutions will enhance the pace and quality of economic growth</b></li> <li>▶ <b>Robust institutions and good governance matter!</b></li> </ul> |

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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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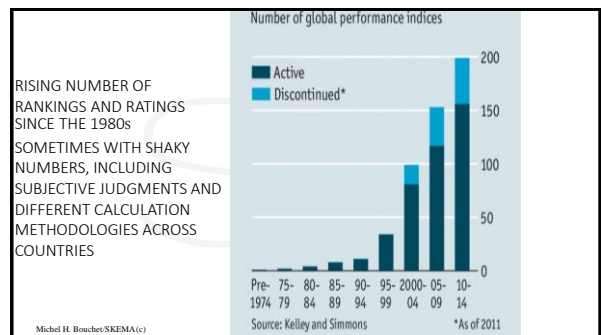


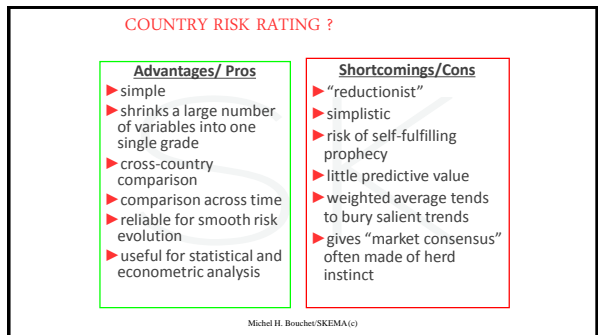
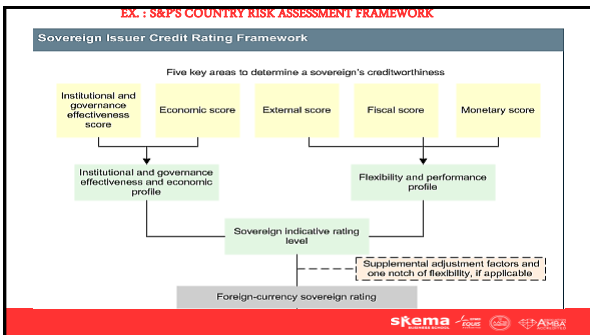
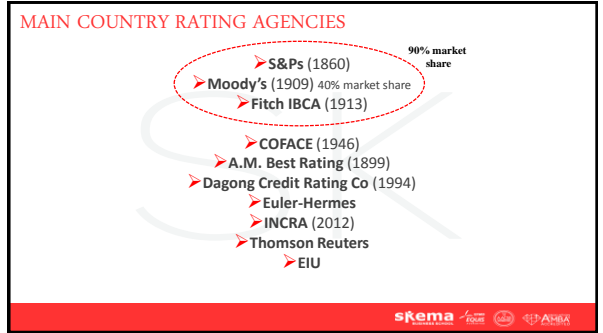
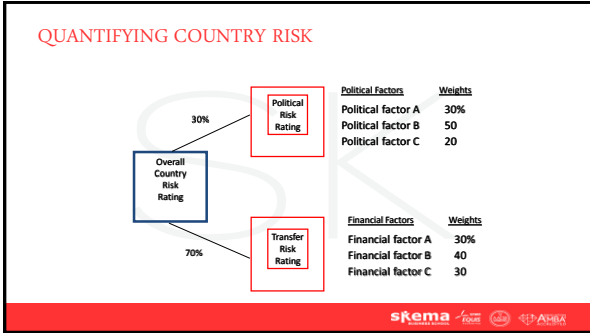
## 5 OBJECTIVES

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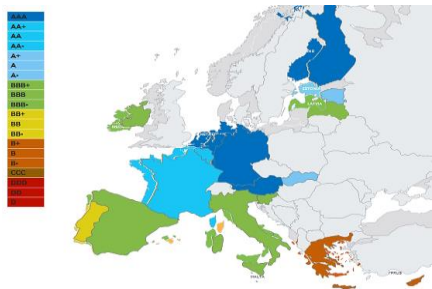
**THE OCDE IMPLEMENTS A RATING AND RANKING OF COUNTRY RISK FOR PROVIDING A LEVEL PLAYING FIELD TO EXPORT GUARANTEE COMPANIES WITHIN THE GROUP OF 34 DEVELOPED COUNTRIES AND FOR THE PURPOSE OF SETTING MINIMUM PREMIUM RATES FOR EXPORT CREDIT TRANSACTIONS**

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                         | AUS                         | Australia             | 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                         | Bahrain and Hong Kong | 7       | 7     |         |
| 24                         | BRA                         | Brazil                | 2       | 2     |         |
| 25                         | BRA                         | Brazil                | 5       | 5     |         |
| 26                         | BRA                         | Brazil (Specialized)  | -       | -     | (S)     |
| 27                         | BRA                         | Brazil                | 3       | 3     |         |
| 28                         | BFA                         | Burkina Faso          | 7       | 7     | (R)     |
| 29                         | BUR                         | Burundi               | 7       | 7     |         |
| 30                         | CPV                         | Cape 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

skema   

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

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        |

**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'S

- ▶ 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>

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## 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, archaic business infrastructure, sophisticated financial system regulator with deep capital markets, inflation insurance industry forward |
| CR2               | Robust and transparent legal environment, legal system, archaic business infrastructure, sufficient financial system regulator, mature insurance industry forward                                 |
| 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 underdeveloped regulatory structure                                  |
| CR5               | Unreliable and opaque political, legal, and business environment, with limited or nonexistent capital markets, no financial development and/or credit mobility, repeat repayment history          |

### BEST'S COUNTRY RISK REPORT

**Algeria CRT-5**  
Region: Middle East & North Africa  
August 22, 2018  
Country Risk Group: **Emerging**

Country Risk Tier 1 (CR1) to Low Level of Country Risk  
Country Risk Tier 2 (CR2) to High Level of Country Risk  
Country Risk Tier 3 (CR3) to Moderate Level of Country Risk  
Country Risk Tier 4 (CR4) to High Level of Country Risk  
Country Risk Tier 5 (CR5) to Very High Level of Country Risk

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

CR1-5 GDP growth rates: 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 CR1-5 to CR5.

**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.

|                 | 2017  | 2018 (est.) |
|-----------------|-------|-------------|
| Revenue/GDP     | 100%  | 100%        |
| Population      | 38.1  | 41.1        |
| GDP/Per Capita  | 4,282 | 4,282       |
| New GDP Growth  | %     | 2.0         |
| Interest Rate   | %     | 1.0         |
| Unemployment    | %     | 11.4        |
| Government Debt | %     | 92.7        |
| Gov Expenditure | %     | 17.0        |

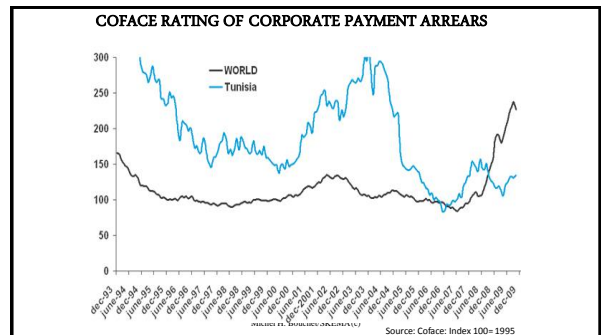
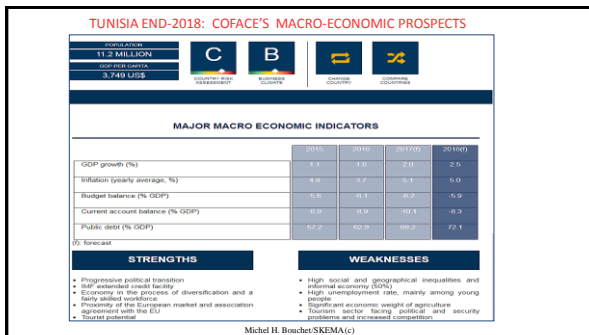
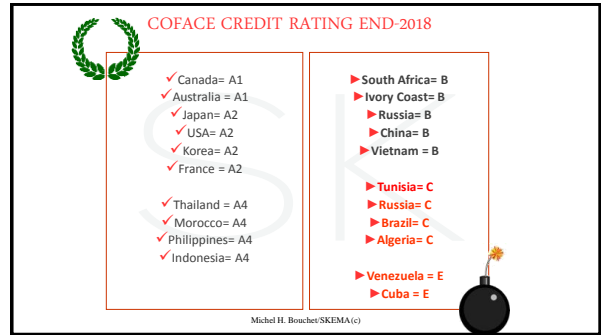
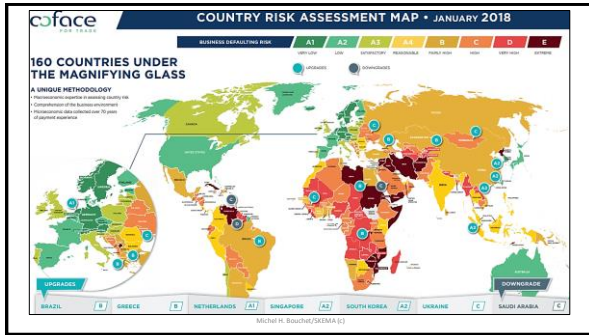
## COFACE

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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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 (mese import.)   | 13,5       | 15,9  | 15,8       | 15,3  | 14,8  |

Fonte: EIU, Giugno 2014

s: stime; p: previsioni

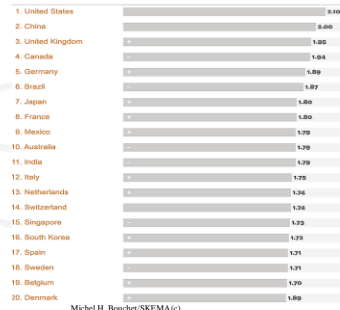
AT KEARNEY: THE FDI CONFIDENCE INDEX

- ▶ 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



Michel H. Bouchet/SKEMA(G)

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.

Source: www.imd.ch

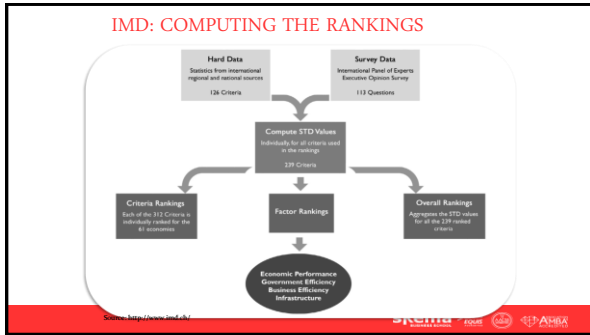


**IMD CRITERIA**

⇒ 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

| Rank | Country         | Score |
|------|-----------------|-------|
| 1    | China Hong Kong | 78.00 |
| 2    | Denmark         | 76.00 |
| 3    | Japan           | 75.00 |
| 4    | USA             | 74.00 |
| 5    | Sweden          | 73.00 |
| 6    | Finland         | 72.00 |
| 7    | Switzerland     | 71.00 |
| 8    | France          | 70.00 |
| 9    | Germany         | 69.00 |
| 10   | UK              | 68.00 |
| 11   | Spain           | 67.00 |
| 12   | Italy           | 66.00 |
| 13   | Canada          | 65.00 |
| 14   | South Korea     | 64.00 |
| 15   | Belgium         | 63.00 |
| 16   | Portugal        | 62.00 |
| 17   | Spain           | 61.00 |
| 18   | China           | 60.00 |
| 19   | USA             | 59.00 |
| 20   | France          | 58.00 |
| 21   | Germany         | 57.00 |
| 22   | UK              | 56.00 |
| 23   | Japan           | 55.00 |
| 24   | Canada          | 54.00 |
| 25   | Italy           | 53.00 |
| 26   | Spain           | 52.00 |
| 27   | China           | 51.00 |
| 28   | France          | 50.00 |
| 29   | Germany         | 49.00 |
| 30   | UK              | 48.00 |
| 31   | Japan           | 47.00 |
| 32   | Canada          | 46.00 |
| 33   | Italy           | 45.00 |
| 34   | Spain           | 44.00 |
| 35   | China           | 43.00 |
| 36   | France          | 42.00 |
| 37   | Germany         | 41.00 |
| 38   | UK              | 40.00 |
| 39   | Japan           | 39.00 |
| 40   | Canada          | 38.00 |
| 41   | Italy           | 37.00 |
| 42   | Spain           | 36.00 |
| 43   | China           | 35.00 |
| 44   | France          | 34.00 |
| 45   | Germany         | 33.00 |
| 46   | UK              | 32.00 |
| 47   | Japan           | 31.00 |
| 48   | Canada          | 30.00 |
| 49   | Italy           | 29.00 |
| 50   | Spain           | 28.00 |
| 51   | China           | 27.00 |
| 52   | France          | 26.00 |
| 53   | Germany         | 25.00 |
| 54   | UK              | 24.00 |
| 55   | Japan           | 23.00 |
| 56   | Canada          | 22.00 |
| 57   | Italy           | 21.00 |
| 58   | Spain           | 20.00 |
| 59   | China           | 19.00 |
| 60   | France          | 18.00 |

France = 32

Michel H. Boschet/SKEMA (c)



# SK


SKEMA BUSINESS SCHOOL

## COUNTRY RISK RATING

Michel-Henry Bouchet

skema BUSINESS SCHOOL EFMD EQUIS AACSB ASSOCIATION OF AMBA ACCREDITED

## COUNTRY RISK SPECIFIC INDICES



ICRG  
Euromoney  
Institutional Investor  
OECD  
COFACE

## 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.
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Source: [www.icrg.com](http://www.icrg.com)

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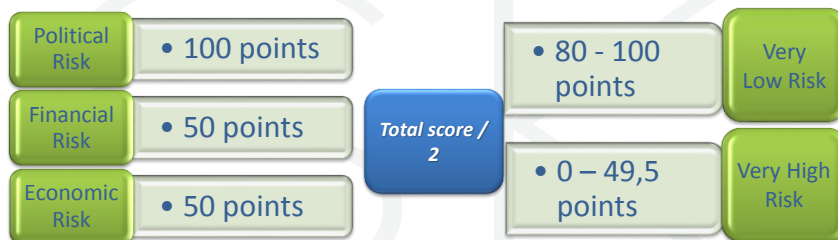
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AACSB  
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ASSOCIATION  
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## INTERNATIONAL COUNTRY RISK GUIDE (ICRG)

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  - Claim to have the longest history of country risk data for analysis
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  - Useful for multinational firms, banks, and equity and currency traders

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## 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                                 |
| <b>100</b> | <b>Total number of points for weighted influence</b> |

Source: [www.icrg.com](http://www.icrg.com)

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## 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](http://www.icrg.com)

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## 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](http://www.icrg.com)

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EUROMONEY

## EUROMONEY : RATING METHODOLOGY

- ▶ 186 countries
- ▶ 15 criteria
- ▶ Delphi Technique: Panel of 250 leading economists in international financial institutions evaluating 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%

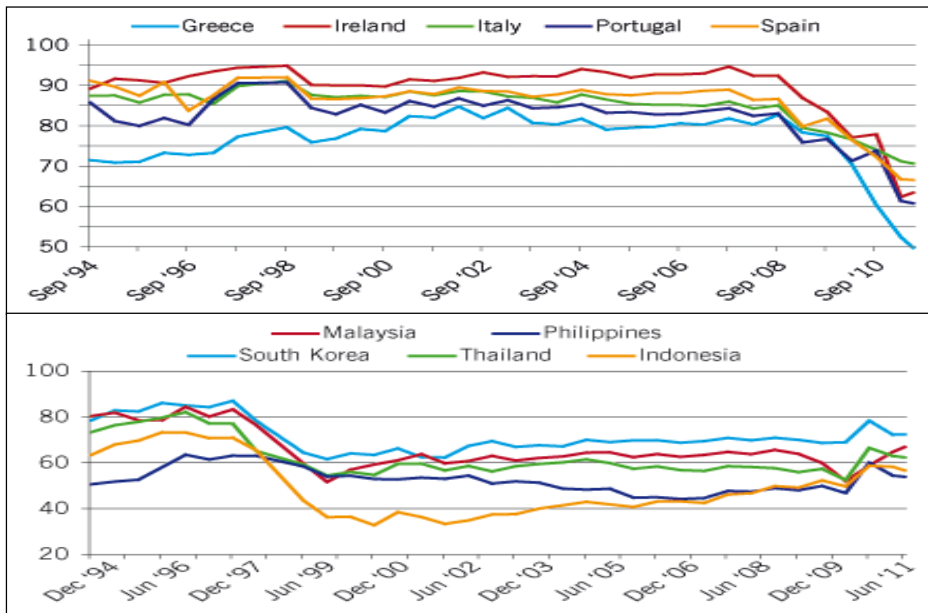
## EUROMONEY COUNTRY RISK RATINGS 2001-2016

| End-2001      | End-2005         | End-2006         | End-2012         | End-2016     |
|---------------|------------------|------------------|------------------|--------------|
| 14= Singapore | 9= Ireland       | 20=Singapore     | 11=Singapore     | 1= Singapore |
| 28= Taiwan    | 19= Singapore    | 41=Hungary       | 15= USA          |              |
| 30= HongKong  | 22= New Zealand  | 44= Poland       | 19= Chile        |              |
| 40= Chile     | 24= Taiwan       | 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= Taiwan   |
| 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       |              |

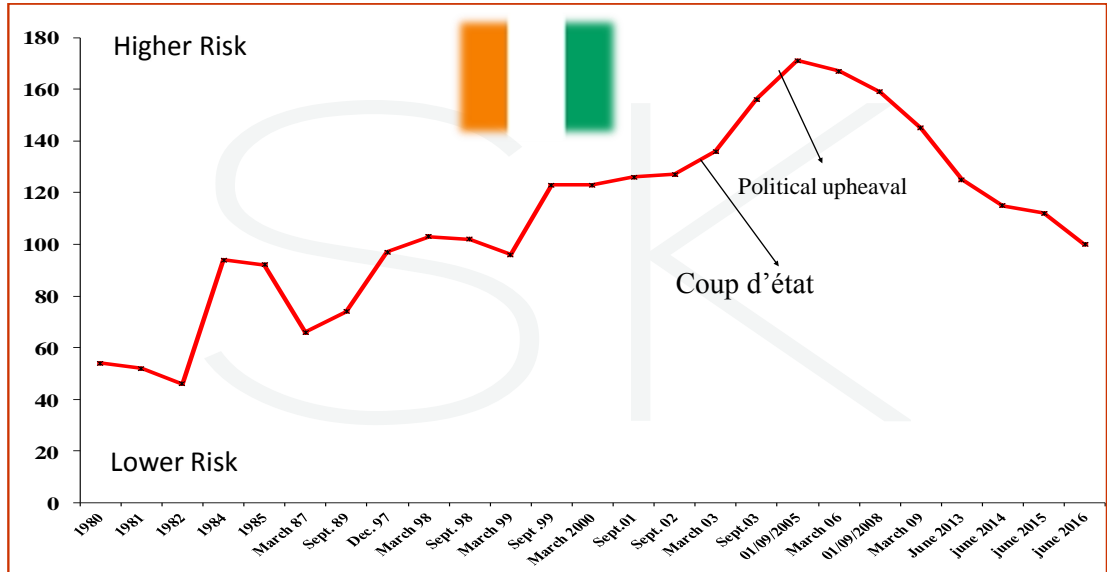
**EUROMONEY COUNTRY RISK MAP**



**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

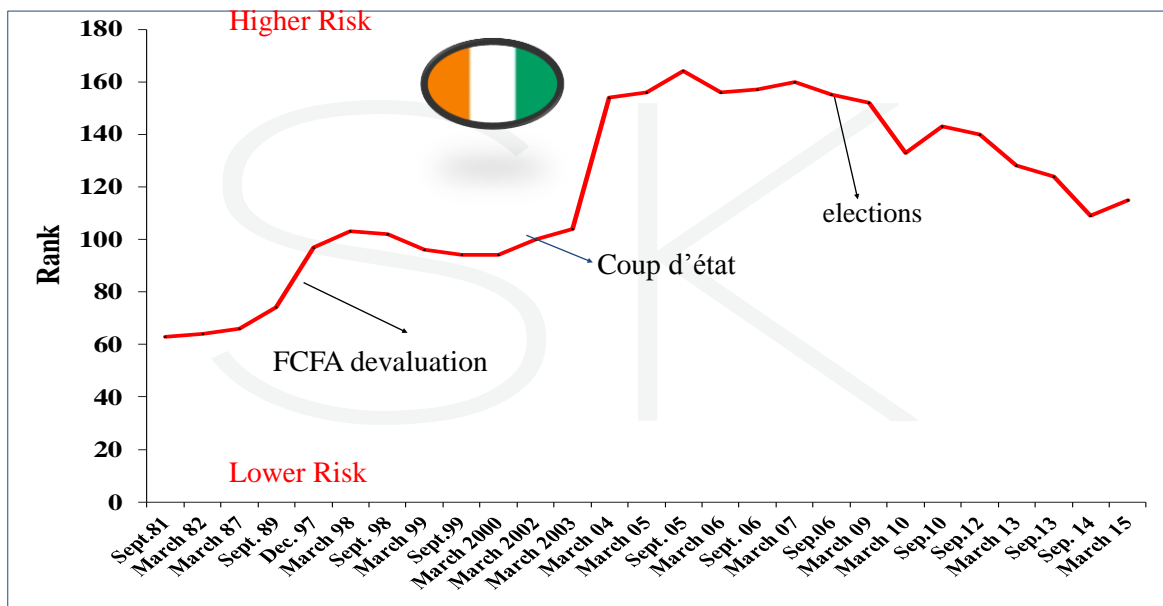
Global average risk rating 03/2015 = 45

## 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 RISK RATING OF ASIA

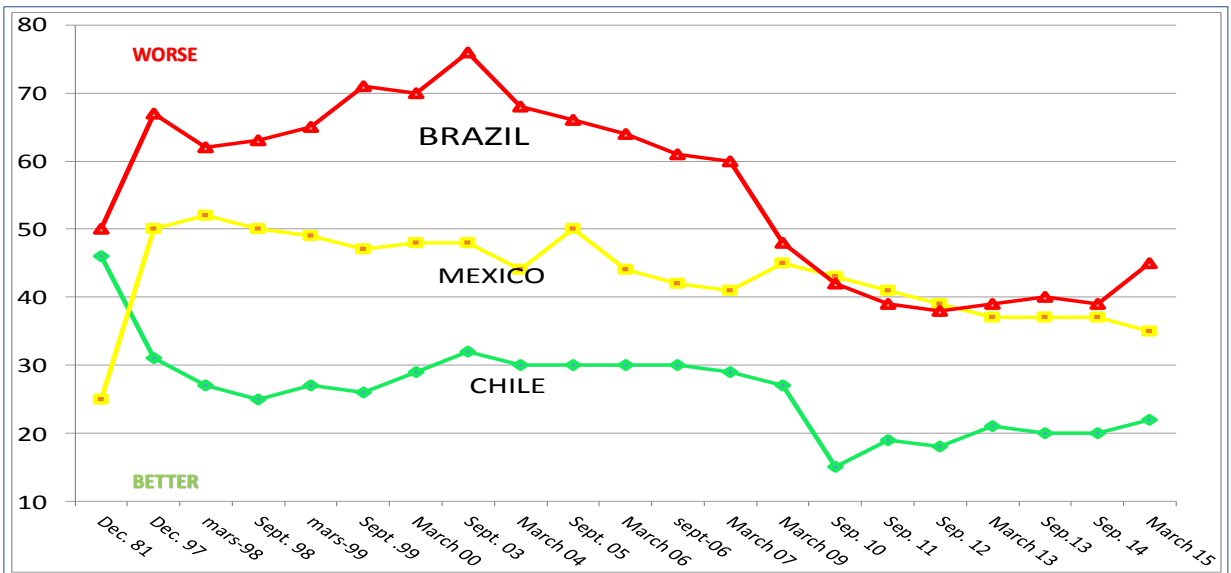
➤ **Switzerland = 1**

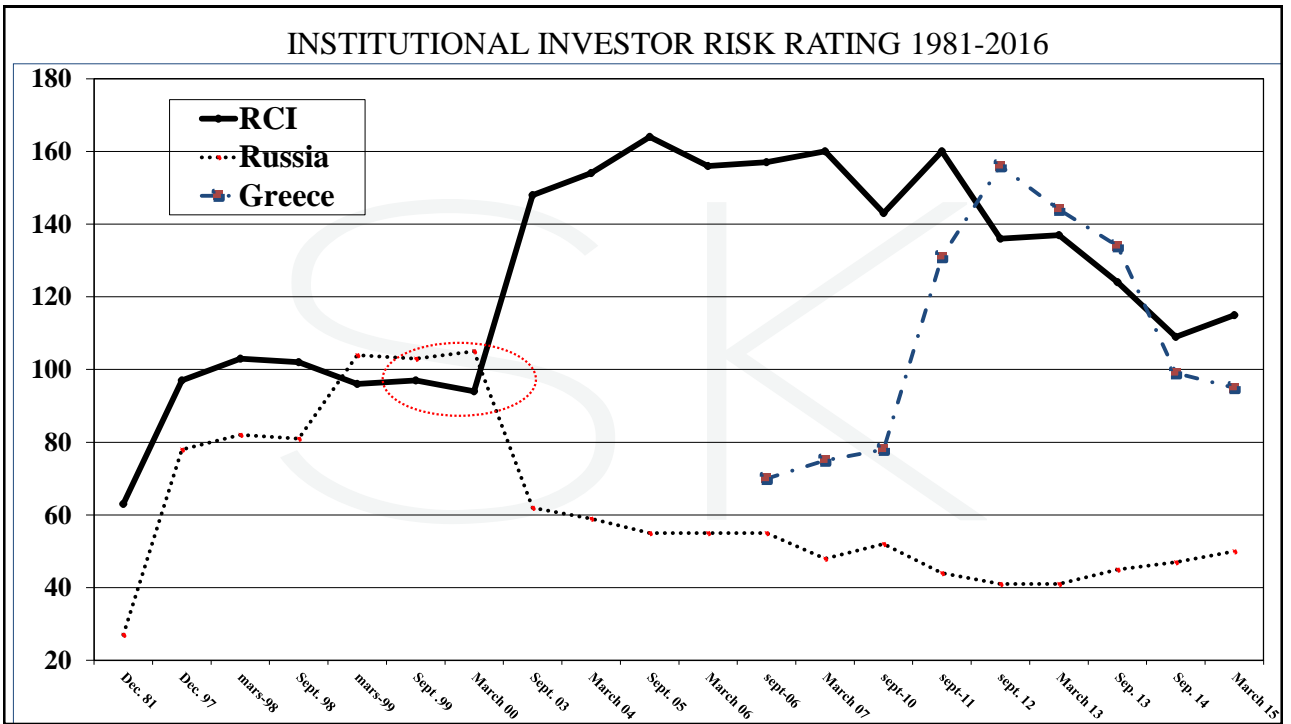
➤ **Norway= 2**

- 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 RISK RATING 1981-2017





## 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 »  
2017 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 |

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**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           |

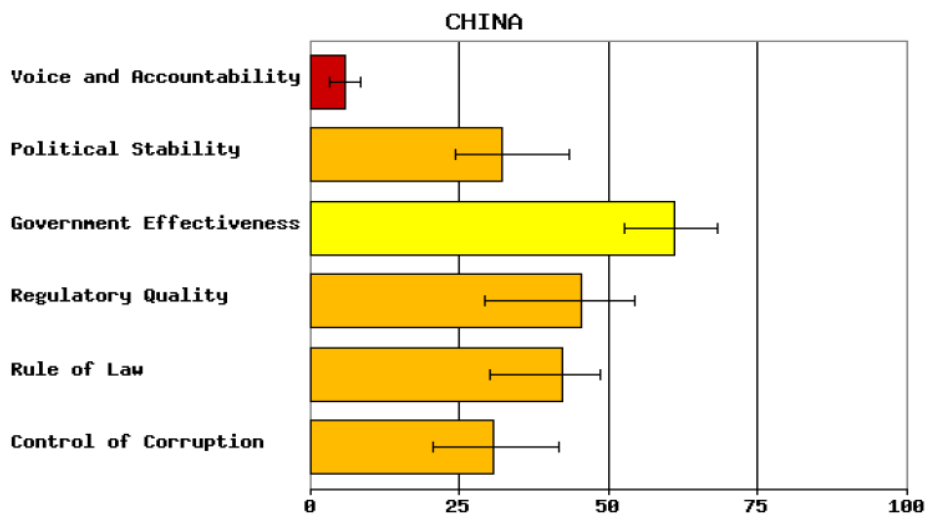
## BLOOMBERG DOING BUSINESS RANKING

| 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 2009

## 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

## MEASURING CORRUPTION?

|    |             |
|----|-------------|
| 1  | New Zealand |
| 2  | Denmark     |
| 3  | Singapore   |
| 3  | Sweden      |
| 5  | Switzerland |
| 6  | Finland     |
| 6  | Netherlands |
| 8  | Australia   |
| 8  | Canada      |
| 8  | Iceland     |
| 11 | Norway      |
| 12 | Hong Kong   |
| 12 | Luxembourg  |
| 14 | Germany     |
| 14 | Ireland     |
| 16 | Austria     |



|     |                   |
|-----|-------------------|
| 162 | Guinea-Bissau     |
| 162 | Kyrgyzstan        |
| 162 | Venezuela         |
| 168 | Burundi           |
| 168 | Equatorial Guinea |
| 168 | Guinea            |
| 168 | Haiti             |
| 168 | Iran              |
| 168 | Turkmenistan      |
| 174 | Uzbekistan        |
| 175 | Chad              |
| 176 | Iraq              |
| 176 | Sudan             |
| 178 | Myanmar           |
| 179 | Afghanistan       |
| 180 | Somalia           |

## EMCS & SHADOW ECONOMY

| Country↓   | % GNP Informal<br>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
- =
- ▶  $\Sigma$  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        |  | 170 | Malawi          |
| 2. Australia     |  | 171 | Sudan           |
| 3. United States |  | 172 | Zimbabwe        |
| 4. Netherlands   |  | 173 | Ethiopia        |
| 5. Germany       |  | 174 | Liberia         |
| 6. New Zealand   |  | 175 | Afghanistan     |
| 7. Ireland       |  | 176 | Guinea-Bissau   |
| 8. Sweden        |  | 177 | Sierra Leone    |
| 9. Switzerland   |  | 178 | Guinea          |
| 10. Japan        |  | 178 | Burundi         |
| 11. Canada       |  | 180 | Central African |
| 12. Korea        |  | 181 | Eritrea         |
| 13. Hong Kong    |  | 182 | Mali            |
| 14. Iceland      |  | 183 | Burkina Faso    |
| 15. Denmark      |  | 184 | Chad            |
| 16. Israel       |  | 185 | Mozambique      |
| 17. Belgium      |  | 186 | Niger           |
| 18. Austria      |  | 186 | Congo (DR)      |
| 19. Singapore    |  |     |                 |
| 20. France       |  |     |                 |

## 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)

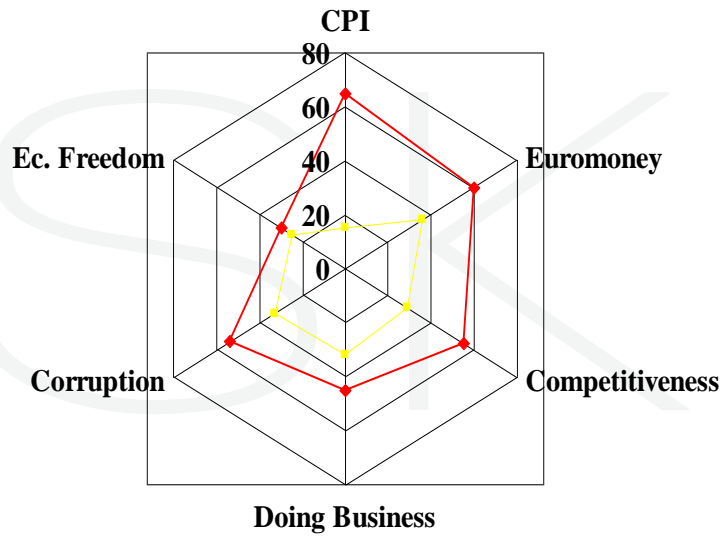
- ▶ Australia
- ▶ Finland
- ▶ Malta
- ▶ Slovenia
- ▶ Uruguay
- ▶ Bulgaria
- ▶ Chile
- ▶ Costa Rica
- ▶ Mauritius
- ▶ Poland

#### Not Free countries (47)

- ▶ Cameroon
- ▶ Congo
- ▶ Haiti
- ▶ Iran
- ▶ China
- ▶ Vietnam
- ▶ Burma
- ▶ Cuba
- ▶ Saudi Arabia
- ▶ Syria
- ▶ Turkménistan



## COUNTRIES X &amp; Y: A MULTI-INDEX COMPOSITE GRAPH





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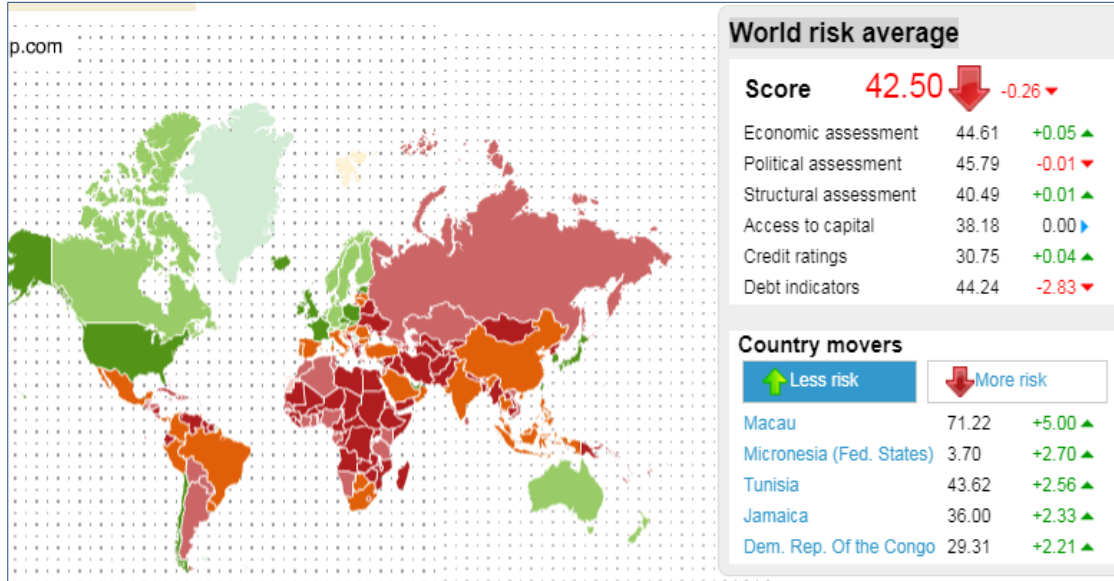
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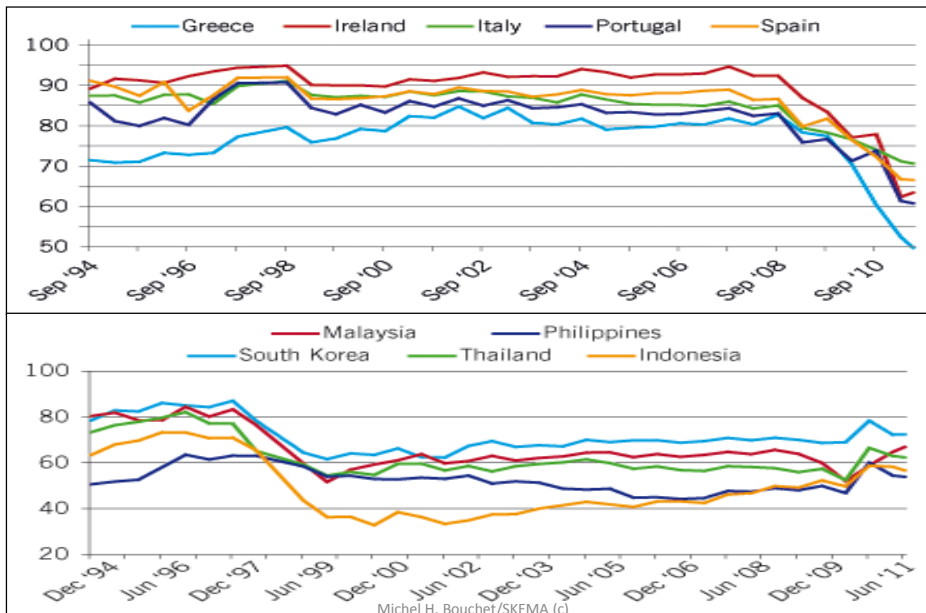
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|---------------|------------------|------------------|------------------|--------------|
| 14= Singapore | 9= Ireland       | 20= Singapore    | 11= Singapore    | 1= Singapore |
| 28= Taiwan    | 19= Singapore    | 41= Hungary      | 15= USA          |              |
| 30= HongKong  | 22= New Zealand  | 44= Poland       | 19= Chile        |              |
| 40= Chile     | 24= Taiwan       | 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= Taiwan   |
| 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**



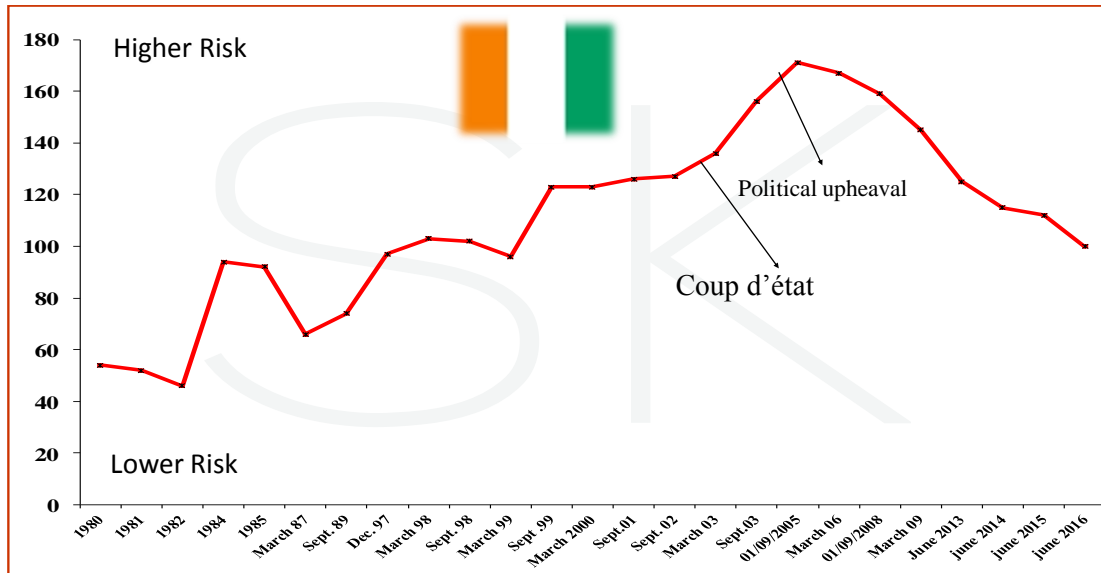
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**EUROMONEY COUNTRY RISK SCORE 1994-2011**



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## EUROMONEY RISK RATING: IVORY COAST 1980-2016



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## 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

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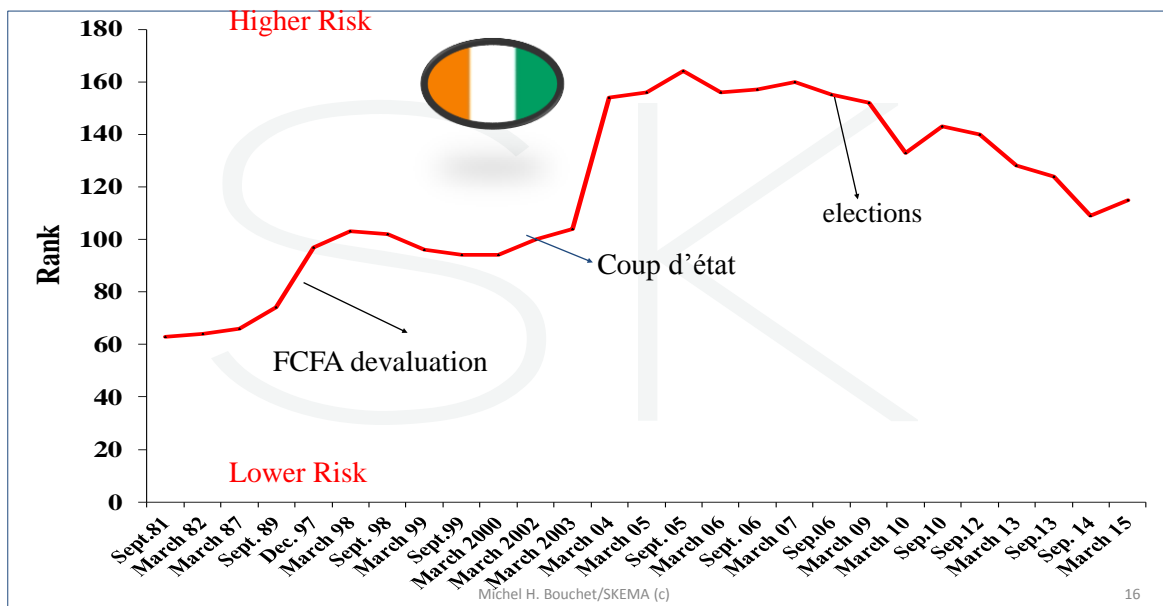
14

## 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 RISK RATING OF ASIA

➤ **Switzerland = 1**

➤ **Norway = 2**

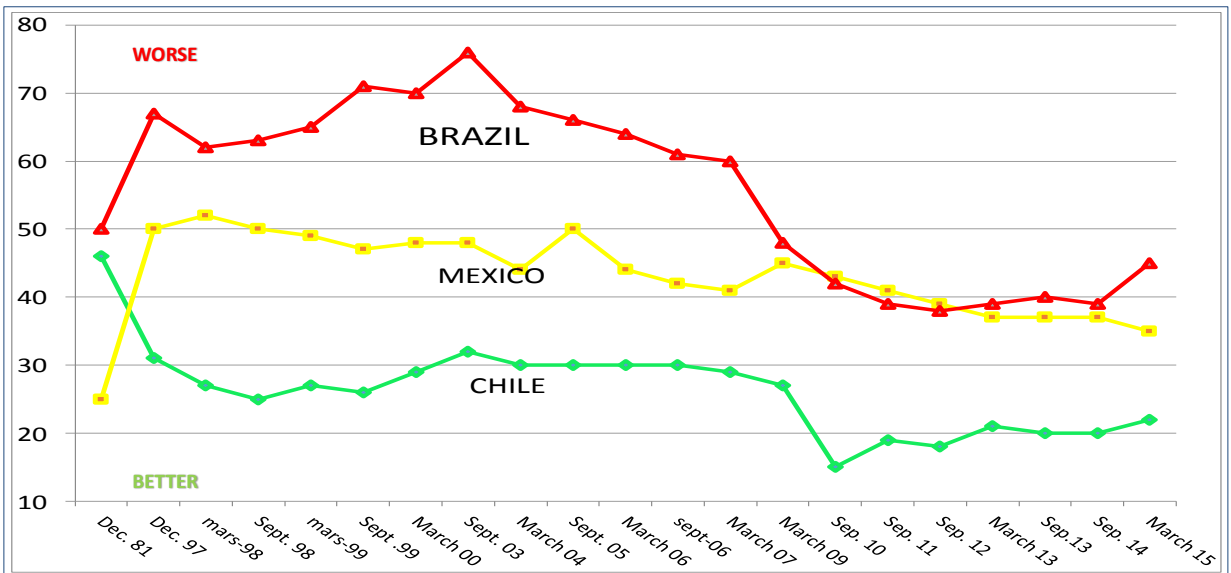
- Singapore = 6
- Australia = 11
- HK= 17
- Japan = 19
- South Korea = 20
- Taiwan = 21
- **China = 26**
- Malaysia= 37
- Thailand= 47
- India= 48

- 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

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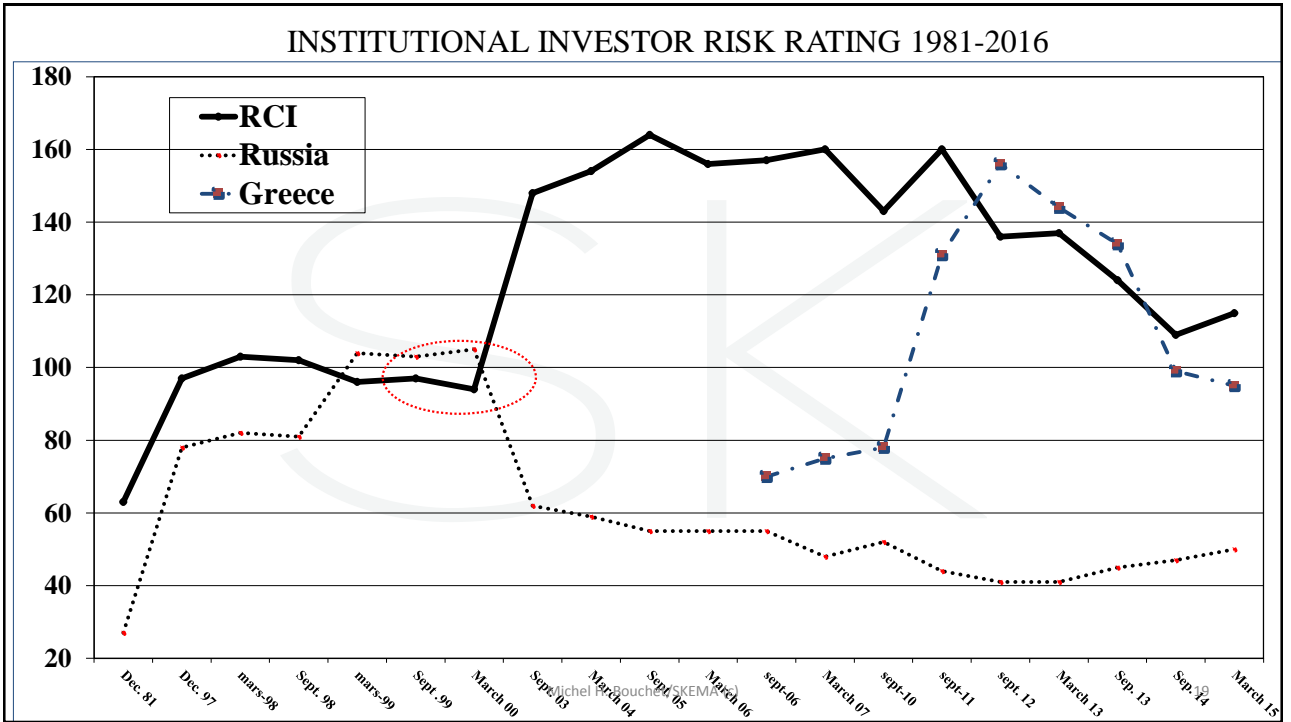
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## INSTITUTIONAL INVESTOR RISK RATING 1981-2017



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## COUNTRY RISK: GOVERNANCE MATTERS!

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

| WORLD BANK:<br>« DOING<br>BUSINESS »<br>2017 RANKING |    |
|--|----|
| 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 |

*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 |

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## 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           |

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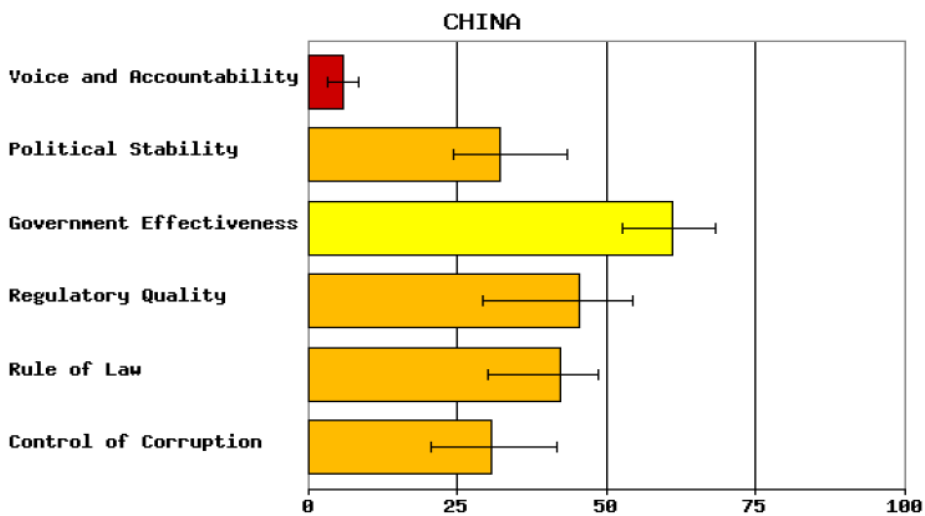
## BLOOMBERG DOING BUSINESS RANKING

| 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                                   |

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



Source: World Bank

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## 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

## MEASURING CORRUPTION?

|    |             |
|----|-------------|
| 1  | New Zealand |
| 2  | Denmark     |
| 3  | Singapore   |
| 3  | Sweden      |
| 5  | Switzerland |
| 6  | Finland     |
| 6  | Netherlands |
| 8  | Australia   |
| 8  | Canada      |
| 8  | Iceland     |
| 11 | Norway      |
| 12 | Hong Kong   |
| 12 | Luxembourg  |
| 14 | Germany     |
| 14 | Ireland     |
| 16 | Austria     |



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|     |                   |
|-----|-------------------|
| 162 | Guinea-Bissau     |
| 162 | Kyrgyzstan        |
| 162 | Venezuela         |
| 168 | Burundi           |
| 168 | Equatorial Guinea |
| 168 | Guinea            |
| 168 | Haiti             |
| 168 | Iran              |
| 168 | Turkmenistan      |
| 174 | Uzbekistan        |
| 175 | Chad              |
| 176 | Iraq              |
| 176 | Sudan             |
| 178 | Myanmar           |
| 179 | Afghanistan       |
| 180 | Somalia           |

## EMCS & SHADOW ECONOMY

| Country↓   | % GNP Informal<br>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

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## UNDP HUMAN DEVELOPMENT INDEX

- ▶ What is development?
- ▶ **Economic growth** + those conditions that make growth **sustainable** over the long-term
- =
- ▶  $\Sigma$  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        |  | 170 | Malawi          |
| 2. Australia     |   | 171 | Sudan           |
| 3. United States |   | 172 | Zimbabwe        |
| 4. Netherlands   |   | 173 | Ethiopia        |
| 5. Germany       |   | 174 | Liberia         |
| 6. New Zealand   |   | 175 | Afghanistan     |
| 7. Ireland       |   | 176 | Guinea-Bissau   |
| 8. Sweden        |   | 177 | Sierra Leone    |
| 9. Switzerland   |   | 178 | Guinea          |
| 10. Japan        |   | 178 | Burundi         |
| 11. Canada       |   | 180 | Central African |
| 12. Korea        |   | 181 | Eritrea         |
| 13. Hong Kong    |   | 182 | Mali            |
| 14. Iceland      |   | 183 | Burkina Faso    |
| 15. Denmark      |   | 184 | Chad            |
| 16. Israel       |   | 185 | Mozambique      |
| 17. Belgium      |   | 186 | Niger           |
| 18. Austria      |   | 186 | Congo (DR)      |
| 19. Singapore    |   |     |                 |
| 20. France       |   |     |                 |

## 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

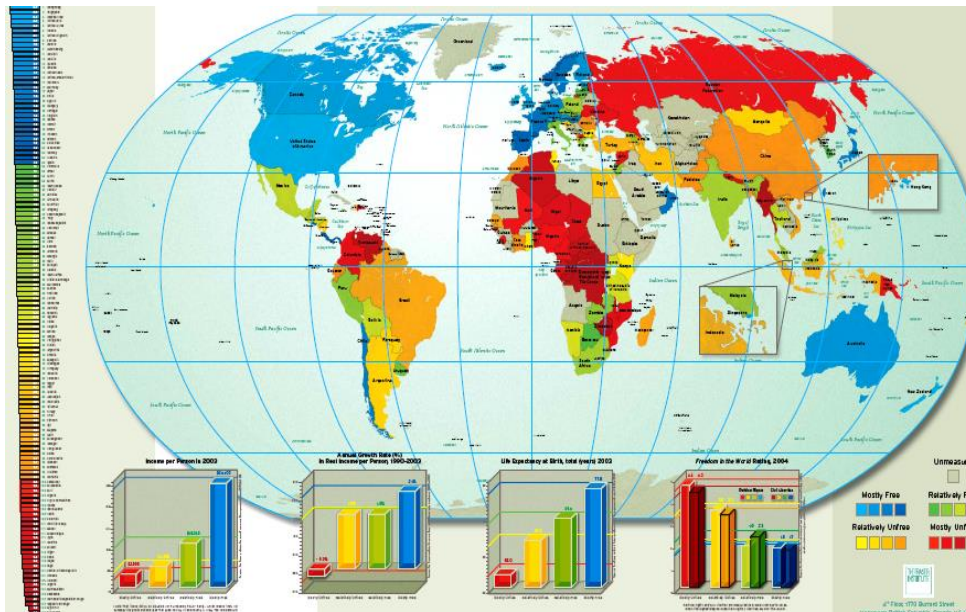
#### Not Free countries (47)

- ▶ Cameroon
- ▶ Congo
- ▶ Haiti
- ▶ Iran
- ▶ China
- ▶ Vietnam
- ▶ Burma
- ▶ Cuba
- ▶ Saudi Arabia
- ▶ Syria
- ▶ Turkménistan

## FRASER INSTITUTE

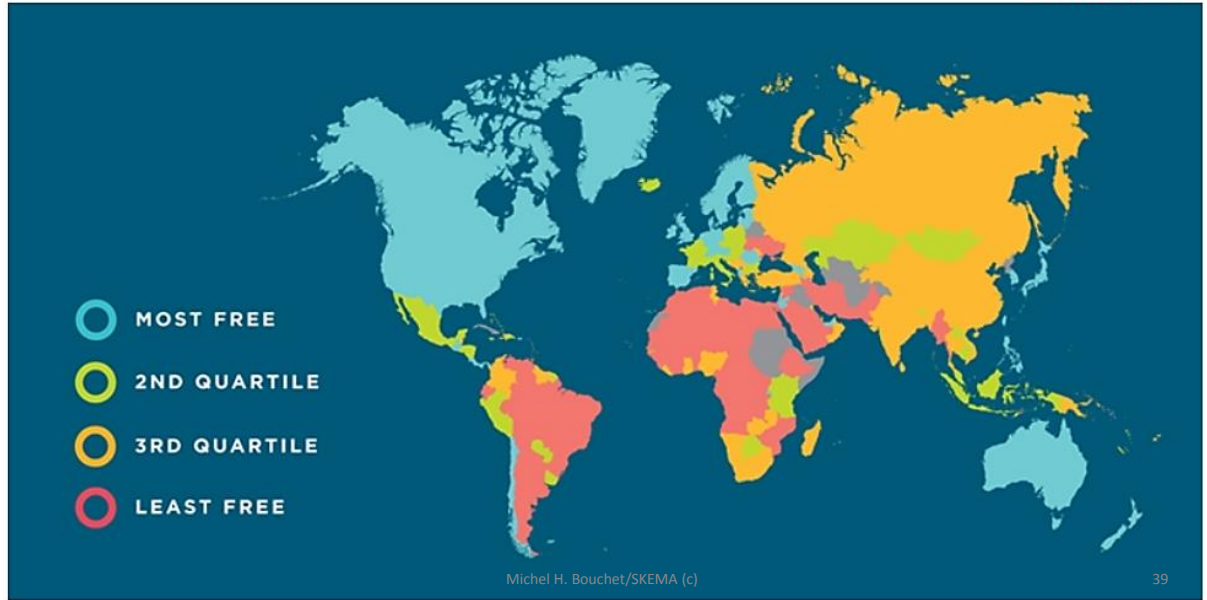
- ▶ Since 1975
- ▶ Annual Indices of Economic & Human Freedom in the world: reliable measure of cross-country differences in economic freedom, using third-party data to help ensure objectivity
- ▶ **Criteria:** government quality, legal structure, security of property rights, access to sound money, personal 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



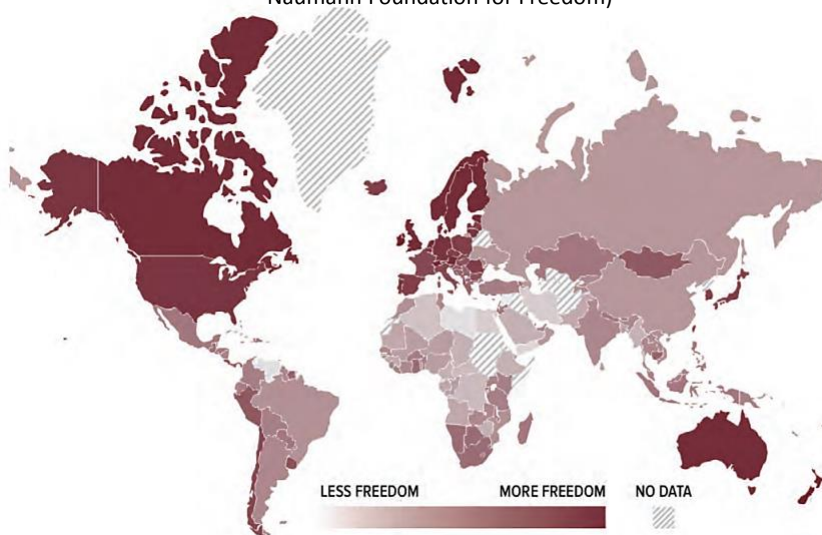
## Economic Freedom of the World: 2017 Annual Report

— Sep 28, 2017

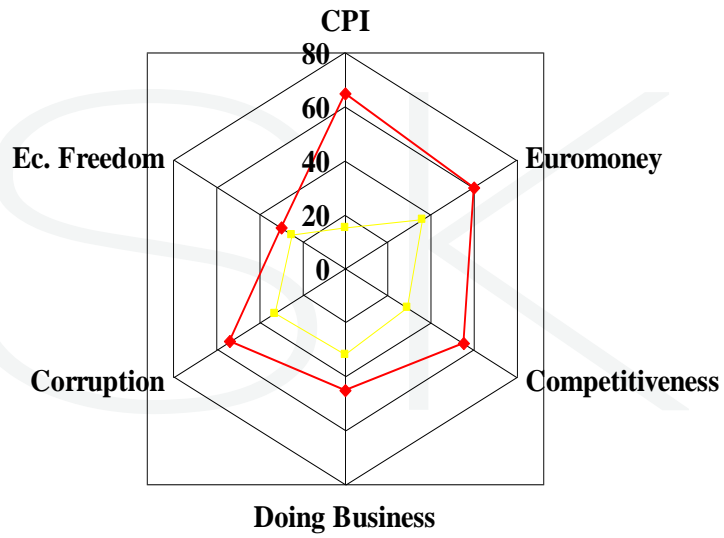


## FRASER INSTITUTE: HUMAN FREEDOM INDEX 2018

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 &amp; Y: A MULTI-INDEX COMPOSITE GRAPH



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## Political Risk Mitigation

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## HEDGING POLITICAL RISK

### How to manage country risk?

- ▶ Information & Intelligence gathering
- ▶ Financial hedging (collateral and guarantees)
- ▶ National and international private and public insurance agencies: OPIC, MIGA, Platus, Lloyds, Berne Union (ECAs), Hiscox, COFACE... provide insurance coverage against political risk

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## POLITICAL RISK INSURANCE I

| Status          | Entity  | Members  | Political Risk Insurance Focus  |
|-----------------|---|--|---|
| <b>National</b> | Export credit and investment insurance agencies | Developed countries  | Cross-border trade and investment for nationals                               |
|                 | US EXIMBANK (1934)                              | Independent US federal agency  | War, revolution, expropriation, terrorism, currency freeze                    |
|                 | OPIC US (1971)                                  | Self-sustaining U.S. Government agency for promoting US investment in emerging markets | War, civil strife, coups, terrorism, expropriation, and transfer restrictions |
|                 | SACE (Italy) 1977                               | Italian joint stock company wholly owned by Cassa depositi e prestiti                  | Nationalisation and civil disorders   |
|                 |   |  |   |
|                 |   |  |   |

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## POLITICAL RISK INSURANCE II

|                      |   |  |  |
|----------------------|---|--|--|
| <b>Multinational</b> | African Trade Insurance Agency (2001)                           | 12 African members countries                             | Political risk and trade credit risk insurance products  |
|                      | Asian Development Bank (1966)                                   | 67 members countries, including 48 from Asia             | Loans guarantees against political risks and credit risks, and equity investment   |
|                      | Inter-American Development Bank (1959)                          | 48 member countries                                      | Political risk guarantees for foreign debt investors   |
|                      | Inter-Arab Investment Guaranty (1975)                           | Arab autonomous regional organization                    | Insurance coverage for interArab investments and for export credits against non-commercial risks   |
|                      | MIGA (1990)   | 181 member countries, including 156 developing countries | Political risk insurance to provide investors and lenders<br>Currency inconvertibility and transfer restriction<br>expropriation, war, terrorism, cvl disturbances<br>breach of contract |
|                      | Islamic Corp. for Insurance of Invest. and Export Credit (1994) | 6 islamic members countries                              | Sharia compliant risk mitigation tools   |
|                      |   |  |  |
|                      |   |  |  |

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## POLITICAL RISK INSURANCE III

|                |  |  |  |
|----------------|--|--|--|
| <b>Private</b> | Berne Union (international non-profit organization) founded 1934 | 84 companies from 73 countries               | Association for the global export credit and investment insurance industry |
|                | COFACE (France) 1946   | Wholly-owned subsidiary of Natixis           | export credit and investment insurance                                     |
|                | HISCOX (UK)  | London-based insurer                         | Political risk (kinap and ransom) and terrorism                            |
|                | EULER-HERMES (Hermes-Germany: 1917)                              | Allianz-owned private credit agency          | Transactional cover (political risk and fraud insurance)                   |
|                | Sovereign Risk Insurance (1997)                                  | Bermuda-based insurance company              | Political and devaluation risks for bond issues                            |
|                | Steadfast Insurance company                                      | Subsidiary of Zurich-American Insurance      | Inconvertibility, transferability and expropriation risks                  |
|                | AIG (1919)   | American multinational insurance corporation | Political risk turbulences (confiscation terrorism, war)                   |
|                | LLOYD's (17th century)   | 50 leading underwriting insurance companies  | Political violence insurance   |
|                | MARSCH (1871)  | Insurance broking and risk management        | Political risk insurance and saguard against disputed claims               |

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## POLITICAL RISK INSURANCE

- ▶ It is estimated that investors have lost \$20 billion in Argentina following the 2001 economic collapse. Many have brought claims against Argentina before the ICSID, to get compensation by reference to « creeping expropriation » due to the 2002 emergency legislation measures!
- ▶ August 2000: ICSID's arbitral tribunal found that a number of measures taken by Mexico's government against Metalclad boiled down to expropriation due to incidental interference!

## ICSID: INTERNATIONAL CENTER FOR THE SETTLEMENT OF INVESTMENT DISPUTES

- ▶ Autonomous international institution established under the Convention on the Settlement of Investment Disputes
- ▶ 155 signatory States
- ▶ The ICSID Convention is a multilateral treaty formulated by the Executive Directors of the International Bank for Reconstruction and Development (the World Bank). It entered into force on October 14, 1966.
- ▶ The Convention sought to remove major impediments to the free international flows of private investment posed by non-commercial risks



## OPIC: US OVERSEAS PRIVATE INVESTMENT CORPORATION

- ▶ Overseas Private Investment Corporation: Independent US Federal government agency in Washington, D.C., that provides political risk insurance to encourage and assist **US private investment** in 160 developing nations:
  - ▶ War, civil strife, coups and other acts of politically-motivated violence, including terrorism
  - ▶ Expropriation, including abrogation, repudiation, and/or impairment of contract and other improper host government interference
  - ▶ Restrictions on the conversion and transfer of local-currency earnings



## THE OVERSEAS PRIVATE INVESTMENT CORPORATION (OPIC)

- ▶ OPIC was established as a development agency of the U.S. government in 1971. OPIC helps **U.S. businesses** invest overseas, fosters economic development in new and emerging markets, complements the private sector in managing the risks associated with foreign direct investment, and supports U.S. foreign policy.
- ▶ By expanding economic development in host countries, OPIC-supported projects can encourage political stability, free market reforms and U.S. best practices.
- ▶ OPIC projects also support American jobs and exports—over 280,000 new U.S. jobs and \$65 billion in exports since 1971. Because OPIC charges market-based fees for its products, it operates on a self-sustaining basis at no net cost to taxpayers.

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## OPIC POLITICAL RISK INSURANCE?

### POLITICAL RISK INSURANCE

#### ELIGIBILITY

OPIC reviews all potential projects to ensure they will have no negative impact on U.S. jobs or the U.S. economy.

This checklist will help you determine whether you and/or your company may be eligible to apply for OPIC Political Risk Insurance.

##### Ownership

For an investment to be considered eligible, it must meet one or more of the following criteria:

- U.S. Citizens
- Corporations established in the U.S. and more than 50% owned by U.S. citizens or corporations
- Not-for-profits established in the U.S.
- Entities established outside the U.S. at least 95% owned by U.S. citizens or corporations

#### TYPES OF COVERAGE

OPIC offers several types of political risk coverage, such as currency inconvertibility, expropriation, political violence and more targeted specialty products:

- Currency Inconvertibility
- Expropriation and Other Forms of Unlawful Government Interference
- Political Violence
- Reinsurance
- Capital Markets

## THE WB'S GUARANTEE AUTHORITY AND ITS SUPPORT OF PRIVATE SECTOR INVESTMENT

- ▶ **MIGA** (established in 1988) is the investment insurance affiliate of the World Bank. It promotes the flow of capital and technology into developing countries: provides political risk insurance against **non-commercial risks** (currency transfer restriction, expropriation, breach of contract, war and civil disturbance) and technical assistance.
- ▶ Members: 175 (o/w 125 EMCs)
- ▶ Capital stock of \$2 billion (K increase approved in 1999)
- ▶ Source of funds: member capital
- ▶ Cumulative guarantees issued: US\$16 billion with >1000 guarantee contracts in 92 countries
- ▶ Estimated FDI facilitated: > 30 billion
- ▶ MIGA offers guarantees for up to 15-20 years

## MIGA AND POLITICAL RISK INSURANCE

- ▶ **Currency transfer restrictions**
- ▶ **Expropriation:** loss of the insured investment as a result of acts by the host government that may reduce or eliminate ownership of, control over, or rights to the insured investment.
- ▶ **War and civil disturbance:** loss due to the destruction, disappearance, or physical damage to tangible assets caused by politically motivated acts of war or civil disturbance, including revolution, insurrection, and coups d'état.

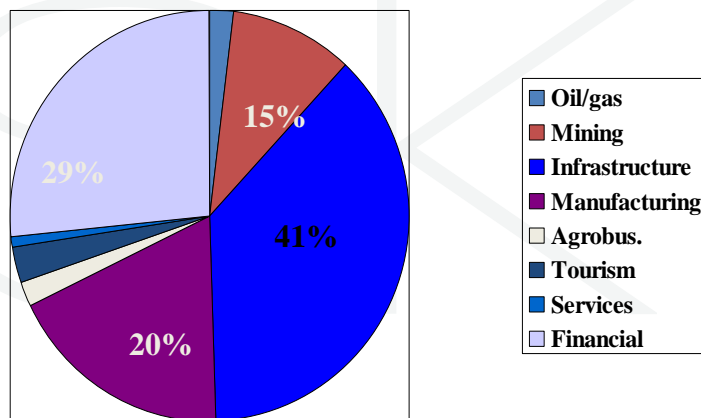
## MIGA AND POLITICAL RISK INSURANCE

- ▶ **Breach of contract** coverage protects against losses arising from the host government's breach or repudiation of a contractual agreement with the investor.

The investor must be able to invoke a dispute resolution mechanism (e.g., arbitration) set out in the underlying contract and obtain an award for damages. The investor may file for a claim if, after a specified period of time, payment is not received.

- ▶ **Technical assistance**
- ▶ **Dispute mediation**

## MIGA'S OUTSTANDING GUARANTEE PORTFOLIO BY SECTOR



## MIGA'S GUARANTEE PROCESS

- ▶ Only **new** investments and new contributions towards the expansion, privatization, or modernization of existing enterprises are eligible. MIGA must obtain approval from the host government to offer a guarantee to the investor.
- ▶ MIGA's legal department undertakes a range of mediation activities to encourage the amicable settlement of disputes between investors and host countries, to forestall the need for formal international arbitration.

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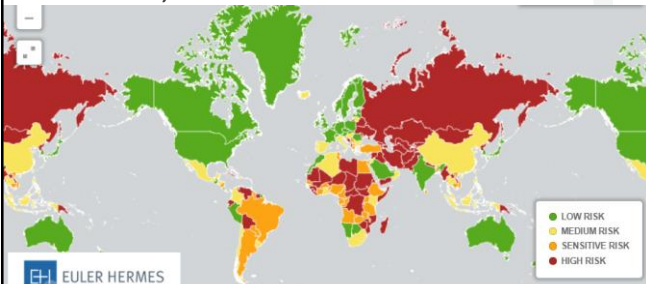
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## POLITICAL RISK INSURANCE



- ▶ **The Political Risk Rating** is based on the analysis of mechanisms for transferring and concentration of power, the effectiveness of policy-making, the independence of institutions, social cohesion, and international relations



Political risk insurance for MNCs, project lenders, banks, contracts and trade

- ▶ Confiscation, expropriation, or nationalization
- ▶ Currency inconvertibility and non-transfer
- ▶ Political violence (including terrorism and war)
- ▶ Contract frustration due to political events.
- ▶ Sovereign payment default

MH BOUCHET/Skema<sup>16</sup> (c)

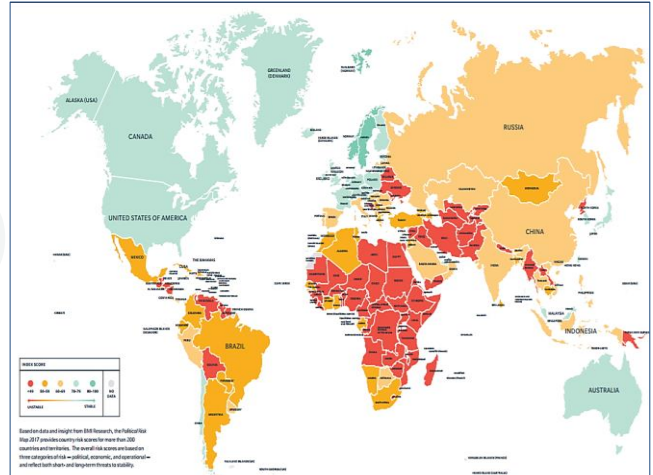
# POLITICAL RISK INSURANCE

LLOYD'S

MARSH

Political violence insurance provides cover for physical damage to property as a result of political risks and any consequential financial loss:

- ▶ Confiscation of property
- ▶ Inconvertibility of currency: cover for the financial loss incurred by the insured when it cannot convert local currency or repatriate funds out of a territory
- ▶ Trading risks
- ▶ Kidnap and ransom



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| <p><b>Business Environment Risk Intelligence BERI</b> 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.<br/><a href="http://beri.com">http://beri.com</a></p>             | <p><b>Political Risk Services</b> The PRS analyses cover a hundred countries and are updated on a quarterly basis. <b>International Country Risk Guide</b> 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.<br/><a href="http://prsgroup.com">http://prsgroup.com</a></p>  | <p>Thanks to its unique policy dialogue with more than 180 countries, the <b>World Bank</b> 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.<br/><a href="http://www.worldbank.org/wbi/governance/">www.worldbank.org/wbi/governance/</a></p>   |
| <p>The London-based <b>Economist Intelligence Unit (EIU)</b> provides a comprehensive 6-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.<br/><a href="http://eiu.com">http://eiu.com</a></p>   | <p>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.<br/><a href="http://moodys.com">http://moodys.com</a></p>  | <p><b>Standard and Poor's</b> 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&amp;P assigns short term and long-term ratings.<br/><a href="http://standardandpoors.com">http://standardandpoors.com</a></p> |
| <p><b>Euromoney</b> 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).<br/><a href="http://www.euromoney.com">www.euromoney.com</a></p> | <p><b>Institutional Investor's</b> 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).<br/><a href="http://www.institutionalinvestor.com">www.institutionalinvestor.com</a></p> | <p><b>Transparency International</b>, 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.<br/><a href="http://www.transparency.org">www.transparency.org</a></p>  |

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|   |   |  |
|---|---|--|
| <p><b>Heritage Foundation</b> 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. <a href="http://www.heritage.org">www.heritage.org</a></p>                                     | <p>PricewaterhouseCoopers's <b>Opacity Index</b> 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 transparency 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. <a href="http://www.opacityindex.com/">www.opacityindex.com/</a></p> | <p>The Institute for Management Development's <b>World Competitiveness Report</b> 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. <a href="http://www.imd.ch">www.imd.ch</a></p> |
| <p><b>Freedom House</b> 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). <a href="http://www.freedomhouse.org/ratings.index.html">www.freedomhouse.org/ratings.index.html</a></p> | <p><b>The Political and Economic Stability Index</b> 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. <a href="http://www.legsi.com">www.legsi.com</a></p>   | <p><b>Political and Economic Risk Consultancy (PERC)</b> 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. <a href="http://www.asiarisk.com">www.asiarisk.com</a></p>                        |

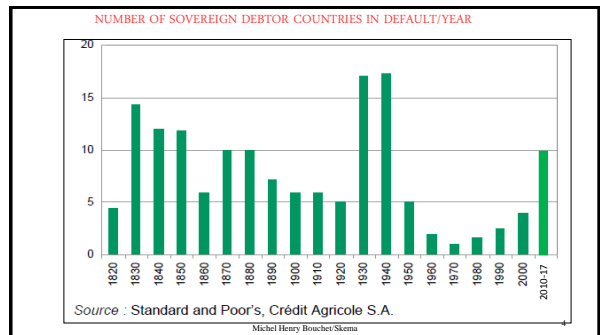
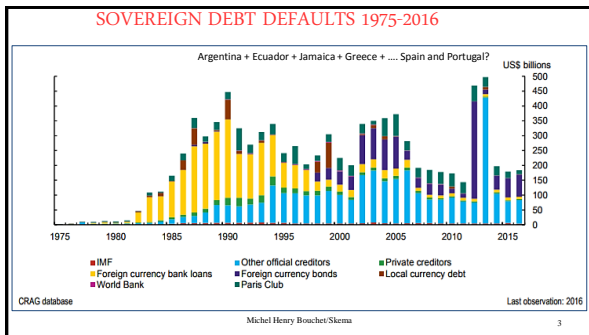
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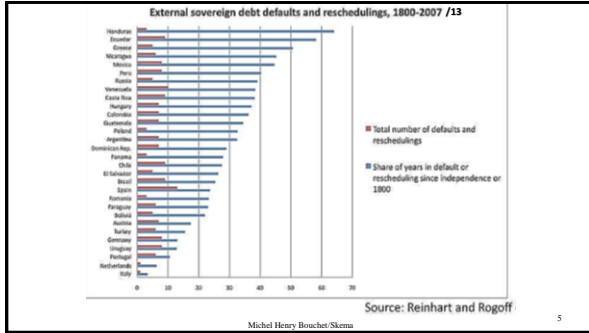
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**Country risk crisis:  
In search of early warning indicators?**

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.

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

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RD – Restricted default.

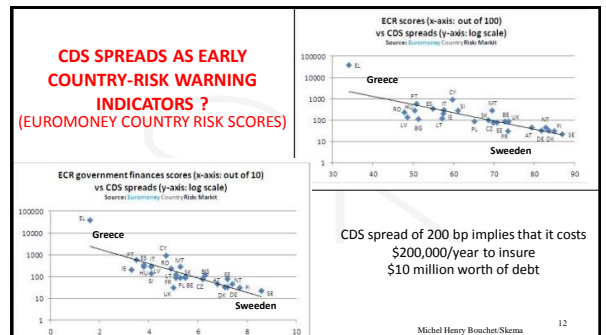
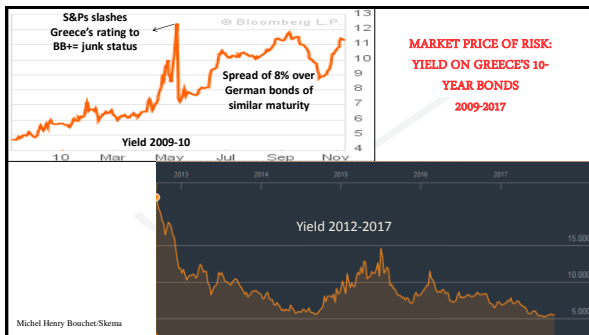
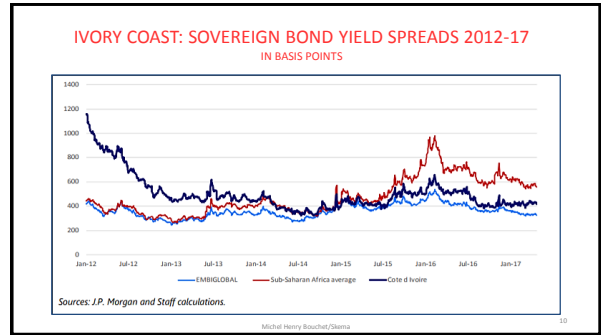
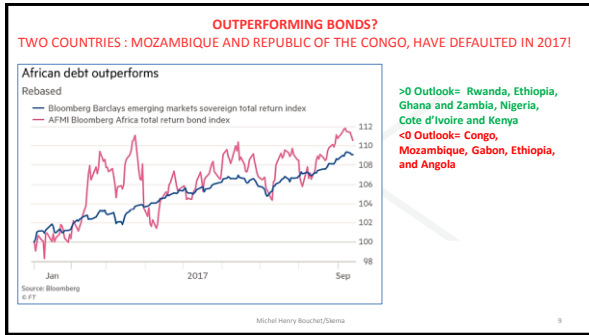
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- ### LOOKING TOWARD EARLY WARNING SIGNALS OF UPCOMING FINANCIAL AND SOCIO-POLITICAL CRISIS?
- ▶ IMF reports?
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  - ▶ CDS prices?
  - ▶ Stock market volatility
  - ▶ Spreads and yields?
  - ▶ Minsky's speculative bubbles and herd-instinct
    - ▶ B. Mandelbrot's fractal geometry
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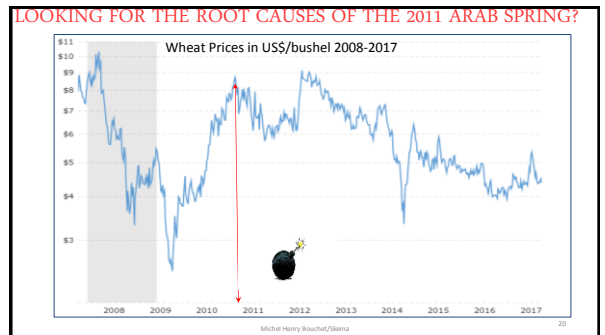
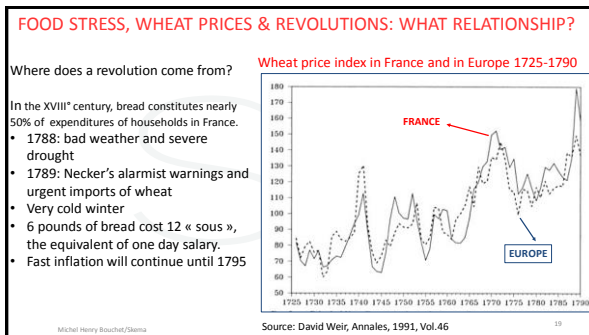
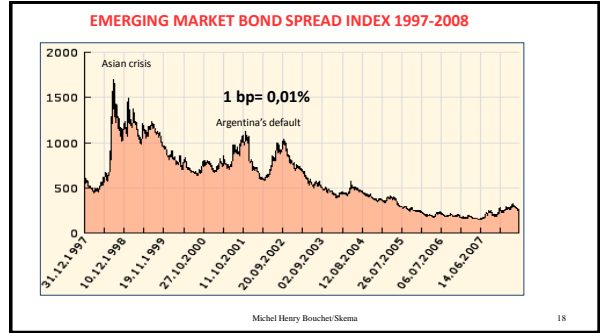
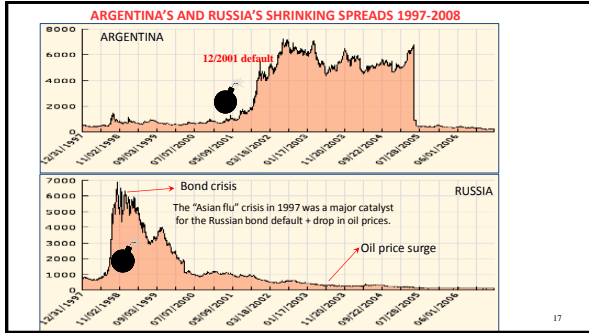
### WAS THE 1998 ASIAN CRISIS ANTICIPATED BY RATING AGENCIES?

|             | 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        |

Michel Henry Bouchet/Skema







**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!

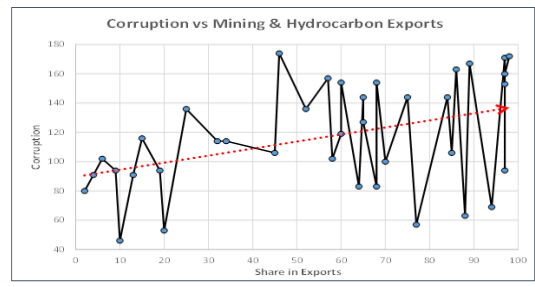
**PUSH AND PULL FORCES OF CAPITAL FLIGHT**

|                                    | Internal Push Forces/<br>Domestic factors  | External Pull Forces/<br>Foreign factors   |
|------------------------------------|--|--|
| <b>Socio-political instability</b> | Political upheaval, nationalization, strikes, confiscation threats, capital controls, high and rising tax pressure                       | Socio-political stability, dynamic and sustainable development process                             |
| <b>Institutional weaknesses</b>    | 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 |
| <b>Opacity and bad governance</b>  | Corruption and bribery, breach of contract, transfer and convertibility restrictions   | Stable regulations, conducive legal framework, strong property rights                              |

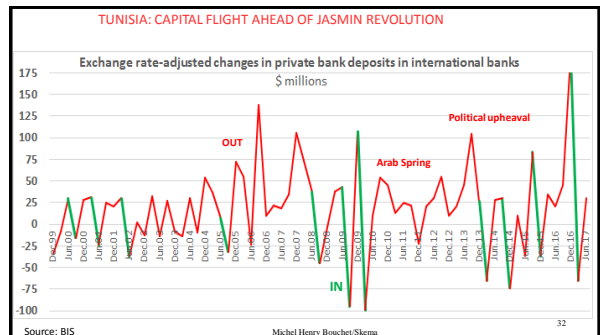
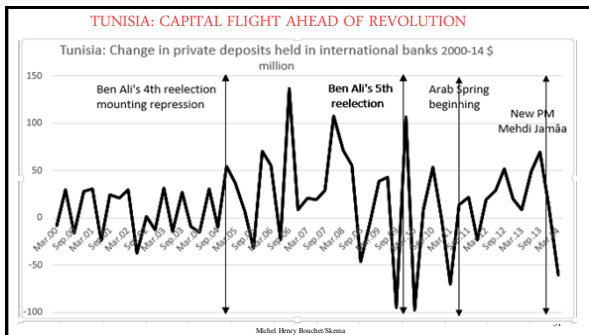
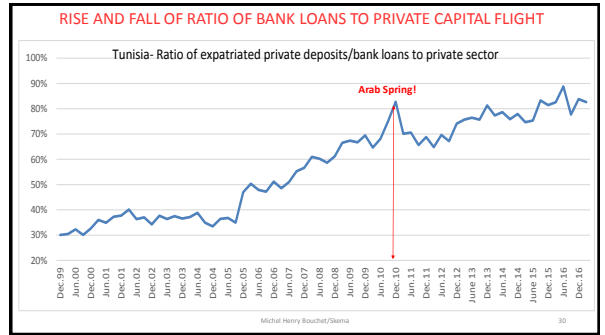
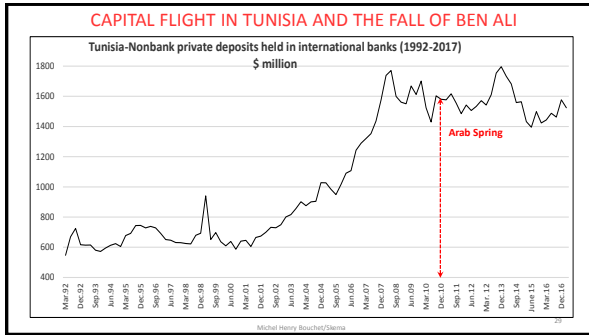
**MEASURING CAPITAL FLIGHT**

| Definition   | Methodology and Measure   | Authors   |
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| 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**



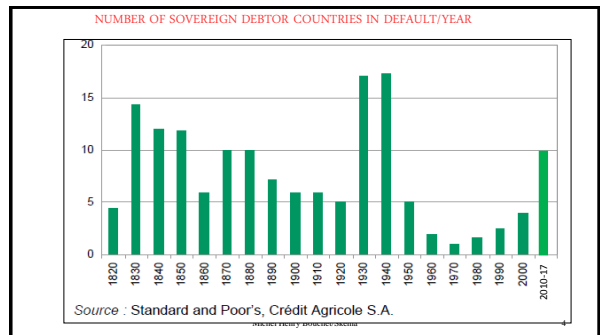
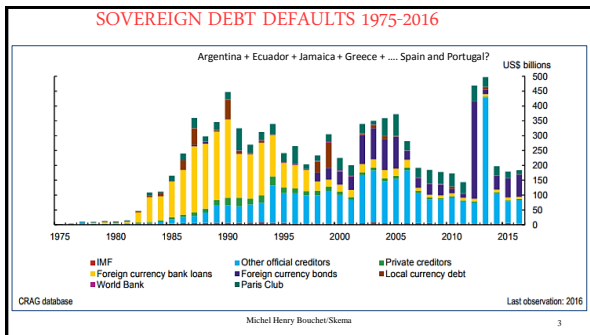


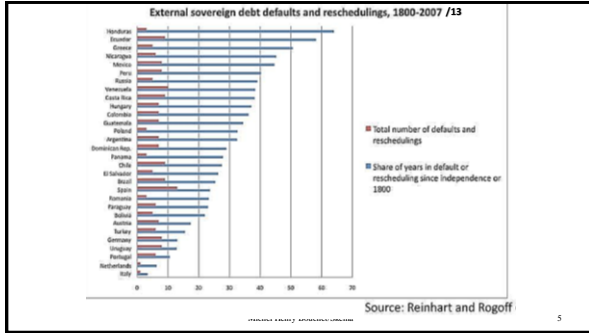


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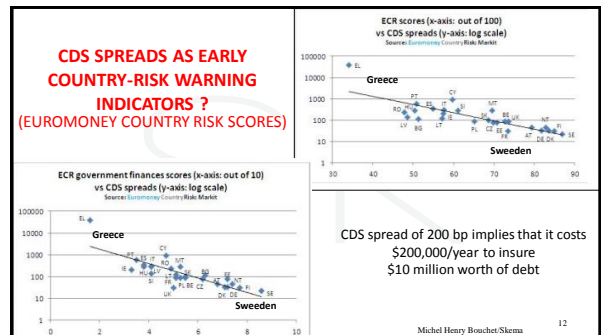
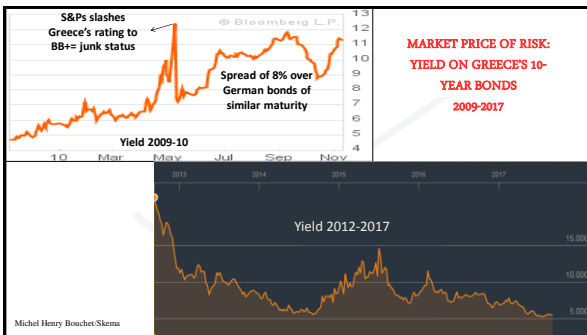
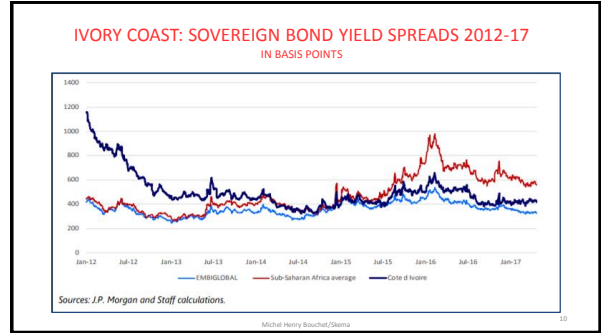
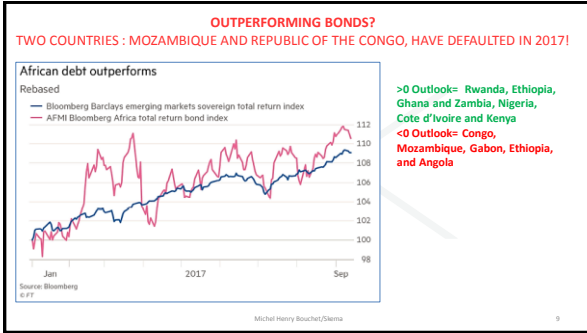
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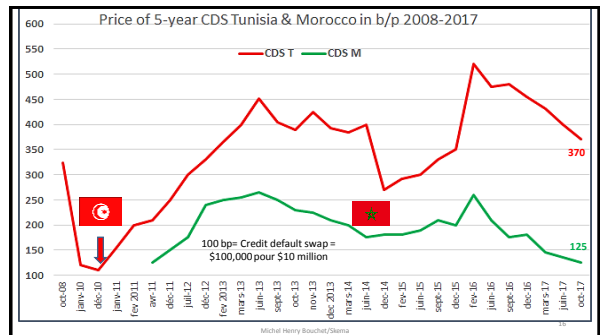
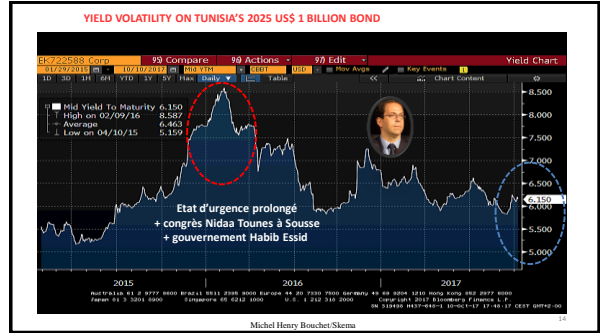
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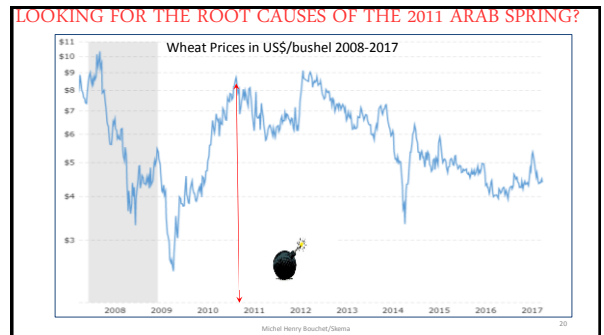
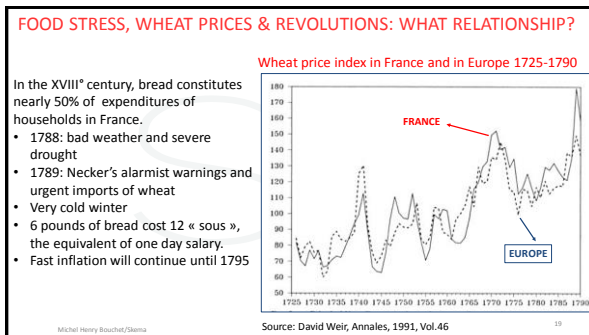
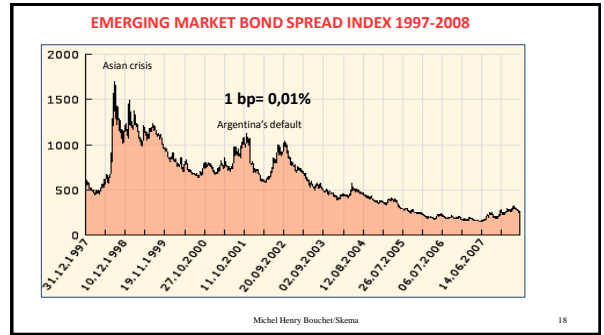
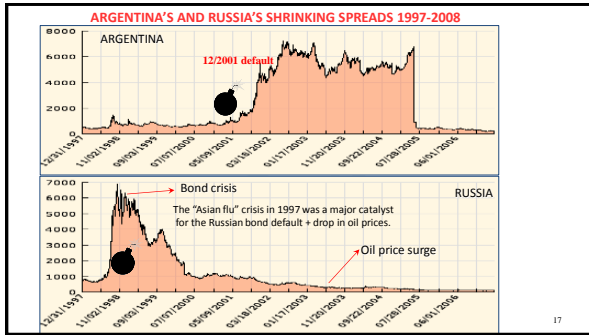
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Michel Henry Bouchet/Skema







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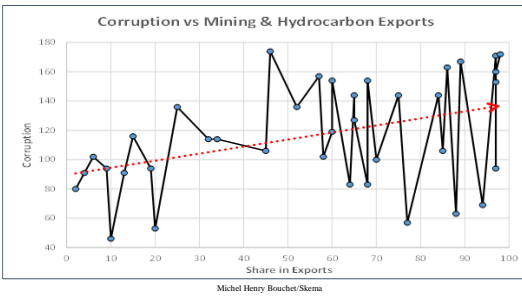
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**CORRUPTION, AND HYDROCARBON AND MINING-BASED GROWTH**



**INTERNATIONAL BANKS' BALANCE SHEETS**

**Liabilities**

- ▶ Deposits
- Banks
- Government
- Central banks
- Companies
- Households

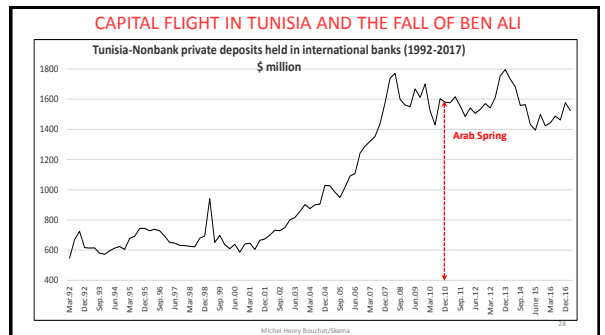
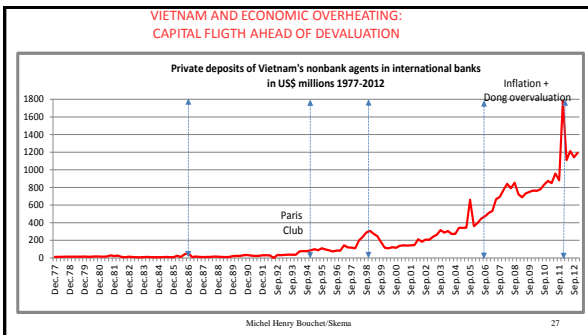
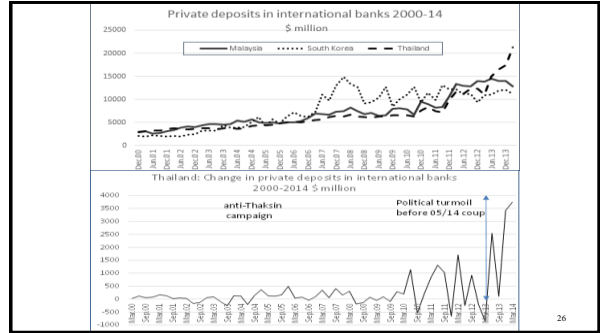
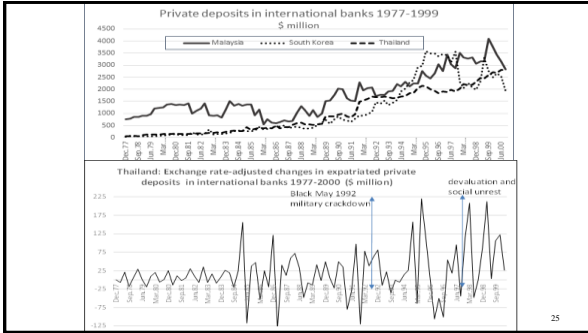
**Claims**

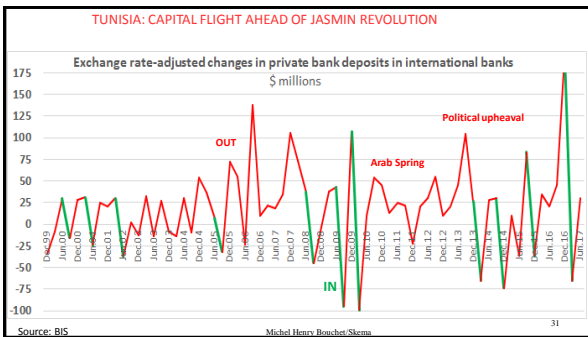
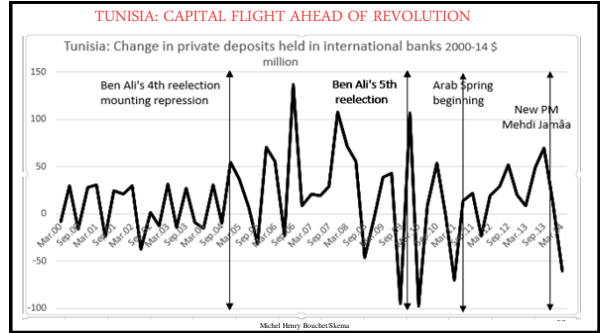
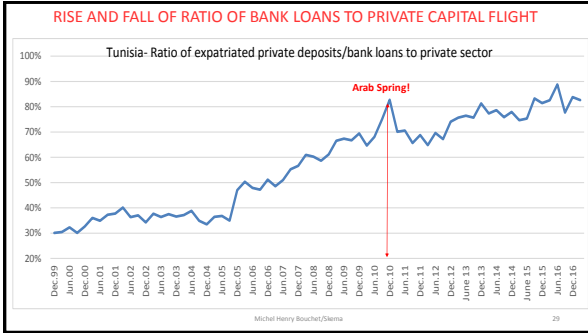
- ▶ Loans
- To banking sector
- To private sector
- To government

Counterparties resident in Tunisia  
Cross-border positions reported by banking offices located in the US-reporting countries, in millions of US dollars

| Tunisia                   |         | Claims |       | Liabilities |       |
|---------------------------|---------|--------|-------|-------------|-------|
|                           | Q4 2014 | Q4 14  | Q4 14 | Q4 14       | Q4 14 |
| By sector of counterparty |         |        |       |             |       |
| Of which:                 |         |        |       |             |       |
| Intergroup                | 24      | 135    | 676   | 125         | 55    |
| Non-bank financial        | 77      | 36     | 2,007 | 47          | 1,564 |
| Non-financial             | 4       | 5      | 77    | 4           | 340   |
| Total                     | 105     | 176    | 2,760 | 176         | 1,959 |

Michel Henry Bouchet/Skema 24







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. **Aval:** an endorsement on a bill guaranteeing payment.
4. **Bilateral loans:** loans from governments and their agencies (including central banks), loans from autonomous bodies, and direct loans from official export credit agencies.

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5. **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).
6. **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.

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7. **Bullet Maturity:** one-time payment of principal at maturity.
8. **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.

**9. 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.

**10. Collateral:** guarantee (mortgage, deposit, commodity...)

**10. 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.

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.

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

**12. 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.

**13. 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).

- 14. 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.
- 15. Debt Service** is the sum of principal repayments and interest payments actually made.
- 16. Disbursements:** drawings on loan commitments by the borrower during the year.

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- 17. 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.
- 18. Equity-linked bonds:** convertible bonds or bonds with equity warrants (amounted to \$64 billion in 1997, and \$32 billion in 1998).
- 19. Equity-linked bonds:** convertible bonds or bonds with equity warrants (amounted to \$64 billion in 1997, and \$32 billion in 1998).

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- 20. 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.
- 21. Euro-commercial paper:** short-term euronotes issues by companies.

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- 22. Eurocredits:** medium to long-term loans denominated in euro-currencies (> 1 year).
- 23. Exceptional Financing:** a special "below the line" category in the IMF Balance of Payments used to accommodate transactions undertaken on behalf of the monetary authorities to compensate for any overall imbalance.
- 24. Fiduciary Fund (or Trust Fund):** fund in which assets are safeguarded and whose stream of interest income is used to fund a specific project.

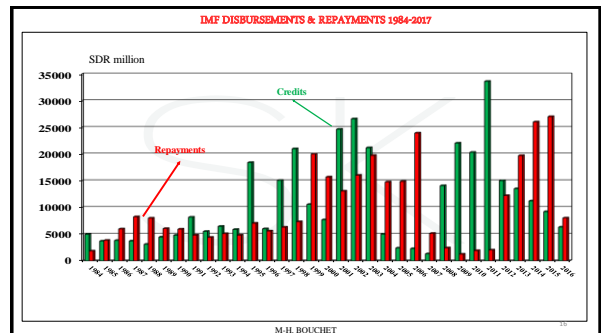
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- 25. Free Rider:** individual banks may refuse to participate in a bailout loan with the international banking community, thereby not matching their expected share of the concerted loan package. Similarly, small-exposure banks might refuse joining 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.
- 26. 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.

- 26. 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.
- 27. 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.

- 28. IMF purchases:** Total drawings on the general resources account of the IMF during the year specified, excluding drawings in the reserve tranche.
- 29. IMF repurchases:** Total repayments of outstanding drawings from the general resources account during the year specified, excluding repayments due in the reserve tranche.
- 30. 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.
- 31. Interest in arrears on long-term debt:** defined as interest payment due but not paid, on



32. **Interest payments:** are the amounts of interest paid in foreign currency, goods, or services in the year specified.
33. **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.
34. **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.

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35. **Loans from multilateral organizations:** are 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.
36. **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.

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37. **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.

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.



38. **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.



- 39. **Net flows on debts** (or net lending or net disbursements): are disbursements minus principal repayments.
- 40. **Net resource flows** (long term): sum of net resource flows on long-term debt (excluding IMF) plus non-debt-creating flows.
- 41. **Net transfers on debt**: net flows minus interest payments (or disbursements minus total debt service payments).
- 42. **New Money Bonds**: bonds issued by debtor countries in exchange for additional financing. Such instruments are usually more senior and tradable than old claims.

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- 43. **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.
- 44. **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.

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- 45. **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...).
- 46. **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.
- 47. **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

- 48. **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.
- 49. **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.

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

- 54. **Publicly guaranteed debt:** external obligation of a private debtor that is guaranteed for repayment by a public entity.
- 55. **Refinancing:** provision of new money to cover obligations on existing loans in part or in full.
- 56. **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.

- 57. **Rescheduling:** re-timing of the principal due on a loan. Usually, Paris Club debt agreements include interest rescheduling in place of new money.
- 58. **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.

- 59. **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.
- 60. **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)

- 61. 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.
- 62. 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).

- 63. 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.
- 64. Suppliers Credit:** export finance which is available to a supplier of items as distinct from credits to the foreign purchasers under buyer's credit.
- 65. 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.

- 66. Total debt service due:** contractual debt service payments on total long-term debt (public and publicly guaranteed and private nonguaranteed) and the use of IMF credit.
- 67. 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.
- 68. Total debt stocks:** sum of public and publicly guaranteed long-term debt, private nonguaranteed long-term debt, the use of IFM credit, and short-term

- 69. Unallocated Loan-loss Reserves:** value of anticipated future charge-offs on the existing loan portfolio that cannot yet be identified with any particular asset.
- 70. 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)

- 71. 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.
- 72. 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.
- 73. 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.