

# Challenge of Global Country Risk Assessment




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September 2013

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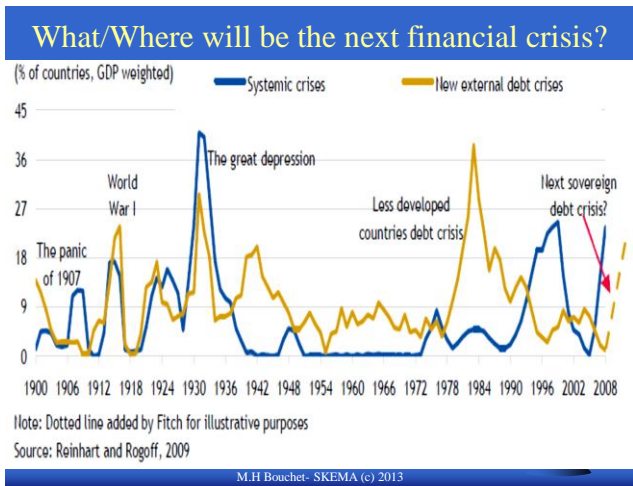
## Risk = Uncertainty = Information deficit

### You cannot predict risk



Risk is anywhere, anytime!


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### What is Risk about?

Risk stems from a situation of uncertainty regarding current or future situations, where information about the situation's outcome is insufficient, lacking or simply wrong!

- Information availability is, in itself, a measure of risk (BOP, debt data, governance...)
- Information scarcity then requires taking action that might produce negative and costly consequences (investigation time, transaction cost, delays...)



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Risk has to do with **uncertainty** regarding the future, hence the need of tackling the future prospects!



« Ancient times » = circular time (until the Middle Age)

« Modern time » = linear time of ...Economic & Financial Time!



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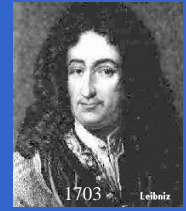
## The « discovery » of risk



Pascal 1654



Fermat 1654



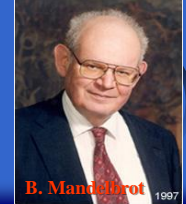
1703 Leibniz



Markowitz 1952



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B. Mandelbrot 1997

## Country risk analysis?



☞ Assessment of a foreign entity's ability and willingness to meet its external obligations **in full and in 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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## 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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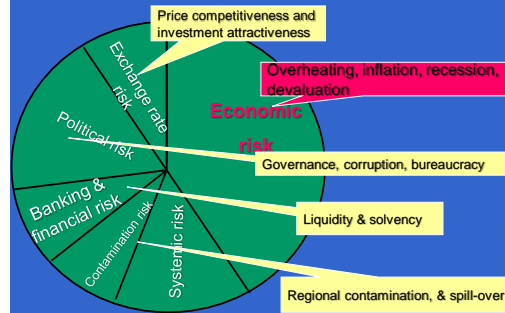
## The interplay of **country risk** with the **global economy**



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## Main Country-Risk component

- Globalization= volatility + spill-over of risk components!



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## Country risk assessment

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

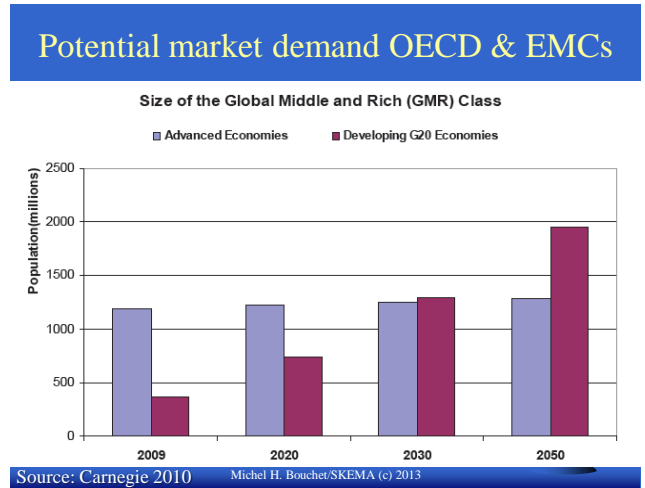
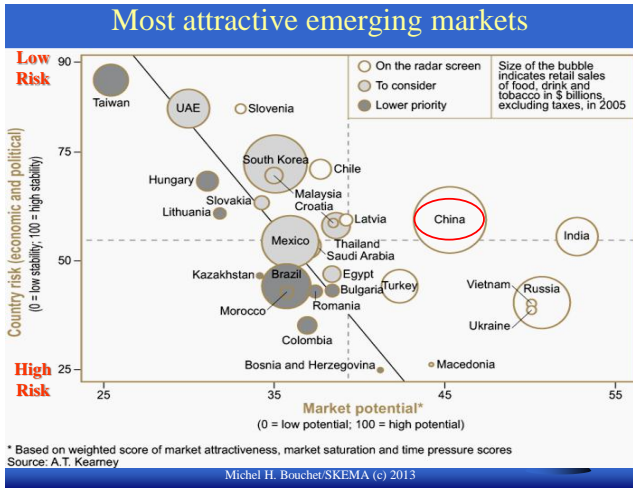
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## Analysis and information sources

IMF & World Bank  
UNCTAD  
BIS  
OECD  
EBRD  
Coface  
Moody's, S&P, Fitch  
CIA & State Department  
Transparency International

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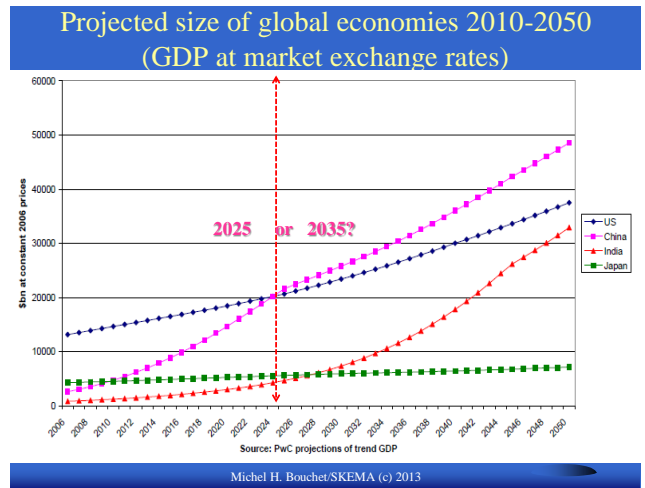
## Assessing country risk = Assessing LT opportunities

### The future global leaders?

- The **BRIC**: « **Toward 2050** » : Goldman Sachs  
 Brazil, Russia, China & India's GDP > G7 in US\$

### Challenge: how to forecast the « Top 10 » in 2050?

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## Approaches to country risk assessment

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



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## External Debt Analysis

### Key Objectives:

- ☞ Examining the robustness of the **growth engine** and the sources of **financial vulnerability**
- ☞ Assessing debt servicing **sustainability**
- ☞ Analyzing **liquidity & solvency** prospects:
- ☞ **How much is too much?** (debt sources, maturity, mismatch...)



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## Is there a Debt/GDP threshold that triggers a debt crisis and lower growth?

- ☞ **The Rogoff-Reinhart 2010 thesis:** Economic growth severely suffers when a country's public debt level reaches 90% of GDP (1946-2009)
- ☞ **The 2013 challengers:** the average real GDP growth rate for countries carrying a public debt-to-GDP ratio >90% is actually **2.2 percent, not -0.1 percent** as published by Reinhart and Rogoff (Herndon, Ash & Pollin)
- ☞ Further challenge regarding the **causality:** Countries might have high debt-to-GDP ratios because they have slow growth, rather than the other way around!



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## External Finance Analysis: The dual face of Country Risk

### *Liquidity Risk*

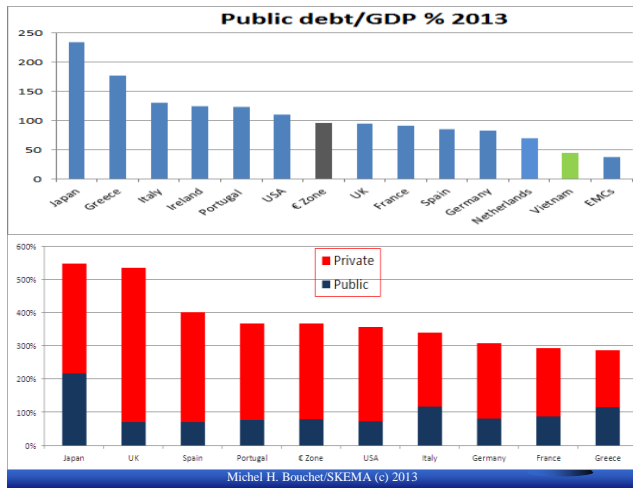
- ☞ Debt Service Ratio: (P+I/X)
- ☞ Interest Ratio (I/X)
- ☞ Current account/GDP
- ☞ Reserve/Import ratio
- ☞ Elasticity of exports
- ☞ Growth rate of exports/ Average external interest rate

### *Solvency Risk*

- ☞ Debt/Export ratio
- ☞ Debt/GDP ratio
- ☞ Debt/Reserves
- ☞ ST Debt/Reserves



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## Country Risk Analysis SOVEREIGN RISK RATING

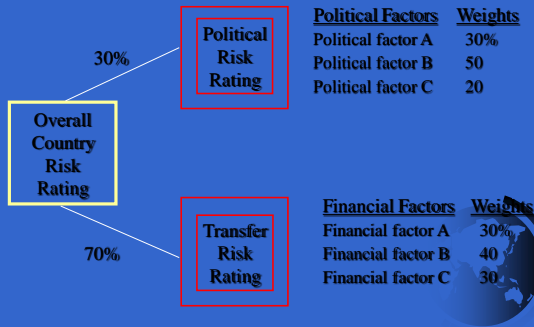
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## Quantitative approach: Rating

- 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

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## Quantifying Country Risk



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## Country Risk Rating

### Advantages/ Pros

- simple
- shrinks a large number of variables into one single grade
- cross-country comparison
- comparison across time
- reliable for smooth risk evolution

### Shortcomings/Cons

- “reductionist”
- over-simplistic
- risk of self-fulfilling prophecy
- little predictive value
- weighted average tends to bury salient trends
- gives “market consensus” often made of herd instinct

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## WEF Competitiveness index Components:

Expert opinions of over 11,000 business leaders and entrepreneurs on:



Source: www.weforum.org

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## Competitiveness index 2013

Davos-World Economic Forum

1	<b>Switzerland</b>	130	<b>Madagascar</b>
2	<b>Singapore</b>	131	<b>Côte d'Ivoire</b>
3	<b>Finland</b>	132	<b>Zimbabwe</b>
4	<b>Sweden</b>	133	<b>Burkina Faso</b>
5	<b>Netherlands</b>	134	<b>Mauritania</b>
6	<b>Germany</b>	135	<b>Swaziland</b>
7	<b>United States</b>	136	<b>Timor-Leste</b>
8	<b>United Kingdom</b>	137	<b>Lesotho</b>
9	<b>Hong Kong SAR</b>	138	<b>Mozambique</b>
10	<b>Japan</b>	139	<b>Chad</b>
11	<b>Qatar</b>	140	<b>Yemen</b>
12	<b>Denmark</b>	141	<b>Guinea</b>
13	<b>Taiwan, China</b>	142	<b>Haiti</b>
14	<b>Canada</b>	143	<b>Sierra Leone</b>
15	<b>Norway</b>	144	<b>Burundi</b>

China = 29  
Brazil = 48  
South Afr = 52  
India = 59  
Russia = 67

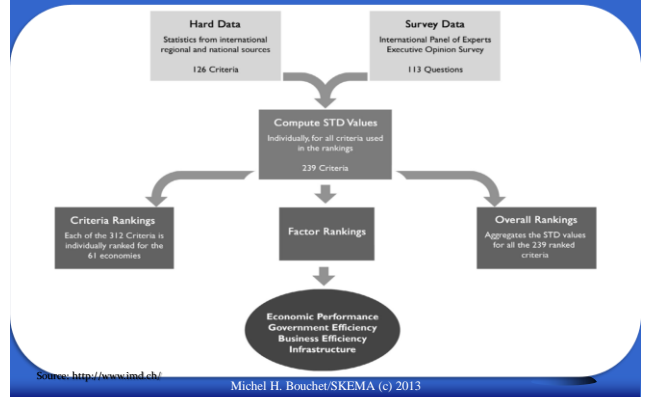
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## IMD World Competitiveness yearbook

- World Competitiveness Index : ability of nations to provide an environment that sustains the competitiveness of enterprises.
- Extensive coverage of 59 countries chosen because of their impact on the global economy and the availability of comparable international statistics.
- Over 300 competitiveness criteria are selected.

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## IMD: Computing the Rankings



## IMD Competitiveness Scoreboard

180.000	(2) HONG KONG 1
100.000	(3) USA 1
98.557	(1) SINGAPORE 3
94.063	(6) SWEDEN 4
92.588	(4) SWITZERLAND 5
92.011	(8) TAIWAN 6
90.782	(7) CANADA 7
90.219	(15) QATAR 8
89.259	(5) AUSTRALIA 9
87.824	(16) GERMANY 10
86.475	(11) LUXEMBOURG 11
86.418	(13) DENMARK 12
86.313	(9) NORWAY 13
85.707	(12) NETHERLANDS 14
84.380	(19) FINLAND 15
84.120	(10) MALAYSIA 16
81.629	(17) ISRAEL 17
81.619	(14) AUSTRIA 18
81.100	(18) CHINA MAINLAND 19
80.728	(22) UNITED KINGDOM 20
79.729	(20) NEW ZEALAND 21
78.499	(23) KOREA 22
77.599	(25) BELGIUM 23
77.101	(21) IRELAND 24
76.827	(18) CHILE 25
75.214	(27) JAPAN 26
74.886	(26) THAILAND 27
73.188	UAE 28
71.394	(24) FRANCE 29
70.990	(29) CZECH REPUBLIC 30
70.821	(30) ICELAND 31
70.649	(31) INDIA 32

China= 19  
India= 32  
Brazil= 44  
Russia= 49  
South Afr = 52

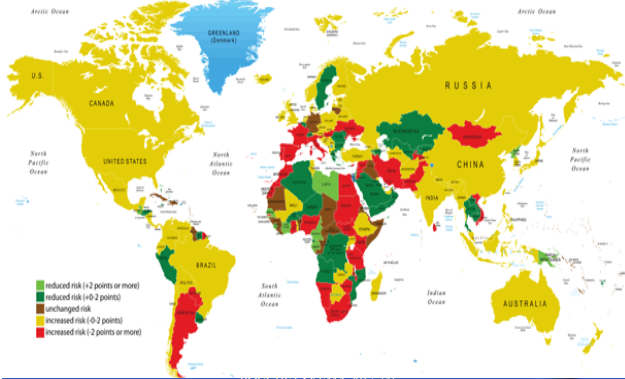
## COUNTRY RISK SPECIFIC INDICES

Euromoney  
Institutional Investor  
COFACE

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## Country risk: no longer the monopoly of developing countries

Euromoney Country Risk Survey Results, June 2012



## 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

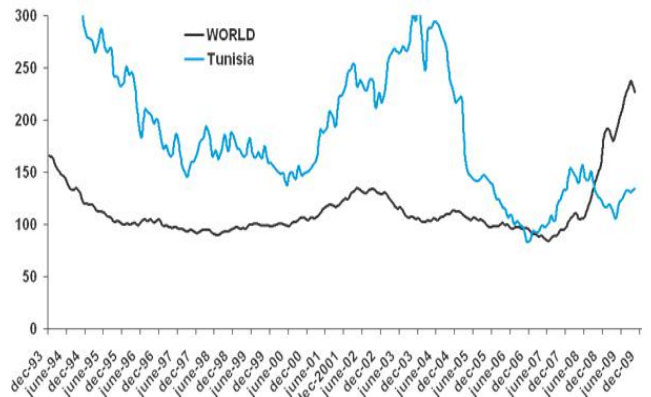
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## Coface Credit Rating (2013)

- Canada= A1
- Australia = A1
- Japan= A1
- USA= A2
- Korea= A2
- Chile = A2
- China= A3
- Brazil = A3
- India= A3
- Mexico= A4
- Tunisia= B
- Russia= B
- Algeria= B
- Egypt= C
- Vietnam= C
- Ukraine = C
- Venezuela = C
- Argentina = C
- Cuba = D
- RCI = D
- Nigeria = D

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## Coface rating of corporate payment arrears



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Source: Coface; Index 100= 1995

## Country risk: **Governance** matters!

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

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## World Bank: « Doing Business » in 2013

1835 Countries  
10 Parameters  
Ranking does not take into consideration the macroeconomic framework nor organized crime

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

China= 91  
Russia= 112  
Brazil= 130  
India= 132

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## Doing Business in China?

REGION	East Asia & Pacific	DOING BUSINESS 2013 RANK	DOING BUSINESS 2012 RANK	CHANGE IN RANK
INCOME CATEGORY	Upper middle income	91	91	0
POPULATION	1,344,130,000	DOING BUSINESS 2013 DTF** (% POINTS)	DOING BUSINESS 2012 DTF** (% POINTS)	IMPROVEMENT IN DTF** (% POINTS)
GNI PER CAPITA (US\$)	4,930	60.6	59.5	↑ 1.1

TOPIC RANKINGS	DB 2013 Rank	DB 2012 Rank	Change in Rank
Starting a Business	151	153	↓ 2
Dealing with Construction Permits	181	181	No change
Getting Electricity	114	113	↓ -1
Registering Property	44	41	↓ -3
Getting Credit	70	67	↓ -3
Protecting Investors	100	98	↓ -2
Paying Taxes	122	118	↓ -4
Trading Across Borders	68	60	↓ -8
Enforcing Contracts	19	20	↑ +1
Resolving Insolvency	82	78	↓ -4

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## 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...

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## Freedom House: Freedom in the World

### 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
- ☞ Turkmenistan

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**World Bank & Governance Assessment=**  
traditions and institutions by which authority is exercised  
= overall quality of public and private management process

CHINA



Country's Percentile Rank (0-100)

Source: World Bank-2012

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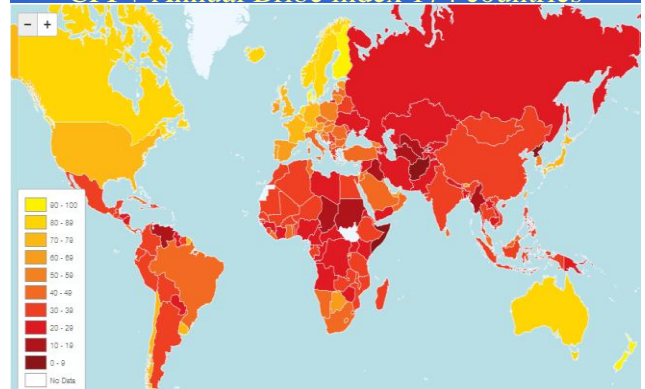
## EMCs & Shadow Economy

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

Sources: World Bank, July 2010  
Hernando de Soto

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## Assessing corruption? CPI + Annual Bribe index 174 countries



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### Measuring Corruption? CPI-2012/13

1	Denmark	150	Paraguay
1	Finland	154	Guinea
1	New Zealand	154	Kyrgyzstan
4	Sweden	156	Yemen
5	Singapore	157	Angola
6	Switzerland	157	Cambodia
7	Australia	157	Tajikistan
7	Norway	160	Dem. Rep. Congo
9	Canada	160	Laos
9	Netherlands	160	Libya
11	Iceland	163	Equatorial Guinea
12	Luxembourg	163	Zimbabwe
13	Germany	165	Burundi
14	Hong Kong	165	Chad
15	Barbados	165	Haiti
16	Belgium	165	Venezuela
17	Japan	169	Iraq
17	United Kingdom	170	Turkmenistan
19	United States	170	Uzbekistan
20	Chile	172	Myanmar
		173	Sudan
		174	Afghanistan
		174	Korea (North)
		174	Somalia

Brazil= 69  
 China= 80  
 India= 94  
 Russia= 133



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## UNDP Human Development Index

What is development?

Economic growth + those conditions that make growth **sustainable** over the long-term =


Σ life expectancy, education, health, infrastructure, institutions, governance.



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### UNDP HDI


1. Norway	144. Côte d'Ivoire
2. Australia	145. Comoros
3. United States	146. Malawi
4. Netherlands	147. Sudan
5. Germany	148. Zimbabwe
6. New Zealand	149. Ethiopia
7. Ireland	150. Liberia
8. Sweden	151. Afghanistan
9. Switzerland	152. Guinea-Bissau
10. Japan	153. Sierra Leone
11. Canada	154. Burundi
12. Korea	155. Guinea
13. Hong Kong	156. Central Af. Rep
14. Iceland	157. Eritrea
15. Denmark	158. Mali
16. Israel	159. Burkina Faso
17. Belgium	160. Chad
18. Austria	161. Mozambique
19. Singapore	162. Congo (DR)
20. France	163. Niger



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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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Conclusion  
Assessing country risk?  
Economic Intelligence!

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

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