WHAT IS RISK ALL ABOUT?
"CONVERTING RISKS INTO SPRINGBOARDS OF SUCCESS"

CIFE SEMINAR ROMA-BERLIN-NICE 2024-25
MICHEL-HENRY BOUCHET

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CAN YOU PREDICT RISK?
RISK = UNCERTAINTY = INFORMATION DEFICIT

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2 TYPES OF CRISES:

► Type 1 Crisis

It emerges brutally, its timing cannot be anticipated, and it requires drastic adjustment

1. 1929 crisis
2. 1973 OPEC oil crisis
3. 12/2004 Asian tsunami
4. 2011 earthquake-driven Fukushima disaster
5. Twin Towers 1/11
6. Turkish lira crisis 04/2021

► Type 2 Crisis

It emerges brutally, it is unprecedented but probable, and it could have been expected

1. 1985 EMCs debt crisis
2. 1986 Chernobyl
3. 1999 Asian banking crisis
4. 2008 financial crisis
5. **CoviD-19 (**CIA 2005 report, Bill Gates 2015 TED talk, 2016 World Bank Facility, Obama 2016 pandemic report, 10/2019 Crimson Contagion planning)
6. **Russia's war against Ukraine**
7. **10/7/24 Hamas attack and subsequent retaliatory spiral**
8. (next) **Climate change crisis!**
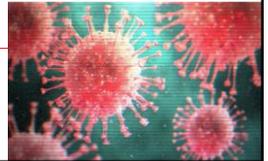
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VIX = « FEAR INDEX » : Q1-2020 AND Q4-2024
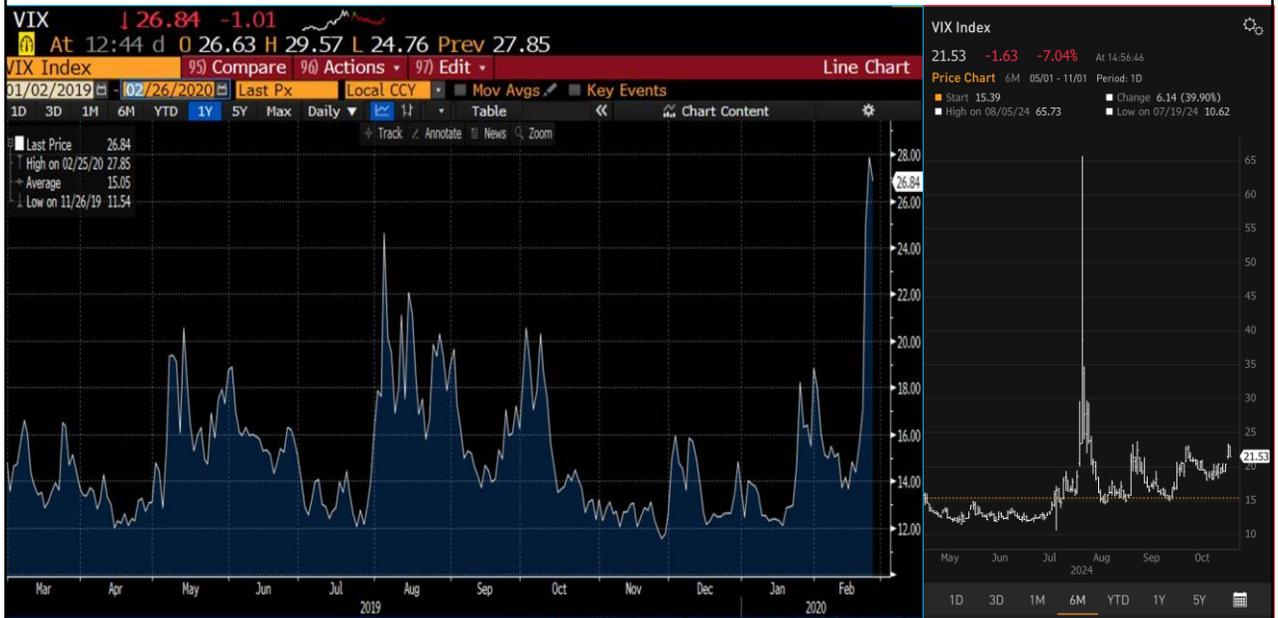
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ANTICIPATING ABRUPT STOCK MARKET DOWNTURNS
WHAT IS THE ULTIMATE TRIGGER?

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TOTAL SOVEREIGN DEBT IN DEFAULT 1975-2024
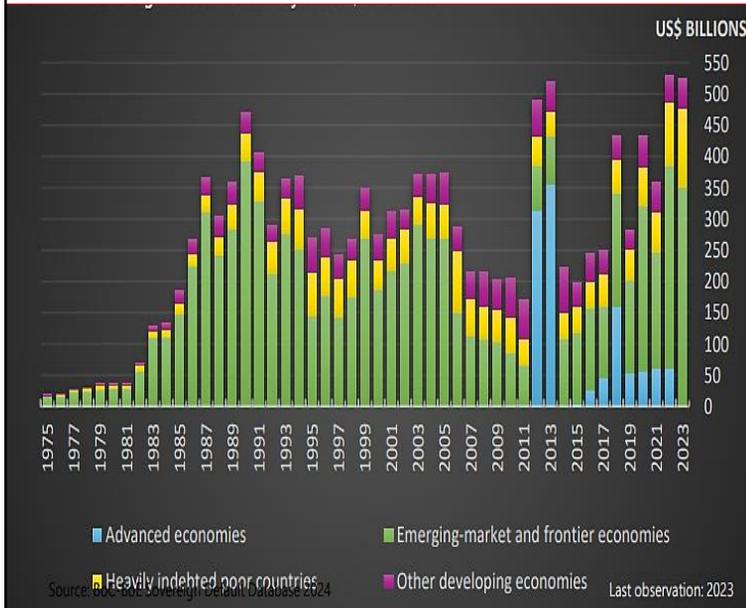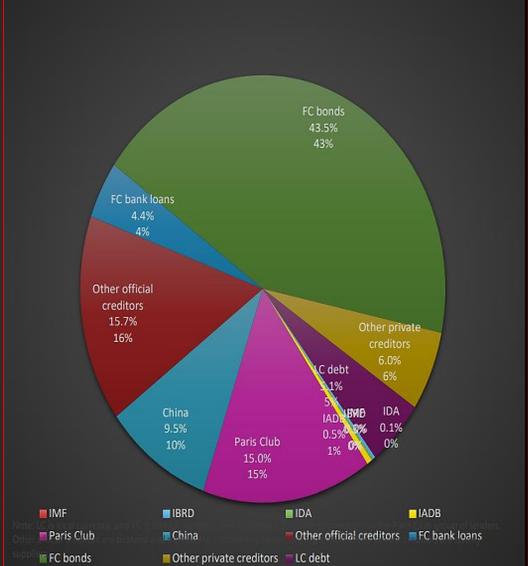
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WHICH KEY QUESTIONS WILL UNDERPIN
RISK ASSESSMENT STRATEGIES?

1. What about the **time frame**?
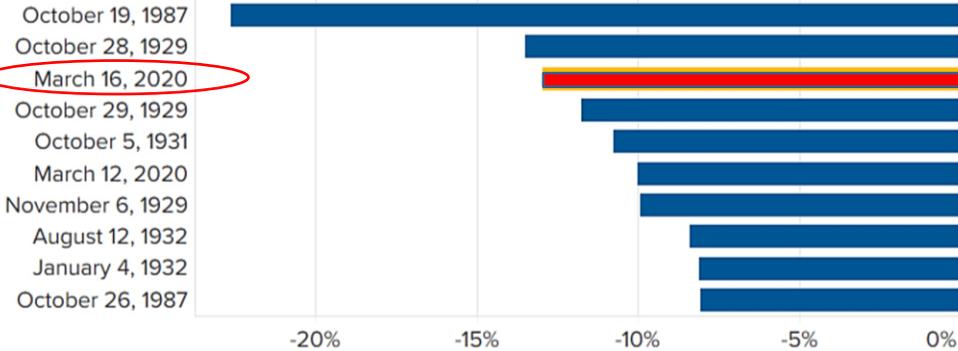2. What about the risk **exposure**? (investor, exporter, importer, banking, NGO, IFI)
3. What is the **type** of risk? (direct, indirect, spill-over?)
4. What is the risk **profile**, e.g., sectoral, global, economic, socio-political, institutional, country specific?
5. Can the risk be **mitigated**?
6. Can the risk consequences be **insured**? e.g. MIGA, OPIC, Coface…

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2020 WEF SURVEY: RISKS ARE ABOUT TO INCREASE OR DECLINE IN 2020-25?

	Significantly/Somewhat decrease	No change	Somewhat increase	Significantly increase
Political or economic confrontations/frictions between major powers		6%	53%	40%
State-on-state military conflict or incursion		20%	60%	19%
Regional conflicts drawing in major power(s)		19%	58%	20%
Erosion of multilateral trading rules and agreements		20%	53%	20%
Loss of confidence in collective security alliances		27%	51%	16%
Erosion of global policy coordination on climate change	14%	26%	39%	19%

Percentage of respondents

Environmental and sanitary risks? ?

Significantly decrease | Somewhat decrease | No change | Somewhat increase | Significantly increase

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WEF 2023-24 GLOBAL RISK PERCEPTION SURVEY

2-5 Years		
Climate action failure		35.7%
Extreme weather		34.6%
Social cohesion erosion		23.0%
Livelihood crises		20.1%
Debt crises		19.0%
Human environmental damage		16.4%
Geoeconomic confrontations		14.8%
Cybersecurity failure		14.6%
Biodiversity loss		13.5%
Asset bubble burst		12.7%

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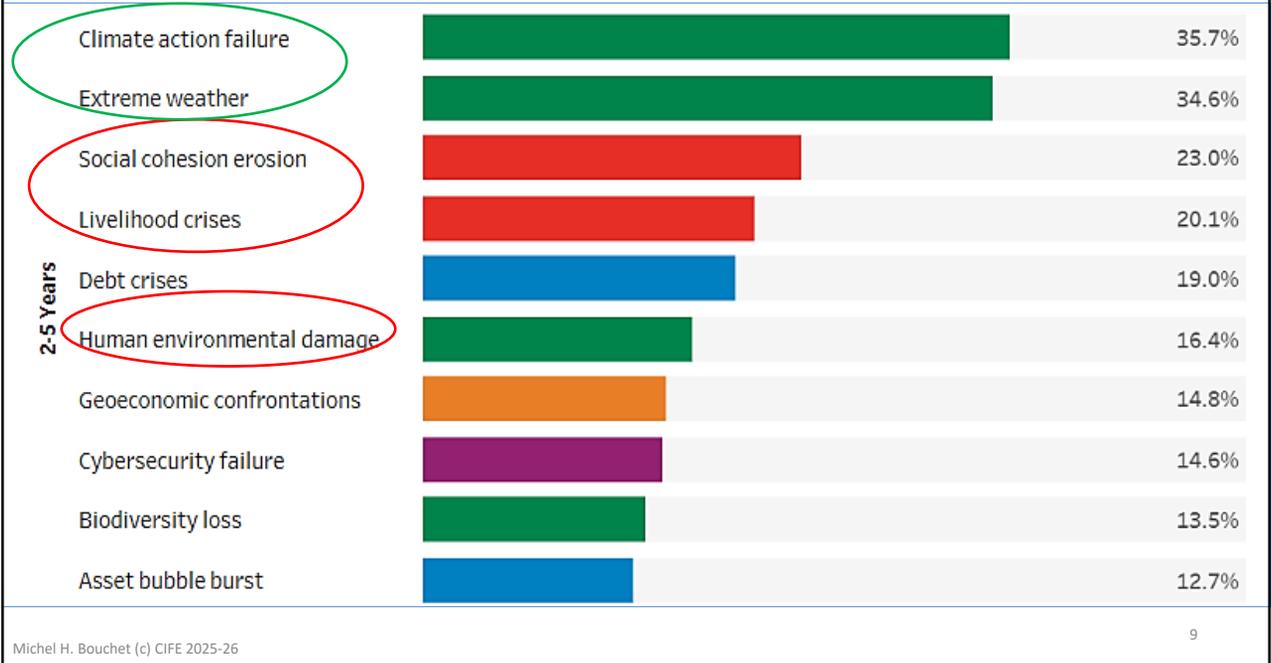
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WEF RISK PERCEPTIONS OVER 2-10 YEAR HORIZON

Source
World Economic Forum Global Risks
Perception Survey 2023-2024.

Note
Severity was assessed on a 1-7 Likert scale [1 – Low severity, 7 – High severity].

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162 COUNTRIES UNDER THE MAGNIFYING GLASS

A UNIQUE METHODOLOGY
- Macroeconomic expertise in assessing country risk
- Comprehension of the business environment
- Microeconomic data collected over 70 years of payment experience

BUSINESS DEFAULTING RISK | A1 VERY LOW | A2 LOW | A3 SATISFACTORY | A4 REASONABLE | B FAIRLY HIGH | C HIGH | D VERY HIGH | E EXTREME

UPGRADES   DOWNGRADES

COFACE GLOBAL RISK MAP 2024

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

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

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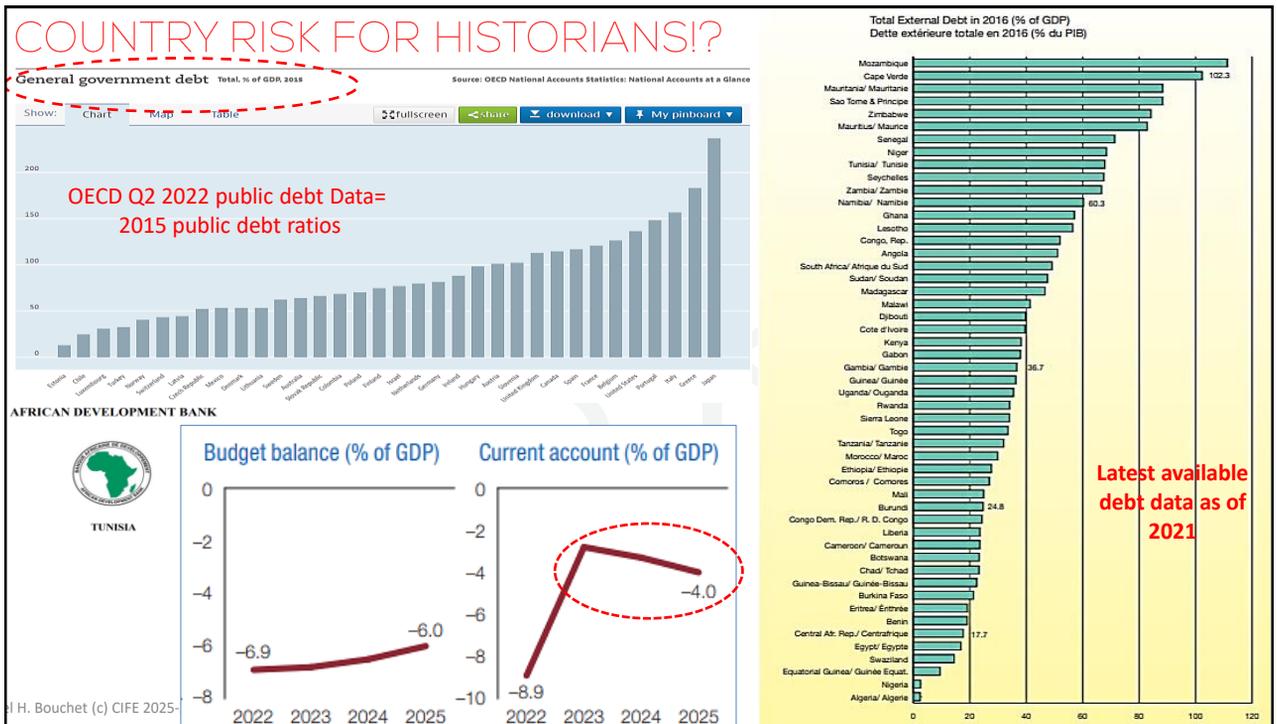
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RISK & UNCERTAINTY

►**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.

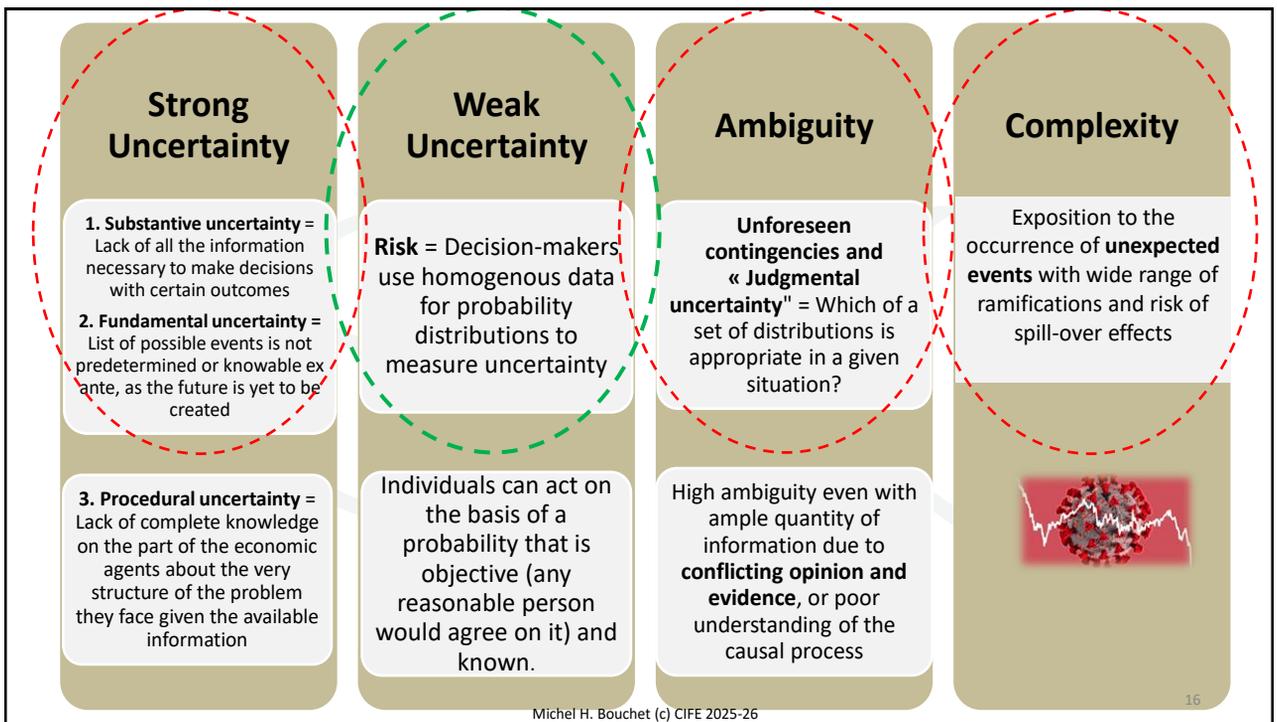But **risk diversification** and tolerance also matter!

►**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…)= secular stagnation?

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

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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 post-Brexit UK	Exchange rate depreciation	Inflation decrease; growth slowdown	Sharp fall in oil prices Corona Virus
Socio-political events	Revolution, strikes and coup d'état	New market-oriented and pro-business government	High rate of electoral abstention	Upcoming elections; mounting corruption
Financial events	Nationalization of banking system	Interest-rate increase	Over-valuation of tech companies QE & ultra-low rates	External debt default
Spill-over events	Regional crisis contamination	US economic recession	€/USD volatility	Regional competitive devaluations Systemic crisis

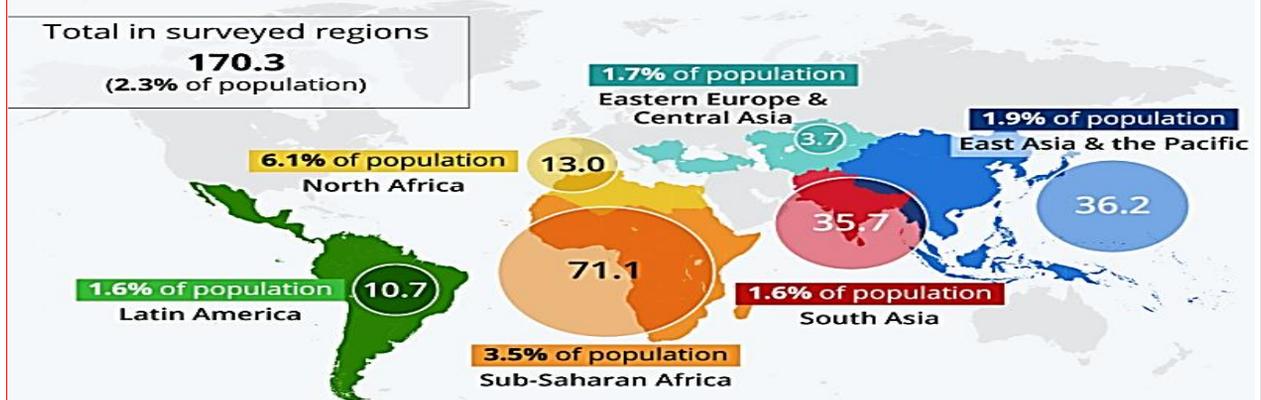Michel H. Bouchet (c) CIFE 2025-26

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ECONOMIC AND SOCIO-POLITICAL + REGIONAL CONTAMINATION

Climate Change, the Great Displacer

Average number of internal climate migrants by 2050 per region (in millions)*

Total in surveyed regions 170.3 (2.3% of population)

1.7% of population Eastern Europe & Central Asia 3.7
1.9% of population East Asia & the Pacific 36.2
6.1% of population North Africa 13.0
1.6% of population Latin America 10.7
71.1
35.7
1.6% of population South Asia
3.5% of population Sub-Saharan Africa

* Modeled on pessimistic reference = High emission & unequal development scenarios concerning water availability, crop productivity and sea-level rise
Source: World Bank

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THE DISCOVERY OF RISK

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XIII° CENTURY: GRADUAL SHIFT FROM CIRCULAR TIME TO LINEAR TIME

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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 +
secular progress

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THE « DISCOVERY » OF RISK

Pascal 1654

Fermat 1654

Leibniz 1703
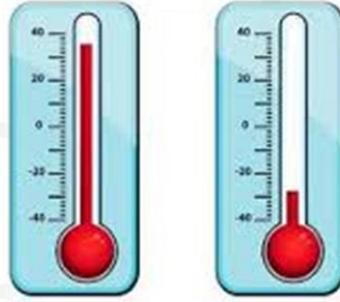
Markowitz 1959

M. Scholes 1990

B. Mandelbrot 1990

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THE DISCOVERY OF THE **MEASURE** 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 CRISIS

THE CANARI IN THE COAL MINE?

► IMF & WB + UN reports?
► Rating agencies?
► CDS prices?
► Stock market volatility
► Vix Index
► 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?
► Cife governance barometer?

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MEASURING « EXPECTED UNCERTAINTY »?

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MEASURING UNCERTAINTY IS CHALLENGING!

High levels of uncertainty can freeze investment and consumption, tank markets, and help spark a recession! The three main measures rely on textual analysis, financial markets, and business surveys.

1. **Text-based measures** (newspapers, country reports & official publications) show exceptionally high levels of uncertainty. The **Economic Policy Uncertainty index** (EPU-2016) analyzes articles in hundreds of newspapers for mentions of terms related to economics, policy, and uncertainty. The US EPU has typically surged during crises, spiking after 2008 financial crisis and 2020 COVID pandemic. In 2025, the EPU reached a record high, indicating extensive discussions of uncertainty in national and local newspapers.

To reduce media bias: **EIU-based World Uncertainty Index** (WUI).

2. **Financial-market-based measures** show only moderate levels of uncertainty at end-2025 despite trade and geopolitical tensions. Chicago Board Options Exchange Volatility Index (VIX) calculates the one-month-ahead implied volatility of the S&P 500 Index of US stocks, based on a basket of put and call options.

3. **Survey-based measures** (US Survey of Business Uncertainty SBU-Atlanta Federal Reserve Bank) which spiked during the pandemic, have largely flatlined.

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MEASURING UNCERTAINTY?

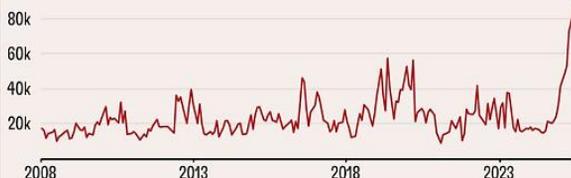Michel H. Bouchet (c) CIFE 202

Words point to turmoil

Text-based measures of uncertainty reach new heights in 2025.

US Economic Policy Uncertainty Index
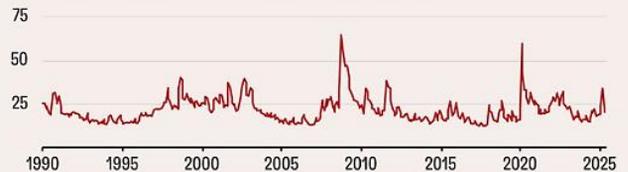
World Uncertainty Index

SOURCES: Baker, Bloom, and Davis 2016; and Ahir, Bloom, and Furceri 2022.
NOTE: An increase in the index means that uncertainty is rising and vice versa.
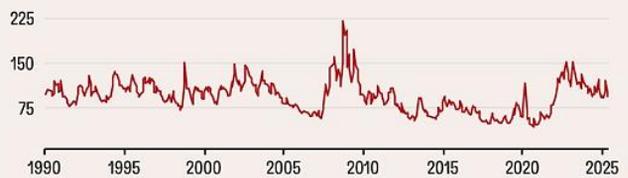
Markets stir, don't shake

Financial market measures signal modest rise in uncertainty.

Chicago Board Options Exchange Volatility Index (VIX)

Intercontinental Exchange Bank of America MOVE Index

SOURCES: Federal Reserve Economic Data; and Haver Analytics.
NOTE: The VIX measures expected stock market volatility and reflects investor fear about equity markets; the MOVE Index gauges volatility in US Treasury bond markets.

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## MEASURING « EXPECTED GLOBAL ECONOMIC UNCERTAINTY » 2007-25

Monthly Index with 3 underlying components

1. EIU coverage of policy-related economic uncertainty.
2. number of federal tax code provisions set to expire in future years.
3. disagreement among economic forecasters as a proxy for uncertainty.

World Uncertainty Index
Uncertainty surged again following Russia's invasion of Ukraine.
(Index, GDP weighted average)
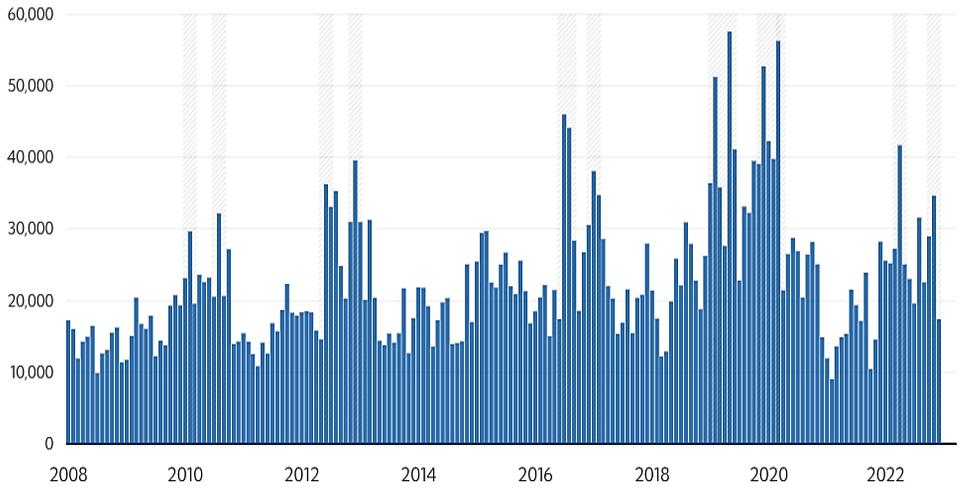
Michel H. Bouchet (c) CIFE 2025-26   Source= IMF, Stanford, Chicago + Northwestern-Kellog School universities (143 countries)   29
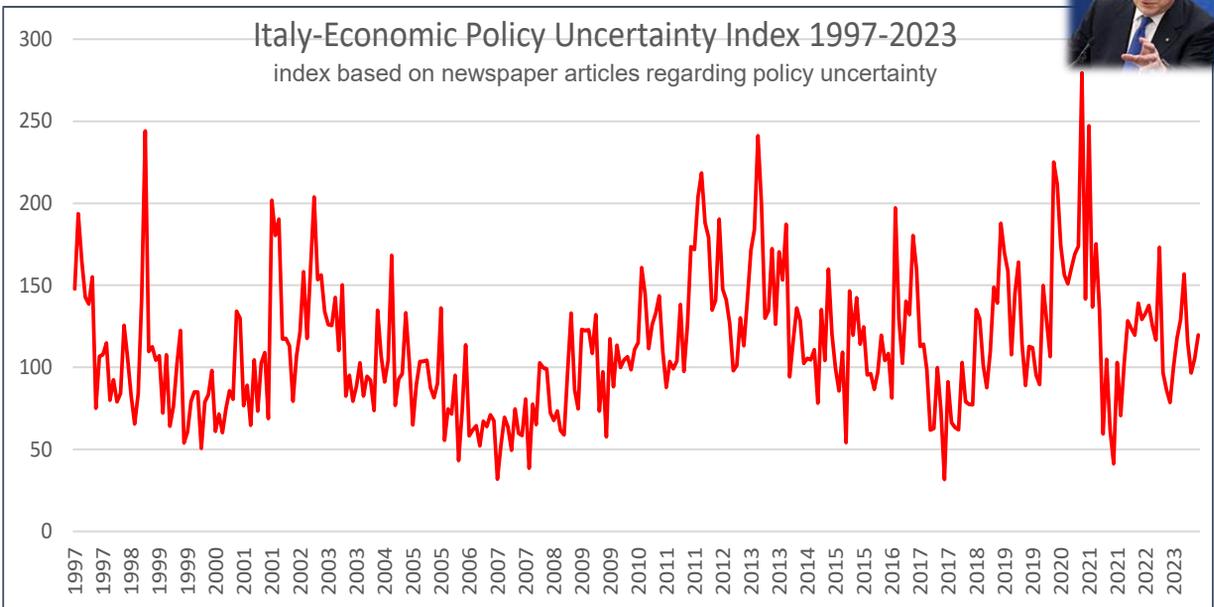
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THE UPS AND DOWNS OF ECONOMIC POLICY RISK & UNCERTAINTY

Italy-Economic Policy Uncertainty Index 1997-2023
index based on newspaper articles regarding policy uncertainty


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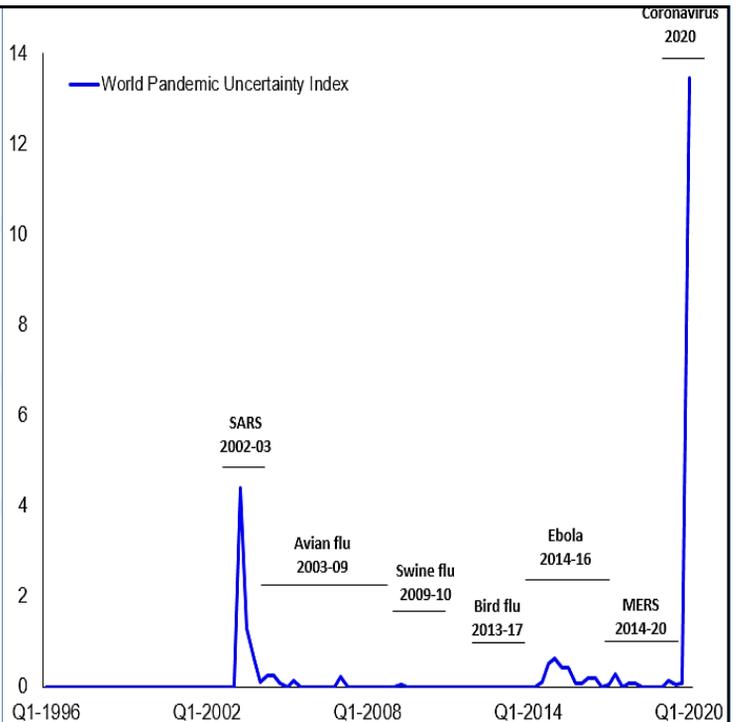
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THE GEOPOLITICAL RISK INDEX

MONTHLY INDEX OF GEOPOLITICAL RISK COUNTING THE OCCURRENCE OF WORDS RELATED TO GEOPOLITICAL TENSIONS IN 11 LEADING INTERNATIONAL NEWSPAPERS. THE INDEX IS NORMALIZED TO AVERAGE A VALUE OF 100 IN THE 2000-2009 DECADE. KEY INPUTS = GEOPOLITICAL RISK, MILITARY-RELATED TENSIONS, NUCLEAR TENSIONS. WAR THREATS AND TERRORIST THREATS, TERRORIST ACTS OR THE BEGINNING OF A WAR.

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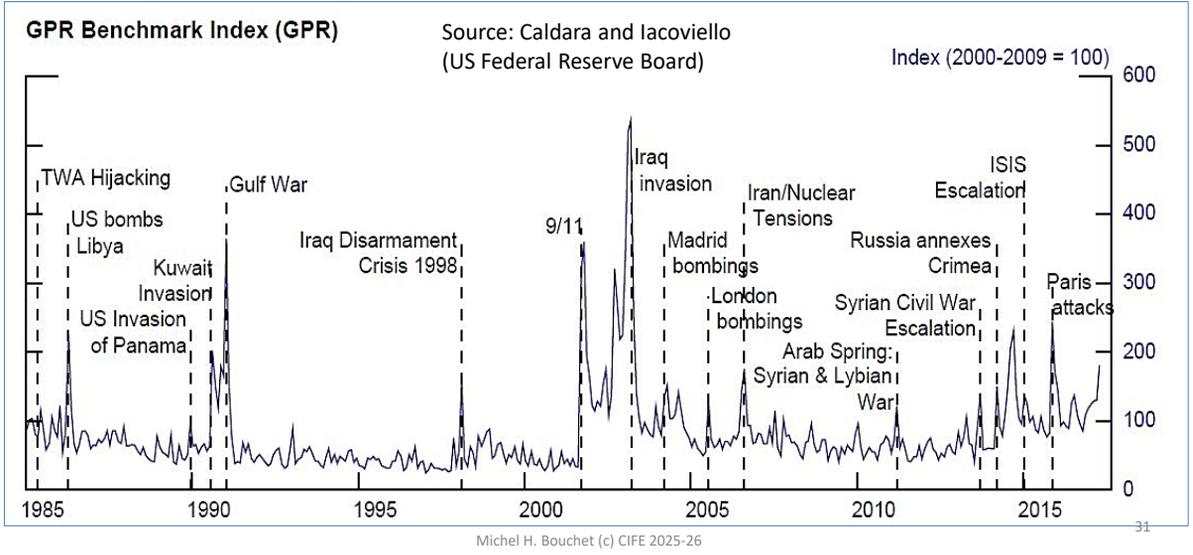
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THE WORLD PANDEMIC UNCERTAINTY INDEX 1996-2020

Note: The WPUI is the number of times that a word out of 100,000 in a given EIU country report mentions the word uncertainty near a word related to pandemics or epidemics. A higher number means higher global uncertainty around pandemics/epidemics and vice-versa. The numbers for 2020Q1 are based on the reports for March or the latest available. The WPUI is a sub-index of the World Uncertainty Index (https://worlduncertaintyindex.com/).

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VIX INDEX IN PERSPECTIVE: 2015-2021

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VOLATILITY INDEX : EX-**POST** CRISIS -OUTBREAK SIGNAL

S&P 100 implied volatility index
Index level

3/18/2020 level

Source: Bloomberg. March 18, 2020.

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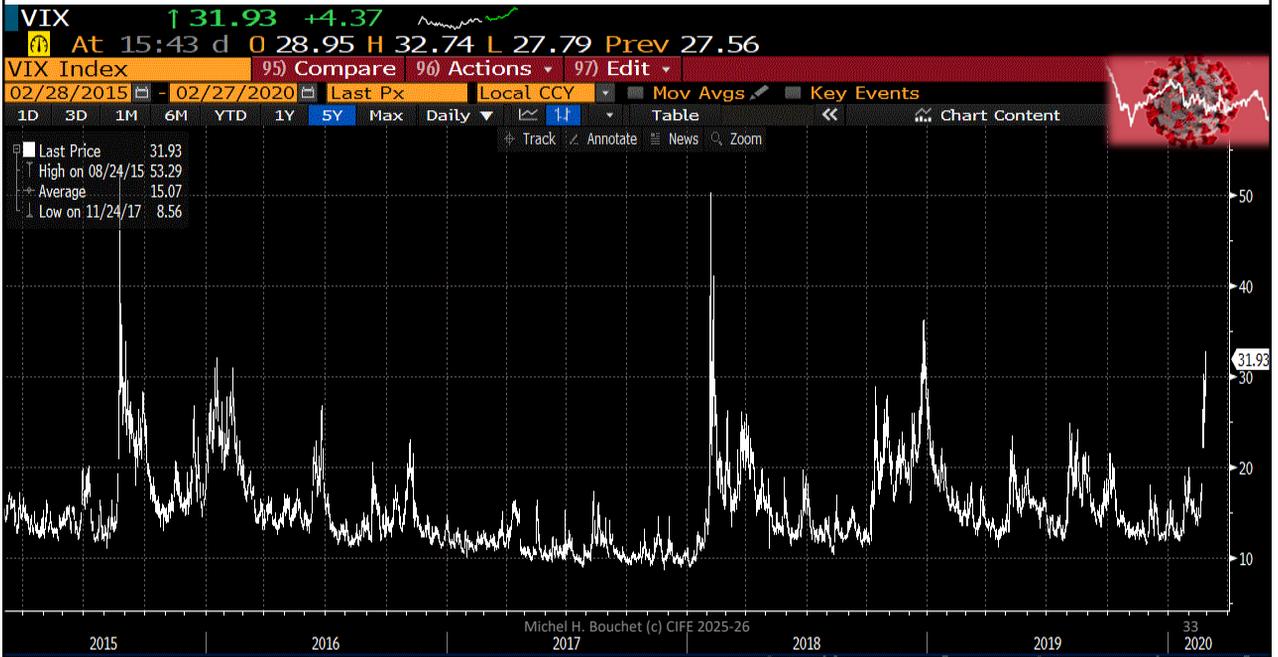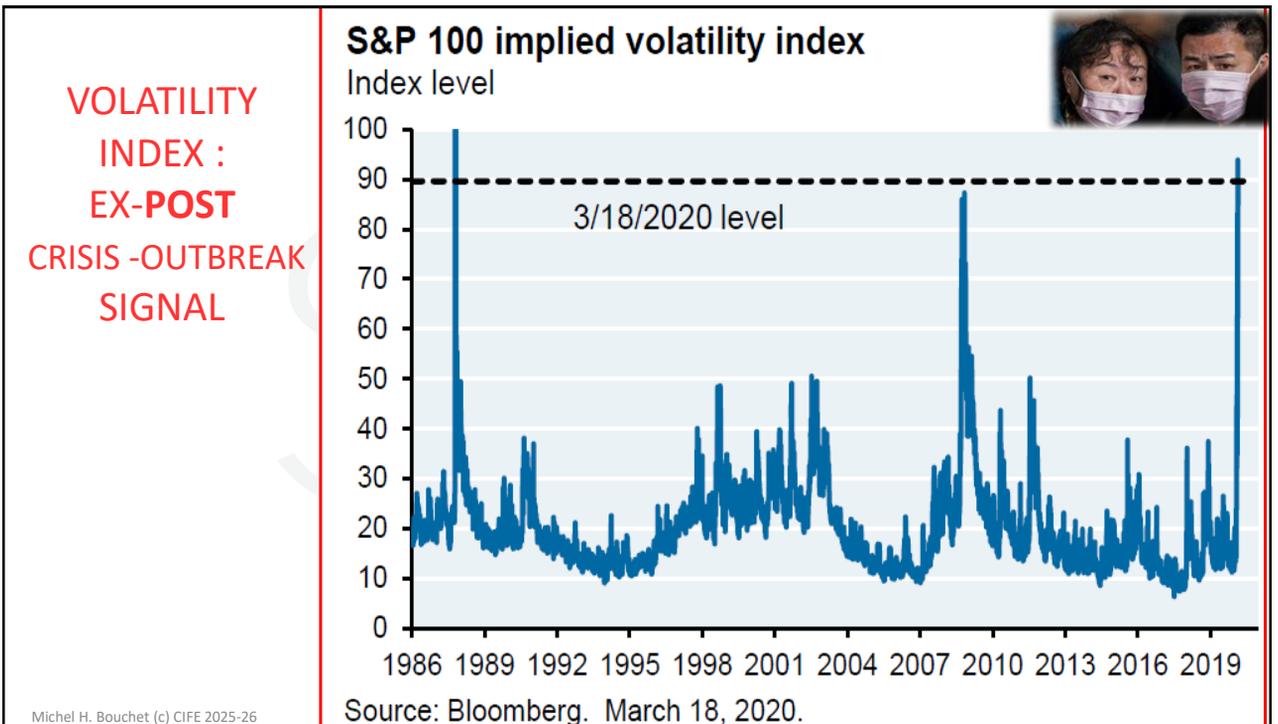
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CHALLENGE? HOW PREDICTING AN ABRUPT **SOCIO-POLITICAL CRISIS**?

Liquidity indicators

▶ Inflation
▶ Foreign-exchange reserves
▶ interest rates differential
▶ Non-compressible import cover
▶ Debt servicing ratio and current account deficit

➢ **Socio-political and behavioral indicators**
▪ Corruption and institutional weaknesses
▪ 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)
▶ Worsening terms of trade
▶ Productivity's protracted weakness

➢ **Exogenous and global indicators**
• Systemic crisis
• Regional crisis contagion
• Commodity prices
• $ Exchange rate volatility

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THE COMPLEXITY OF FINANCIAL RISK!

Cost to protect against Turkish debt default abruptly jumps
Five year CDS spread (basis points)

Source: Refinitiv
© FT

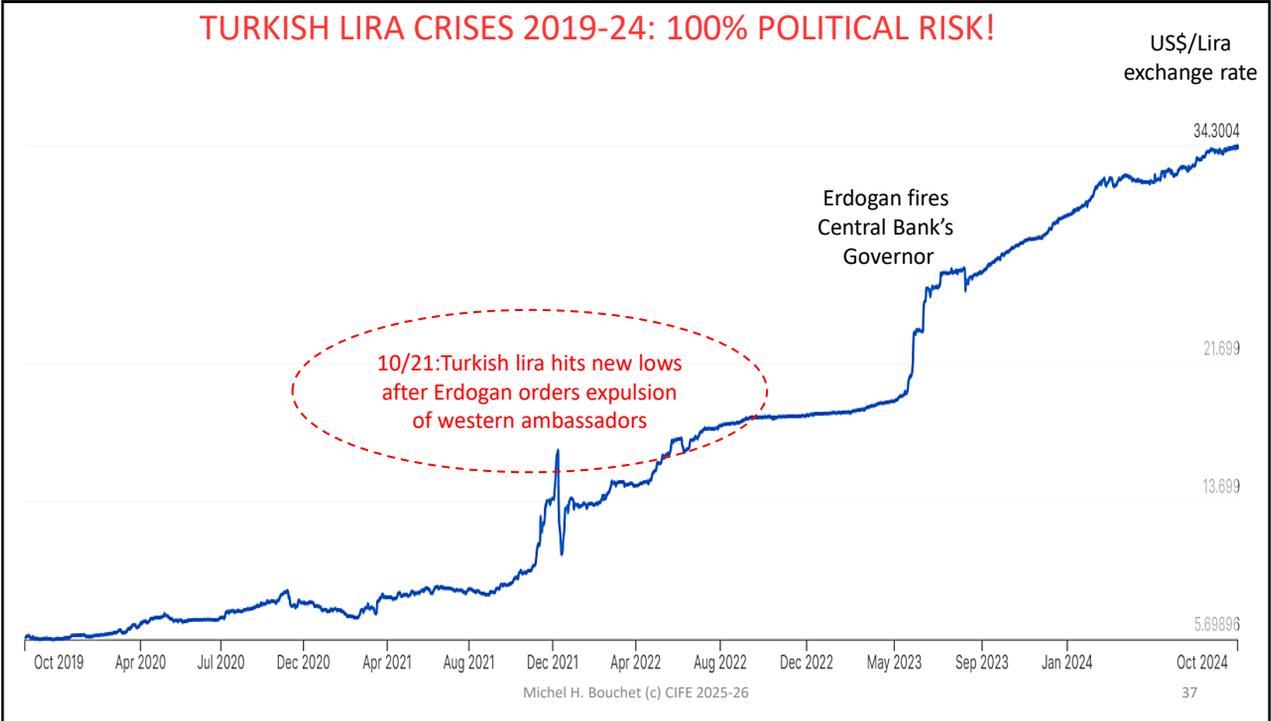Naci Agbal in his office in February 2021, and his successor, Sahap Kavcioglu, less than two months later © Reuters
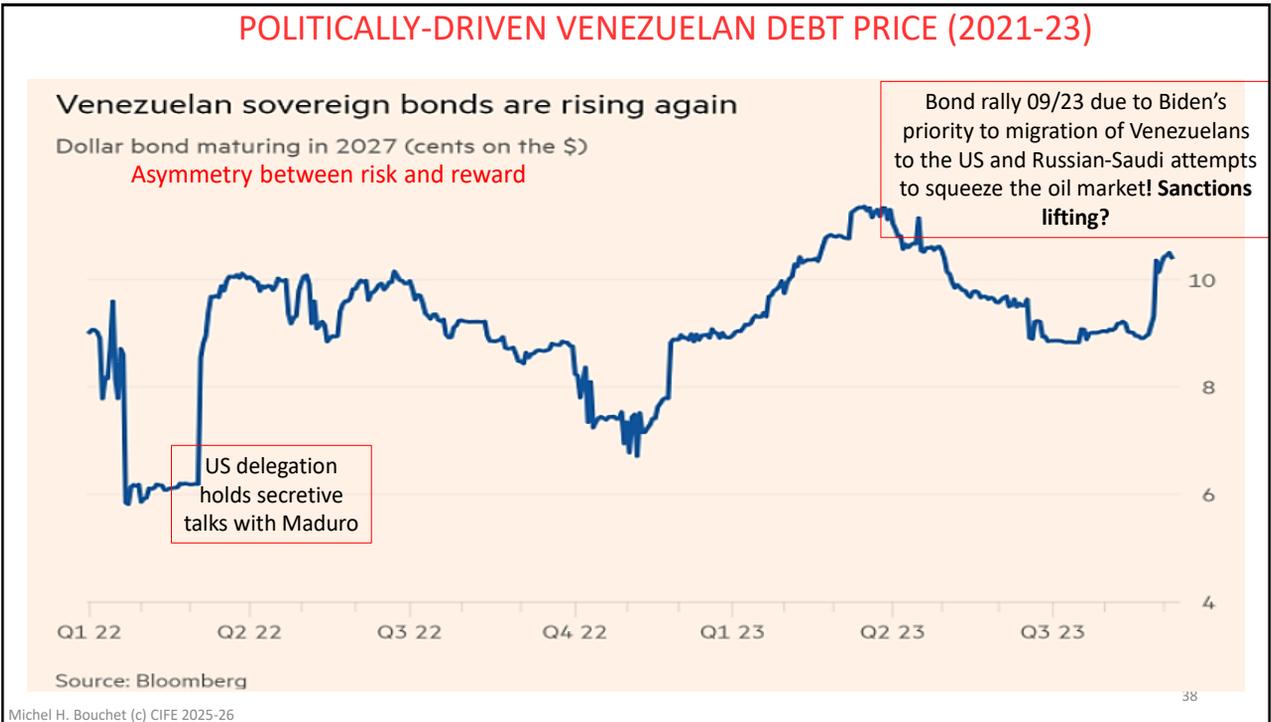

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TURKISH LIRA CRISES 2019-24: 100% POLITICAL RISK!

US$/Lira
exchange rate

34.3004

Erdogan fires
Central Bank's
Governor

21.699

10/21:Turkish lira hits new lows
after Erdogan orders expulsion
of western ambassadors

13.699

5.69896

Oct 2019 Apr 2020 Jul 2020 Dec 2020 Apr 2021 Aug 2021 Dec 2021 Apr 2022 Aug 2022 Dec 2022 May 2023 Sep 2023 Jan 2024 Oct 2024

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POLITICALLY-DRIVEN VENEZUELAN DEBT PRICE (2021-23)

Venezuelan sovereign bonds are rising again

Dollar bond maturing in 2027 (cents on the $)

Asymmetry between risk and reward

Bond rally 09/23 due to Biden's
priority to migration of Venezuelans
to the US and Russian-Saudi attempts
to squeeze the oil market**! Sanctions
lifting?**

10

US delegation
holds secretive
talks with Maduro

8

6

4

Q1 22   Q2 22   Q3 22   Q4 22   Q1 23   Q2 23   Q3 23

Source: Bloomberg

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BUT 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
- ► Institutional weaknesses
- ► Growth slowdown
- ► Inflation rise

= « Gaussian law »

Abrupt turmoil and crisis

- ➢ War
- ➢ Coup d'état and Revolution
- ➢ Pandemic crisis (Ebola, HIV, Covid-19)
- ➢ Commodity crisis
- ➢ Sharp Exchange rate devaluation
- ➢ Bank run
- ➢ Global virus contamination
- ➢ Debt crisis and default
- ➢ Nationalization & confiscation

= « Fat tails and Black swans »

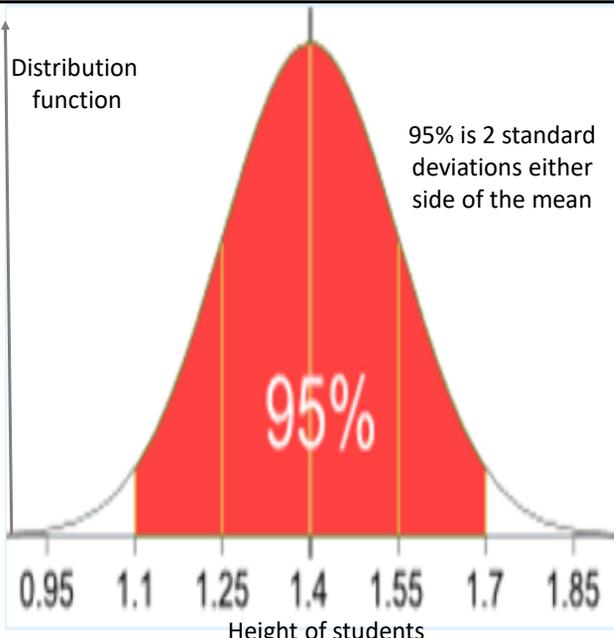Michel H. Bouchet (c) CIFE 2025-26   39

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BELL-SHAPED CURVE NORMAL DISTRIBUTION AND FAT TAILS?

As the number of discrete events increases, the function looks like a normal distribution Values < one standard deviation away from the mean account for 68% of the set

Distribution function

95% is 2 standard deviations either side of the mean

95%

| 0.95 | 1.1 | 1.25 | 1.4 | 1.55 | 1.7 | 1.85 |

Height of students
Solvency ratios
Current account deficits

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## WHAT ABOUT RARE BUT CONSEQUENTIAL RISK AND FAT TAILS?

►Measuring average height

We select randomly two persons on earth and their total height is … 4 m

What is the most likely correlation between them??

►Measuring growth inequality within and between rich and poor nations?

We select randomly two persons on earth and their combined income is $40 million: What is the most likely correlation between them?

Globally an additional 88 million to 115 million people fell into extreme poverty in 2020, a number that could rise to 150 million in 2021-22.

Probability

Normal Distribution

Fat-Tailed Distribution
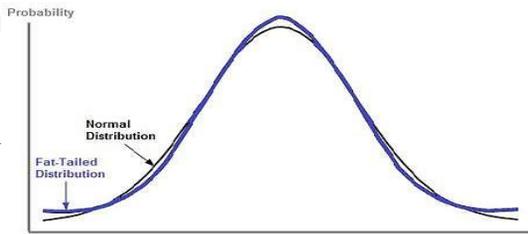
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FAT TAILS: OUTSIDE THE COMFORT OF THE « BELL CURVE »

Good morning Britain. This is what happened to your currency while you were asleep.

Sterling dives into uncharted waters
Daily moves in the UK pound vs the US dollar (%)

June 23, 2016

1971   80   90   2000   10   16

Source: FT John Authers

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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 come from a small number of observations with a very large impact!

➢ **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. Their occurrences **can be diagnosed ex-ante**, bringing back responsibility and accountability.
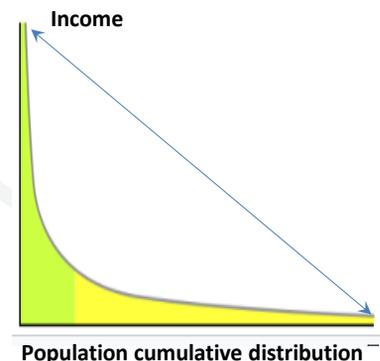
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POWER LAWS AND EXTREME RISKS?

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
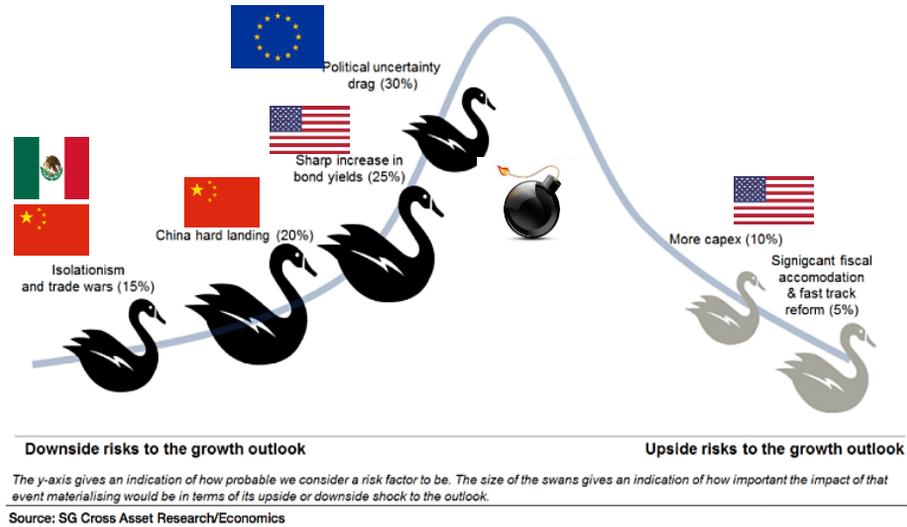

Income
Population cumulative distribution

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

SG Swan Chart

Political uncertainty drag (30%)

Sharp increase in bond yields (25%)

China hard landing (20%)

Isolationism and trade wars (15%)

More capex (10%)

Signigcant fiscal accomodation & 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 materialising would be in terms of its upside or downside shock to the outlook.

Source: SG Cross Asset Research/Economics

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CONCLUSION

▶ **Transforming information into knowledge & economic intelligence = Best risk mitigation strategy!**

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COFACE + UNDP + TI + WORLD BANK= BETTER OFF IN ITALY OR IN SPAIN?

ITALY
▶ GDP Per capita ppp= $43000
▶ HDI= 29
▶ Life expectancy f = 85,5
▶ Infant mortality= 3/1000
▶ Gender inequality: 0,07
▶ Doing Business= **58/190**
▶ Corruption = **52/180** ⬆

▶ **Debt/GDP = 135%**
▶ **Unemployment = 6%**
▶ **Budget Deficit: -3%**

SPAIN
▶ GDP Per capita ppp=$41000
▶ HDI= 28
▶ Life expectancy f= 86
▶ Infant mortality= 2,5/1000
▶ Gender inequality: 0,07
▶ Doing Business= **30/190**
▶ Corruption = **46/180** ⬇

▪ **Debt/GDP 2025 = 103%**
▪ **Unemployment= 11%**
▪ **Budget Deficit = -2,7%**

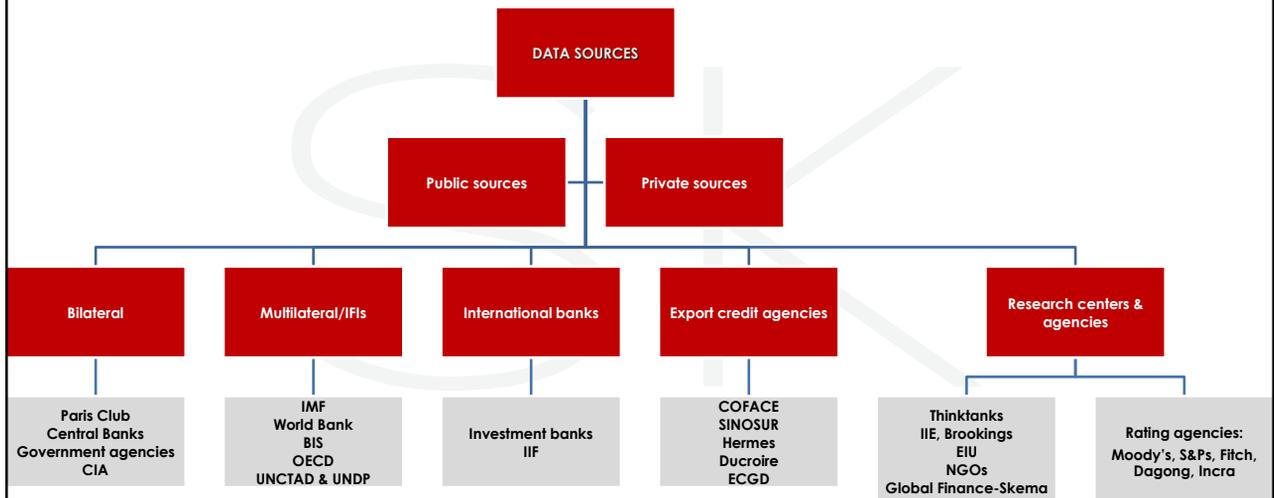Michel H. Bouchet (c) CIFE 2025-26   48

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COUNTRY RISK ASSESSMENT IN AN AGE OF GLOBALIZATION?

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

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MAJOR SOURCES OF COUNTRY RISK INTELLIGENCE

DATA SOURCES

Public sources — Private sources

Bilateral	Multilateral/IFIs	International banks	Export credit agencies	Research centers & agencies	
Paris Club Central Banks Government agencies CIA	IMF World Bank BIS OECD UNCTAD & UNDP	Investment banks IIF	COFACE SINOSUR Hermes Ducroire ECGD	Thinktanks IIE, Brookings EIU NGOs Global Finance-Skema	Rating agencies: Moody's, S&Ps, Fitch, Dagong, Incra

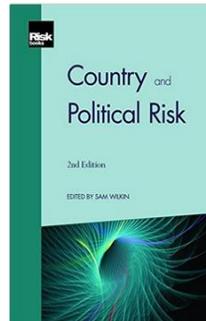Michel H. Bouchet (c) CIFE 2025-26   50
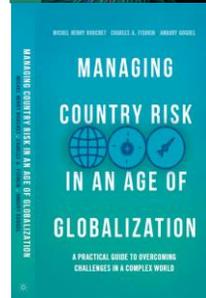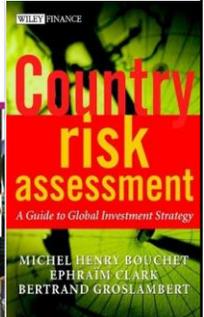
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INFORMATION SOURCES & ANALYSIS

IMF, World Bank, IFC & MIGA
UNCTAD & UNDP
Fed Reserve Bk of St Louis
BIS, OECD, EBRD, EIB
Coface, Euler-Hermes
Moody's, S&P, Fitch, Dagong
Euromoney, Institutional Investor
CIA & US State Dept, ICRG
Transparency International
Hiscox, AON, Control Group
DEFI www.developingfinance.org

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Hello CIFE students! HELP!
I need a *quick* risk assessment of Morocco vs Tunisia and Algeria… !
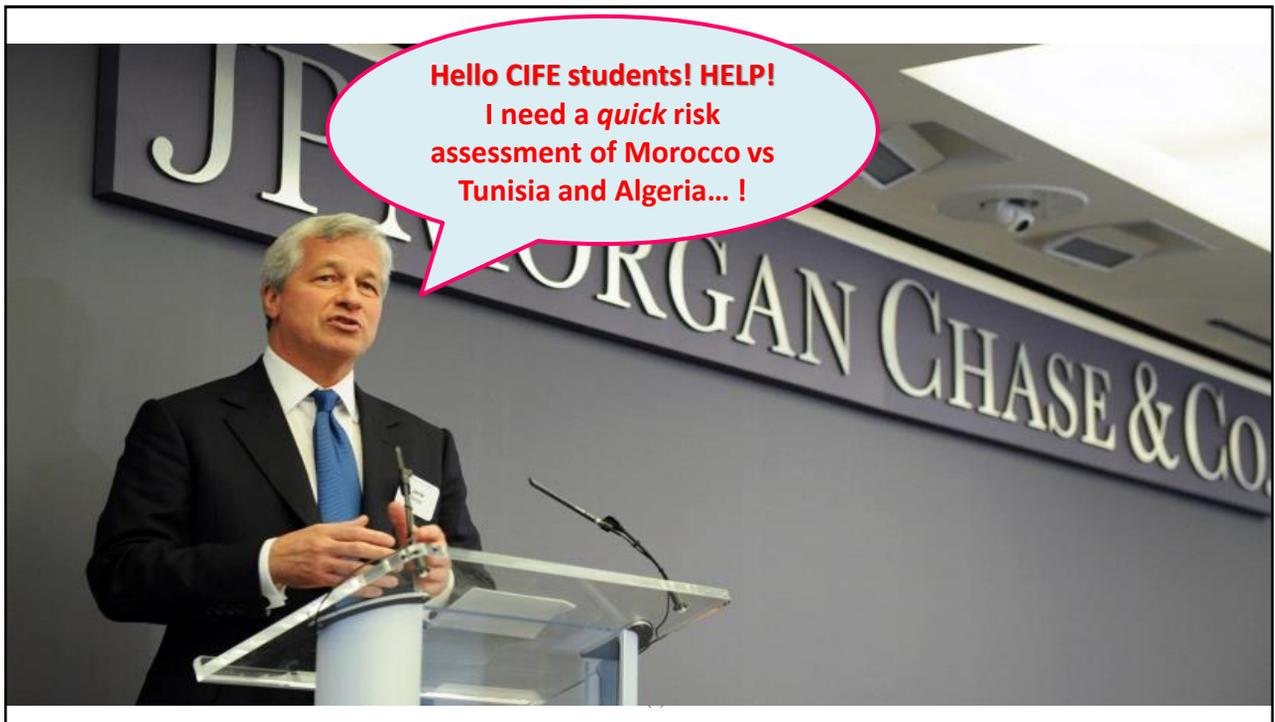
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COFACE + UNDP + TI + WORLD BANK= BETTER OFF IN TUNISIA, MOROCCO OR ALGERIA?

TUNISIA	ALGERIA	MOROCCO
▶ GDP Per capita = $10700	▶ GDP Per capita=$11800	▶ GDP per capita ppp= $8300
▶ HDI= 101	▶ HDI= 93	▶ HDI = 120
▶ Life expectancy f = 75	▶ Life expectancy f= 76	▶ Life expectancy= 73
▶ Infant mortality= 13/1000	▶ Infant mortality= 22/1000	▶ Gender inequality = **0,49**
▶ Gender inequality: 0,28	▶ Gender inequality: 0,43	▶ Infant mortality= **23,7/1000**
▶ Doing Business= **78/190**	▶ Doing Business= **157/190**	▶ Doing Business = **53/190**
▶ CPI Corruption = 92/180	▶ CPI Corruption = **107/180**	▶ CPI corruption= **99/180**
▶ MDPov Index: 2,8% of pop	▶ MDPov Index: 4%	▶ MDPov Index: 11%

UNDP: Pop vulnerable to muldimentional poverty

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