

CIFE Centre international de formation européenne
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WHAT IS COUNTRY RISK ALL ABOUT IN AN AGE OF GLOBALIZATION & PANDEMIC CRISIS?



CIFE SEMINAR NICE MAY 6-8, 2020
MICHEL-HENRY BOUCHET

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«YESTERDAY'S» COUNTRY RISK

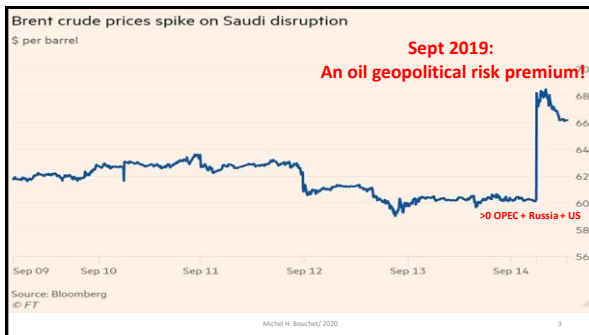
► Cross-border risk =
Assessment of a foreign entity's ability and willingness to meet its external obligations in full and on time

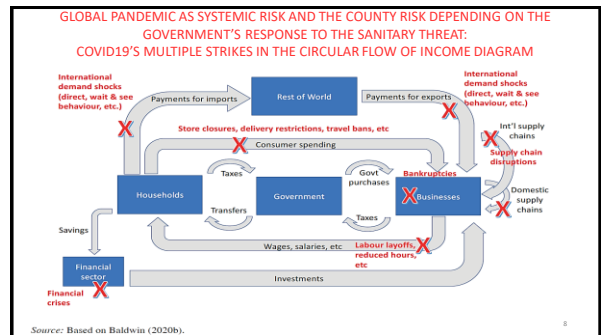
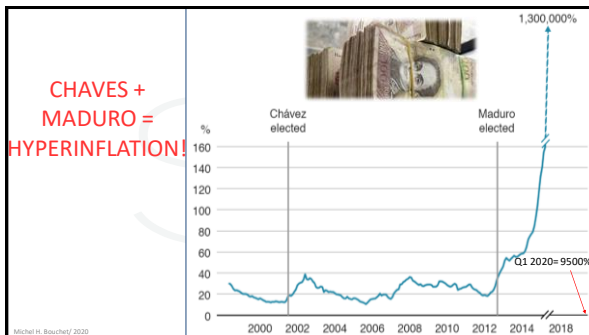
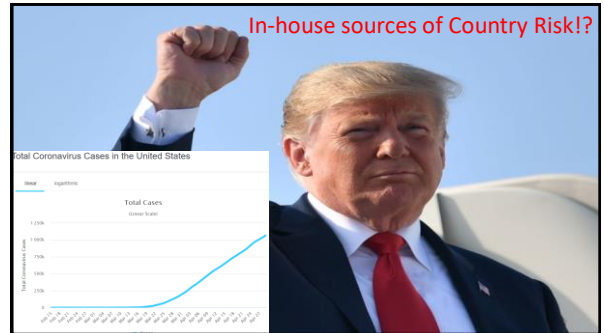
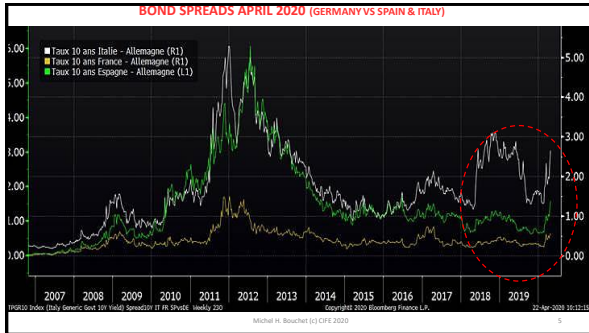
Foreign entity? Private firm, debtor country government, bank, investment fund, supplier, client, partner...

Country risk is composed of a complex combination of political, financial and macro-economic risk

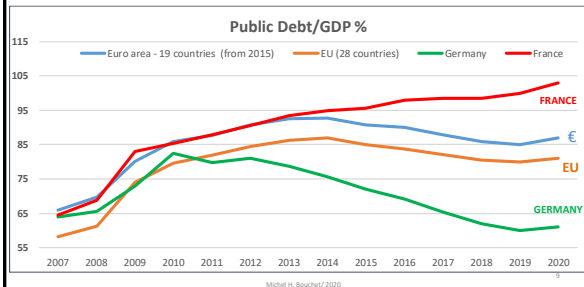
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2020 OECD PUBLIC DEBT/GDP %



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

Operational definition:

Set of interdependent factors, specific to a country in the global economy, which can affect both foreign and domestic agents

- Factors? Economic, financial, environmental, sanitary and socio-political
- Domestic agents? Private firms, households, banks, merchants, fund managers, exporters and importers, students...
- Foreign agents? Debtor country government, central bank, bank, supplier, client, partner...
- Country risk is composed of a complex combination of risks 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 US-North Korea; sharp rise in interest rates and fall in bond prices; fall in oil prices; pandemic corona crisis; stock market crash; large weakening of USD; trade retaliation by Mexico, China, and Canada; mounting trade and geopolitical tensions with China and Russia



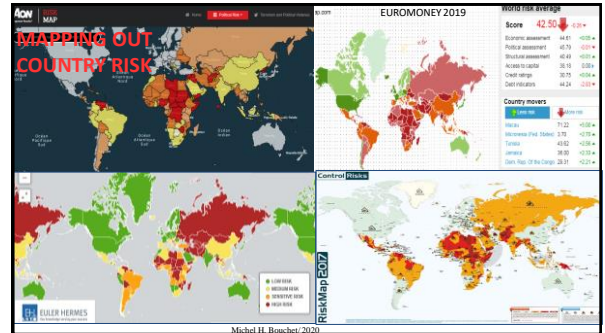
Indirect «Surrounding Risks»

- Risk materialization stems from a more hostile environment: protracted Corona virus crisis; stalemate between White House and Congress regarding budgetary policy and National Security Strategy; ongoing saber-rattling with North Korea, Iran, and Pakistan; regional crisis in the Western Hemisphere and in the Middle East; protracted failed NAFTA renegotiations

Collateral «Soft Risks»

- Risk materialization as byproduct of unfavorable interactions between power groups: impeachment of Donald Trump; global protectionism; geopolitical volatility; mounting wealth gap; pressure groups and hostile NGOs; lagged institutional reaction to covid-19 crisis

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TACKLING COUNTRY RISK

COUNTRY + RISK

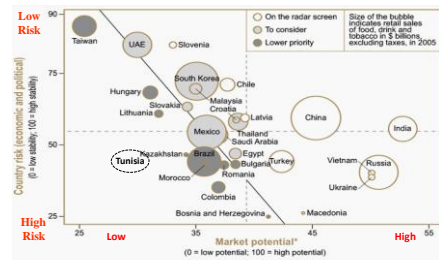
- **Country** = sovereign entity, culture and values, geographical distance, national laws and regulations, socio-political parameters
- **Risk** = lack of perfect information in real time, spill-over effect, abrupt changes



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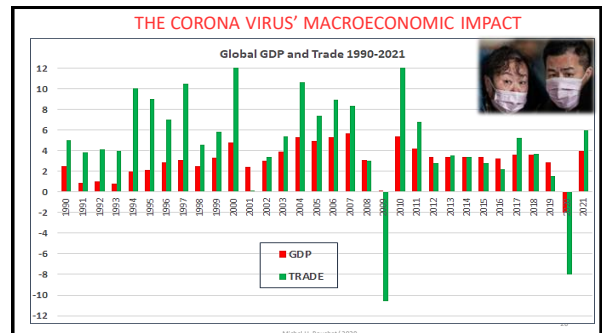
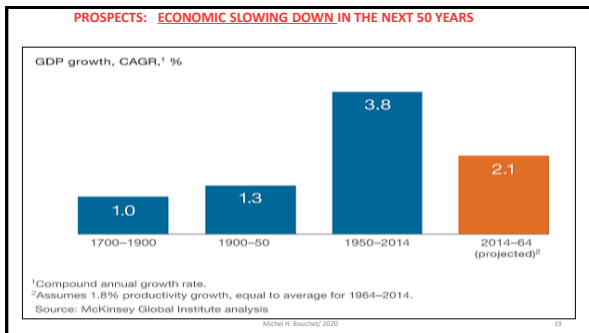
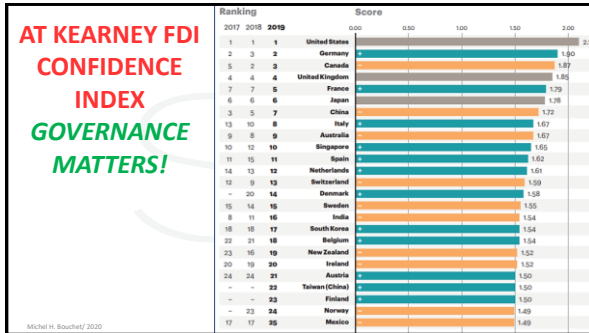
MOST ATTRACTIVE EMERGING MARKETS? = COMBINING RISK EXPOSURE + MARKET OPPORTUNITIES

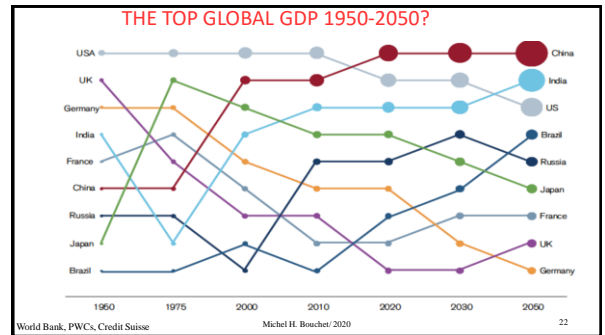
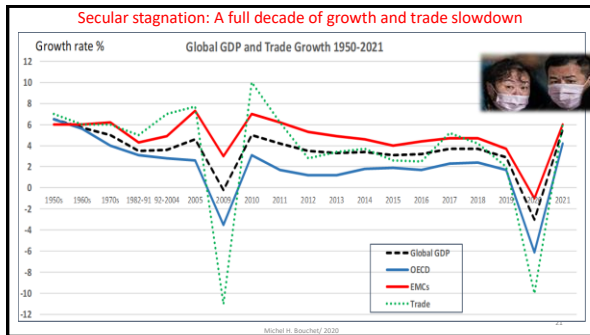


¹ Based on weighted score of market attractiveness, market saturation and time pressure scores

Source: A.T. Kearney

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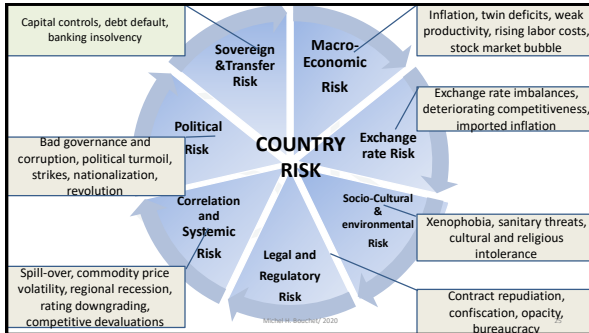
THE KEY COMPONENTS OF COUNTRY RISK?

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5 MAIN APPROACHES TO COUNTRY RISK ASSESSMENT

1. **Qualitative « macro » approach:** financial, macroeconomic, legal, regulatory, environmental (incl. sanitary) and political parameters
2. **External debt analysis:** Balance of payments + liquidity and solvency
3. **Quantitative approach :** rating, ranking, and scoring
4. **Market signals:** yields, spreads, CDS, Vix
5. **Econometric approach** and modelization

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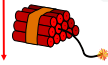


MAIN COMPONENTS OF GLOBAL RISK

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

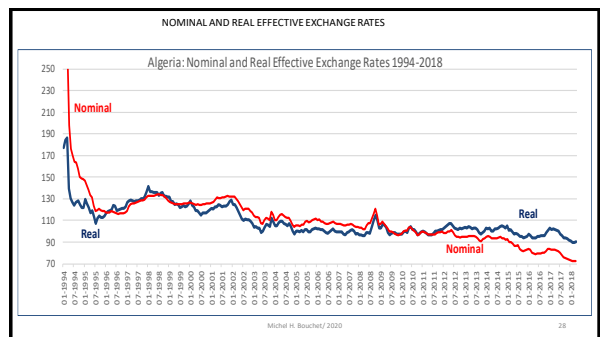
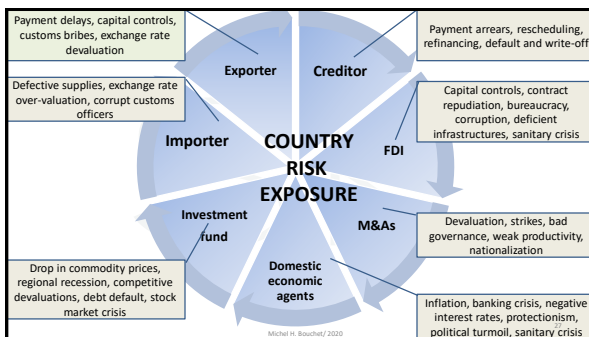
Quantifiable
but ultimately
judgmental

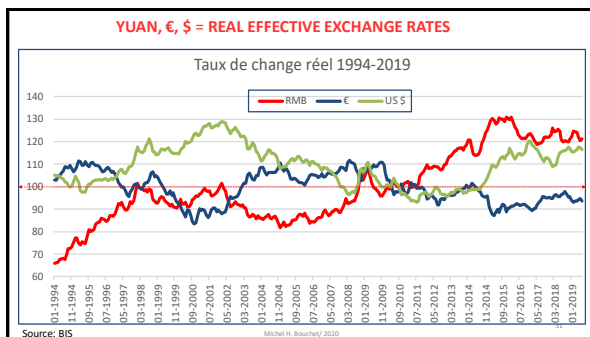
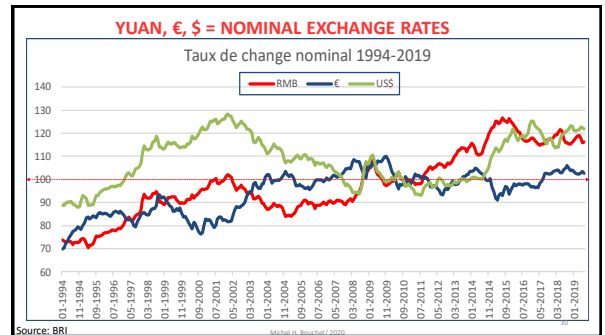
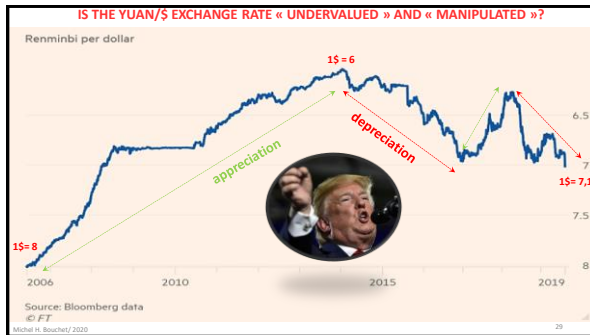
Subjective,
insurable and
diversifiable



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BETTER OFF IN TUNISIA, MOROCCO OR ALGERIA?



TUNISIA

- ▶ GDP Per capita = \$10500
- ▶ HDI= 97
- ▶ Life expectancy f= 78
- ▶ CA/GDP%= -10%
- ▶ Doing Business= **80**
- ▶ Corruption = 74
- ▶ Coface = C/B



ALGERIA

- ▶ GDP Per capita=13500
- ▶ HDI= 83
- ▶ Life expectancy f= 75
- ▶ CA/GDP%= -12%
- ▶ Doing Business= **157/190**
- ▶ Corruption = **112**
- ▶ Coface = C/C



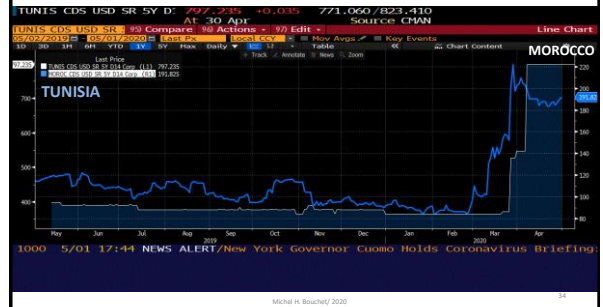
MOROCCO

- ▶ GDP per capita ppp= \$8000
- ▶ HDI = 123
- ▶ Life expectancy= 76
- ▶ CA/GDP% = -5%
- ▶ Doing Business = **60**
- ▶ CPI corruption= 81
- ▶ FDI= Tunisia * 2 (=2,4% GDP)
- ▶ Coface = A4/A4

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THE PRICE OF COUNTRY RISK = 5 YEAR CDS TUNISIA VS MOROCCO



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BOLIVIA

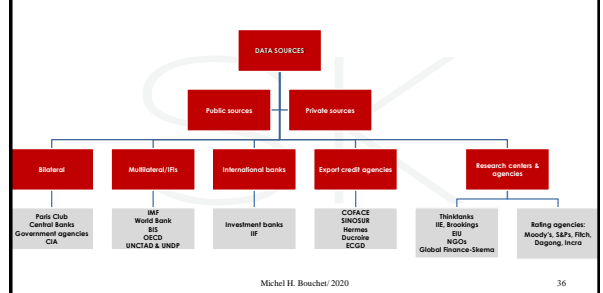


- ▶ GDP per capita ppp= \$7500
- ▶ HDI = 118
- ▶ Life expectancy= 68
- ▶ CPI corruption= 112
- ▶ CA/GDP% = -8%
- ▶ Doing Business = **156/190**
- ▶ FDI = **minimal**
- ▶ Coface = C/B

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MAJOR SOURCES OF COUNTRY RISK INTELLIGENCE



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ANALYSIS AND INFORMATION SOURCES

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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