

WHAT IS COUNTRY RISK ALL ABOUT IN AN AGE OF GLOBALIZATION & PANDEMIC CRISIS?



CIFE SEMINAR NICE APRIL, 2021
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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

Brent crude prices spike on Saudi disruption

\$ per barrel

Sept 2019:
An oil geopolitical risk premium!



Source: Bloomberg
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THE ABRUPT RISE IN CDS PRICES APRIL 2020

NIGERIA CDS USD SR 5Y **1006.67** **-0.05** 988.30 / 1025.03
At 24 Apr Source CMAN



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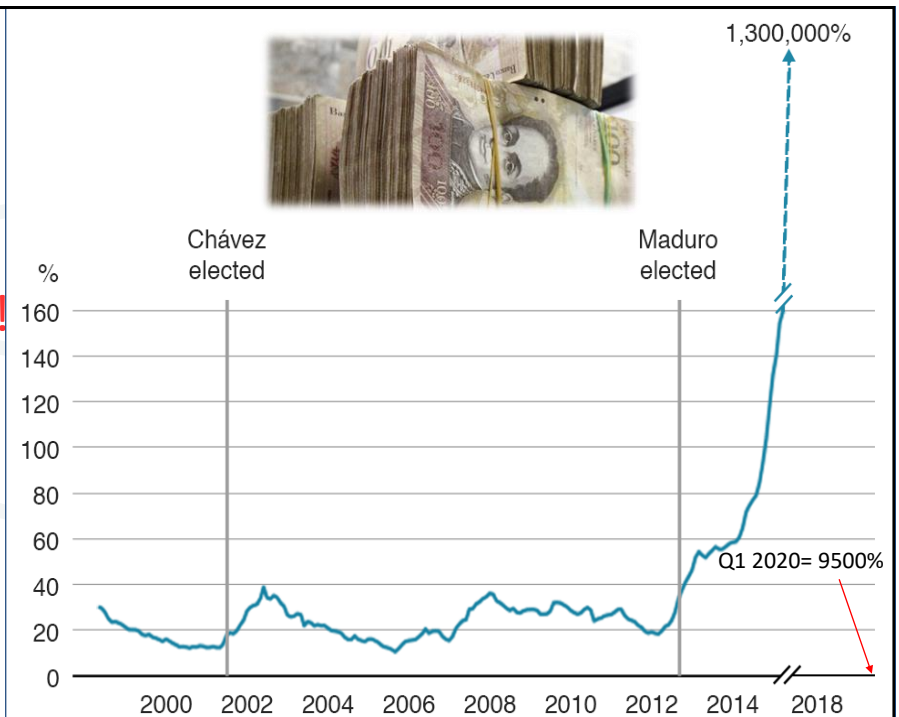
BOND SPREADS APRIL 2020 (GERMANY VS SPAIN & ITALY)



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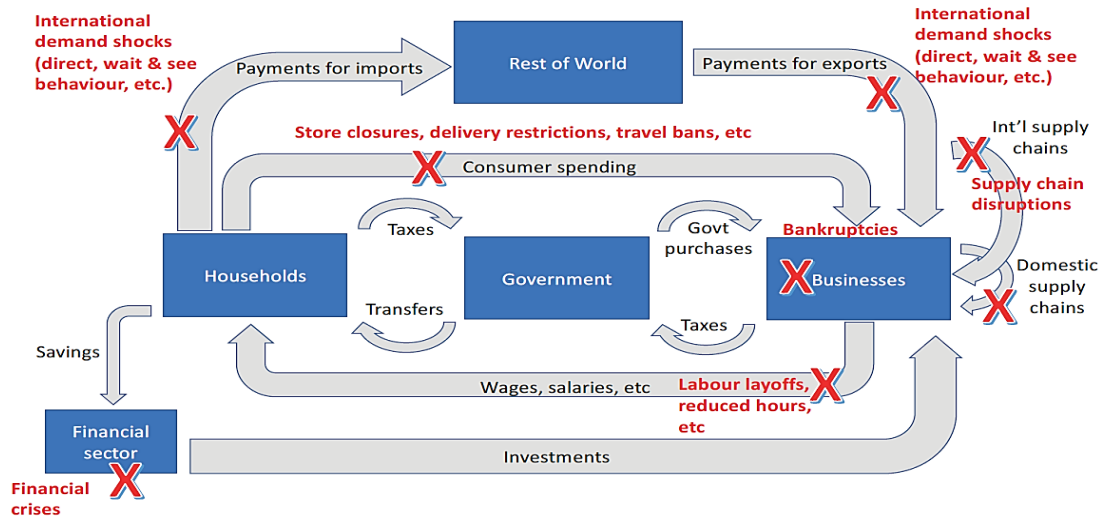
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**CHAVES +
MADURO =
HYPERINFLATION!**



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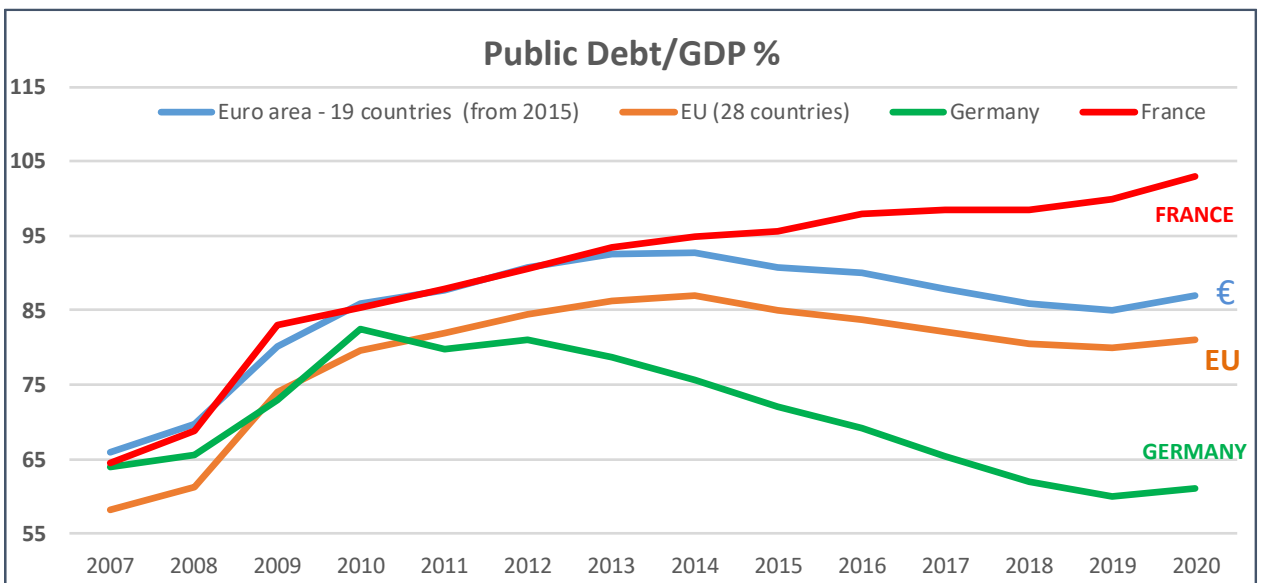
**GLOBAL PANDEMIC AS SYSTEMIC RISK AND COUNTRY RISK DEPENDING ON THE GOVERNMENT'S RESPONSE TO THE SANITARY THREAT:
COVID19'S MULTIPLE STRIKES IN THE CIRCULAR FLOW OF INCOME DIAGRAM**



Source: Based on Baldwin (2020b).

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2021 OECD PUBLIC DEBT/GDP %



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

Operational definition:

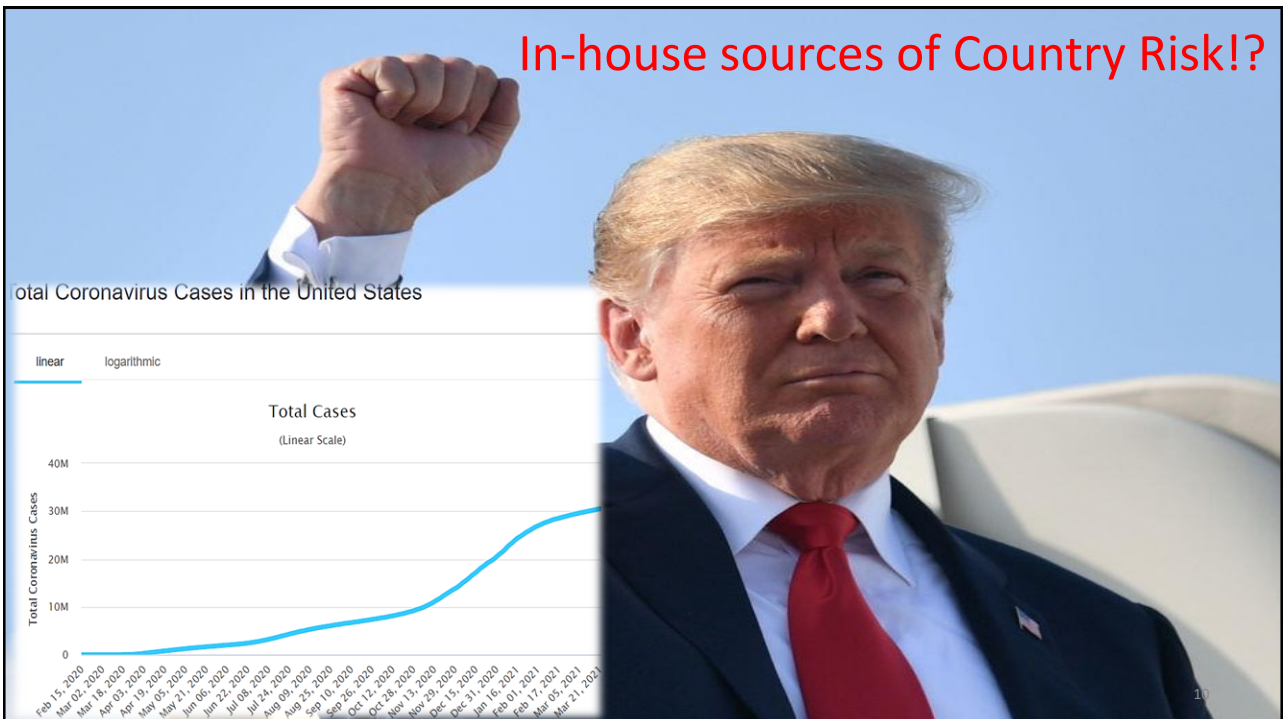
Set of interdependent factors, specific to a country in the global economy, which can affect both foreign and domestic agents

- 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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In-house sources of Country Risk!?



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»

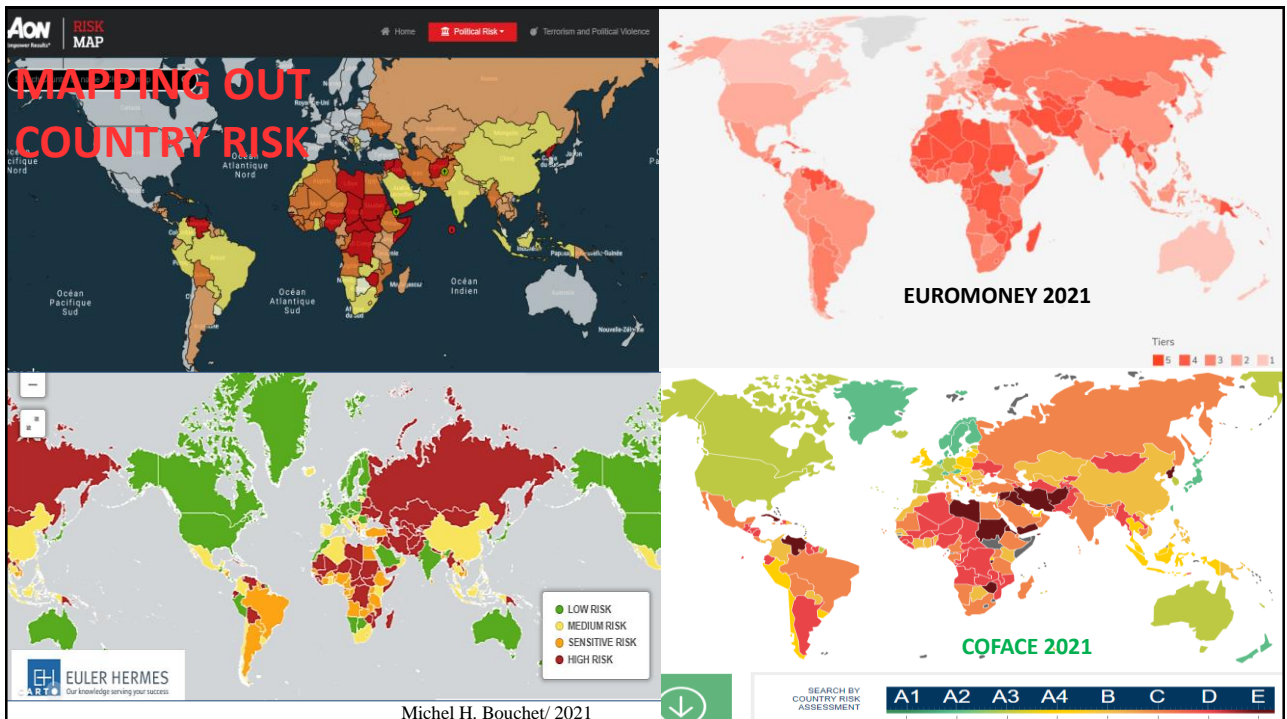
- **Risk materialization stems from a more hostile environment:** protracted Corona virus crisis; stalemate between White House and Congress regarding budgetary policy and National Security Strategy; ongoing saber-rattling with North Korea, Iran, and Pakistan; regional crisis in the Western Hemisphere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

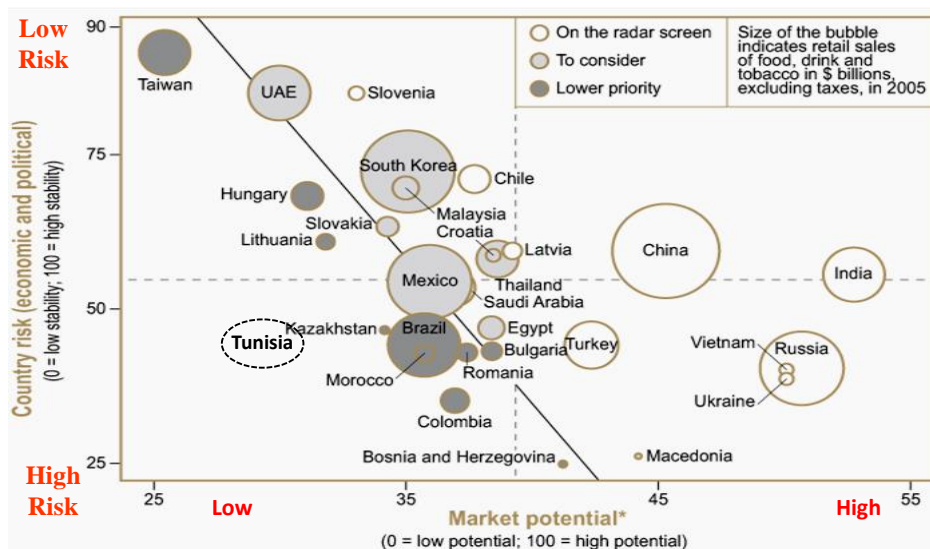


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MOST ATTRACTIVE EMERGING MARKETS?

= COMBINING RISK EXPOSURE + MARKET OPPORTUNITIES

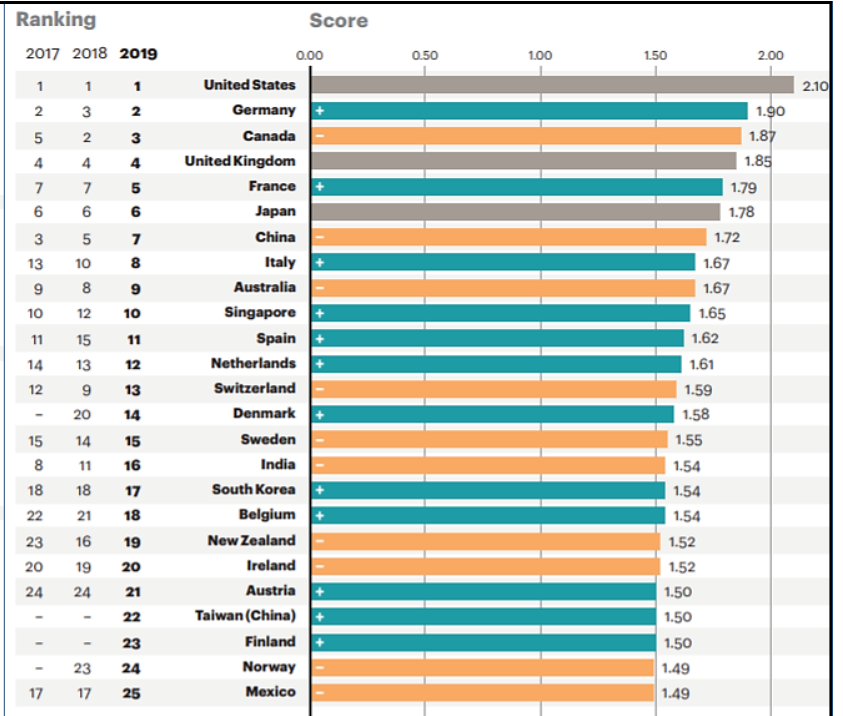


* Based on weighted score of market attractiveness, market saturation and time pressure scores
Source: A.T. Kearney

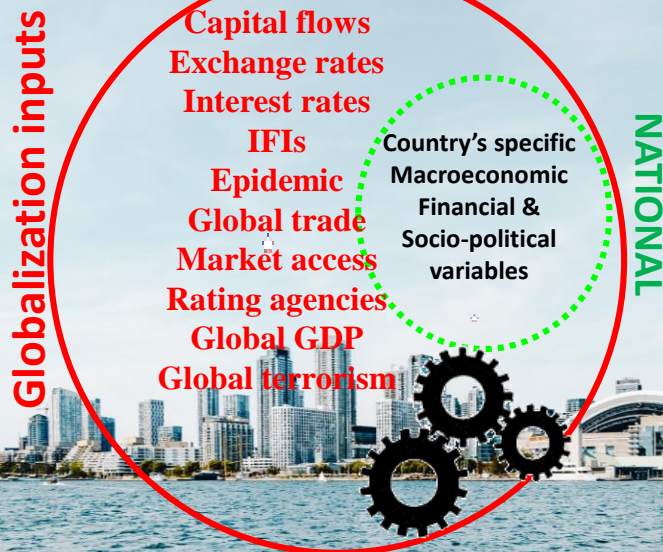
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AT KEARNEY FDI CONFIDENCE INDEX GOVERNANCE MATTERS!

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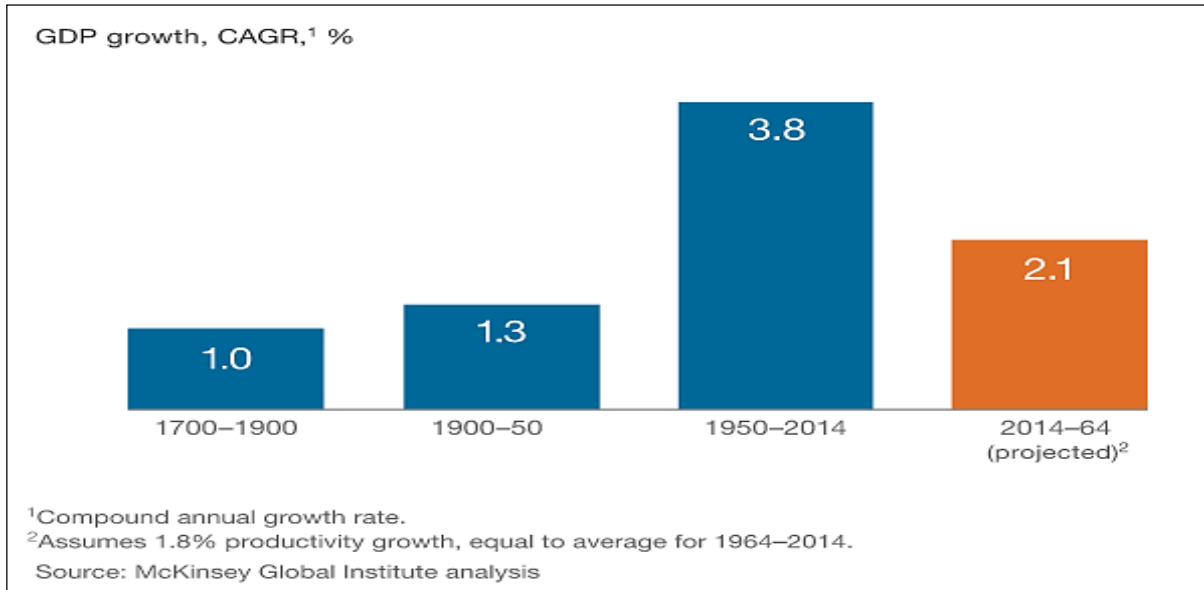
INTERPLAY OF COUNTRY RISK WITH THE GLOBAL MARKET ECONOMY



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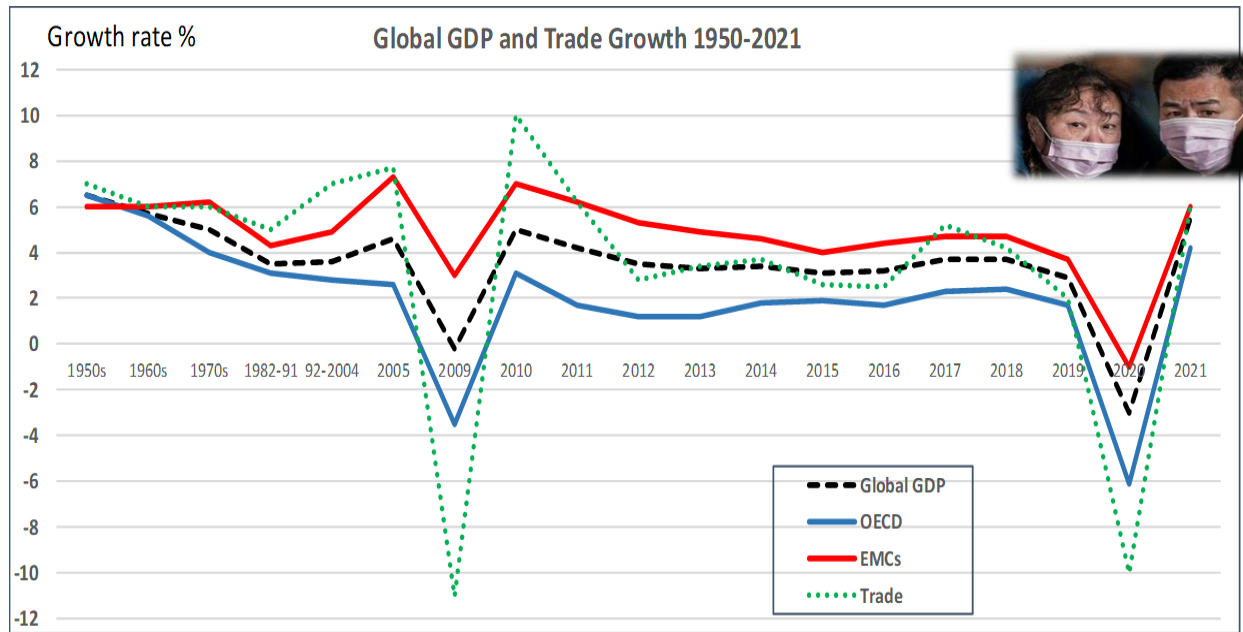
PROSPECTS: ECONOMIC SLOWING DOWN IN THE NEXT 50 YEARS



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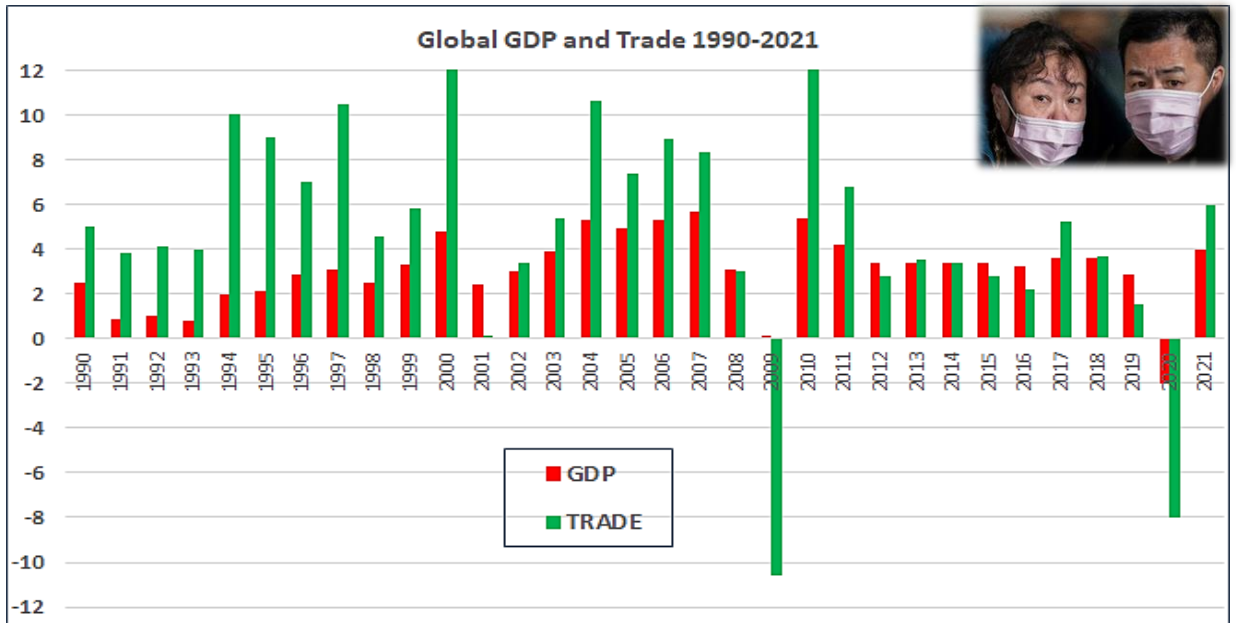
Secular stagnation: A full decade of growth and trade slowdown



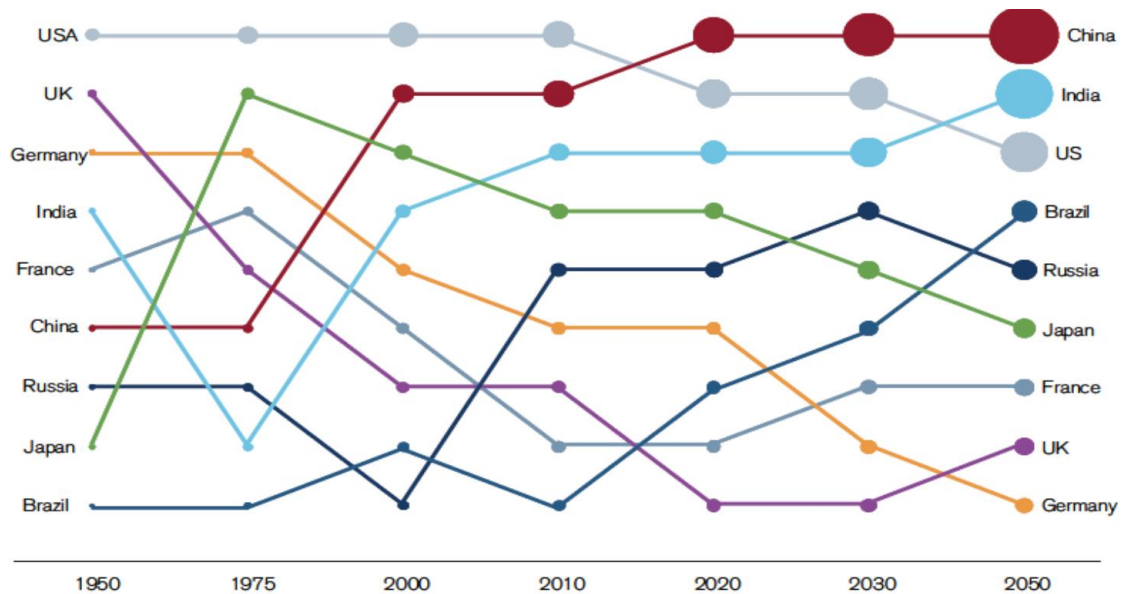
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THE CORONA VIRUS' MACROECONOMIC IMPACT



THE TOP GLOBAL GDP 1950-2050?



THE KEY COMPONENTS OF COUNTRY RISK?



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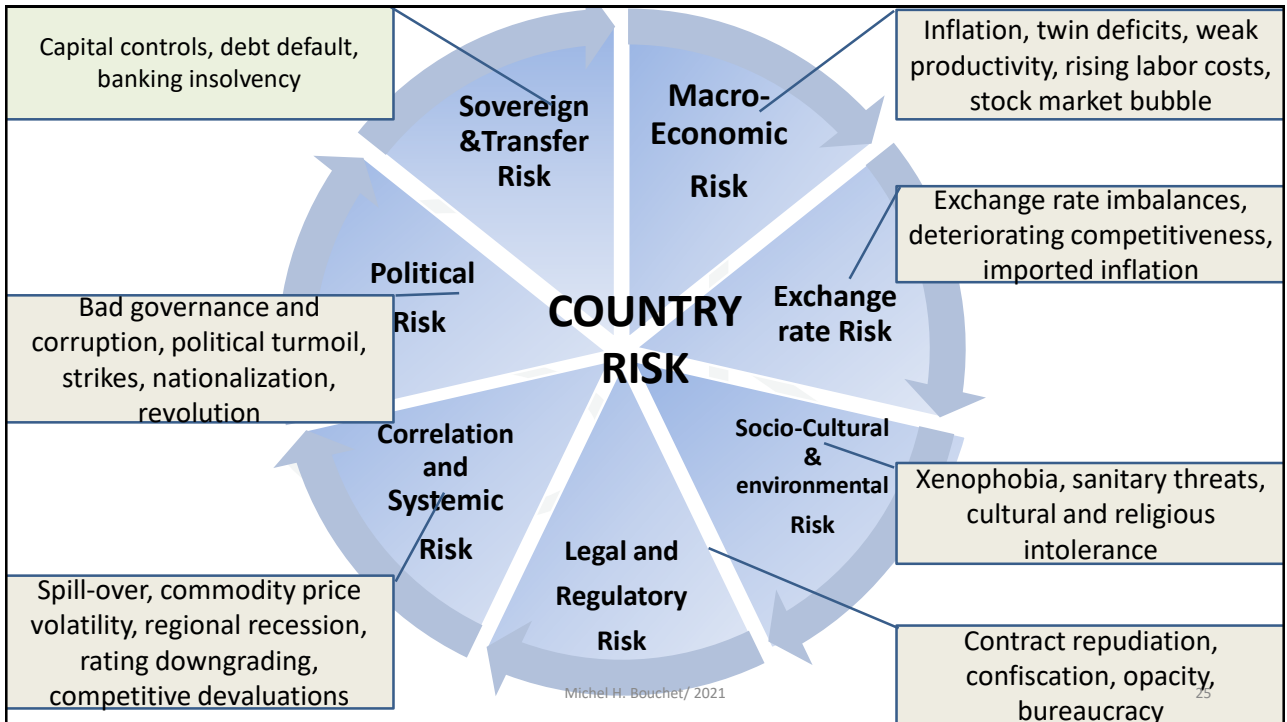
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5 MAIN APPROACHES TO COUNTRY RISK ASSESSMENT

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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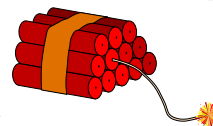


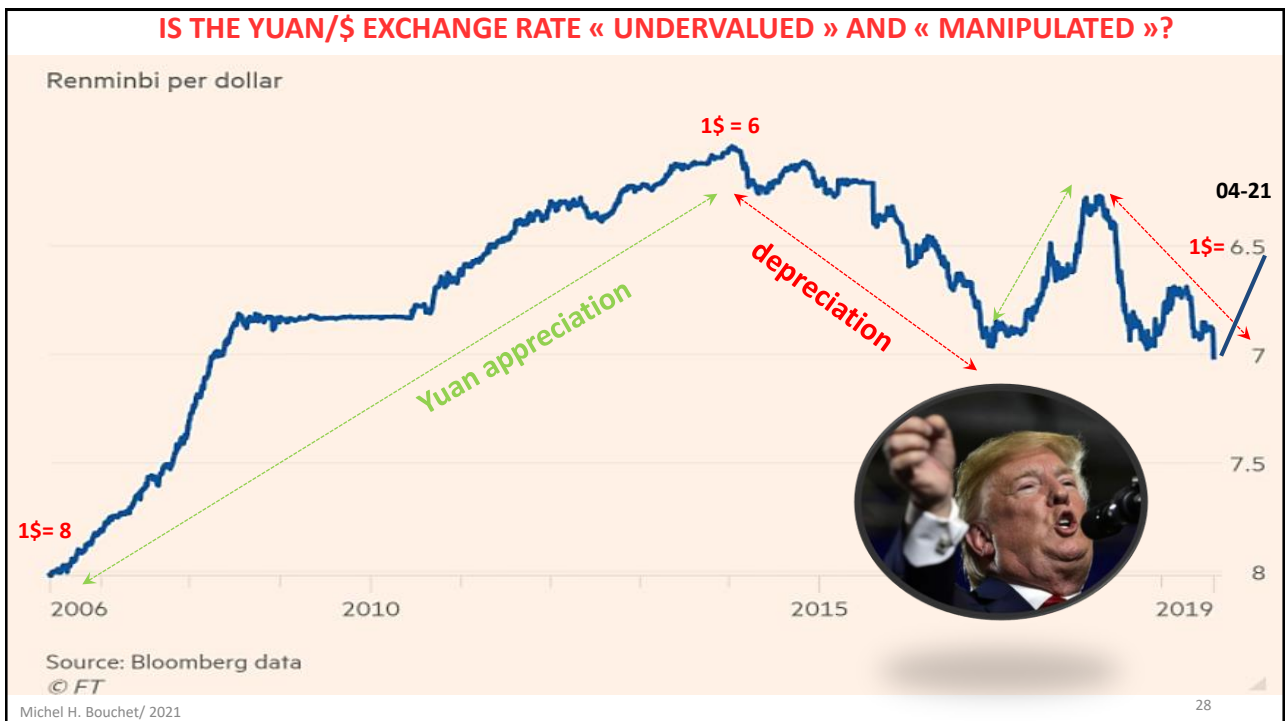
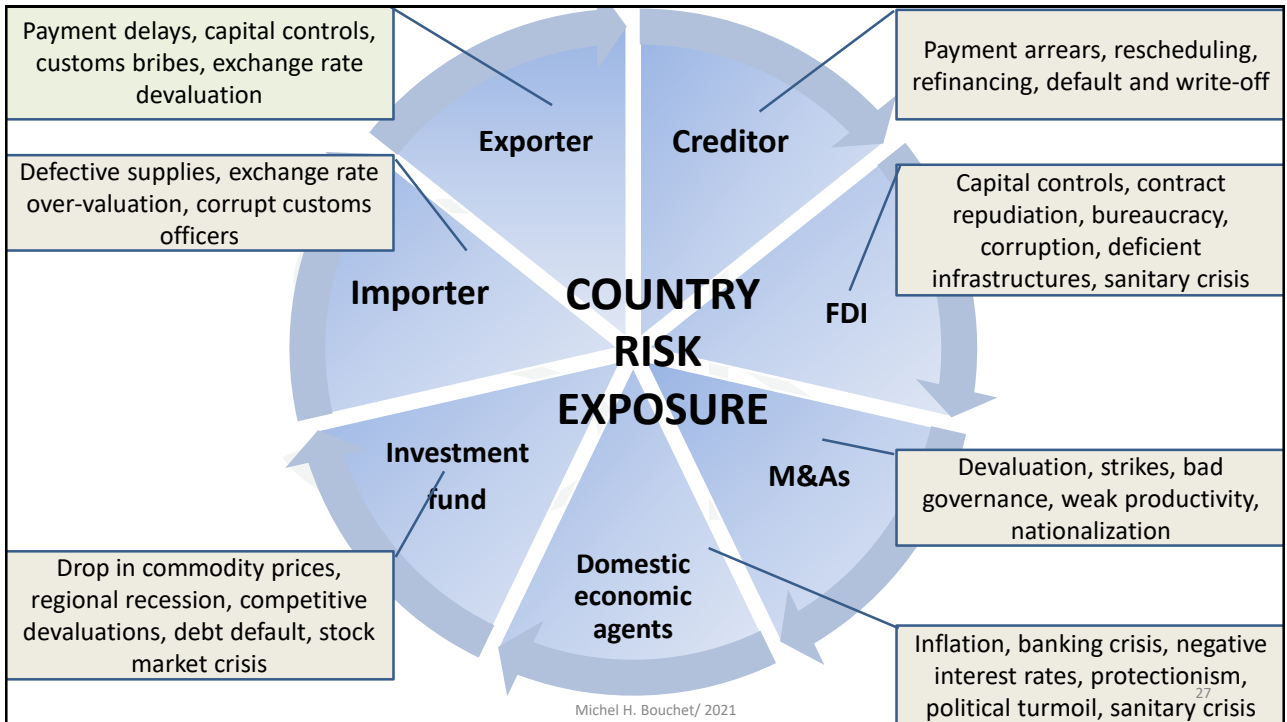
MAIN COMPONENTS OF GLOBAL RISK

- 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

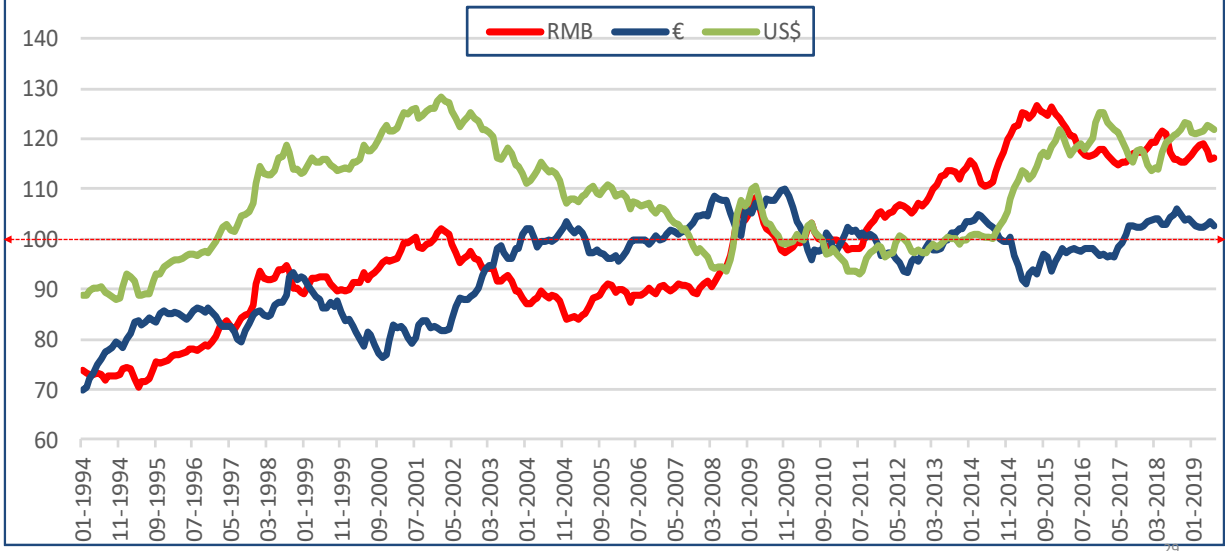
Subjective,
insurable and
diversifiable





YUAN, €, \$ = NOMINAL EXCHANGE RATES

Taux de change nominal 1994-2019

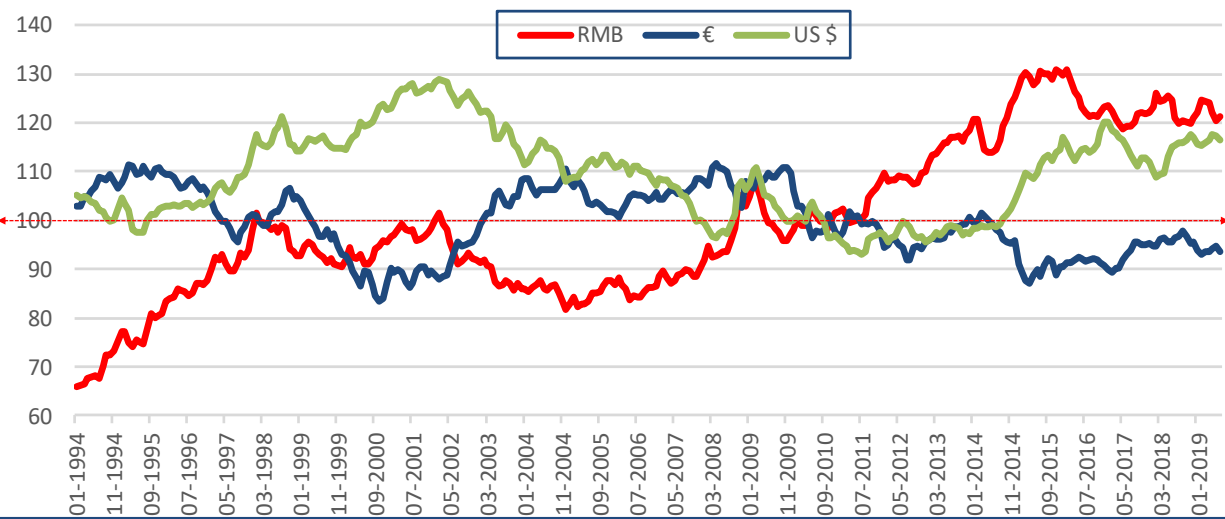


Source: BRI

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YUAN, €, \$ = REAL EFFECTIVE EXCHANGE RATES

Taux de change réel 1994-2019



Source: BIS

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BETTER OFF IN TUNISIA, JORDAN OR BOLIVIA?



TUNISIA

- ▶ GDP Per capita = \$10500
- ▶ HDI= 95
- ▶ Life expectancy f = 77
- ▶ CA/GDP%= **-8%**
- ▶ Doing Business= **78**
- ▶ Corruption = 69
- ▶ Coface = **C/B**



JORDAN

- ▶ GDP Per capita = \$10000
- ▶ HDI= 102
- ▶ Life expectancy f = 75
- ▶ CA/GDP%= **-4%**
- ▶ Doing Business= **75**
- ▶ Corruption = 60
- ▶ Coface = **C/B**



BOLIVIA

- ▶ GDP per capita ppp= \$8600
- ▶ HDI = 107
- ▶ Life expectancy= 71
- ▶ CPI corruption= 124
- ▶ CA/GDP% = **-5%**
- ▶ Doing Business = **150/190**
- ▶ **FDI = minimal**
- ▶ Coface = C/B

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

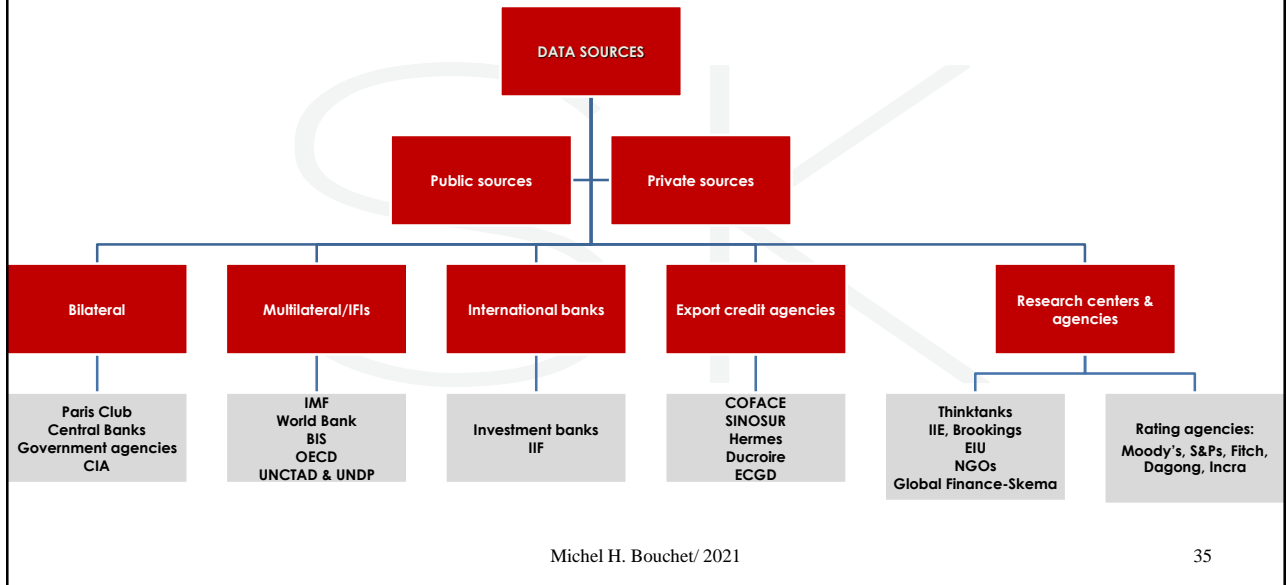


BOLIVIA

- ▶ 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



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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