Economist Intelligence Unit The Economist

# Country Risk Model

## An interactive tool for analysing country and sovereign risk

**Country Risk Model** is a reliable, customisable model designed to measure and compare risks across countries. An interactive tool, Country Risk Model allows you to quantify the risk of cross-border transactions such as bank loans, trade finance, and investments in securities.

Country Risk Model is the model which our analysts use to rate the 120 countries covered in our Country Risk Service. The model is an ideal tool for analysing country credit risk, as input into your in-house risk assessment process, or as a check on your institution's country assessments. The Model has been back-tested to 1997 and performs to a high standard in terms of predictive power.

Country Risk Model delivers robust and reliable support needed by asset managers and hedge funds interested in entering today's emerging and rapidly changing markets.


### How do banks, corporations, and governments use Country Risk Model?

The Model provides valuable support both to banks with cross-border credit or financial exposure and to large corporations with cross-border treasury operations. Given the growing interest in emerging markets, asset managers increasingly require the kind of country risk assessment provided by the Country Risk Model.

- Banks use Country Risk Model to set or review their country credit limits.
- Asset managers use the model to assess risks to their global asset portfolio stemming from exposure to foreign governments, financial institutions, and currencies.
- Treasury departments use the Model to understand and evaluate the risks of keeping cash and profits in a country.

### The EIU advantage

- **Objectivity** — As part of The Economist Group, we pride ourselves on our objectivity and independence: unlike the international ratings agencies we are not compensated by governments for our country ratings.
- **Constant vigilance** — EIU analysts run our model and update our ratings regularly. Monthly or quarterly updates ensure that we catch deteriorating or improving trends early; often before the large ratings agencies issue formal rating or outlook changes.
- **Deep expertise** — Our analysts are country experts who are responsible for tracking no more than two or three countries. This allows them to pay frequent visits to the countries they cover, to establish a network of contacts, and to provide timely insights into economic and political developments.
- **A modern approach to risk management** — The Model reflects changes in the structure of the global economy and global capital markets in the past decade. In addition to assessing sovereign risk, the model provides an assessment of the soundness of each country's financial system and the risk of a currency devaluation.
- **A rich data set** — The Model encompasses a wide range of macroeconomic data relating to economic performance, financial markets, public finances, external accounts, and external debt. It includes monthly and quarterly data where available.

# What does a Country Risk Service report contain?

The service is split into two parts:

1. The **Country Risk Model** allows you to view the individual scores for each indicator in the model for all of the countries. You can modify the scores of any of the indicators in the Model and see how this changes the overall scores and ratings for each of the six risk categories. You can also adjust the weightings of any of the indicators to create a model tailored to your needs. In addition to the ratings, a textual country risk overview summarises the main assumptions and forecasts.

Country risk ratings

2. A **data selection** module allows you to view, manipulate, and download the underlying dataset, including historical data going back for 1997 for most countries. The dataset encompasses scores for each variable in the model as well as overall scores for each of the six risk categories.

Select and compare ratings across countries

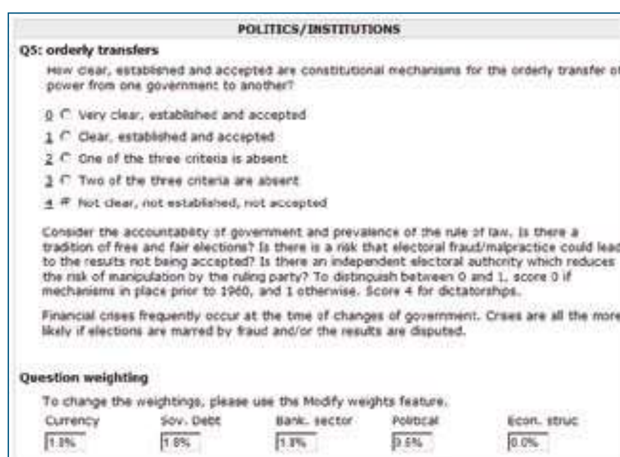
### How does Country Risk Model work?

Country Risk Model is an easy-to-use web-based service. It provides risk scores (on a scale from 0-100) and ratings of six risk categories (sovereign debt, currency, banking sector, political, economic structure, and overall country risk). The scores can be compared across countries and over time.

View and change scores

The Model provides “point-in-time” rather than “through-the-cycle” ratings. It works on a rolling 12-month time horizon, serving as an early warning system of financial crises.

The model covers 100 countries on a monthly basis (all emerging markets plus some developed economies such as Australia and New Zealand) and a further 20 industrialised countries on a quarterly basis.




Understand rating components

#### Country risk ratings explained:

Country Risk Model uses quantitative and qualitative indicators covering 6 risk categories.

- **Sovereign risk** measures the risk of a build-up in arrears of principal and/or interest on foreign- and/or local-currency debt that is the direct obligation of the sovereign or guaranteed by the sovereign.
- **Currency risk** measures the risk of devaluation against the reference currency (usually the US dollar, occasionally the Euro) of 25% or more in nominal terms over the next 12-month period.
- **Banking sector risk** gauges the risk of a systemic crisis whereby bank(s) holding 10% or more of total bank assets become insolvent and unable to discharge their obligations to depositors and/or creditors.
- **Political risk** evaluates a range of political factors relating to political stability and effectiveness that could affect a country's ability and/or commitment to service its debt obligations and/or cause turbulence in the foreign-exchange market. This rating informs the first three.
- **Economic structure risk** is derived from a series of macroeconomic variables of a structural rather than a cyclical nature. Consequently, the rating for economic structure risk will tend to be relatively stable, evolving in line with structural changes in the economy. This rating informs the first three.
- **Overall country risk** is derived by taking a simple average of the scores for sovereign risk, currency risk, and banking sector risk.

## Which variables are included in the model?

### Politics/institutions

- External conflict
- Governability/social unrest
- Electoral cycle
- Orderly transfers
- Event risk
- Sovereignty risk
- Institutional effectiveness
- Corruption
- Corruption in the banking sector
- Commitment to pay

### Economic policy

- Quality of policymaking/ policy mix
- Monetary stability
- Use of indirect instruments
- Real interest rates
- Fiscal balance/GDP
- Fiscal policy flexibility
- Transparency of public finances
- Domestic debt
- Unfunded pension and healthcare liabilities
- Exchange-rate regime
- Black-market/dual exchange rate

### Economic structure

- Income level
- Official data (quality/timeliness)
- Current-account balance, 48 months
- Volatility of GDP growth
- Reliance on a single goods export
- External shock/contagion
- Public debt/GDP
- Gross external debt/GDP
- Default history
- Financial regulation and supervision

### Macroeconomic

- Real OECD GDP growth
- Credit as % of GDP, growth
- Real GDP growth, 48 months
- Real GDP growth, 12 months
- Inflation, 48 months
- Inflation, direction
- Trade-weighted real exchange rate
- Exchange-rate misalignment
- Exchange-rate volatility
- Export receipts growth, 12 months
- Current-account balance, 12 months
- Asset price bubble

### Financing and liquidity

- Transfer and convertibility risk
- IMF programme
- International financial support
- Access to financing
- Gross external financing requirement
- Debt-service ratio
- Interest due/exports
- External short-term debt/ foreign exchange reserves
- Change in foreign exchange reserves
- Net external debt/exports
- FDI/gross financing requirement
- Import cover
- OECD short-term interest rates
- Non-performing loans
- Banks' credit management
- Banks' foreign asset position

### Country Risk Model delivers:

- A **Data Selection** module allows you to manipulate and download the underlying dataset.
- 100 Emerging Markets (monthly).
- 20 OECD Markets (quarterly).
- 20 emerging markets (quarterly—custom only).
- A text **Risk Overview** summarises the main assumptions.
- Ratings and data can be **compared** across countries and over time.
- Model weightings adjustment tools to create ratings tailored to your organisation's needs.
- 6 categories of risk ratings and scores.
- 61 indicators with historical scores to 1997 (a full set is not available for all countries).

Custom data feeds on request. Model details upon request.

### Interface features:

- Website interactive model.
- Adjustable weightings.
- Compare countries and ratings.
- Saved weightings and country comparisons.
- Excel® downloadable data.
- Interactive charting.

## Which countries are covered?

100 emerging markets and developed economies with monthly ratings

- *Algeria • Angola • Argentina • Australia*
- *Azerbaijan • Bahrain • Bangladesh • Bolivia*
- *Bosnia and Hercegovina • Botswana • Brazil*
- *Bulgaria • Cambodia • Cameroon • Chile • China*
- *Colombia • Costa Rica • Côte d'Ivoire • Croatia*
- *Cuba • Czech Republic • Dominican Republic*
- *Ecuador • Egypt • El Salvador • Equatorial Guinea*
- *Estonia • Ethiopia • Gabon • Ghana • Guatemala*
- *Honduras • Hong Kong • Hungary • India • Indonesia*
- *Iran • Iraq • Israel • Jamaica • Jordan • Kazakhstan*
- *Kenya • Kuwait • Latvia • Lebanon • Libya*
- *Lithuania • Macedonia • Serbia and Montenegro*
- *Singapore • Slovakia • Slovenia • South Africa*
- *South Korea • Sri Lanka • Sudan • Syria • Taiwan*
- *Tanzania • Thailand • Trinidad and Tobago*
- *Tunisia • Turkey • Uganda • Ukraine*
- *United Arab Emirates • Uruguay • Uzbekistan*
- *Venezuela • Vietnam • Yemen • Zambia*
- *Zimbabwe*

20 industrialised countries with quarterly ratings

- *Austria • Belgium • Canada • Cyprus • Denmark*
- *Finland • France • Germany • Greece • Ireland*
- *Italy • Japan • Netherlands • Norway • Portugal*
- *Spain • Sweden • Switzerland • United Kingdom*
- *United States*

Ratings on request for

- *Anguilla • Antigua and Barbuda • Aruba*
- *Bahamas • Barbados • Belarus • Belize*
- *Bermuda • Brunei • Burkina Faso*
- *Cayman Islands • Central African Republic*
- *Congo • Democratic Republic of Congo • Dominica*
- *Gambia • Grenada • Iceland • Liechtenstein*
- *Luxembourg • Madagascar • Malta • Mauritania*
- *Mongolia • Montserrat • Mozambique*
- *Netherlands Antilles • Niger • Puerto Rico*
- *Seychelles • Sierra Leone • St Kitts & Nevis*
- *St Lucia • St. Vincent • Togo • Virgin Islands (British)*

## For any queries, Contact: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