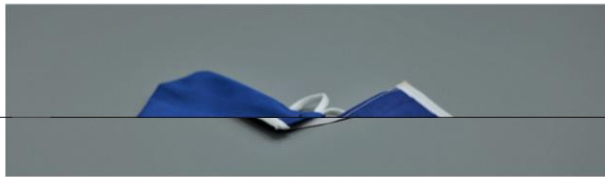


Special risk survey: Germany resilient, Italy vulnerable, as second Covid wave sparks Europe downgrades

Jeremy Weltman Thursday, November 05, 2020

Investor safety in countries such as France, Italy and the UK is called into question again as delays to vaccines and new national lockdowns undermine economic recovery, magnify fiscal problems and exacerbate social tensions.



For Euromoney's special risk survey, contributing experts were asked to reassess their risk evaluations for Europe after the announcement of tighter restrictions to address the second wave of the coronavirus pandemic.

The results indicate the crisis is once again worsening the survey's macroeconomic risk factors for GDP growth, employment and government finances, and is also having an impact on political indicators, leading to downgraded risk scores across Europe.

Germany's score is now down by 3.90 points this year to 75.00, but the country is still one of the safest in the eurozone, lying 12th out of 174 countries in the global risk rankings. This has been aided by the fact activity is impaired by disruptions in its trading partner countries, rather than directly through restrictive measures.

Germany has handled the crisis better than its European partners and has therefore invoked only a partial lockdown in November.

The score for France (26th) is down by 1.75 points to 68.04, with the government now considering a night-time curfew for Paris and the surrounding Ile-de-France region to stop breaches of the new rules after a second national lockdown – a less restrictive one than that in the spring – was introduced on Friday.

“The uprisings in Italy and the lack of regional support to state measures in the second wave, increase political risk south of the Alps
- Monica Bertodatto, public finance consultant”

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[The UK](#) (31st) went into a similar national lockdown on November 5, through to December 2, at which point it is supposed to return to the pre-existing tiering system involving targeted regional lockdowns, which had seen the tightest restrictions imposed predominantly in the north.

The UK is now downgraded by 2.10 points to 63.76, with the possibility of a no-deal Brexit looming when the UK's transition deal expires at the end of this year, adding to investor uncertainty.

Italy's score is also lower and from a risk viewpoint considerably more concerning.

As in Belgium, Spain and other countries in Europe now tightening measures, it has been badly hit by repeat waves of the virus this year, with the tourism industry – similar to Spain's – suffering disproportionately.

There is now a tiering system in place alongside other national restrictions, including the recent curfew announcement, and its score is 3.27 points lower than at the start of the year, at 54.82, extending a long-term downward trend in the survey.

This means Italy has fallen further to 61st in the global rankings, 18 places below Spain and only four above Greece.

Analysts explain

This pandemic is particularly concerning as far as unemployment and social-instability risks in Europe are concerned, warns Marco Vicenzino, director of the Global Strategy Project, who is one of several experts to have lowered their forecasts in the survey.

He fears the risk of public protests, which can often take a violent turn, will lead to greater economic and social paralysis, and isolation.

"Although the European Central Bank's (ECB) financial assistance and stimulus bills by different governments are helping to provide indispensable immediate relief, considerable segments of society remain exposed and extremely vulnerable for the foreseeable future," he says, adding that vaccines will take time for market distribution.

Covid will continue to inflict enormous economic damage on both the short- and long-term outlooks, warns Vicenzino, adding that future national budgets will have to take into account those who have been affected and will be "enormously strained" as a result.

Monica Bertodatto, a public finance consultant, believes France is in a comparatively better position than Italy.

"Although intervention during the crisis was similarly supported by the population in Italy and France, the current uprisings and gatherings in Italy, and the lack of regional support to state measures in the second wave of the pandemic, increase political risk south of the Alps," she says.

Bertodatto notes that tensions between the government and opposition on the use of EU funds and lockdown conditions could stall government action or lead to its dismissal, meaning Italy's legislative elections would then be held earlier than required in 2023.

Risk expert and economist Norbert Gaillard, of NG Consulting, provides three main reasons for his downgraded risk scores.

"First, the intensification of the pandemic severely disturbs business relations and international migration," he says. "Second, in a highly inter-dependent world, any slowdown of activity in a single European country will affect its neighbours.

"Third, and most importantly, the pandemic obliges national governments to take exceptional measures designed to reduce sanitary risk."

“European governments and institutions should increase cooperation in key economic areas to reassure foreign investors
- Norbert Gaillard, NG Consulting”

As with other survey contributors, Gaillard expects the new national lockdowns to depress growth. The harder and longer the lockdown, the more impact it will have, although delayed measures to fight the pandemic may also lead to more drastic decisions later, he points out.

In that instance, he believes a short-sharp lockdown may be the least-worst option, limiting the downgrading of risk ratings.

In particular, Gaillard sees the lockdown in France knocking one percentage point off growth in 2020, with a similar outcome to be expected for the UK. There will be more job losses and larger fiscal deficits with long lockdowns exceeding four weeks, which will be especially damaging for Italy and Spain.

He notes the fact the ECB is willing to provide whatever liquidity is necessary, but agrees with Vicenzino this cannot mitigate the political and social risks. Gaillard highlights the recent protests and riots against curfews and lockdowns in Barcelona, Madrid, Naples and Rome as a source of concern that imply the second wave of Covid-19 could undermine political systems as well as macroeconomic stability.

Sher Mehta, founder and CEO of Virtuoso Economics, sees the second wave of the pandemic and possible no-deal Brexit leading to a shallow recovery for the UK, with subdued business investment, increased corporate bankruptcies, unemployment and government debt, leading to taxes rising over the longer term.

He also adds that Italy faces an enormous challenge reducing its budget deficit, which has increased to more than 10% of GDP this year, with a public debt burden that was already nearly 135% of GDP before the onset of the crisis. This, in addition to other macroeconomic risk factors, has also led him to lower his score for bank stability.

"The banking sector has very weak profitability coupled with being less-capitalized than banks in other countries of the eurozone," says Mehta.

"Banks face a greater risk of weaker balance sheets at a time when they already hold a large percentage of government debt that can heighten their stress if financial markets are exposed to too much volatility."

He adds: "Tackling the vexed problem of debt sustainability at a time when Italy's medium- and long-term economic outlook seems increasingly bleak, amid the government's high gross financing needs in 2020 and 2021, could challenge the Italian government's access to financial markets."

Mehta also sees the risk of a far-right Eurosceptic government taking over in Italy whenever the next elections are held, which poses its own problems.

Exit strategy

As for the economic and fiscal fallout from the crisis, public finance consultant Bertodatto notes that corporate defaults and unemployment may well increase when the special labour support measures are withdrawn.

The crisis raises difficult political choices, though, such as which measures or sectors to stop supporting first.

She says a longer-term "deep reassessment of EU fiscal policy will need to be initiated and higher fiscal integration achieved".

New short- and medium-term measures with a limited impact on debt might be considered to support the economy. Short term, Bertodatto sees "the reduction of the payment deferral for public purchases, so that private suppliers would see their credits to the state cashed in earlier and limit liquidity shortfalls".

In the medium term, she sees "the increased issuance of public contingency liability bonds, as reinsurers or the World Bank already did with pandemic bonds. These instruments would allow a government to share with investors the burden created by extraordinary events and free up resources for fiscal easing."

NG Consulting's Gaillard says: "European governments and institutions – including among others the ECB and OECD – should increase cooperation in key economic areas to reassure foreign investors."

He adds that the present economic system is unsustainable and governments will have to spend more on public services, which will lead to higher taxes, including some form of tax harmonization in the EU, and stepping up efforts against tax fraud and evasion.

There will also be a rethink on how funds are invested and a greater determination to address the problem of zombie firms.

For Virtuoso Economics' Mehta, there is light at the end of the tunnel, as developed economies have several advantages. They have introduced strong fiscal and monetary policy responses to the pandemic, mitigating the unemployment risks and supporting household incomes and investment by firms.

Extraordinary monetary policy easing "enables governments to borrow at record low rates and makes debt servicing sustainable", he says.

These countries also have safe-haven currencies and greater capacity in their respective financial systems following regulatory reforms and other bold policies since the banking crisis to weather the current pandemic, even in countries where the banks are battling a prolonged low or negative interest-rate environment.

Nevertheless, as Mehta points out, elevated corporate and sovereign debts, and little ability to introduce additional monetary easing in future, makes these economies vulnerable to new exogenous shocks.

Furthermore, he states that business investment is likely to languish in the medium term, which in turn has downside implications for innovation, productivity, government revenues and hiring.

Which means, for European investors, the risks have become even more challenging.



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