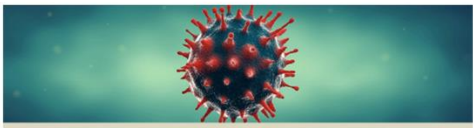
ECR survey results Q1 2020: China, US, Italy among 80 countries downgraded by risk analysts

Jeremy Weltman Tuesday, April 14, 2020

Euromoney's survey shows the pandemic crisis is having both predictable and unexpected effects on economic, political and structural indicators as the world faces the biggest investor shock in living memory.



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Not since the financial crisis in 2008 has the global economy been plunged into such turmoil and uncertainty, with sharp falls in asset prices and volatility in oil and other key commodity prices occurring just as Euromoney was conducting its latest quarterly risk survey.

Among the 174 countries featured, 80 have been downgraded, with Argentina and Lebanon among the biggest fallers following their selective defaults.

A further 27 are unchanged from December, but many of these were already very high risk options predominantly situated in Africa, Latin America and the Caribbean.

Euromoney's unique crowd-sourcing risk survey is a responsive guide to the changing perceptions of participating analysts in both the financial and non-financial sectors, focusing on a range of key economic, political and structural factors affecting investor returns.

The survey is conducted quarterly among several hundred economists and other experts, with the results compiled and aggregated, along with a measure of capital access and sovereign debt statistics, to provide total risk scores and rankings.

Although the first survey of 2020 shows far fewer countries upgraded, there are still 67 that analysts consider to be safer options in comparison with their standings in the final quarter of 2019.

Several, such as Hungary, Israel and Ghana, are not considered to be as badly affected by the pandemic and the resultant lockdowns and have been upgraded due to improvements in political stability or structural indicators, highlighting the importance of a diverse and multi-factor approach to investor risk.

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Steve Hanke, a professor of applied economics at the Johns Hopkins University and one of Euromoney's many survey contributors, also says: "Countries that rank highly in the Fraser Institute's Economic Freedom of the World report have relatively small, efficient governments and practice austerity.

"These countries have done rather well at mitigating the force of the blow."

Taiwan in particular is one of the more interesting anomalies, climbing four places, above Belgium, Canada and the US, to 16th in the global risk rankings. Analysts have previously alluded to its improved political stability following the elections, an effective policy response to control the spread of the virus and the island's strong economy to begin with.

It shows that even in the worst of times portfolio selection is everything.

Global risk perceptions, Q1 2020

	---points difference in risk scores---			
	q/q	2019	5-yr trend	10-yr trend
MINTs[2]	-1.91	-4.71	-4.20	-1.22
North America	-1.67	-7.33	-6.69	-12.09
Brics[1]	-1.61	-2.14	-2.75	-7.95
G-10	-1.40	-4.25	-3.07	-10.64
Eurozone	-0.86	-0.35	3.20	-6.25
European Union	-0.81	-0.46	2.76	-6.02
MENA	-0.77	-0.16	-1.61	-8.69
Latin America	-0.44	0.36	0.64	2.43
CEE (ex CIS)	-0.34	0.79	3.83	-0.82
Asia (ex CIS)	-0.03	1.17	2.47	0.14
Sub-Saharan Africa	0.96	4.10	5.13	6.94
Caribbean	1.10	5.95	6.54	2.00
Australasia	1.45	2.08	3.65	3.44
CIS	2.48	5.23	8.35	2.51

Note: minus sign indicates increased risk; ordered by ytd change - less risk to more risk

[1] Brazil, Russia, India, China, South Africa [2] Mexico, Indonesia, Nigeria, Turkey

Source: Euromoney Country Risk

Economic punch

Still, the overriding theme is one of huge economic shock from the temporary closure of much of the global economy and the exaggerated oil price slump precipitated by the refusal of Russia and Saudi Arabia to agree on a coordinated response to lower oil production.

This has delivered "a ruthless one-two punch to the world economy," says Hanke.

The sudden, severe and indefinite disruption to normal economic activity, prompting the furloughing or dismissal of workers and governments abandoning fiscal responsibility to provide immediate and expansive emergency financial assistance, means that economic rather than political risk has taken centre stage.

Analysts have downgraded the GDP growth/economic outlook indicator for 113 countries, the employment/unemployment indicator for 108 and government finances for 93. Currency stability has worsened for 87and bank stability for 83.

With all major industrialized nations downgraded, the average G10 risk score has never been lower at any point since the collapse of Lehman Brothers in 2007 precipitated the financial crisis and sovereign debt shock.

> The new coronavirus pneumonia epidemic will pose a serious challenge to China's economic development
> - Xianming Wu, Wuhan University

Survey contributor M Nicolas Firzli, director-general of the World Pensions Council and advisory board member of the World Bank Global Infrastructure Facility, believes that in times of acute crisis, people tend to focus on what is essential for their immediate survival.

“Economists and political scientists are no different,” he says. “And that’s why all expert eyes are now turned toward G10 nations and large emerging markets. They’re all scrambling to assess what will happen next from different macro, fiscal, financial and socio-political angles.

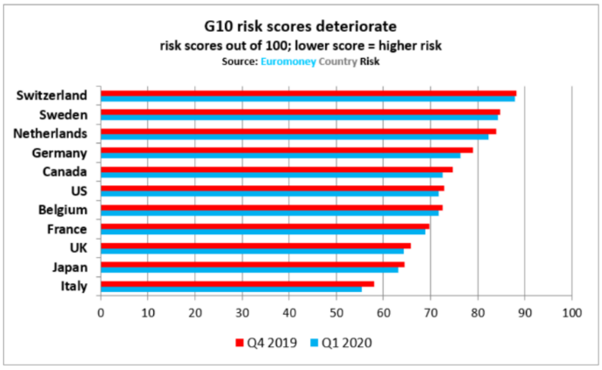
“If the lockdowns are extended across the board, which seems very likely, except, perhaps, for Scandinavia and parts of the United States (Arkansas, Utah, Nebraska, Wyoming, Dakota), Brazil, Taiwan, and mainland China, then unemployment metrics can only deteriorate in the coming weeks, which will further contaminate the industrial and social fabrics of many nations – a far more deadly ‘pandemic’ than the coronavirus outbreak.”

Firzli, like other survey contributors, is concerned that as unemployment rates spiral out of control, more aggravation of fiscal and economic situations will ensue, with export-oriented nations such as Germany, Italy and Japan hit hard.

Those that have the best chances of survival, he argues: “Are the large enough jurisdictions with solid finances, reasonably strong social safety nets (decent unemployment insurance) and truly diversified sectoral bases.”

In what he has repeatedly referred to as the ‘Age of Geoeconomics’, “Sweden and Switzerland fit the bill perfectly.” In fact both countries have been downgraded the least among the advanced industrialized economies and also have the highest risk scores (iethe lowest risk profiles) among the G10.

Moreover, although it is meagre consolation at this stage, the US, France and the UK should perform better than the G10 average, he says.



Developed world succumbs

In the US, where normal economic activity is at a standstill and the total number of claims for unemployment benefit has now reached 16.6 million in just three weeks (the unemployment rate is already soaring past 15%), analysts have taken a pessimistic view with the country falling one place in the global rankings to 18th.

One of those contributors is Sher Mehta, macroeconomist – sovereign risk at Virtuoso Economics, who is now expecting "a bruising recession in 2020", with GDP probably falling by around 3% or more in 2020, despite the $2 trillion fiscal stimulus and monetary policy interventions by the Federal Reserve.

The risks are magnified by the strong probability of a collapse of discretionary consumer spending, which accounts for around 40% of GDP in the US.

"The negative wealth effect of the marked plunge in US financial markets will amplify the downturn in consumer spending and the rise in corporate debt (which touched 74.2% of GDP in Q3 2019 – according to the International Institute of Finance) is a key vulnerability that could result in corporate defaults, bankruptcies, more layoffs and putting off investment that will exacerbate the economic downturn," says Mehta.

"The possibility of a widespread downgrade of investment grade corporate bonds to junk levels in the near future – contributing to market illiquidity and a further widening of credit spreads in the US corporate bond market – would make refinancing more difficult, raise the default rate and lead to a higher cost of capital for firms."

However, the decline in the US score is not as large as it is for Japan and the major eurozone countries.

Japan started the year with a weakened economy after raising consumption tax from 8% to 10% at the beginning of October. And after being forced to postpone the Tokyo Olympic Games until 2021, its score has fallen further, extending a longer-term negative risk trend.

Italy's moribund economy and its worryingly high levels of sovereign debt have made Europe's analysts particularly cautious and its country risk score has fallen more than any other G10 country. With Germany, France, the Netherlands, Spain and the UK also adopting draconian lockdowns to deal with the pandemic, this will undoubtedly push the continent into a deep recession this year.

Germany alone is expected to decline by 4.2%, according to the latest report from the country's leading economic institutes, as its services sector is hit even harder than manufacturing.

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Constantin Gurdgiev, a professor at the Middlebury Institute of International Studies and Trinity Business School, explains why Europe will experience such a big impact. He says it reflects not only the duration and strength of the pandemic containment measures adversely affecting the continent but also the generally weak fundamentals evident before the pandemic, linked to the protectionist global trade climate.

He adds that there are concerns with the room for fiscal, and to a lesser extent monetary, policy expansion.

“Euro area member states have no effective control of their currencies. Under the ECB’s rules, asset purchases across these economies are governed by less flexible guidelines and criteria than in Australia, Canada, the US and UK.”

Germany and Italy have more robust fiscal deficits and current account dynamics than the US, but: “Both suffer from more substantial fiscal exposures to external demand (international trade) and are therefore more susceptible to hard stops where trade flows are concerned.”

He, like other experts, sees Europe experiencing a more prolonged and deeper recession than the US, where fiscal deployment measures will be stronger and monetary policy more flexible.

This, he says generates the: “Rising risk of sovereign and financial sector crises reigniting in the later parts of 2020 and lasting into 2021.”

Further afield both Australia and New Zealand are also marked down this quarter, with their dependence on international trade and tourism key factors, although there are also political risk implications, according to Claire Matthews at Massey Business School.

“New Zealand has an election later this year and effective handling of the situation is likely to enhance the re-election chances of the current government as the prime minister is winning plaudits from across the political spectrum of her handling of the situation, despite the critics,” she says.

“As for Australia, the prime minister’s standing has not been improved as his handling of the Covid-19 situation has been less decisive.

“The Australian situation is complicated by the state system, with different states implementing restrictions differently. Economically, the effect will depend on how long the severe restrictions last. Both countries are putting large sums of government money towards minimizing the economic impact, but it can only alleviate the impact to a limited extent.”

Torrid time for China and other EMs

China, Brazil and India are among the emerging markets suffering the largest consequences of disruptions to global trade and tourism. All three are heavily downgraded, along with Indonesia, Malaysia, Mexico and Turkey.

“The new coronavirus pneumonia epidemic will pose a serious challenge to China's economic development,” says survey contributor Xianming Wu, a professor at Wuhan University.

“The massive cancellation of overseas orders has a huge impact on exports and many export enterprises face bankruptcy. Although the government’s economic stimulus plan will work, financial risks will also increase.”

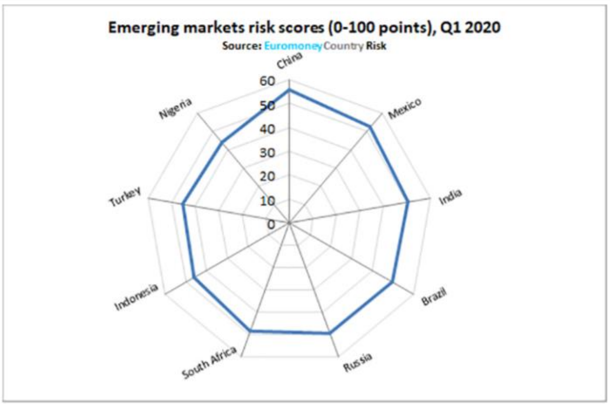
“The outbreak of 2019-nCoV started to have significant impact on the economy from the Chinese New Year period (end January/early February) on particularly certain industries such as tourism, retailing, catering etc. that exhibit substantial seasonal effects, and gradually reached out to sectors such as educational training, exports and manufactures,” says Yue Jiang, a teaching fellow at the International Business School Suzhou, Xi'an Jiaotong-Liverpool University.

Many of Euromoney's experts covering China see the biggest hit occurring in the first half of this year but with its longer-term prospects undimmed. This is highlighted by the Asian Development Bank's latest forecasts showing only 2.3% real GDP growth for this year and an unchanged prediction of 7.3% for 2021.

Russia and South Africa appear less exposed, however. Russia is not as vulnerable to the negative oil price shock as it might be presumed to be, which in any event has eased a little in response to signs that the disagreement with Saudi Arabia over production quotas could be smoothed over.

South Africa's resilience mainly reflects the fact it had been already substantially downgraded before the recent credit rating downgrade, discounting the higher risks attached.

South Africa's risk score has nevertheless fallen more than most other large emerging markets on a 10-year trend basis; as has Turkey's, which is further reeling from the economic impact of the coronavirus and would appear to be one of the most vulnerable of the G20 economies given its weak position before the crisis.



Mixed impact for Asia

The survey shows the majority but not all of Asia's markets suffering the consequences of the pandemic, partly through supply chain links to China.

Hong Kong, Malaysia, Indonesia, Mongolia, the Philippines and Singapore are among the countries downgraded in the survey, as is most of the Indian subcontinent.

Friedrich Wu, a professor at Nanyang Technological University, notes that even before the coronavirus outbreak, the China-US trade war and the months of violent protests had already had a massive impact on the Hong Kong economy, causing a 1.2% decline in real GDP last year.

"Now the coronavirus is dealing the SAR a third, perhaps even more severe blow. Although the government is dishing out a $3.86 billion relief package to bail out struggling industries and fund the fight against the virus, the financial aid is insufficient to rescue the economy from recession."

However, Hong Kong's plight is not merely an economic one, there is also a crisis of authority.

Pointing to the week-long strike by hospital workers and explosions of homemade bombs by activists, Wu notes the loss of trust between local residents and the administration, which is reflected in across-the-board downgrades to all political and economic factors by the survey's contributors.

On the Philippines, and echoing comments received on other countries affected by coronavirus, Daniel Wagner of Country Risk Solutions says: "Any implied positive impacts for the economy [from the oil shock] are likely to be offset by declines in tourism and manufacturing, and declining overall demand.

"For that reason, I do not foresee much in the way of gains for the Philippine economy this year as a result of the dramatic reduction in oil prices."

Argentina leads LatAm crash

The crisis poses a particular problem for Argentina, worsening the economic outlook at a time of deep concern over its ability to handle debt repayments. As such, the country is showing the steepest downgrade in the region, falling 25 places in the rankings to 122nd, just below Ecuador, another notable faller.

Economists now expect the economy to shrink by around 4% to 5% in real terms this year. All of its economic risk factors are downgraded, as are all the political indicators, highlighting a lack of faith in the government's effectiveness and ability to manage an orderly debt restructuring after postponing payments on $9.8 billion of bonds until at least the end of this year, which ostensibly means a selective default.

Experts have also made substantial downgrades to Brazil, Chile and Mexico. All three have seen their survey scores for GDP growth, employment/unemployment and government finances downgraded.

Sandstorm sweeps MENA

While some of the Gulf states are showing resilience to the effects of the negative oil price and global trade shocks, reflecting their substantial sovereign wealth and capacity to loosen the purse strings, other, higher-risk countries in the region are more exposed and have been forcefully downgraded.

These include Iran, Iraq, Syria and Lebanon, which shows the largest decline of any country in the Q1 survey after it defaulted for the first time in early March.

Alex Heneine, a Beirut-based financial markets and country risk analyst, says the credit event leaves the country in a tight spot.

"Since the eruption of widespread demonstrations in October last year, thousands of businesses have closed and over 250,000 people have lost their jobs. In a country of four million nationals and two million refugees and foreign workers, the figures are alarming," says Heneine.

"GDP is expected to contract by over 10%, sending the world's third-highest debt to GDP ratio closer to 200%."

Rafah Toubia Farah, head of country and financial institutions risk management at Credit Libanais, says Iraq may be also destabilized: "Since the country already encounters a precarious political situation, largely depends on oil revenue and is expected to witness a decrease in GDP due to the reduced religious tourism.

"Furthermore, small and medium enterprises are threatened to collapse in the region. Many of the countries where SMEs are important, such as Lebanon and Egypt, may have difficulties providing these businesses with the adequate help to survive the crisis."

Africa is next

The survey also shows increased risk for Angola, Egypt, Gambia, Ethiopia, Liberia, Mali and Zimbabwe, among others, as the continent slowly comes to the realization that it too will be affected by the pandemic.

In some cases countries were already facing political and security crises before it emerged, and the economic and social consequences are feared even more than the virus itself.

Survey contributor Lionel Kpenou-Chobli, associate director at Optimum Consulting, says: "What people are thinking about is the impact on people (80% of whom in some countries live in the informal sector), on the SMEs, on tax collection, on the prices of commodities (cotton, cashew, coffee, cocoa etc.) and then on the smallholders and merchants.

"Then you have a major concern around the fall of international cooperation, the silence of donors as their own countries are affected and the disruption of the global value chains."

The shock it seems will be felt the world over, but whenever the recovery happens Africa could be left struggling.

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