FOCUS ON
The 2016 SACE Risk Map: The Old Normal Is Back in a Less Level World

Produced by the Economic Analysis and Research

EXECUTIVE SUMMARY

- *The first victim of the international financial crisis was "zero-risk". Country risk has returned even in the advanced markets, starting with Greece. The differences between advanced and emerging markets had narrowed in recent years, and it was growth in those latter markets that fueled the recovery. Today, however, in the wake of lower commodity prices and a slowdown in Asian demand, we are again faced with the "**Old Normal**", or better yet a "**New Old Normal**", where the advanced countries have begun to grow again and the others limp along behind.*
- ***Low raw material prices, the return of debt with the weakening of public accounts, and the resurgence of political violence will be the hallmarks of 2016.** These three key factors will impact Italian exports. Rising risk has resulted in a decline in exports of over € 5 billion this year, but € 31 billion can be recovered in the next four years by focusing on accurate information, specific coverage, and a strategic approach to investment.*
- ***Risk has remained fairly stable in the advanced markets** (SACE index: -1 point), **while it has increased significantly in the large emerging countries** (+ 4 points) and in a few other areas, specifically the Middle East and North Africa (+ 4 points) and Latin America (+ 2 points).*
- ***Many opportunities still exist** in places like Algeria, Chile, China, India, Iran, Kenya, Malaysia, Mexico Morocco, Peru, Philippines, Poland, Spain, Turkey and United Arab Emirates. Some of them simply require greater caution due to temporary imbalances.*
- ***Thus the ability to select "winners" and "losers" will be increasingly critical for channeling exports** toward the recovering industrialized countries and continuing to harvest the fruit of what has been sowed in recent years in the emerging markets through adequate, targeted insurance coverage. The world in 2016 is less level: the SACE Risk Map can be a useful tool for identifying potential threats and seeking new opportunities.*

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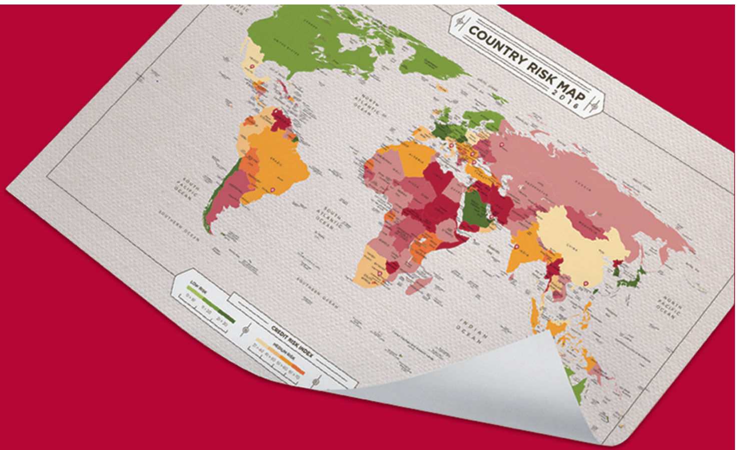
DISCOVER THE

COUNTRY RISK MAP

2016



The Country Risk Map is an instrument developed by our Research Office team to indicate the various types of risk to which countries are exposed when they operate abroad.
More specifically, the **map is based on an analysis of the credit risk** to which exporters, lenders, industrial investors and contractors are exposed in 196 countries.
By **credit risk** we mean the possibility that a foreign counterparty (**sovereign, banking, or corporate**) is unable or unwilling to honor its obligations deriving from a commercial or financial contract.
Each country is assigned a score of 0 to 100 (with 0 being minimal risk and 100 maximum risk) calculated as the simple average of the three credit risks (sovereign, banking and corporate).

Discover **the interactive map at sace.it/riskmap or download the new SACE app for iOS and Android!**

Just one click will provide you with a simple, immediate instrument for obtaining a real-time assessment of the risks in the countries where you operate and help you will discover the best export opportunities for your company.

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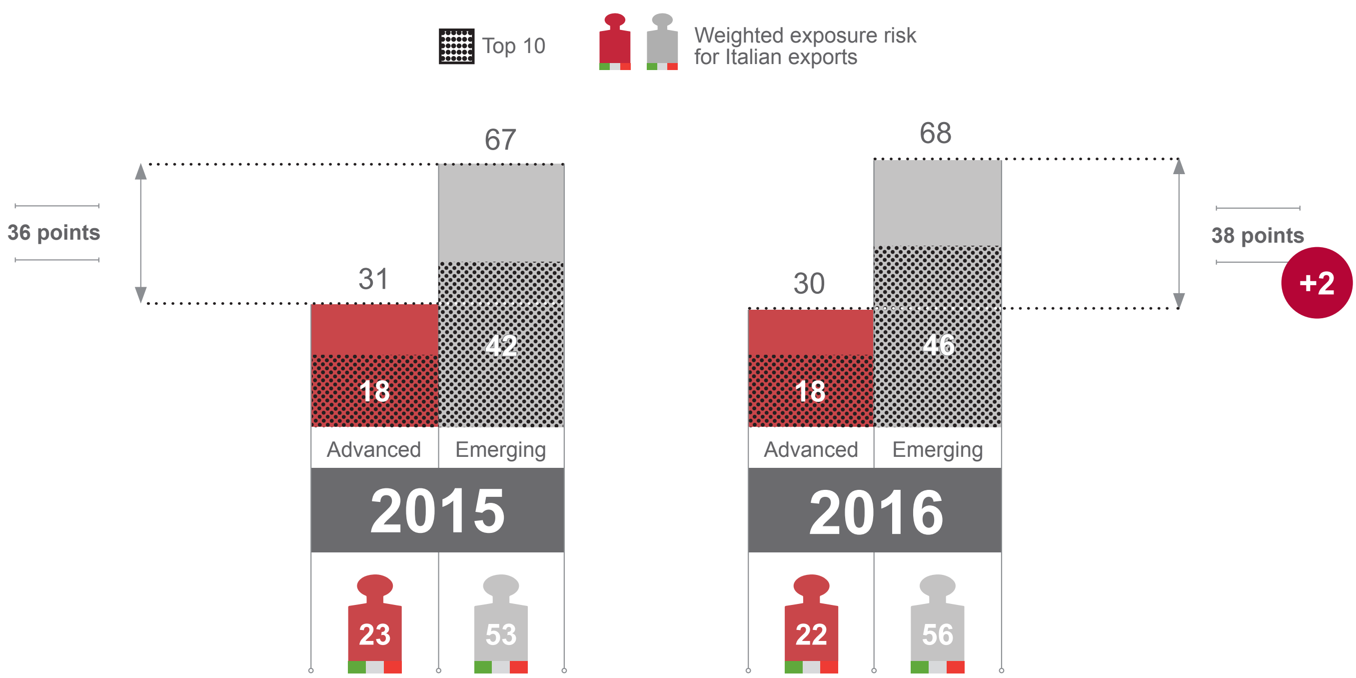
GROWTH AND RISKS: FROM THE NEW NORMAL TO THE OLD NORMAL

The "New Normal" following the crisis of 2007 brought significant changes: a slowdown in global demand, a crisis in the advanced countries with a need to adopt extraordinary economic policy measures, and emerging markets as engines of growth. One of the consequences was a narrower gap between advanced and emerging. Something changed in the past year, however, and with all probability 2016 will reflect this change: the emerging economies have lost momentum and revealed some structural weaknesses, while the advanced countries have resumed growth, though at less-than-optimal rates. The gap has begun to grow again in the 2016 SACE Risk Map. So **in terms of country risk, we have returned to the "Old Normal"**, a **"New Old Normal"**.

The credit risk gap[01] between advanced markets[02] and emerging markets[03] has grown by 2 points, from 36 in 2015 to 38 (Chart 1). If we consider the importance of the various markets for Italian exports, measuring risk based on the "exposure" for Italian exporters[04] , the gap widens to 4 points (from 30 to 34). **Of course, Italian exports reflect international dynamics, but they could be based on a more solid geographical mix less exposed to credit risk.** The top ten advanced countries in world trade registered no change in their composite risk profile last year (holding steady at 18). The same cannot be said for the emerging markets: the principal importers expressed weaknesses, with a four-point increase in credit risk, greater than the emerging country average! In other words, there are smaller economies that are improving their operating context.

CHART 1. *Risks and exposure to risk of Italian exports*[05]



Source: SACE

Variability within the various geographical areas remains high (Table 1). One example is the Middle East and North Africa (the MENA area), which had the greatest increase in risk terms but also shows broad dispersion, demonstrating that not all the countries of the region are precluded to exporters and investors. Risk has increased significantly in the MENA area but also in the countries of Asia and Latin America. In each area, even those with the greatest problems, **there are markets that, though risky, can be accessed by companies through careful selection and with the right instruments. Selecting which countries to do business with has thus become more rigorous, but there are still windows of opportunity that can bring healthy returns**: as demand is reviving in the advanced countries, we must not overlook markets recently discovered and must seek new ones.

TABLE 1. *Credit risk by geographical areas*[06]

Area	2015	2016	Change	Dispersion 2015	Dispersion 2016
ADVANCED	31	30	↓ -1	27	27
EMERGING	67	68	↑ +1	27	25
Sub-Saharan Africa	74	74	↔ 0	23	16
Asia	67	69	↑ +2	28	22
CIS	67	67	↔ 0	12	14
LAC	60	62	↑ +2	27	22
MENA	56	60	↑↑ +4	45	38
WORLD	59	60	↑ +1	-	-

Source: SACE

[01] *The SACE credit risk indicator, based on a scale of 0-100, where 100 represents the maximum risk, provides a succinct measurement of payment default risk in a given country by public or private (banking and corporate) counterparties. A country's risk category is expressed as the simple average of the risk sub-categories.*

[02] *As defined by the IMF.*

[03] *For simplicity of analysis, it is the residual category. When planning an investment or deciding which areas to export to, however, a company must consider that the emerging markets are not a single bloc, "from Albania to Zambia" (see Kairos, Dall'Albania allo Zambia, November 2015), passing through the remaining BRICs.*

[04] *Calculated as the average of the SACE risk indicators weighted by the amount of Italian exports within the reference category (advanced or emerging).*

[05] *This table shows the average SACE risks and "risk exposure of Italian exporters" with respect to the top ten advanced and emerging countries by volume of world trade. These countries are: Belgium, Canada, France, Germany, Hong Kong, Japan, Netherlands, South Korea, United Kingdom and USA for the advanced; Brazil, China, India, Malaysia, Mexico, Poland, Russia, Thailand, Turkey and UAE per the emerging.*

[06] *The amount of dispersion indicates the diversification of scores obtained by countries in the same area. It indicates the width of the interval containing 50% of the values centered on the regional average.*

In particular, sovereign risk has worsened in Greece and Japan among the advanced and in Brazil, Libya, Russia and Venezuela among the emerging, **and banking and corporate risk** in Belarus, Nigeria and Tunisia. Payment defaults are increasing throughout the corporate world along with a declining availability of foreign currency to pay commercial debts, and the situation will not improve in 2016: company bankruptcies in the emerging economies should reach 6.5-7% by the end of the year, against less than 1% in 2011[07].

Three key factors will affect risks and opportunities in the coming year, in our opinion: **low commodity prices, renewed indebtedness in the emerging countries, and the resurgence of political violence and terrorism**[08].

THE *COMMODITIES GLUT: IS FLAT THE NEW OLD NORMAL?*

Low commodity prices are the principal source of threat for the economies that are not yet sufficiently equipped and diversified to sustain such a sharp and lingering decline. The early days of the year are demonstrating that expectations from the Asian locomotive - as a source of demand for commodities - are rapidly declining despite the great potential and the production levels reached in the past 10-15 years.

In **2015 all commodities declined in value: 42 raw materials out of 46 reached the lowest values for the last 30 years.** This is not just a temporary decline but a structural trend that seems primarily to involve the fundamentals of the sector. **Businesses are expecting broad volatility**, within a framework of low prices and near-zero returns.

The decline in hydrocarbon prices was triggered by the unconventional pioneers in the USA, who in just a few years went from being the principal importers of petroleum and natural gas to potential exporters. Prices remain low primarily because **there are no markets capable of absorbing such overproduction**. The context is conditioned well beyond the price fundamentals due in part to a series of political decisions: OPEC, but also the USA and Russia, are striving to improve energy efficiency and reduce the environmental impact of fossil fuels.

[07] *Barclays, The Emerging Markets Quarterly, November 2015.*
[08] *See Appendix 1 a table summarizing the key factors influencing countries.*

The indicators show that these are not levels sustainable in the medium-long term for various markets (oil & gas, but also copper, coal and steel). Meanwhile, the accounts of several traditional exporting countries are eroding, with an impact on companies and banks. **The quality of bank credit and the fragility of public accounts may heighten operational risks and make payments in currency more difficult**: along with the problems that may derive from a downsizing of government budgets (cuts to subsidies, less investment, and reduced purchasing power), we can foresee some additional problems for companies operating in those markets, such as long collection times, limitations on currency conversion, and temporary interruptions in the foreign activity of local banks.

CURRENCY TRANSFER RISK IS RISING IN THE EMERGING MARKETS

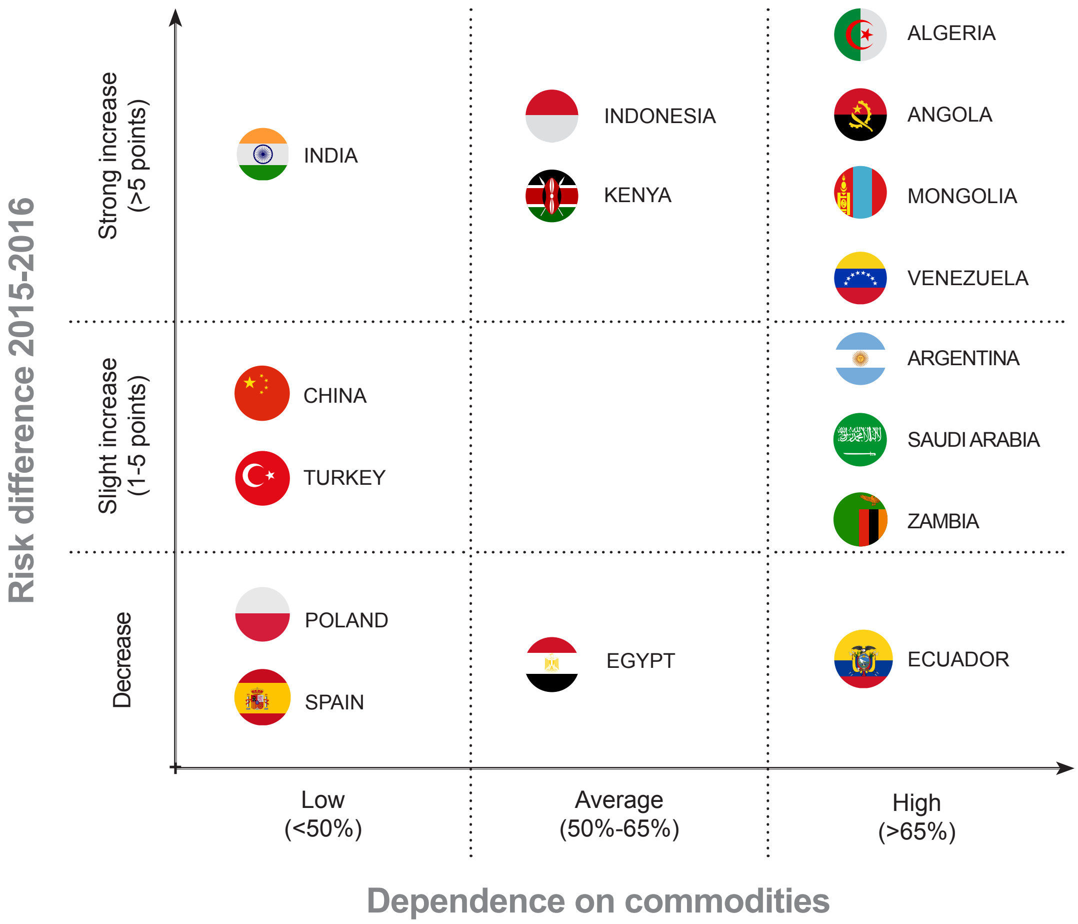
In 2015 there was increased risk for currency transfers from the emerging markets. There is a growing risk that financial transfers in strong currencies (international payments but also repatriation of capital and dividends) may be subject to restrictions (or delays) in countries with a shortage of foreign currency. The shrinking financial resources in commodity-exporting countries have forced some governments (in Ghana, Nigeria and Tajikistan) to restrict the access of local businesses to strong currencies, adopting more arduous documentary procedures or lengthening conversion and transfer times. In other countries (Argentina and Ethiopia) the average time required for currency exchange and transfer have grown longer, though no legislative or regulatory changes are apparent. The situation is different in those countries (Angola, Egypt, Greece, Ukraine) that, due to a persistent shortage of strong currencies, have introduced (or tightened) restrictive measures on payments in those currencies, limiting the amount available to businesses (companies and banks) and the possibility of transferring currency abroad. **This has had a major impact on businesses (exporters and investors) active in those countries, which have experienced longer collection times and difficulty in repatriating capital and dividends**. Advisory services regarding currency transfer may prove essential for orienting the foreign investment decisions of companies. And protecting their sales and investments from this risk through specific SACE instruments, by mitigating the risks of internationalization, is a valid competitiveness factor for Italian companies interested in consolidating their foreign presence.

This does not only relate to oil & gas: copper is among the first to decline in period of lower infrastructure investments and limited economic growth. **Iron, coal and steel** follow close behind. Alternatives such as recycling, demonstrating the abundance of available resources, have become increasingly feasible, as by definition they reduce requirements and make further increases in production capacity superfluous (and unmarketable).

This is particularly damaging to economies with less diversification that survive by exporting those goods: this applies to **Africa** (Algeria, Angola, Zambia) but also to **Latin America** (Argentina, Ecuador, Venezuela), the **Far East** (Indonesia) and **Oceania** (Australia). The African situation seems the most worrisome: the concentration of investments planned and launched in recent years, and an industrial system more susceptible to capital flows, might have significant effects on various economies north and south of the Sahara.

Nine economies, accounting for 7% of Italian exports, are showing declining fundamentals, due primarily to the current commodities cycle. These include major exporting countries like Algeria, Saudi Arabia and Venezuela (Chart 2). **At the same time, seven countries, representing almost twice that export volume (13.7%), might benefit from current conditions**. These are importing economies (China and Egypt but also Poland and Spain), systems sufficiently diversified (Kenya and Turkey) and markets that finally seem close to expressing their potential (India).

CHART 2. *Dependence on commodities affects country risk*



Sources: SACE, Unctad

DEBT STRIKES AGAIN

The domestic and foreign debt position of several emerging countries has become less sustainable (with inevitable effects in such areas as currency transfers) and the risk of escalation of conflicts in a few areas has become more likely. The decline of commodity prices, the slowdown in China, and the end of USA quantitative easing have made it more difficult for many countries (especially, but not only, those in Sub-Saharan Africa) to repay their debts and sustain their social programs.

In 2015, in fact, the "debt issue" arose in the emerging countries. After a surge of debt in the advanced economies caused by the financial crisis, expansive fiscal policies in recent years have helped increase the stock of debt (domestic and foreign) in the emerging countries as well. The total debt of the emerging countries has risen from 150% of GDP in 2009 to 195% today[09].

Until 2015 this fact failed to arise particular concerns: the deficits were, in fact, covered by excess financial liquidity moving from the advanced countries to the emerging countries, the BRIC and beyond, and to countries increasingly exotic and risky (a prime example is the interest with which international investors greeted the recent bonds issued by Sub-Saharan African countries like Zambia and Mozambique).

The context seems to be changing now. While for some countries their debt position is not critical (e.g. Peru, China, Saudi Arabia), in others the repayment of debt has been made more difficult by the decline in commodity prices, the slowdown in China, and the gradual raising of rates by the Fed. The process has been further complicated in those countries where the depreciation of the local currency has hampered the servicing of debt contracted in strong currency, as in the case of Turkey, Indonesia and Zambia (Table 2), which represent 2.7% of Italian exports overall. The currencies of those countries have depreciated in one year by 24%, 10% and 72% against the dollar, respectively.

What can we expect this year in the emerging countries afflicted by these problems? In some cases, they will attempt to reverse the trend of debt accumulation through **more restrictive fiscal policies**, which may help improve their debt position on the one hand but will **depress their economic growth** on the other. In these economies we would therefore expect cuts in current expenditures and a slowdown or rescheduling of capital expenditures (e.g. public investment in major projects, strategic infrastructure, etc.). **For Italian businesses (exporters, financers, investors, builders), this will result in fewer opportunities and a postponement of negotiations in progress**. Where restrictive fiscal policies are not feasible, or the sustainability of debt is already somewhat compromised, we expect more serious problems, with an **increased risk of delays in receiving payments or not receiving them at all**. Among the countries with the greatest decline in creditworthiness we find Brazil, Ghana and Mongolia.

[09] *The Economist, The never-ending story, Novembre 2015.*

TABLE 2. *Problems in a few emerging countries*

	Public debt/surplus (as % of GDP, 2015)	Foreign debt (% of GDP, 2015)	Local currency vs USD (% chg, 2015)	Average credit risk (2016 and chg. 2015)
Mongolia	-7.7	119.8	-5.7	88 ↓
Egypt	-11.5	13.8	-9.4	80 ↑
Ghana	-7.3	52.0	-18.6	71 ↓
Zambia	-7.1	37.8	-71.8	69 →
Ecuador	-4.7	31.1	*	67 →
Bangladesh	-5.1	13.3	-0.6	66 →
Indonesia	-2.2	32.4	-10.4	60 →
Turkey	-1.3	55.2	-24.0	55 →
India	-4.0	20.2	-4.4	54 ↓
Brazil	-10.5	30.9	-0.5	53 ↓
South Africa	-3.8	41.6	-33.5	44 ↓
Botswana	-3.1	14.1	15.2	43 ↑
Colombia	-2.2	36.2	-33.2	42 ↑
Peru	-1.0	31.7	-14.5	41 ↓
China	-2.5	8.1	-4.5	36 →
Malaysia	-3.2	62.8	-22.7	32 →
Saudi Arabia	-18.1	25.7	0.0	28 →
Qatar	0.9	87.5	0.0	26 ↑

Critical risk *Average risk* *Limited Risk*

* *Ecuador adopts the USD as legal tender.*

Source: SACE and EIU BUREAU VAN DIJK

But the situation is also deteriorating for the private sector, particularly for companies. In the past decade, the debt contracted by companies in the emerging markets has **increased fivefold**, particularly in Asia, due to the favorable conditions for foreign capital in the markets, and the changing conditions and greater difficulty of generating cash to pay down debt in the past year have **increased the number of defaults**. This phenomenon has been further magnified in the emerging economies, where a stronger dollar is hampering the servicing of debt contracted by companies in strong currency.

POLITICAL RISK: THE WEIGHT OF GEOPOLITICS AND THE IMPACT OF TERRORISM

In the past[10] we have examined the economic effects of resurgent geopolitical risks. **In 2015 we saw an increase in the arenas of conflict at the global level and the growing role of international terrorism as a source of geopolitical instability and no longer a "simple" element of risk due to instances of violence within countries**. This phenomenon has come to assume para-state and transnational proportions. We are thinking of the Islamic State (IS) problem and its territorial claims on portions of Iraq and Syria. But it does not stop there. Geopolitical crises of terrorist/fundamentalist origin can be found in Nigeria (we see a six-point increase in risk; Chart 3), where Boko Haram holds control over the northeast; in Yemen (+ 12 points), where the strife between Shiite and Sunni factions has resulted in an institutional collapse; in Libya (+ 12 points), where the conflict between two governments has left a vacuum for the internal growth of IS.

CHART 3. *Political risks, worst vs best performers*

**simple average of the SACE risk indicators (political violence, transfer and convertibility, expropriation). The comparison considers the average political risk in 2015.*

Source: SACE

[10] *SACE, Focus On: 2014 SACE Risk Map – "What opportunities in an increasingly uncertain, volatile world?", September 2014.*

The repercussions of international terrorism result not only in greater insecurity but also a "net loss" for the global economy (destruction of property, reduction of trade, high transaction costs) estimated by the Institute for Economics and Peace at over USD 64 billion[11], a value equivalent to the GDP of Kenya or Luxembourg. According to the institute's survey, the greatest damage from episodes of terrorism is suffered by individuals, private property and commercial assets (targets of 40% of terrorist attacks). The areas most affected are the MENA area and Sub-Saharan Africa. This vulnerability is reflected in the SACE risk indicators, which place those two areas at the highest level in the risk classification, with average values of 65 and 51, respectively.

On top of this geopolitical driver, there is the more "traditional" political uncertainty and the increased internal conflict in situations where social participation is low and economic performance on the decline. Low commodity prices will be among the special indicators for changes in political risk in 2016. Decreased revenues take resources away from welfare; slow growth depresses the aspirations of the emerging middle class and accentuates the demand for reforms and new leadership to manage the transition. This is how we interpret the increased risk in Brazil, where the economic situation moves in lockstep with the political context, and the continuing high risk in Venezuela (SACE political risk rating of 90, stable with respect to 2015).

Although problems seem to prevail, given the geographical proximity of our country to some of the more problematic areas, there are several cases where the operating context has improved. Two that may offer the greatest benefits to Italian companies are Iran (with a political risk average of 79, improved by four points)[12] and Morocco (left unscathed by the disturbances of the Arab Spring). There have also been peaceful elections in Ivory Coast that confirmed the leaders in power and set a course of economic-institutional recovery in 2011. Then there is Bangladesh, a SACE Frontier Country[13] that has shown the greatest advancement with a moderate level of governability and favorable attitude toward foreign investors.

STABLE EXPROPRIATION RISK IN THE EMERGING MARKETS

While the risk of nationalization increased during the boom years for commodities, when the positive trend in prices induced many countries to modify sector regulations to the benefit of the state, the current decline in commodities and the general climate of geopolitical uncertainty have helped stabilize the risk of state intervention in strategic sectors through expropriation and nationalization. This risk remains high, however, in countries with heavy political interference in economic activity (Argentina, Kazakhstan, Libya and Venezuela); the attitude toward foreign investors has improved, however, in countries that require a foreign presence to revive their strategic sectors (Bangladesh, Romania, Zambia).

[11] *Institute for Economics and Peace, "Global Peace Index 2015".*

[12] *The recent tensions with Saudi Arabia (political risk score 40, a point higher than in 2015) and other Sunni countries following the murder of Shiite Imam Nimr Al-Nimr, and the break in diplomatic relations, might have repercussions difficult to estimate at this time.*

[13] *To view the SACE publication "Frontiers Asia", click here.*

OPPORTUNITIES IN 2016: WHAT HAS CHANGED IN THE LAST YEAR?

The events of 2015 and expectations for coming years have altered the list of countries offering the greatest opportunities for Italian exports (Table 3). New entries include Chile, the United Arab Emirates, Iran and Spain, while we recommend greater caution toward Brazil, Colombia, Indonesia and South Africa, where the economies are significantly slowing. The opportunities also include geographical areas like Algeria, Kenya and Turkey with improving credit risk but temporary imbalances.

TABLE 3. *Countries of opportunity for Italian exports*

OPPORTUNITY	
2015	2016
Algeria	Algeria
Brazil ←	→ Chile
China	China
Colombia ←	→ United Arab Emirates
Philippines	Philippines
India	India
Indonesia ←	→ Iran
Kenya	Kenya
Malaysia	Malaysia
Morocco	Morocco
Mexico	Mexico
Peru	Peru
Poland	Poland
South Africa ←	→ Spain
Turkey	Turkey

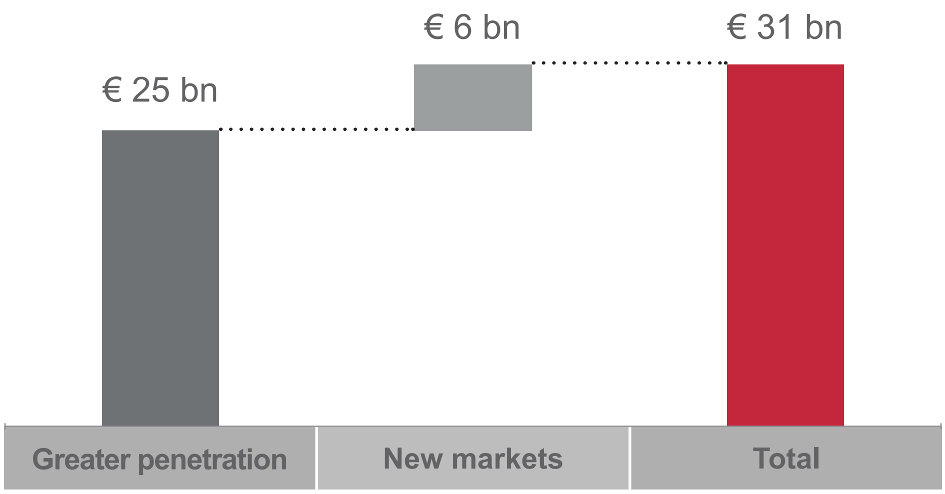
Source: SACE

← *Countries of opportunity with structural weaknesses or affected by global dynamics last year and now requiring prudence.*

→ *New sources of demand for Italian products.*

These countries of opportunity could provide € 31 billion **in additional exports over the next four years, largely due to greater penetration of those markets where Italy is already present** (Chart 4).

CHART 4. *Potential recovery of Italian exports*



Source: SACE

This is necessary, considering that in 2015 alone Italian exports may have "lost" **over € 5 million in the higher-risk economies**[14].

By shifting their emphasis to countries less affected by the global crisis, like the emerging countries, Italian exporters have been able to absorb much of the impact. In 2016 companies should focus on their "right" mix to capture the principal sources of demand. The crisis has taught us that the concept of risk-free no longer exists, **but with structured, precise support instruments Italian exporters can reach almost the entire world**. Without making clear distinctions (such as advanced vs emerging), that are few markets that should be avoided and many the sources of risk, at least perceived, peculiar to the individual markets.

The increased difficulties in a few countries resulted in a loss of € 5 billion in exports in the past year. But by channeling our products toward more dynamic markets, we can reverse this trend and generate € 31 billion more in the next four. How? **By drawing upon a broad range of information to support their decisions, utilizing a specialized advisory service, developing a strategic approach to investments and, of course, taking specific forms of coverage.** The SACE range of instruments can readily neutralize the principal risks associated with export markets, pave the way to financing by selected banks, and accompany company management in the markets that now represent the real frontier of opportunity for exports and investments. **A world less level requires expert guidance to safely explore new (and old) markets and expand abroad without concern.**

[14] *This figure was estimated by applying the change in Italian exports to those countries in the first nine months of 2015 to the value of exports in 2014, assuming no change in data in the last three month. These countries include: Angola, Belarus, Brazil, Greece, Iraq, Kazakhstan, Libya, Nigeria, Pakistan, Russia, Syria, South Africa, Tunisia, Ukraine and Venezuela.*

APPENDIX 1. *Which key factor will influence the country in 2016*

ADVANCED COUNTRIES

Europe and Oceania

Country	Commodity prices	Debt	Political violence
Poland	✖		
Spain	✖		
Norway	✖		
Australia	✖		

EMERGING COUNTRIES

Sub-Saharan Africa

Country	Commodity prices	Debt	Political violence
Angola	✖		
Botswana		✖	
Burundi			✖
Ivory Coast			✖
Ghana		✖	
Kenya	✖		
Mozambique		✖	
Nigeria			✖
South Africa		✖	
Zambia	✖		

Asia			
Country	Commodity prices	Debt	Political violence
Bangladesh		✖	✖
China	✖		
India	✖		
Indonesia	✖		
Malaysia		✖	
Maldives		✖	
Mongolia	✖	✖	
Myanmar			✖
Pakistan			✖
Thailand			✖

Latin America			
Country	Commodity prices	Debt	Political violence
Argentina	✖		
Brazil		✖	
Chile		✖	
Dominican Republic		✖	
Ecuador	✖		
Peru		✖	
Uruguay			✖
Venezuela	✖		✖

Commonwealth of Independent States			
Country	Commodity prices	Debt	Political violence
Azerbaijan		✕	
Belarus		✕	
Georgia	✕		
Kazakhstan	✕		
Russia	✕		
Ukraine			✕

Middle East and North Africa			
Country	Commodity prices	Debt	Political violence
Algeria	✕		
Egypt	✕	✕	
Libya			✕
Tunisia			✕
Saudi Arabia	✕		
Iran			✕
Iraq		✕	✕
Syria			✕
Turkey	✕	✕	✕

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