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Country risk: Hot Chile leaves the region trailing

by Andrew Mortimer

Brazil, Colombia and Chile receive their highest ever scores in Euromoney's Country Risk survey, benefiting from improved macroeconomic policies and the region's robust economic growth. But Mexico, Argentina and Venezuela are riskier than a decade ago.

The latest rankings from Euromoney Country Risk (ECR) show that Latin American sovereigns receive higher ratings from economists than ever before, with improved scores for the region's top borrowers across a range of political, economic and structural risk indicators.

The ratings indicate a convergence trend between the scores of the region's highest-rated sovereigns and their counterparts in Europe and North America.

However, the results also confirm the widely held view that some of the region's largest economies are heading backwards and are now considered riskier than they were 10 years ago.

The ECR survey evaluates investment risks by asking experts to rate countries across a range of political, economic and structural criteria. More than 400 economists participate in the survey, which assigns a country risk score to 186 markets globally.

As Euromoney's heat map of country risk illustrates, there is a large disparity between economists' perceptions of risk in Latin America.

Country risk: Latin America heat map

Source: Euromoney Country Risk

Chile, the top-rated sovereign in the region and the only country included in the green second tier of ECR's five-tier system, has a country risk score of 75 out of a possible 100, the 18th highest score in the world.

Chile's rating puts it alongside developed economies such as France, the UK and the US, whose ratings have each deteriorated in recent years.

In contrast, Guyana, the riskiest sovereign in the region, has a country risk score of 28 out of 100. With low survey scores for corruption, government interference/non-repatriation and access to capital markets, Guyana's risk ranking is more than 100 places below Chile's, placing it near the bottom, in ECR's tier five.

A further six sovereigns in the region are included in the fifth tier (red in Euromoney's heat map), essentially cut off from global capital markets due to high levels of transfer, business and political risk.

However, bounded by these two extremes, a group of seven sovereigns have a moderate country risk outlook, placing them in ECR's third tier. Typically consistent with an investment-grade rating, tier-three countries are usually emerging but underdeveloped economies with stable political systems.

The performance of many of these sovereigns in ECR's survey during the past decade illustrates the improving risk outlook of the region as a whole.

Latin America's largest economies have had mixed fortunes over the past decade. Brazil, Colombia, Peru and Chile are considered much less risky than they were in 2000. The four sovereigns have risen by more than 20 places each in the ECR rankings during this period. Peru's risk rating improved the most, climbing 37 places. Colombia made the next biggest gains, rising 29 places.

Chile, the region's pace-setter, retains its long-standing position as the safest economy in Latin America, rising 21 places. But Venezuela and Argentina have both tumbled since 2000 to become the riskiest of the region's leading economies.

A main driver behind Latin America's improvement has been rising scores in the survey's economic assessment. They have risen in each of the region's leading economies, including Argentina, which defaulted in 2002.

In part, this is a story about economic growth. Colombia, which saw the largest score gain in this period, has benefited from the post-conflict improvement in its domestic security in the last decade that has enabled large foreign-direct-investment flows to its energy and resources sectors, spurring growth.

Rising global commodities prices have also driven economic growth in Peru, Chile and Argentina during the past decade, with a concomitant improvement in per capita GDP and government debt ratios.

The trend is reflected in ECR's economic outlook indicator, one of five economic variables within the survey, where three Latin American sovereigns – Chile, Peru and Colombia – score highly enough to be included in the global top 20.

Similarly, high global oil prices have enabled Venezuela's policymakers to persevere with the isolationist policies of its president, despite the country's deteriorating economic and fiscal outlook. Its economic outlook score, though falling, remains a supportive factor in its overall country risk score.

However, the high scores awarded to Latin American sovereigns by ECR economists also reflect the improved macroeconomic policy framework adopted by the region's most successful countries.

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Latin America's new generation of policymakers appears to have grasped the lessons of the sovereign debt crises of past decades, enacting legislation to ensure sustainable government debt levels, while taking effective measures to tackle inflation.

For example, Colombia's leaders won plaudits from the IMF and other commentators last summer after the enactment of legislation placing a legal limit on the budget deficit and mandating the creation of a stabilization fund using oil revenues.

Rafael Amiel, an analyst at IHS Global Insight, says: "We have a more optimistic view of the government's ability to manage its deficit and allocate resources effectively now that the budget legislation has been passed."

Colombia rose nine places in the ECR rankings last year, with an improved score in the government finances indicator.

A similar story has taken place in Peru, whose fiscal framework was praised by the IMF in a recent country note for helping reduce gross government debt from 44% of GDP in 2004 to 24% in 2010. It's no coincidence that Peru's overall economic score has improved by 36 points since 2000, more than any other Latin American sovereign.

Winners and losers

ECR score changes from December 2000 to December 2011

Country	Rank Dec '11	Rank change since 2000	ECR score	ECR change	Economic change	Political change
Chile	18	+21	75.2	+9.4	+35.5	+5.6
Brazil	39	+28	62.9	+11.6	+30.5	+12.4
Colombia	42	+29	59.7	+10.8	+37.1	+18.8
Mexico	44	+2	58.7	-1	+21.5	-8.3
Peru	52	+37	55.8	+16.7	+35.8	+7.4
Argentina	95	-38	38.9	-16	+6.3	-15.7
Venezuela	105	-29	36.1	-7.8	+16.4	-14.1

Source: www.euromoneycountryrisk.com

These and similar efforts have registered in ECR's macroeconomic indicators, where scores for selected Latin American sovereigns are now on a par with European and North American sovereigns.

In the survey's monetary policy/currency stability assessment – essentially a measure of economists' confidence in a country's central bank – Chile, Colombia and Peru feature in the global top 30. Each of these sovereigns now receives higher scores in this category than the UK, US and Italy.

In ECR's bank-stability indicator, which measures the strength of national financial systems, experts now rate Chile as the ninth safest in the world, with a higher score than many triple-A rated sovereigns. Brazil and Colombia also make the bank stability global top 30, with both sovereigns receiving a score of seven or higher out of 10 from economists.

André Loes, chief economist at HSBC Brazil and a member of ECR's expert panel, says: "Important reforms of the institutional framework took place in Brazil during the 1990s, along with the strengthening of macro-prudential oversight and regulation. The next phase must bring about increased efficiency in the public and private sectors, and further investment in hard and soft infrastructure. This will lead to productivity gains that will lead to increased GDP growth without an increase in inflation."

Unlike the widespread improvement in Latin America's economic assessment, political risk scores in the region sharply diverged during the decade. Political risks have moderated in Brazil, Colombia, Peru and Chile since 2000, but Argentina, Venezuela and Mexico are now riskier than they were 10 years ago, according to ECR economists.

Political risks are rising fastest in Venezuela, which has the lowest political score of the three countries. Venezuela's political score fell by 3.4 points last year, with warning signals flashing red across a range of indicators.

Scores for corruption, information access/transparency, institutional risk, regulatory and policy environment, and government stability deteriorated during 2011. Venezuela now has one of the lowest scores in the world in ECR's government non-payments/non-repatriation category (GNP), the survey's most explicit indicator of transfer risk.

Argentina's political scores in other indicators are marginally better than Venezuela's, but its overall political risk score (35.5 out of 100) remains poor in comparison with regional and international standards. Economists consider Argentine transfer risk to be as pronounced as in Venezuela, with both countries receiving the same GNP score (2.8 out of 10).

The unreliability of Argentina's official government statistics is indicated by low scores for information access/transparency, while survey scores of four or less in business environment indicators reflect the hurdles facing international investors.

Mexico's country risk score has stagnated during the past decade. It is now rated a point lower than in 2000, although it remains far above Venezuela or Argentina in the rankings. The country, the fourth-safest economy in the region, continues to perform well in the survey's macroeconomic indicators, but its political risk score has declined by eight points during the past decade.

Mexico receives poor scores for corruption, government stability and institutional risk. The business environment deteriorated again in 2011, with Mexico's overall political score falling by a point during the year. Many blame Mexico's political system for its low growth rate relative to other emerging economies in recent decades. The recent spate of drug-related violence is also having a negative effect on FDI flows.

Neil Pyper, an analyst at Oxford Analytica and a member of ECR's expert panel, is pessimistic about Mexico's political outlook. "Many vestiges of the old one-party system need an overhaul," he says.

Neil Pyper, Oxford Analytica

"Employment legislation needs to become more flexible, the tax system needs reform and general fiscal reform is needed to reduce dependence on oil revenues. But the political constraints to action remain very high."

Structural deficiencies remain the main factor impeding Latin American sovereigns from rising further in ECR's rankings. Latin American scores in Euromoney's four structural indicators – hard and soft infrastructure, labour market/industrial relations and demographics – trail the European and North American averages by 30 points out of 100, reflecting the emerging status of the region's economies.

If Chile – whose policymakers pursued market-oriented reforms much earlier than elsewhere in the region – is removed from the average, the deficit becomes even larger.

The biggest weakness throughout Latin America is hard infrastructure. Brazil, which receives a score of 4.8 out of 10, is below average for the region. Colombia, where infrastructure development was delayed longer than elsewhere on the continent by internal security issues, receives an infrastructure score of just 4.1.

However, this is beginning to change. Medellín-based construction firm Condor recently proposed a $111 million IPO to fund domestic highway and airport development projects. The new National Infrastructure Agency, created in November, should also help streamline public bidding processes for infrastructure projects.

"Improved security is opening up swathes of the country for infrastructure developments," says Amiel at IHS Global Insight.

Average scores for soft infrastructure are also low. Peru and Venezuela are the region's worst performers, and only Chile receives a score of seven or more. The same is true in the labour market/industrial relations indicator, in which the Latin American average is three points lower than the European average. Chile, Mexico and Brazil receive the highest scores in the region for demographics.

Latin American country risk scores weathered the crisis in the eurozone in the fourth quarter of 2011. Average scores for political, economic and structural risk improved across the region during the quarter – Latin America was the only region in the world to achieve this.

In addition, Latin America was the only region to receive higher average-bank-stability scores during the quarter. The performance mirrored the robustness of Latin America's country risk scores after the global financial crisis in 2008, where few countries registered weighty declines.

However, external shocks remain a threat. Growth forecasts across the region have been slashed as the crisis in the eurozone has escalated. The region's largest commodities exporters could also be hit hard in the event of a GDP shock in China. In Colombia, commodity exports accounted for about 65% of export revenue in 2010 – up from 50% in 2007. Brazil would also be affected by a slowdown in China through its iron ore and coal exports.

"Brazil is largely insulated from a eurozone shock," says Loes at HSBC Brazil. "The obvious transmission channels – portfolio flows – are less significant for Brazilian institutions than they were in 2008. But Brazil is exposed to a slowdown in China, as China is the buyer of last resort for global commodities, which dominate Brazil's trade balance."

ECR uses expert opinion to create a live indicator of country risk, rating 186 markets worldwide.

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