Country Risk Forecasting

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# Table of Contents

1. Why Do We Forecast?  
2. How Do We Forecast?  
3. Country Risk Case Studies  
4. Common Questions  
5. Q&A
1. Why Do We Forecast?
Why Do We Forecast?

Forecasts Help Our Clients In Several Ways

• Our macroeconomic forecasts help our corporate clients develop pan-regional and country-level growth strategies. We help by:
  – Identifying regional and country-level trends in growth and government policy.
  – Identifying sub-sector trends on a GDP by expenditure basis (consumption, investment, exports etc), or on a industry-basis (autos, commodities, shipping, pharmaceuticals, telecoms etc).

• We help our financial clients by identifying short-to medium term trade ideas for the major asset classes including fixed income, equities, currencies & commodities.
  – These are investment-focused ideas.
  – Focus is on financial markets, but heavily influenced by our macro views.

• Importantly, we also help all of our clients identify key risks. They can be:
  – Macroeconomic risks related to growth, politics, business environment, regulation etc
  – Financial markets risks related to the currency, the cost of finance or commodities.
Why Do We Forecast?

What Are We Forecasting Anyway?

• **Our forecasts help tell a story about what the future will look like.** Our forecasts are a narrative (based on analysis) of how we see the global, regional, our country-level economies/sectors evolving over time and how it will impact market participants, whether they are corporations, governments, or investors.

• **All of our analysis and forecasts are underpinned by data.** This includes:
  – Historical data and forecasts out 10 years for 175 countries & 23 sectors. Total of 762,380 lines of data (including derived data).
  – Integration of data throughout the whole research process.
  – Proprietary, databases and risk ratings (economics, politics and sovereign ratings)

• **This allows our clients to navigate uncertain waters and plan for future growth, while managing risk.**
2. How Do We Forecast?
How Do We Forecast?

A Visual Representation Of Our Methodology:
The most important idea behind our forecasting methodology is that one cannot look at any area of risk in isolation:
- There is a reflexive process that ties the different areas of risk together
- One area of risk can impact another, so ignore them at your own peril

All areas of risk are inter-related. Here is a great corporate example:
- **Carlsberg** is a beverage company. 30% of revenues come from Eastern Europe & Russia in particular.
- So roughly 30% of revenues depend on sales to the Russian consumer, which in turn is affected by:
  - *Wages, economic activity* → determined by government policy, oil price/sales, investment, inflation, credit conditions.
  - *Currency movements* → determined by macro policy, investment, oil exports, etc.
  - *The price of oil* → determined by global demand & supply as well as political risk: China, US, Eurozone, Saudi Arabia, Iran etc.
How Do We Forecast?

A Visual Representation In Practice

Brazil Economic Outlook

- Oil & Gas Research
  - O&G Price Forecasts
  - O&G Output Forecasts

- Infrastructure Research

- Agribusiness Research
  - Coffee/Cocoa/Sugar/Grains Output Forecasts

- Mining Research
  - Iron ore Price Forecasts
  - Iron ore Output Forecasts

- Global Economic View
  - Investor risk appetite
  - US$/EUR
  - Eurozone
  - US

- Regional Economic View

- BMI Ratings

- Politics

- Local Data
  - O&G Output Forecasts
How Do We Forecast?

What Are The Benefits Of This Integrated Methodology?

- **Proactive Analysis & Forecasting**
  - Forward looking views, rather than reactive analysis

- **Consistency & Coherence**
  - Due to the large number of countries & industries we cover, we have a systematic approach

- **Independence**
  - Our methodology is wholly proprietary
  - Out of consensus views that can have a significant material implications for countries & corporate clients
3. Case Studies

- In 2007 we saw some very concerning signals
  - Country-wide falling house prices
  - Poor lending standards
  - High leverage in the banking and shadow banking system
  - High commodity prices sapping consumer spending
  - Large international macroeconomic imbalances (current account imbalances)
  - A slowing of economic growth
  - Some stress in financial markets

- In October 2007, we became very cautious, due to rising stress in financial markets
  - Credit conditions were tightening quickly, despite monetary easing
  - Equity markets looked very weak
  - Any deterioration in financial markets would have negative effects on growth
  - A US recession would have a negative effect on emerging markets growth and commodities due to the nature of rebalancing
Could Greece 2010 Be Worse Than Argentina 2001?

- In April 2010, we ran a comparison between Greece In 2010 and Argentina 2001, which suggested that Greece would be much worse:
  - Greece would not be able to devalue (as part of the euro)
  - The costs of exiting the eurozone would be too high
  - Financial stress would see a rise in bond yields, affecting investment
  - Political cohesion would be difficult

Key Analysis
- Macroeconomics
- Politics
- Global Dynamics
- Financial Markets
2011-2012 China Slowdown

• We have long-held a below consensus view on Chinese growth. Although we were a little early in 2011, the view has played out very well in 2012.

  – Growth of 7.5% in 2012, well below consensus
  – Housing property bubble would start to deflate
  – Huge state/provincial off balance sheet debt
  – Negative return on infrastructure investment (ROI) due to overcapacity
  – Limited room for government stimulus similar to 2009
  – Currency is not a one way bet due to short-term financial flows

– This view has significant ramifications for global growth and for the extractive sectors of Latin America given that China accounts for 40-50% of global metals demand.
Potential For Another Venezuela Devaluation

- There are several imbalances which will lead to another devaluation:
  - M2/reserves ratio & the black market rate suggest at least a 30% devaluation
  - Oil accounts for 95% of exports
  - High inflation and government controls deter investment
  - Capital controls remain in effect
  - Political power is highly concentrated
  - Upcoming elections may lead to uncertainty with regard to policy
  - Increased presence of military in the government
  - Core view is that Chávez wins in October
2012 Risks To Infrastructure Investment

- We have been highlighting risks to investment in global infrastructure. A primary example was Australia:
  - Below consensus growth on China
  - Australia’s exposure to Chinese growth & a strong exchange rate
  - Below consensus view on commodity prices (China)
  - Mining investment would weaken as margins fall
  - Infrastructure plans (railways and ports) to support mining expansion in doubt
  - **Result:** Several companies have announced Capex under review (ex: US$20bn Port Hedland by BHP)

- This trend will likely spread to other resource-related countries such as Canada, Peru, Chile, Brazil etc.
4. Most Common Questions
Most Common Questions

Examples of The Type of Questions We Receive

- What is your outlook for China and why?

- What is your outlook for the Eurozone and will Greece default?

- How resilient is the Latin American consumer to a global slowdown?

- What is your view on political reforms, and what does this mean for growth?

- Is security in the region a problem?

- Are Latin American governments in better shape to deal with another recession?
5. Q&A
In January 2007, Citi released a Climate Change Position Statement, the first US financial institution to do so. As a sustainability leader in the financial sector, Citi has taken concrete steps to address this important issue of climate change by: (a) targeting $50 billion over 10 years to address global climate change; includes significant increases in investment and financing of alternative energy, clean technology, and other carbon-emission reduction activities; (b) committing to reduce GHG emissions of all Citi owned and leased properties around the world by 10% by 2011; (c) purchasing more than 52,000 MWh of green (carbon neutral) power for our operations in 2006; (d) creating Sustainable Development Investments (SDI) that makes private equity investments in renewable energy and clean technologies; (e) providing lending and investing services to clients for renewable energy development and projects; (f) producing equity research related to climate issues that helps to inform investors on risks and opportunities associated with the issue; and (g) engaging with a broad range of stakeholders on the issue of climate change to help advance understanding and solutions.

Citi works with its clients in greenhouse gas intensive industries to evaluate emerging risks from climate change and, where appropriate, to mitigate those risks.