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**Country risk
Emerging economies caught in the storm**

- *The global crisis is affecting emerging country risk*
- *The crisis has revealed their vulnerabilities, but with contrasting situations*
- *Analysis of risk in Russia, Turkey and India*

Euler Hermes has published its analysis of country risk in a global economic crisis. Country risk takes on another dimension in a recessionary environment. Emerging countries are faced with dwindling sources of external financing, the recession of the major economies and falling commodities prices. These difficulties have been exacerbated by bank liquidity problems, volatile exchange rates and the withdrawal of foreign capital. These economies' weaknesses, less visible during growth periods, have resurfaced. Countries that seemed perfectly safe a short while ago now represent a risk for the companies that do business with them.

Against this backdrop, Euler Hermes Country Risk Analyst David Atkinson said: *"The present economic crisis is affecting all countries, with no exception. Although some countries are in a better position to resist the crisis, many are experiencing a rapid deterioration in their situation. It is essential that trade partners and exporters keep a close watch on these countries, on the reforms implemented and on future trends"*.

Emerging economies are slowing

Euler Hermes is forecasting growth of less than 1% for the global economy in 2009 with the large developed economies experiencing their first recession since World War II. At the same time, emerging economies are being severely hurt by a world crisis that does not correspond to a normal economic cycle. The decoupling theory, whereby emerging economies would continue to grow, has been largely invalidated. These countries now face numerous problems:

- Wide-scale withdrawal of foreign investment
- Drop in exports
- Tumbling commodities prices (oil, etc.)

Against this difficult background, Euler Hermes expects economic growth to slow sharply in emerging countries.

Regional real GDP (% change)	2003-2006 annual average	2007	2008 Euler Hermes projections	2009 Euler Hermes projections
Emerging Europe	6.8	7.0	5.4	2.0
Russia	7.1	8.1	6.1	1.5
Turkey	7.5	4.5	2.3	1.0
Emerging Asia	8.4	9.2	7.1	5.0
China	10.5	11.9	9.2	7.0
India	8.7	9.0	7.0	5.0
Latin America	4.6	5.5	4.6	1.9
Brazil	3.4	5.1	5.5	2.3
Mexico	3.3	3.3	2.0	0.0
Middle East & Africa	5.8	5.7	5.9	4.6

A growing number of high-risk countries

The overall trend in the risk ratings assigned by Euler Hermes to each country (see methodology) reflects the general trend in risk of international trade. With the risk ratings of 16 countries downgraded in 2008, international trade has entered a more turbulent period.

2000	-1
2001	-5
2002	-8
2003	+3
2004	+11
2005	+1
2006	-1
2007	+3
2008	-16

At the individual level, each country's rating reflects its sensitivity to a downturn in its environment and its capacity to stand firm. In the present conditions, individual country risk ratings can change rapidly and should therefore be monitored closely by exporters and their partners.

Since the economic crisis worsened, Euler Hermes has downgraded the country risk ratings of eleven countries:

	Grade Change
South Korea	A → BB
Hungary	B → C
Romania	B → C
Bulgaria	B → C
Lithuania	B → C
Guatemala	B → C
Jordan	B → C
Iceland	A → D
Argentina	C → D
Pakistan	C → D
Vietnam	C → D

Euler Hermes has identified a group of more vulnerable countries:

- With a C rating: Hungary, Romania, Russia, Turkey, Lithuania, Bulgaria, Latvia, Kazakhstan, Indonesia, Dominican Republic, Honduras and Jamaica
- With a D rating: Iceland, Ukraine, Serbia, Bosnia Herzegovina, Vietnam, Argentina, Venezuela, Ecuador, Kenya, Lebanon and Pakistan

Some countries are in a better position than others to face the crisis

Some countries have resources and structures that offer more shelter from the global crisis: Singapore (rated AA), Chile (A), Czech Republic (A), Hong Kong (A), Malaysia (A), Slovenia (A), Taiwan (A), Bahrain (BB), Botswana (BB), Brazil (BB), Israel (BB), South Korea (BB), Kuwait (BB), Mexico (BB), Oman (BB), Poland (BB), Qatar (BB), Saudi Arabia (BB), Slovakia (BB), South Africa (BB), Thailand (BB) and Tunisia (BB).

Russia: liquidity crunch and tumbling oil prices

Russia's economic growth is expected to slow significantly, from 6.1% in 2008 to 1.5% in 2009 according to Euler Hermes estimates, after several strong years (7.4% in 2006 and 8.1% in 2007). The rapid slowdown was visible in the fourth quarter of 2008 with a very sharp fall in industrial production. The business slowdown has been accompanied by a slump in the share prices of listed Russian companies (down 70% in six months) and the weakening of the rouble, down 13% against the dollar, despite heavy intervention.

Foreign exchange reserves have decreased by more than 25% since August 2008 and the fall in the price of oil will have a significant impact on the fiscal and external current account balances.

Euler Hermes has left its C rating unchanged but notes the risks from banking and corporate foreign exchange illiquidity and lower oil prices.

Turkey: strong inflation and low foreign exchange reserves

Turkey's economic growth has slowed significantly since 2007 (6.9% in 2006, 4.5% in 2007). Euler Hermes is expecting economic growth to stand at 2.3% in 2008 and fall to 1.0% in 2009. Inflation remains relatively high. Euler Hermes estimates that the inflation rate will have risen to 10.1% in 2008 and remain at a similar level in 2009 (10%).

The large current account deficit and reliance on short time capital flows is a key vulnerability and the Turkish Lira has fallen sharply. Foreign exchange reserves have also fallen but currently still cover 3.5 months of imports, though only 60% of external debt due in 2009.

Euler Hermes has left its C rating unchanged but is closely monitoring the situation, including developments with regards to the IMF programme currently under discussion.

India: substantial foreign exchange reserves but limited possibilities

India recorded a sharp downturn in industrial activity in the fourth quarter of 2008. The banking sector has been relatively sheltered from the global financial crisis directly though credit conditions have tightened noticeably. The Indian stock market and exchange rates have also been affected. Economic growth has slowed significantly but remains relatively high in the global context (7.0% in 2008 and 5.0% in 2009 according to Euler Hermes forecasts).

Government support for the currency have significantly decreased into foreign exchange reserves but these still cover seven months of imports and the total stock of external debt.

However, the size of the fiscal deficit considerably constraints government action to offset the slowdown in economic activity.

Euler Hermes has maintained its B rating. Regional and political uncertainties will also need to be monitored.

Methodology

Euler Hermes assigns each country a risk rating that reflects the country's economic and political risk. The economic factors taken into account are the macroeconomic indicators (indebtedness, fiscal deficit, etc) and institutional and structural factors. The political factors taken into account are the efficiency and stability of the political system in place. The combination of these two types of indicators are reflected in a rating – AA, A, BB, B, C or D; AA is the strongest rating. This classification constitutes a first filter for any credit limit request and influences the terms and conditions of cover extended by Euler Hermes.

Euler Hermes country risk analysis

Three Euler Hermes specialists, two in London and one in Hamburg, are dedicated to country risk. A country risk committee, which also includes representative of group subsidiaries, meets every two months. The country risk specialists' work is published in a weekly bulletin. Any change in a country's risk results in an immediate, ad hoc review.

David Atkinson is one of Euler Hermes' three country risk analysts. He joined the group in 1999 and has established a Group-wide framework for country risk analysis. Previously, David spent twenty-five years in international banking as an emerging markets and country risk analyst, specialising in Latin America, Eastern and Southern Europe and East Asia including China. David is based in the United Kingdom and holds a degree in Economics from the University of Nottingham.

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Euler Hermes has developed a credit intelligence network that enables it to analyse the financial stability of 40 million businesses across the globe. The group protects worldwide business transactions totalling €800 billion.

Euler Hermes, subsidiary of AGF and a member of the Allianz group, is listed on Euronext Paris. The group and its principal credit insurance subsidiaries are rated AA- by Standard & Poor's.

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