THE PRS GROUP EST.1979

CHALLENGING BORDERS CHALLENGING RISK

The ICRG Methodology

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"A VITAL SOURCE FOR MANAGING AND ADVISING INVESTMENT FUNDS THAT FOCUS ON VOLATILE COUNTRIES, BOTH EMERGING AND DEVELOPED."

— DR MICHEL-HENRY BOUCHET

DISTINGUISHED FINANCE PROFESSOR, SKEMA BUSINESS SCHOOL, PARIS.

CHALLENGING BORDERS
CHALLENGING RISK

OVERVIEW

The International Country Risk Guide (ICRG) has been the world's leading quant-driven geopolitical risk data and forecasting series for over 40 years. Used by universities, institutional investors, transnational firms, central banks, multilateral organizations, and think tanks, ICRG covers some 150 developed, emerging, frontier markets, and offshore banking centers. The ICRG methodology evaluates, scores, and ranks countries separately according to 32 political, economic, and financial risks. A composite score, derived from the risk categories, is provided for each country.

> *Christopher's diverse and enduring presence in the geopolitical risk field has been instrumental in making the International Country Risk Guide one of the most authoritative and respected quant-driven risk and forecasting series globally.*
>
> — *Dr Nassar Abaalkhail*
>
> *Chairman of the G20 Anti-corruption Working Group, Assistant to the President for International Collaboration, Control and Anti-Corruption Authority Saudi Arabia*

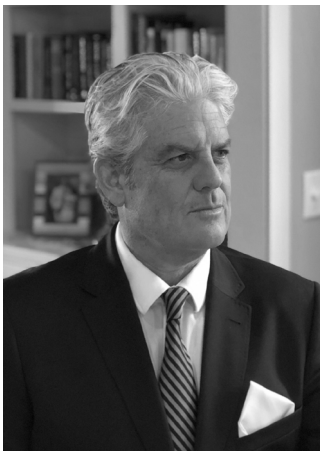
The political risk ratings integrate 12 weighted metrics, covering a range of elements that could prove injurious to business and other commercial interests. ICRG's economic and financial risk variables comprise such items as real GDP growth, inflation, fiscal and current account balances, external debt and debt servicing capacity, liquidity sufficiency, and currency stability. The composite risk scores are a weighted product of the three risk categories noted above.

The ICRG methodology is exceptional in that all metrics contain "Type II" forecasts, which offer users one-year and 5-year outlooks. Such a feature is vital to investment hedging or corporate planning efforts as they provide a guide to the nature and extent of future risks for country exposures, capital budgeting, or insurance needs.

Moreover, to facilitate and promote objective cross-country comparisons, the metrics are informed by multiple risk bands populated with proprietary qualifying criteria.

Unlike other geopolitical risk series, ICRG has been featured in leading academic and trade journals for decades and are cited frequently in the IMF and NBER Working Paper series along with those various central banks and the Bank for International Settlements. Moreover, for over two decades, ICRG's corruption scores have been vital input into Transparency International's annual Corruption Perceptions Index (CPI).

As we now adjust to different realities in the wake of the pandemic and by the onset of war in Europe, our work is more significant than ever. The scope of government power, new regulations and mandates, reconfigured trade relations and supply chains, stagflation, and inequality – to name just a few of the challenges facing us – have come to the fore at a rapid pace, challenging the most seasoned investor and business, and presenting untold research opportunities to the academic world.



Updated monthly, the ICRG risk series extends to the early 1980s, and is balanced by two related products: CountryData Online (CDO), a 40 year series of all of PRS' political, economic, financial and social data, comprising over two million data points, and Country Reports and Economic Forecasts (CREF), 18-month and five-year regime forecasts affecting 100 countries, including assessments of a dozen government actions that could prove injurious to commercial enterprises.

Christopher McKee, PhD
CEO/Owner of The PRS Group
Executive Chairman of the International Country Risk Guide (ICRG)

PART ONE: INTELLECTUAL FOUNDATIONS & OUR HISTORY

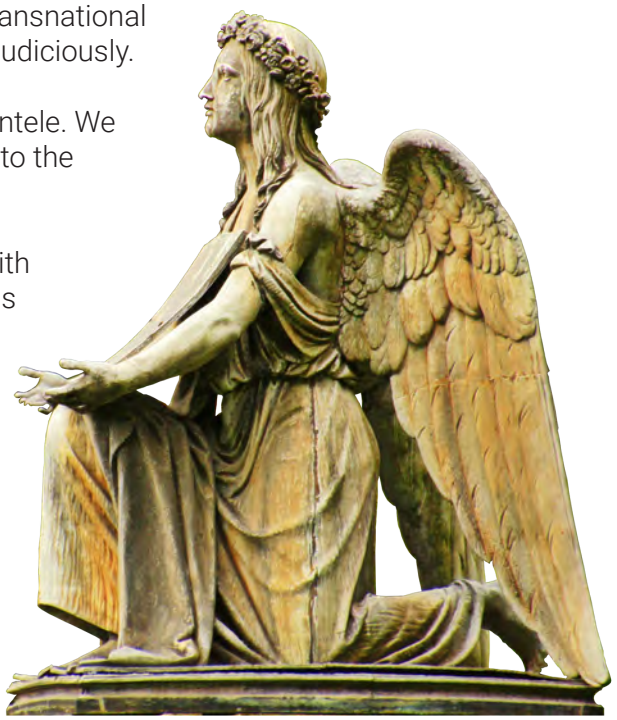
From a Hindu-Arabic numbering system to Luca Pacioli's 'probability of points' and the commercial activities of early Venetian merchants, each helped move us beyond empty prophesies. Yet it was during the languid summer of 1654 and the correspondence of two French arithmeticians that helped refine the concept of probability, later forming the basis of risk management. Blaise Pascal and Pierre de Fermat altered our way of thinking about the future. How we saw the world changed. The Gods were no longer in charge.

The late 1960s saw the US State Department and the CIA ask two university professors to undertake a unique task: to assign probabilities to the potential decisions of country officials ahead of high-level meetings in Washington. The professors already had their models – it was the application that was key.

Success was achieved. It was the dawn of the Behavioral Revolution, and the models were the first methodical and practical effort at geopolitical risk assessment and forecasting, and a unique extension to the literature that sought to systematize and quantify its subject matter. This was the genesis of PRS.

From that beginning, our quest to quantify political risk and make it relevant to a range of interests has continued. As our risk models were refined, the metrics expanded, our firm emerged as the first commercial entity to position itself as the principal actor in this burgeoning field. Print and television appearances came alongside gaining interest in our work by the academicians. Independent back-testing occurred, and the results published in scholarly journals. Our accuracy was acknowledged.

The Iranian Revolution saw a large-scale expropriation of Western assets, making our data and forecasts even more relevant. ICRG offered a way of quantifying the probability of a range of geopolitical risks, from expropriation to social turmoil, capital repatriation, to terrorism. Transnational firms could now plan more effectively, manage their assets more judiciously.



Throughout the 1980s and 1990s the firm grew in stature and clientele. We passed through Black Friday and later aided investors venturing into the then relatively unknown world of emerging markets.

By the mid-90s, our risk data continued to be empirically tested, with remarkable results. Just two years prior to the Asian financial crisis our metrics were found to be linked to equity returns in emerging markets. Investors could also use our data to contruct portfolios that returned 25% annually, with less risk and less volatility. No other firm has accomplished this task - then and now. In addition to scholarly writings, *Barron's* magazine took notice of our work and, with it, millions of readers, and investors.

At the outset of the new millennium, terrorism entered center stage of world affairs. Our risk metrics were able to form an assessment of the likelihood of future extremism not found anywhere else. Later, our government stability and

liquidity ratios helped guide our clients through the Financial Crisis of 2007-08. Our metrics affecting various socioeconomic conditions, internal turmoil, and democratic responsiveness put us ahead of all others, as we warned clients of the Arab Spring months before the first signs of instability in the Middle East reared its head.

By the next decade, our quant-driven data series had been fully incorporated into the mainstream of Artificial Intelligence, machine learning and ESG/impact investing. Our data revealed interesting relationships between and among risk metrics and were successfully integrated into trading and portfolio management systems.

As we now adjust to different realities in the COVID-19 world our work is more significant than ever. The scope of government power, new regulations and mandates, reconfigured trade relations and supply chains, stagflation, and inequality – to name just a few of the challenges facing us – have come to the fore at a rapid pace, challenging the most seasoned investor and business, and presenting untold research opportunities to the academic world.

We've been through crises many times. The future is clearer than assumed.

PART TWO: THE INTERNATIONAL COUNTRY RISK GUIDE

ICRG was created in 1980 by the editors of *International Reports*: a widely respected weekly newsletter on international finance and economics. As commercial interest in emerging and frontier markets began to grow at the time, and as investors began to shed themselves of 'home-bias,' clients required an in-depth and exhaustively researched analysis of the potential risks to international business.

The editors – many of whom later went on to head emerging market operations for some of the largest institutional investors globally – therefore created a quant-driven model to assess the myriad risks. Select written country analyses accompanied the data series to add content and forward guidance to the client.

The result was a unique and comprehensive approach to geopolitical risk assessment that allows various risks to investment and commercial operations to be weighted, measured, and compared across countries and across time.

DATA COLLECTION

The process of data collection for the ICRG is unique in the industry. Our global roster of analysts all hold second degrees – at a minimum – in a relevant discipline as well as practical experience in such fields as investment finance, corporate risk management, private equity, insurance, export credit, and related sectors.

By extension, PRS' longstanding and diverse clientele is a valuable source of applied knowledge, which add a refined dimension to our work not found in mainstream 'web-scraping' programs used by other firms that rely on press reports and those offered by public offices.

The economic and financial data is derived from respected sources, from central banks and multilateral organizations. Econometric modeling is conducted in-house to complete incomplete data series and for forecasting.

SELECT EMPIRICAL FINDINGS

ICRG data have been back-tested for accuracy and relevance for decades, with the results appearing in the most respected academic and trade journals. Below is a curated list of some empirical findings associated with the data.

Predictive Power and Asset Returns

ICRG's political risk ratings have predictive power for both political risk insurance claims as well as political risk events measured by news coverage. On average, ICRG ratings begin to deteriorate 44 months before an insurance claim is filed; similarly, declines in the ICRG ratings occur approximately three months prior to the event being reported in the news media. (Bekaert, Harvey, Lundblad & Siegel, "Political Risk Spreads," *J. of Int'l Business Studies*, 2014.

Based on a sample portfolio of 47 countries over a 10-year period, improvements in ICRG's economic risk measures saw those portfolios provide a return of over 25% – with less risk and less volatility. (Erb, Harvey, Viskanta, "Political Risk, Economic Risk, and Financial Risk, *Financial Analysts Journal*, 1996.)

COVID-19

Based on a sample of 133 countries from 2001-18, social unrest (as measured by the ICRG 'civil disorder' risk metric) surged about 14 months after the onset of disease, peaking in areas as far out as 24 months. (Sedik and Xu, "A Vicious Cycle: How Pandemics Lead to Economic Despair and Social Unrest, *IMF Working Paper*, October 2020)

Looking at 55 countries that experienced pandemics from 1990-2019 – and employing ICRG composite scores as a proxy for 'institutional quality' – such events had detrimental medium-term effects on output, unemployment, poverty, and inequality. But well-managed fiscal and related policies went a long way toward alleviating suffering and fostering an inclusive recovery. (Cuestra Aguirre and Hannan, "Recoveries After Pandemics: The Role of Policies and Structural Features," *IMF Working Paper*, July 2021).

ICRG's Government Stability risk indicators were highly predictive of governments' responsive times to the onset of COVID-19 and continue to affect subsequent efforts, especially in emerging markets. (Eichengreen, Saka, Aklsoy, 'The Political Scar of Epidemics,' *NBER Working Paper*, June 2020).

ESG Investing and Climate Change

ICRG measures of Internal and External Conflict have been able to shed light on income inequality and war, as per capita GDP tends to decline by 28% a decade following armed conflict, and official trade flows suffer markedly. (Novta & Pugacheva, 'The Macroeconomic Costs of Conflict,' *IMF Working Paper*, June 2020).

Using ICRG data to gauge political support & costs, and a sample of 30+ developed and emerging markets from 2001-2015, certain Climate Change Policies – especially market-based measures – are likely to face opposition not only from energy-using industries, but from the public. These costs can be avoided if the design of mitigation policies considers political economy dimensions and complementary policies deployed to protect vulnerable households. (Furceri, Gansimeier, Ostry, 'Are Climate Change Policies Politically Costly?' *IMF Working Paper*, June 2021).

ICRG's composite risk index helped underscore the relationship between income and gender inequality and economic growth in Sub-Saharan Africa, finding that both – including legal gender-based restrictions – are negatively associated with per capita GDP growth. (Hakura, et al., 'Inequality, Gender Gaps and Economic Growth: Comparative Evidenec for Sub-Saharan Africa, *IMF Working Paper*, June 2016).

PART THREE: A MORE GRANULAR LOOK AT THE ICRG METHODOLOGY

THE POLITICAL RISK RATING

The aim of the political risk rating is to provide a means of assessing the political stability of the countries covered by ICRG on a comparable basis. This is done by assigning risk points to a range of political risk components and subcomponents with a maximum total of 100 points.

The minimum number of points that can be assigned to each component is zero, while the maximum number of points depends on the fixed weight that component is given in the overall political risk assessment. In every case the lower the risk point total, the higher the risk, and the higher the risk point total the lower the risk.

To ensure consistency, both between countries and over time, points are assigned by ICRG based on a series of pre-set questions for each risk component.

THE POLITICAL RISK COMPONENTS

The following risk components, weights, and sequence are used to produce the political risk rating:

POLITICAL RISK COMPONENTS		
Sequence	**Component**	**Points (max.)**
A*	Government Stability	12
B*	Socioeconomic Conditions	12
C*	Investment Profile	12
D*	Internal Conflict	12
E*	External Conflict	12
F	Corruption	6
G	Military in Politics	6
H	Religious Tensions	6
I	Law and Order	6
J	Ethnic Tensions	6
K	Democratic Accountability	6
L	Bureaucracy Quality	4
Total		**100**

* Risk rating subcomponent data available starting in May 2001

Government Stability – 12 Points

This is an assessment both of the government's ability to carry out its declared program(s), and its ability to stay in office. The risk rating assigned is the sum of three subcomponents, each with a maximum score of four points and a minimum score of 0 points. A score of 4 points equates to Very Low Risk and a score of 0 points to Very High Risk.

The subcomponents are:

- Government Cohesion
- Legislative Strength
- Popular Support

Socioeconomic Conditions – 12 Points

This is an assessment of the socioeconomic pressures at work in society that could constrain government action or fuel social dissatisfaction. The risk rating assigned is the sum of three subcomponents, each with a maximum score of four points and a minimum score of 0 points. A score of 4 points equates to Very Low Risk and a score of 0 points to Very High Risk.

The subcomponents are:

- Unemployment
- Consumer Confidence
- Poverty

Investment Profile – 12 Points

This is an assessment of factors affecting the risk to investment that are not covered by other political, economic and financial risk components. The risk rating assigned is the sum of three subcomponents, each with a maximum score of four points and a minimum score of 0 points. A score of 4 points equates to Very Low Risk and a score of 0 points to Very High Risk.

The subcomponents are:

- Contract Viability/Expropriation
- Profits Repatriation
- Payment Delays

Internal Conflict – 12 Points

This is an assessment of political violence in the country and its actual or potential impact on governance. The highest rating is given to those countries where there is no armed or civil opposition to the government and the government does not indulge in arbitrary violence, direct or indirect, against its own people. The lowest rating is given to a country embroiled in an on-going civil war. The risk rating assigned is the sum of three subcomponents, each with a maximum score of four points and

a minimum score of 0 points. A score of 4 points equates to Very Low Risk and a score of 0 points to Very High Risk.

The subcomponents are:

- Civil War/Coup Threat
- Terrorism/Political Violence
- Civil Disorder

External Conflict – 12 Points

The external conflict measure is an assessment both of the risk to the incumbent government from foreign action, ranging from non-violent external pressure (diplomatic pressures, withholding of aid, trade restrictions, territorial disputes, sanctions, etc) to violent external pressure (cross-border conflicts to all-out war).

External conflicts can adversely affect foreign business in many ways, ranging from restrictions on operations to trade and investment sanctions, to distortions in the allocation of economic resources, to violent change in the structure of society. The risk rating assigned is the sum of three subcomponents, each with a maximum score of four points and a minimum score of 0 points. A score of 4 points equates to Very Low Risk and a score of 0 points to Very High Risk.

The subcomponents are:

- War
- Cross-Border Conflict
- Foreign Pressures

Corruption – 6 Points

This is an assessment of corruption within the political system. Such corruption is a threat to foreign investment for several reasons: it distorts the economic and financial environment; it reduces the efficiency of government and business by enabling people to assume positions of power through patronage rather than ability; and, last but not least, introduces an inherent instability into the political process.

> *HIGHLY VALUABLE... FOR THE DEVELOPMENT AND IMPLEMENTATION OF ANTI-CORRUPTION PRACTICES.*
>
> — *Dr Jin-young Kwak*
>
> *Vice-Chair of South Korea's Anti-Corruption and Civil Rights Commission*

The most common form of corruption met directly by business is financial corruption in the form of demands for special payments and bribes connected with import and export licenses, exchange controls, tax assessments, police protection, or loans. Such corruption can make it difficult to conduct business effectively, and in some cases may force the withdrawal or withholding of an investment.

Although our measure takes such corruption into account, it is more concerned with actual or potential corruption in the form of excessive patronage, nepotism, job reservations, 'favor-for-favors', secret party funding, and suspiciously close ties between politics and business. In our view these insidious sorts of corruption are potentially of much greater risk to foreign business in that they can lead to popular discontent, unrealistic and inefficient controls on the state economy, and encourage the development of the black market.

The greatest risk in such corruption is that at some time it will become so overweening, or some major scandal will be suddenly revealed, as to provoke a popular backlash, resulting in a fall or overthrow of the government, a major reorganizing or restructuring of the country's political institutions, or, at worst, a breakdown in law and order, rendering the country ungovernable.

Military in Politics – 6 Points

The military is not elected by anyone. Therefore, its involvement in politics, even at a peripheral level, is a diminution of democratic accountability. However, it also has other significant implications.

The military might, for example, become involved in government because of an actual or created internal or external threat. Such a situation would imply the distortion of government policy in order to meet this threat, for example by increasing the defense budget at the expense of other budget allocations.

In some countries, the threat of military take-over can force an elected government to change policy or cause its replacement by another government more amenable to the military's wishes. A military takeover or threat of a takeover may also represent a high risk if it is an indication that the government is unable to function effectively and that the country therefore has an uneasy environment for foreign businesses.

A full-scale military regime poses the greatest risk. In the short term a military regime may provide a new stability and thus reduce business risks. However, in the longer term the risk will almost certainly rise, partly because the system of governance will be become corrupt and partly because the continuation of such a government is likely to create an armed opposition.

In some cases, military participation in government may be a symptom rather than a cause of underlying difficulties. Overall, lower risk ratings indicate a greater degree of military participation in politics and a higher level of political risk.

Religious Tensions – 6 Points

Religious tensions may stem from the domination of society and/or governance by a single religious group that seeks to replace civil law by religious law and to exclude other religions from the political and/or social process; the desire of a single religious group to dominate governance; the suppression

of religious freedom; the desire of a religious group to express its own identity, separate from the country as a whole.

The risk involved in these situations range from inexperienced people imposing inappropriate policies through civil dissent to civil war.

Law and Order – 6 Points

"Law and Order" form a single component, but its two elements are assessed separately, with each element being scored from zero to three points. To assess the "Law" element, the strength and impartiality of the legal system are considered, while the "Order" element is an assessment of popular observance of the law. Thus, a country can enjoy a high rating – 3 – in terms of its judicial system, but a low rating – 1 – if it suffers from a very high crime rate if the law is routinely ignored without effective sanction (for example, widespread illegal strikes).

Ethnic Tensions – 6 Points

This component is an assessment of the degree of tension within a country attributable to racial, nationality, or language divisions. Lower ratings are given to countries where racial and nationality tensions are high because opposing groups are intolerant and unwilling to compromise. Higher ratings are given to countries where tensions are minimal, even though such differences may still exist.

Democratic Accountability – 6 Points

This is a measure of how responsive government is to its people, on the basis that the less responsive it is, the more likely it is that the government will fall, peacefully in a democratic society, but possibly violently in a non-democratic one.

The points in this component are awarded on the basis of the type of governance enjoyed by the country in question. For this purpose, we have defined the following types of governance:

Alternating Democracy

The essential features of an alternating democracy are:

- A government/executive that has not served more than two successive terms,
- Free and fair elections for the legislature and executive as determined by constitution or statute,
- The active presence of more than one political party and a viable opposition,
- Evidence of checks and balances among the three elements of government: executive, legislative and judicial,
- Evidence of an independent judiciary,
- Evidence of the protection of personal liberties through constitutional or other legal guarantees.

Dominated Democracy

The essential features of a dominated democracy are:

- A government/executive that has served more than two successive terms,
- Free and fair elections for the legislature and executive as determined by constitution or statute,
- The active presence of more than one political party,
- Evidence of checks and balances between the executive, legislature, and judiciary,
- Evidence of an independent judiciary,
- Evidence of the protection of personal liberties.

De Facto One-Party State

The essential features of a de facto one-party state are:

- A government/executive that has served more than two successive terms, or where the political/electoral system is designed or distorted to ensure the domination of governance by a particular government/executive,
- Holding of regular elections as determined by constitution or statute,
- Evidence of restrictions on the activity of non-government political parties (disproportionate media access between the governing and non-governing parties, harassment of the leaders and/or supporters of non-government political parties, the creation of impediments and obstacles affecting only the non-government political parties, electoral fraud, etc).

De Jure One-Party State

The identifying feature of a one-party state is:

- A constitutional requirement that there be only one governing party,
- Lack of any legally recognized political opposition.

Autarchy

The identifying feature of an autarchy is:

- Leadership of the state by a group or single person, without being subject to any franchise, either through military might or inherited right.

In an autarchy, the leadership might indulge in some quasi-democratic processes. In its most developed form this allows competing political parties and regular elections, through popular franchise, to an assembly with restricted legislative powers (approaching the category of a de jure or de facto one-party state). However, the defining feature is whether the leadership, i.e. the head of government, is subject to election in which political opponents are allowed to stand.

In general, the highest number of risk points (lowest risk) is assigned to Alternating Democracies, while the lowest number of risk points (highest risk) is assigned to Autarchies.

Bureaucracy Quality – 4 Points

The institutional strength and quality of the bureaucracy is another shock absorber that tends to minimize revisions of policy when governments change. Therefore, high points are given to countries where the bureaucracy has the strength and expertise to govern without drastic changes in policy or interruptions in government services. In these low-risk countries, the bureaucracy tends to be somewhat autonomous from political pressure and to have an established mechanism for recruitment and training. Countries that lack the cushioning effect of a strong bureaucracy receive low points because a change in government tends to be traumatic in terms of policy formulation and day-to-day administrative functions.

> *...A WIDELY USED INDICATOR TO CAPTURE INSTITUTIONAL AND POLITICAL RISK.*
>
> *— IMF, NEPAL: SELECTED ISSUES, COUNTRY REPORT NO. 20/97, FEBRUARY 28, 2020*

ASSESSING POLITICAL RISK

Overall, a political risk rating of 0.0% to 49.9% indicates a Very High Risk; 50.0% to 59.9% High Risk; 60.0% to 69.9% Moderate Risk; 70.0% to 79.9% Low Risk; and 80.0% or more Very Low Risk.

However, a poor political risk rating can be compensated for by a better financial and/or economic risk rating.

THE ECONOMIC RISK RATING

The overall aim of the Economic Risk Rating is to provide a means of assessing a country's current economic strengths and weaknesses. In general terms, where its strengths outweigh its weaknesses it will present a low economic risk and where its weaknesses outweigh its strengths it will present a high economic risk.

These strengths and weaknesses are assessed by assigning risk points to a pre-set group of factors, termed economic risk components. The minimum number of points that can be assigned to each component is zero, while the maximum number of points depends on the fixed weight that component is given in the overall economic risk assessment. In every case the lower the risk point total, the higher the risk, and the higher the risk point total, the lower the risk.

To ensure comparability between countries the components are based on accepted ratios between measured data within the national economic/financial structure. It is the ratios that are compared, not the data themselves. The points assigned to each component (ratio) are taken from a fixed scale.

THE ECONOMIC RISK COMPONENTS

The risk points in each table are assigned according to the following scales to produce the economic risk rating with a maximum total of 50 points.

GDP Per Head – Table 7

The estimated GDP per head for a given year, converted into US dollars at the average exchange rate for that year, is expressed as a percentage of the average of the estimated total GDP of all the countries covered by ICRG.

GDP Per Head	
% of average	Points
250.0 plus	5.0
200.0 to 249.9	4.5
150.0 to 199.9	4.0
100.0 to 149.9	3.5
75.0 to 99.9	3.0
50.0 to 74.9	2.5
40.0 to 49.9	2.0
30.0 to 39.9	1.5
20.0 to 29.9	1.0
10.0 to 19.9	0.5
Up to 9.9	0.0

Real GDP Growth – Table 8

The annual change in the estimated GDP, at constant 1990 prices, of a given country is expressed as a percentage increase or decrease.

Real GDP Growth	
Change (%)	Points
6.0 plus	10.0
5.0 to 5.9	9.5
4.0 to 4.9	9.0
3.0 to 3.9	8.5
2.5 to 2.9	8.0

Real GDP Growth	
Change (%)	**Points**
2.0 to 2.4	7.5
1.5 to 1.9	7.0
1.0 to 1.4	6.5
0.5 to 0.9	6.0
0.0 to 0.4	5.5
-0.1 to -0.4	5.0
-0.5 to -0.9	4.5
-1.0 to -1.4	4.0
-1.5 to -1.9	3.5
-2.0 to -2.4	3.0
-2.5 to -2.9	2.5
-3.0 to -3.4	2.0
-3.5 to -3.9	1.5
-4.0 to -4.9	1.0
-5.0 to -5.9	0.5
-6.0 below	0.0

Annual Inflation Rate – Table 9

The estimated annual inflation rate (the unweighted average of the Consumer Price Index) is calculated as a percentage change.

Annual Inflation Rate	
Change (%)	**Points**
< 2.0	10.0
2.0 to 2.9	9.5
3.0 to 3.9	9.0
4.0 to 5.9	8.5
6.0 to 7.9	8.0
8.0 to 9.9	7.5
10.0 to 11.9	7.0
12.0 to 13.9	6.5
14.0 to 15.9	6.0

Annual Inflation Rate	
Change (%)	**Points**
16.0 to 18.9	5.5
19.0 to 21.9	5.0
22.0 to 24.9	4.5
25.0 to 30.9	4.0
31.0 to 40.9	3.5
41.0 to 50.9	3.0
51.0 to 65.9	2.5
66.0 to 80.9	2.0
81.0 to 95.9	1.5
96.0 to 110.9	1.0
111.0 to 129.9	0.5
130.0 plus	0.0

Budget Balance as a Percentage of GDP – Table 10

The estimated central government budget balance (including grants) for a given year in the national currency is expressed as a percentage of the estimated GDP for that year in the national currency.

Budget Balance	
% GDP	**Points**
4.0 plus	10.0
3.0 to 3.9	9.5
2.0 to 2.9	9.0
1.0 to 1.9	8.5
0.0 to 0.9	8.0
-0.1 to -0.9	7.5
-1.0 to -1.9	7.0
-2.0 to -2.9	6.5
-3.0 to -3.9	6.0
-4.0 to -4.9	5.5

Budget Balance	
% GDP	Points
-5.0 to -5.9	5.0
-6.0 to -6.9	4.5
-7.0 to -7.9	4.0
-8.0 to -8.9	3.5
-9.0 to -9.9	3.0
-10.0 to -11.9	2.5
-12.0 to -14.9	2.0
-15.0 to -19.9	1.5
-20.0 to -24.9	1.0
-25.0 to -29.9	0.5
-30.0 below	0.0

Current Account as a Percentage of GDP – Table 11

The estimated balance on the current account of the balance of payments for a given year, converted into US dollars at the average exchange rate for that year, is expressed as a percentage of the estimated GDP of the country concerned, converted into US dollars at the average rate of exchange for the period covered. The risk points are then assigned according to the following scale:

Current Account % GDP	
% GDP	Points
10.0 plus	15.0
8.0 to 9.9	14.5
6.0 to 7.9	14.0
4.0 to 5.9	13.5
2.0 to 3.9	13.0
1.0 to 1.9	12.5
0.0 to 0.9	12.0
-0.1 to -0.9	11.5
-1.0 to -1.9	11.0
-2.0 to -3.9	10.5
-4.0 to -5.9	10.0
-6.0 to -7.9	9.5

Current Account % GDP	
% GDP	Points
-8.0 to -9.9	9.0
-10.0 to -11.9	8.5
-12.0 to -13.9	8.0
-14.0 to -15.9	7.5
-16.0 to -16.9	7.0
-17.0 to -17.9	6.5
-18.0 to -18.9	6.0
-19.0 to -19.9	5.5
-20.0 to -20.9	5.0
-21.0 to -21.9	4.5
-22.0 to -22.9	4.0
-23.0 to -23.9	3.5
-24.0 to -24.9	3.0
-25.0 to -26.9	2.5
-27.0 to -29.9	2.0
-30.0 to -32.5	1.5
-32.5 to -34.9	1.0
-35.0 to -39.9	0.5
-40.0 below	0.0

ASSESSING ECONOMIC RISK

As noted above, points are awarded to each risk component on a scale from zero up to a pre-set maximum. In general terms, if the points awarded are less than 50% of the total, that component can be considered as very high risk. If the points are in the 50-59.9% range it is high risk, in the 60%-69.9% range moderate risk, in the 70-79.9% range low risk, and in the 80-100% range very low risk. However, this is only a general guideline as a better rating in other components can compensate for a poor risk rating in one component.

Overall, an economic risk rating of 0.0% to 24.9% indicates a Very High Risk; 25.0% to 29.9% High Risk; 30.0% to 34.9% Moderate Risk; 35.0% to 39.9% Low Risk; and 40.0% or more Very Low Risk.

Once again, however, a poor economic risk rating can be compensated for by a better political and/or financial risk rating.

THE FINANCIAL RISK RATING

The overall aim of the Financial Risk Rating is to provide a means of assessing a country's ability to pay its way. In essence, this requires a system of measuring a country's ability to finance its official, commercial, and trade debt obligations.

This is done by assigning risk points to a pre-set group of factors, termed financial risk components. The minimum number of points that can be assigned to each component is zero, while the maximum number of points depends on the fixed weight that component is given in the overall financial risk assessment. In every case the lower the risk point total, the higher the risk, and the higher the risk point total the lower the risk.

To ensure comparability between countries the components are based on accepted ratios between measured data within the national economic/financial structure. It is the ratios that are compared, not the data themselves. The risk points assigned to each component (ratio) are taken from a fixed scale.

THE FINANCIAL RISK COMPONENTS

The risk points in each table are assigned according to the following scales to produce the financial risk rating with a maximum total of 50 points.

Foreign Debt as a Percentage of GDP – Table 12

The estimated gross foreign debt in a given year, converted into US dollars at the average exchange rate for that year, is expressed as a percentage of the gross domestic product converted into US dollars at the average exchange rate for that year.

Foreign Debt % GDP	
Ratio (%)	**Points**
0.0 to 4.9	10.0
5.0 to 9.9	9.5
10.0 to 14.9	9.0
15.0 to 19.9	8.5
20 to 24.9	8.0
25.0 to 29.9	7.5
30.0 to 34.9	7.0
35.0 to 39.9	6.5
40.0 to 44.9	6.0
45.0 to 49.9	5.5

Foreign Debt % GDP	
Ratio (%)	**Points**
50.0 – 59.9	5.0
60.0 to 69.9	4.5
70.0 to 79.9	4.0
80.0 to 89.9	3.5
90.0 to 99.9	3.0
100.0 to 109.9	2.5
110.0 to 119.9	2.0
120.0 to 129.9	1.5
130.0 to 149.9	1.0
150.0 to 199.9	0.5
200.0 plus	0.0

Foreign Debt Service as a Percentage of Exports of Goods and Services – Table 13

The estimated foreign debt service, for a given year, converted into US dollars at the average exchange rate for that year, is expressed as a percentage of the sum of the estimated total exports of goods and services for that year, converted into US dollars at the average exchange rate for that year.

Debt Service % XGS	
Ratio (%)	**Points**
0.0 to 4.9	10.0
5.0 to 8.9	9.5
9.0 to 12.9	9.0
13.0 to 16.9	8.5
17.0 to 20.9	8.0
21.0 to 24.9	7.5
25.0 to 28.9	7.0
29.0 to 32.9	6.5
33.0 to 36.9	6.0
37.0 to 40.9	5.5
41.0 to 44.9	5.0
45.0 to 48.9	4.5
49.0 to 52.9	4.0

Debt Service % XGS	
Ratio (%)	Points
53.0 to 56.9	3.5
57.0 to 60.9	3.0
61.0 to 65.9	2.5
66.0 to 70.9	2.0
71.0 to 75.9	1.5
76.0 to 79.9	1.0
80.0 to 84.9	0.5
85.0 plus	0.0

Current Account as a Percentage of Exports of Goods and Services – Table 14

The balance of the current account of the balance of payments for a given year, converted into US dollars at the average exchange rate for that year, is expressed as a percentage of the sum of the estimated total exports of goods and services for that year, converted into US dollars at the average exchange rate for that year.

Current Account as % XGS	
Ratio (%)	Points
25.0 plus	15.0
20.0 to 24.9	14.5
15.0 to 19.9	14.0
10.0 to 14.9	13.5
5.0 to 9.9	13.0
0.0 to 4.9	12.5
-0.1 to -4.9	12.0
-5.0 to -9.9	11.5
-10.0 to -14.9	11.0
-15.0 to -19.9	10.5
-20.0 to -24.9	10.0
-25.0 to -29.9	9.5
-30.0 to -34.9	9.0
-35.0 to -39.9	8.5
-40.0 to -44.9	8.0

Current Account as % XGS	
Ratio (%)	**Points**
-45.0 to -49.9	7.5
-50.0 to -54.9	7.0
-55.0 to -59.9	6.5
-60.0 to -64.9	6.0
-65.0 to -69.9	5.5
-70.0 to -74.9	5.0
-75.0 to -79.9	4.5
-80.0 to -84.9	4.0
-85.0 to -89.9	3.5
-90.0 to -94.9	3.0
-95.0 to -99.9	2.5
-100.0 to -104.9	2.0
-105.0 to -109.9	1.5
-110.0 to -114.9	1.0
-115.0 to -119.9	0.5
-120.0 below	0.0

Net International Liquidity as Months of Import Cover – Table 15

The total estimated official reserves for a given year, converted into US dollars at the average exchange rate for that year, including official holdings of gold, converted into US dollars at the free market price for the period, but excluding the use of IMF credits and the foreign liabilities of the monetary authorities, is divided by the average monthly merchandise import cost, converted into US dollars at the average exchange rate for the period.

This provides a comparative liquidity risk ratio that indicates how many months of imports can be financed with reserves.

Net Liquidity in Months	
Months	**Points**
15 plus	5.0
12.0 to 14.9	4.5
9.0 to 11.9	4.0
6.0 to 8.9	3.5

Net Liquidity in Months	
Months	**Points**
5.0 to 5.9	3.0
4.0 to 4.9	2.5
3.0 to 3.9	2.0
2.0 to 2.9	1.5
1.0 to 1.9	1.0
0.6 to 0.9	0.5
0.5 or less	0.0

Exchange Rate Stability – Table 16

The appreciation or depreciation of a currency against the US dollar (or against the Euro in the case of the USA) over a calendar year or the most recent 12-month period is calculated as a percentage change.

Exchange Rate Stability		
Appreciation Change, plus	**Depreciation Change, minus**	**Points**
0.0 to 9.9	-0.1 to -4.9	10.0
10.0 to 14.9	-5.0 to -7.4	9.5
15.0 to 19.9	-7.5 to -9.9	9.0
20.0 to 22.4	-10.0 to -12.4	8.5
22.5 to 24.9	-12.5 to -14.9	8.0
25.0 to 27.4	-15.0 to -17.4	7.5
27.5 to 29.9	-17.5 to -19.9	7.0
30.0 to 34.9	-20.0 to -22.4	6.5
35.0 to 39.9	-22.5 to -24.9	6.0
40.0 to 49.9	-25.0 to -29.9	5.5
50 plus	-30.0 to -34.9	5.0
	-35.0 to -39.9	4.5
	-40.0 to -44.9	4.0
	-45.0 to -49.9	3.5
	-50.0 to -54.9	3.0
	-55.0 to -59.9	2.5

Exchange Rate Stability		
Appreciation Change, plus	**Depreciation Change, minus**	**Points**
	-60.0 to -69.9	2.0
	-70.0 to -79.9	1.5
	-80.0 to -89.9	1.0
	-90.0 to -99.9	0.5
	-100 below	0.0

ASSESSING FINANCIAL RISK

As noted above, points are awarded to each risk component on a scale from zero up to a pre-set maximum. In general terms if the points awarded are less than 50% of the total, that component can be considered as very high risk. If the points are in the 50-60% range it is high risk, in the 60%-70% range moderate risk, in the 70-80% range low risk and in the 80-100% range very low risk. However, this is only a general guideline as a better rating in other components can compensate for a poor risk rating in one component.

Overall, a financial risk rating of 0.0% to 24.5% indicated a Very High Risk; 25.0% to 29.9% High Risk; 30.0% to 34.9% Moderate Risk; 35.0% to 39.9% Low Risk; and 40.0% or more Very Low Risk. Once again, however, a poor financial risk rating can be compensated for by a better political and/or economic risk rating.

> *...widely used in the finance industry as a means of assessing the political stability of countries on a comparable basis.*
>
> — I Filippou, et al.
>
> "Global Political Risk and Currency Momentum." Journal of Financial and Quantitative Analysis, 53.5 (2018)

THE COMPOSITE RISK RATING

The Composite Risk Rating is calculated as an aggregate of Political Risk (100 points maximum), Financial Risk (50 points maximum), and Economic Risk (50 points maximum). The total points from the three indices are divided by two to produce the weights for inclusion in the Composite country risk rating.

The following formula is used to calculate the the Composite Political, Financial, and Economic Risk Rating:

$$\text{CPFER (country X)} = 0.5\ (\text{PR} + \text{FR} + \text{ER})$$

where
CPFER = Composite political, financial and economic risk ratings (max. 100 points)
PR = Total political risk indicators (max. 100 points)
FR = Total financial risk indicators (max. 50 points)
ER = Total economic risk indicators (max. 50 points)

The highest overall rating (theoretically 100) indicates the lowest risk, and the lowest rating (theoretically zero) indicates the highest risk.

As a general guide to grouping countries on the basis of comparable risk, the individual risk of each country can be estimated using the following fairly broad categories of Composite Risk.

Composite Risk	
Risk Band	**Points**
Very High Risk	00.0 to 49.9
High Risk	50.0 to 59.9
Moderate Risk	60.0 to 69.9
Low Risk	70.0 to 79.9
Very Low Risk	80.0 to 100

RISK FORECASTS

In addition to the current forecasts of Political, Financial, Economic, and Composite Risk, the ICRG also produces “Type II” forecasts, which offer users One-Year and Five-Year outlooks, produced using the same methodology that is used for the current risk forecasts.

Two forecasts are produced for each time period – a Worst Case Forecast (WCF) and a Best Case Forecast (BCF).

The WCF is produced by extrapolating the worst-case trend for each risk component in each risk category to produce a WCF for Political, Economic, and Financial Risk.

The BCF is produced by extrapolating the best-case trend for each risk component in each risk category to produce a BCF for Political, Economic, and Financial Risk.

Such trends could be an accelerating build-up of debt, political fragmentation, worsening ethnic or religious tensions, inadequate arrangements for government takeover in the case of the death or assassination of a leader, and so on.

In approaching the forecasting exercise, we make a judgment as to the "reasonableness" of the trend or event identified and the ability of the government to counteract such trends.

PRESENTATION

The risk forecasts are presented in the following tables.

- Table 2C: One-Year and Five-Year forecasts of the Composite Risk (WCF and BCF) and their Risk Stability.
- Table 3C: One-Year and Five-Year forecasts of Political Risk (WCF and BCF) and their Risk Stability.
- Table 4C: One-Year and Five-Year forecasts of Financial Risk (WCF and BCF) and their Risk Stability.
- Table 5C: One-Year and Five-Year forecasts of Economic Risk (WCF and BCF) and their Risk Stability.

In addition, the One-Year and Five-Year WCF and BCF for the Composite Risk are presented in Table 2B, along with the current Composite Risk Rating.