2016
Political Risk Map
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Aon's Political Risk Map: measuring risks in emerging markets

Emerging markets continue to attract businesses seeking alternative areas of growth. In such economies, assets, contracts and loans can be adversely affected by government action or inaction.

In today’s geopolitical and economic environment, organisations need to have comprehensive high level overviews of their exposure to emerging market political risk. It is important to plan ahead and to form strategies to be relevant to country risk types and degrees.

Unrivalled access to more than 19 years of data

The Interactive Map and its analytical tools allow users to plot trends, measure exposures and review the potential risks they may face as they look to invest, grow and diversify.

Complementing the print version, the Interactive Political Risk Map produces high level country overviews and tailored comparisons of country ratings and changes in risk. The data is updated quarterly and where appropriate at the time of material political risk events.

Aon’s Political Risk Map is produced in partnership with Roubini Global Economics (RGE) an independent, global research firm founded in 2004 by renowned economist Nouriel Roubini. The Roubini Global Economics Country Insights risk scoring model is adapted from the Aon Political Risk Icons. Country Insights utilizes 168 different data sets drawn from recognized data sources – such as the IMF, the World Bank and the United Nations.

An insightful guide to assess global political risks

Aon’s Political Risk Map is a valuable tool for all those with commercial interests in emerging markets.

At a glance, organisations can see the political risk landscape in countries of interest. Through its risk icons the map measures political risks in 162 countries and territories.

- Exchange transfer
- Legal and regulatory risk
- Political interference
- Political violence
- Sovereign non-payment
- Supply chain disruption
- The risk of doing business
- Banking sector vulnerability
- Risk to fiscal stimulus

“Risk Icons” assess a country’s exposure to each risk along with their likelihood of being able to cope with shocks or crises. The Risk Icons are responsible for generating the overall Country Risk Rating score.
2016 Political Risk Map Portal

Did you know?
Aon’s new look Political Risk portal is free to anyone interested in political risk. With interactive data going back 19 years it represents a comprehensive resource for those looking to better understand how political changes can affect their business.
Country Risk Rating changes in 2016: upgrades dominate

There have been 12 Country Risk Rating changes since the 2015 risk map was released, compared to 19 in 2014, 15 in 2013 and 25 in 2012. For the first time in the last three years, there were more upgrades (reductions in political risk) than downgrades (deterioration in risk).

Smaller oil importing countries accounted for most of the Country Risk Rating upgrades. Lower energy costs, increases in purchasing power and support to consumers were the main contributing factors. Many oil producing countries experienced increases in their sovereign non-payment and exchange transfer risks.

Several countries, including China and Indonesia, have increased anti-corruption measures which should, over time, improve the business environment.

Regional trends

Asia had the most Country Risk Rating changes in 2015, with more upgrades than downgrades. China was the largest country to experience a risk rating change.

African scores were relatively stable after several years of downgrades.

The Caribbean had two upgrades.

There were no changes in the Commonwealth of Independent States.

Eight countries were upgraded (experiencing a reduction in political risk):

China, Ethiopia, Haiti, Iran, Jamaica, Nepal, Pakistan and Serbia

Four countries were downgraded (experiencing an increase in political risk):

Cape Verde, Micronesia, Philippines and Suriname

Overall, twelve country rating changes were recorded in 2015, compared with 19 country risk rating changes in 2014.
Country Risk Rating changes

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Commonwealth of Independent States/Caucasus: No change

Middle East & North Africa: Improvement in Iran

Asia Pacific: Improvement in China, Nepal, Pakistan

Europe: Improvement in Serbia

Sub-Saharan Africa: Deterioration in Cape Verde, Improvement in Ethiopia

Latin America & Caribbean: Deterioration in Suriname, Improvement in Haiti, Jamaica

Global Map: Highlighted regions and countries showing changes.
What happened in 2015: How did we do?

Political risks troubled investors in 2015, as the weakening growth outlook hit economic resilience.

The hoped-for reforms following the 2014 electoral cycle in the largest emerging markets (Brazil, India, Indonesia and South Africa) have been lacklustre.

The intensity of the conflicts in Syria and Yemen increased dramatically.

Positives for 2015 included; the process around the potential lifting of sanctions imposed on Iran and Cuba, and Argentina where signs of reform emerged.

We highlighted the following risks at the launch of the 2015 Political Risk Map;

- The Russia-Ukraine conflict will weigh on the CIS region as sanctions encourage high levels of government intervention and exacerbate institutional risks
- Ongoing conflicts within countries and with non-state actors create heightened levels of political violence and present new risks (cyber security). Groups like ISIS, Boko Haram and others take advantage of porous borders and weak institutions across parts of the Middle East and Africa
- Weaker commodity prices will perpetuate deterioration in economic risks (exchange transfer and sovereign non-payment) in producing countries. Venezuela looks very vulnerable
- Differentiation in risks among commodity exporting nations. Those with more resilient institutions and more savings will prove better equipped, such as Gulf Cooperation Council (GCC), Colombia, Malaysia and Kazakhstan, versus those more institutionally vulnerable to the slump, namely Angola, Ghana, Venezuela, Russia, Ecuador
- A modest U.S. interest rate hiking cycle might increase competition for capital, drawing it out of emerging markets, increasing pressure on local exchange rates, increasing inflationary pressures and raising the cost of servicing external debt

2014: key trends

Middle East & North Africa - richer oil exporters in the Gulf Cooperation Council (GCC) have continued to be more resilient than poorer producers which have fewer policy and financial buffers to cope with the low oil price. ISIS through the conflicts in Libya and Syria maintains regional instability.

Latin America - low commodity prices and the collateral damage from corruption scandals weighed on regional resilience.

The first US monetary policy rate increase came later than expected. The response being capital outflows from the emerging markets as global banks began deleveraging.

Capital for long-term investment became constrained.
What to watch out for in 2016

For 2016 many of the risks we highlighted in both 2014 and 2015 will persist, particularly economic volatility stemming from the current low commodity prices. Similarly, the disruptive ascendance of trans-national terror groups will remain.

2016 will be defined by weak global growth, shifting trade patterns, monetary policy divergence and slow interest rate normalization. Some emerging markets are likely to maintain strong rates of growth, whereas China will see growth rates decline further. Russia’s economy will likely stabilise as it recovers from recession. Brazil and Venezuela are expected to suffer further painful contractions in their economies.

2016 global and regional themes:

- Greater use of capital controls. Countries like Angola, Ghana and Nigeria are expected to keep existing capital account restrictions. China will most probably tighten controls to manage capital outflows; which could discourage foreign investment

- Oil producing nations’ requirements to find substitutes for lost revenues will put pressure on their corporate sectors; at minimums through tax regime adjustments and at extremes through initial public offerings of state owned enterprises. Producers such as the GCC countries, Colombia, Malaysia, Kazakhstan and now Russia that have more resilient institutions and greater foreign currency reserves will be better positioned to survive this cycle. Angola, Ecuador, Ghana and Venezuela are not so fortunate. In the current climate investors should prepare for increases in defaults and arrears from state owned enterprises

- Liquidity support – certain countries will require financial support from the IMF and other multilateral financial institutions to assist their adjustment to the commodity price shock

- Levels of political violence will remain high. ISIS, despite losing territory, is gaining influence and providing cover to other radical extremists. These trends will also increase refugee flows

- Economic challenges and border disputes in Asia will encourage nationalism. In some cases, there will be increased defence spending and military shows of strength

- Greater government intervention and populist pressure in the Commonwealth of Independent State (CIS) countries will further undermine policy implementation. Ukraine could put its IMF programme at risk

- Positive trends will include the progressive lifting of sanctions on Cuba and Iran, and a more pro-business policy stance in Argentina following the election of President Mauricio Macri
Commonwealth of Independent States/Caucasus: Commodity woes and weak growth add to Political Risk

Russia’s weak growth will continue to reduce the value of remittances flowing to the region; Tajikistan and Kyrgyzstan being particularly vulnerable. There are hopes that sanctions imposed on Russia from Europe and the U.S. may be eased later in 2016.

The conflict in eastern Ukraine, particularly in the Donbass, offers no signs of abating.

Central Asian countries continue to experience higher political and economic risks stemming from a lack of growth in Kazakhstan, Russia and the slowdown in China. This puts pressure on local exchange rates and government and local finances. Local and regional banks will also become more vulnerable.

Currency adjustments in Russia, Kazakhstan and other oil producers has reduced the pressure on currency reserves, but has added to inflationary pressures. Such inflationary pressures could affect local stability through civil protests.

Should governments decide to restart long-standing privatization plans it may allow some openings to foreign investment and reduce government intervention in the economy. Such positive moves however, are more likely in 2017 and beyond.

New regional multi laterals like the Asian Infrastructure Investment bank, as well as China’s investment programme “one road, one belt” are sources of potential investment for the region and a means to improve economic security and social stability. Most of the projects may involve the import of goods, labour and capital from China; which will leave a number of countries in the CIS with improved infrastructure.

**Figure 1.1: Selected Commodity Prices, January 2013 - August 2015**

Source: IMF Commodity Price System; and IMF Global Assumptions.
“Central Asian countries continue to experience higher political and economic risks stemming from a lack of growth in Kazakhstan, Russia and the slowdown in China”
Middle East and North Africa: Oil drag deepens

Oil producers face another difficult year. Planned increases in taxes, reductions in public sector spending combined with sharp increases in the cost of living could threaten domestic stability. This will affect countries like Oman and Saudi Arabia as well as much weaker countries like Algeria and Iraq.

In order to facilitate a more moderate transition to the low oil price environment, GCC countries will likely repatriate financial resources to support currency pegs and provide liquidity for local banks. This may weaken liquidity and heighten political challenges for some emerging markets, such as Egypt, as they focus on investing in sectors supportive of economic development.

One of the most meaningful developments in the region was the implementation of the Joint Comprehensive Plan of Action, which prompted an improvement in Iran’s Country Risk Rating, as certain sanctions were lifted. Key to Iran’s future is the role that the Islamic Revolutionary Guards Corps (IRGC) and the wider military play. This means continued commitment to the nuclear deal, the implementation of economic reforms and the future composition of the legislature. Iran will likely play a more meaningful role in regional conflicts which may challenge the GCC.

As Iran gains access to more foreign markets it will increase global oil supply and eventually gas. Certain sanctions remain, which keeps European banks and some corporates cautious in their approach to future trade and investment. Iran has a more diversified economy than the wealthier GCC states and a better developed private sector than its North African counterparts.

A Syrian peace deal still looks far off. The conflict will continue to weigh heavily on regional political stability. The worsening refugee crisis is increasing the strain on regional players such as Jordan, Lebanon and Turkey, while also exerting pressure on Europe and its institutions. Global commitment to fighting ISIS remains high, but the tactical interests diverge, potentially elevating regional political risk.

The commitment of Saudi Arabia and the UAE to the conflict in Yemen remains high. To maintain the current tempo, military spending has been ring-fenced from planned spending cuts.
Oil exporters political and economic fortunes will continue to diverge

![Graph showing financial reserves of various oil exporters](source: IMF, Haver Analytics, Roubini Global Economics)
Sub-Saharan Africa: Commodity price shock

African economies have faced three related shocks:

- weaker commodity prices,
- a slowing China and;
- tighter global financial conditions,

which together have limited foreign and domestic investment. In many cases, the slump in commodity prices has increased i) sovereign non-payment risks as governments fall into arrears and ii) exchange transfer risk as capital controls tighten and dollar shortages worsen. Angola, Ghana, Nigeria and Zambia are countries where these risks have remained high or increased.

In Nigeria, the Buhari government’s focus on currency stabilisation has put pressure on the private sector and discouraged investment. Weak government revenues will delay planned infrastructure, including much-needed power generation. All this offsets the government’s efforts to reduce political violence, especially from Boko Haram.

Political violence risks increased in Burundi and Benin around elections. The conflict in the eastern parts of the Democratic Republic of the Congo remains a source of concern.

East African countries, including Ethiopia, have benefitted from lower energy and food costs. This has led to a reduction in exchange transfer and political violence risks. Although the militant group al-Shabaab is still a source of concern for the region, there are early signs that some of its operations are being contained.

The region’s most developed economy, South Africa, continues to suffer from economic deterioration and political interference. Its positive economic contribution to the southern sub-region is therefore diminishing. The strength of trade unions and the splintering of political groups is leading to increased uncertainty for investors.
“East African countries have benefited from lower energy and food costs. This has led to a reduction in exchange transfer and political violence risks"
Asia Pacific: Resilient, but some new pressures

The Asia region as a whole has experienced a reduction in political risk. Oil importing countries have benefited from lower oil prices while private consumption, a key contributor to growth, has increased. Real Gross Domestic Product (RGDP) growth in Emerging Asia (the 10 ASEAN members plus China and India) is expected to outpace other regions in the medium term. The main risks to growth are the continued slowdown in China, potential interest rate rises in the US and the slowing of productivity. Structural policies in the region are diverse, but there is a clear focus on the need for more inclusive sustainable development, as well as reducing the impact of economic activity on the environment.

China’s growth is projected to weaken further. The country’s economic policies have become more uncertain as the government tries to strike a balance between implementing reform and managing growth. Excess capacity continues; firms, including many SOEs, continue to drive down prices to secure market share at home and abroad. Additional stimulus may be needed if growth slows more than expected. Policy makers will need to address China’s excessive debt burden before the shift to a consumption-driven economy can properly progress. This could lead to divisions between heavily indebted local governments and the national administration. President Xi Jinping continues to consolidate power and remove his political enemies through his anti-corruption campaign.

Less exposed to the region’s dominant economy, the Philippines and Vietnam should be strong performers given their improved macroeconomic fundamentals and better implementation of infrastructure plans. Recovery in agriculture and expansions in tourism and industrial output will boost Cambodia’s and Lao PDR’s economies. Myanmar is also expected to benefit from rising investment and economic reforms.

Reform efforts in Malaysia, Indonesia and India have been delayed, although measures to counter corruption are expected to improve their political and economic resilience. In Malaysia, power struggles within the ruling UNMO party have increased the possibility of sociopolitical change and deferred investment. Government infrastructure investment and plans to open up sectors that have been off-limits to foreign investment are positives for Indonesia.

The weakening economic growth across the Asia-Pacific region seems to be encouraging nationalist sentiment, which in turn has led to increased security and defence spending in countries such as China, India, the Philippines and Vietnam. The effect of this trend is seen through the minor escalations in the long-standing territorial disputes in the East and South China Seas.

North Korea’s recent missile tests have reinforced its reputation as a rogue state, prompting a more coordinated approach from China’s and South Korea’s political leaders. Political violence risks are a concern for both Indonesia and Malaysia as local groups become more linked with ISIS and other global militant groups.
Latin America and Caribbean: Winners and losers

The commodity price slump and the slow down in China’s growth made last year tough economically for the region. Brazil is suffering its longest recession since the 1930s and Venezuela is arguably the world’s worst economy.

Venezuela is the most likely state to default in the region. It is anticipated that the economy will contract 8 percent (following a 10 percent contraction last year); the IMF predicts inflation will reach 720% this year. Price increases and food shortages have led to an escalation in civil protests. The viability of Petrocaribe (a regional oil subsidy scheme) is being put into question as a result of the current oil price environment and following the recent parliamentary elections.

Oil producer Ecuador, is vulnerable to falling into arrears. However, unlike Venezuela, Ecuador has little short-term debt, and has a more diversified export base, which should give it some economic resilience.

Brazil’s economy is expected to contract by 3.5 percent this year. Brazil faces deteriorations in its current account deficit, overall debt levels and debt servicing costs; all of which makes it harder for Brazil to refinance its debts without curbing investment. Dilma Rousseff’s government has been weakened by her potential impeachment and the Petrobras scandal. The required fiscal and economic measures have not been implemented, which further erodes Brazil’s economic credibility. The impact of the Zika virus on the economy is yet unknown. However, if the situation deteriorates further, it could have long-term consequences for the country as a whole.

There are, however, some positives in the region:

- **Argentina** – the new government’s aim is to normalise relations with the rest of the world. Key to its success will be a deal with its “holdout creditors” (who are refusing to accept part payment on their bonds); regaining market access and rolling out new investor-friendly policies. Although regulatory issues remain, there are early signs that this free-market approach will bring benefits to the wider economy. The Country Risk Rating should therefore improve in 2016.

- **Cuba** – is returning from isolation as a result of the progressive lifting of U.S. sanctions.

- **Colombia** – even given the reduction in government revenues, exchange transfer and sovereign non-payment risks remain negligible. Progress in opening up areas of the country to the formal economy will further reduce political violence risks.

“Brazil’s economy is expected to contract by 3.5 percent this year. Brazil faces deteriorations in its current account deficit, overall debt levels and debt servicing costs; all of which makes it harder for Brazil to refinance its debts without curbing investment.”
Map Methodology

Analysis and findings

Aon partnered with Roubini Global Economics (RGE), an independent, global research firm founded in 2004 by renowned economist Nouriel Roubini, to produce the Political Risk Map in order to take advantage of RGE’s unique methodology, Country Insights, for systematically analysing political risk around the world.

The Aon Political Risk Map follows a 3-layered approach in analysing political risk in emerging market countries (excluding EU and OECD countries).

Country ratings reflect a combination of:

- Analysis by Aon Risk Solutions
- Analysis by Roubini Global Economics
- The opinions of Lloyd’s syndicates and corporate insurers actively writing political risk insurance

Country insights as applied to the map allows clients:

- To systematically track changes in country risk
- To obtain more meaningful country comparisons
- To break down each risk to show the various elements that drive that risk

For further information, please visit Roubini’s website: www.roubini.com

Perils analysed

Each country is assigned a rating starting at Low, Medium Low, Medium, Medium High, High, Very High. The scores reflect the severity of risk in each state against nine core risk perils.

The map depicts 9 individual Risk Icons. Country Rating for the map includes input from the six core risk icons (Exchange Transfer, Legal and Regulatory, Political Interference, Political Violence, Sovereign Non-payment and Supply Chain Disruption) but three separate icons are also provided (Risks to Doing Business, Banking Sector Vulnerability and Risks to Fiscal Stimulus).

They are not intended to predict global events or future threats. The scores are weighted to accommodate a wide range of political risk variables.
Brief descriptions of each risk icon

Exchange Transfer: The risk of being unable to make hard currency payments as a result of the imposition of local currency controls. This risk looks at various economic factors, including measures of capital account restrictions, the country’s de-facto exchange rate regime and foreign exchange reserves.

Legal and Regulatory: The risk of financial or reputational loss as a result of difficulties in complying with a host country’s laws, regulations or codes. This risk comprises measures of government effectiveness, rule of law, wider property rights and regulatory quality.

Political Interference: The risk of host government intervention in the economy or other policy areas that adversely affect overseas business interests; e.g. nationalisation and expropriation. This risk is composed of various measures of social, institutional and regulatory risks.

Political Violence: The risk of strikes, riots, civil commotions, sabotage, terrorism, malicious damage, war, civil war, rebellion, revolution, insurrection, a hostile act by a belligerent power, mutiny or a coup d’etat. Political violence is quantified using measures of political stability, peacefulness and specific acts of violence.

Sovereign Non-Payment: The risk of failure of a foreign government or government entity to honour its obligations in connection with loans or other financial commitments. This risk looks at measures of both ability and willingness to pay, including fiscal policy, political risk and rule of law.

Supply Chain Disruption: The risk of disruption to the flow of goods and/or services into or out of a country as a result of political, social, economic or environmental instability.

Risks of Doing Business: The regulatory obstacles to setting up and operating business in the country, such as excessive procedures, the time and cost of registering a new business, dealing with building permits, trading across borders and getting bank credit with sound business plans.

Banking Sector Vulnerability: The risk of a country’s domestic banking sector going into crisis or not being able to support economic growth with adequate credit. This risk comprises measures of the capitalisation and strength of the banking sector, and macro-financial linkages such as total indebtedness, trade performance and labour market rigidity.

Risks to Fiscal Stimulus: The risk of the government not being able to stimulate the economy due to lack of fiscal credibility, declining reserves, high debt burden or government inefficiency.
Measuring Political Risk in a world of rapid change

Political risk scoring tools highlight differences between countries.

The Arab Spring, sparked by events in Tunisia and the 2008 financial crisis, synonymous with the collapse of Lehman Brothers, show the speed at which geopolitical and financial shocks can occur and escalate.

Tracking risk changes over time provides valuable insight into how a country may perform if hit by a major economic shock or unexpected event. Seemingly stable countries can deteriorate while others prove resilient.

Examples of using the PRM icons to identify differences

The Political Risk Map Icons allow us to differentiate between countries that carry the same Country Risk Rating by drilling down into individual risks. This enables investors to make better decisions about resource allocation and risk hedging.

Figure 1: Countries with Medium-High overall risk

<table>
<thead>
<tr>
<th>Political Violence</th>
<th>Legal &amp; Regulatory Risk</th>
<th>Supply Chain Disruption</th>
<th>Political Interference</th>
<th>Sovereign Non-payment</th>
<th>Exchange Transfer</th>
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Roubini Shadow Credit Ratings

The 2016 interactive Political Risk Map incorporates Roubini’s Shadow Credit Rating for 121 countries.

The Roubini Shadow Credit Rating was created to address perceived weaknesses in the existing over-reliance on the three main credit rating agencies (Fitch, Moody’s and S&P). The ratings are often i) slow to pick up changes in the underlying drivers of sovereign credit risk and ii) lag behind financial markets’ re-pricing of the true creditworthiness of a country.

The ratings are generated by applying the Roubini Country Strength Index against the sovereign credit ratings issued by the top three credit rating agencies. The results follow the S&P scaling system, with AAA a rating of the highest quality.

The Shadow Credit Rating, which is an assessment of a government’s ability to repay its sovereign debt, takes into consideration a broader set of variables including:

- sovereign non-payment risk
- institutional robustness
- economic growth potential and social risks

The Roubini Shadow Credit Ratings reveal strengths and weaknesses that may have been overlooked by the current rating agencies, and are therefore a proactive means of assessing the potential for future credit rating upgrades or downgrades.

For more on the Roubini Shadow Credit rating methodology, click here. 
(https://www.roubini.com/analysis/introducing-rges-shadow-credit-ratings)
Ahead of the curve

Below, we take a look at an example which demonstrate how Roubini Shadow Credit Ratings identified unseen risk(s) and foreshadowed eventual rating agency moves:

Brazil

By way of example, Brazil’s vulnerabilities were first signalled in Q3 2014 by Roubini’s Shadow Credit Rating downgrade to BB+. Major agencies at the time rated Brazilian government debt as either BBB or BBB+. Only in Q1 2015 did the major agencies begin to lower their ratings for Brazil once it became apparent that the government had no intention of meeting its own spending targets; most made several downgrades throughout the year.

As at February 2016, Fitch and S&P rate Brazilian government debt as BB+, against the current Roubini Shadow Credit Rating of BB-. Moody’s has, however, placed the country on review and is expected to cut Brazil to junk at some point in the near future.

Figure 2: Roubini Shadow Credit Ratings foreshadow Brazil’s 2015 credit rating slide
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