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Country Insights Methodology Highlights

By Country Insights Team

- In our volatile crisis-prone world, successful global investors must be equipped to identify countries that are resilient to economic and financial stress. Just as a canny investor carefully assesses the quality of a company's assets, liabilities and ownership structure, the Roubini Country Insights™ Model is designed to analyze the economic attractiveness and resilience of countries.
- This "national balance sheet approach" helps us identify risks and opportunities associated with a country and its economic building blocks (such as its banks and private and public sectors).
- Key features of the Roubini Country Insights™ Model:
    - Identifies and quantifies a country's economic, financial and sociopolitical risks, and growth potential;
    - Analyzes over 200 key variables for each of 174 countries to help investors uncover opportunities and hazards;
    - Employs a rigorous and consistent framework that enables precise global comparisons;
    - Utilizes frequently updated data from the key internationally recognized cross-country data sources.

The Risk of Crisis Is Ever Present—Identifying Fundamentally Strong Countries Is Key

Recent examples of acute global turmoil have shown how countries' often underappreciated fundamental weaknesses, such as banking-sector risk, fiscal deficits, debt burdens and low growth potential, can translate into prolonged economic slowdowns. For example, over-reliance on cross-border wholesale borrowing and excessive lending to household sectors led to acute funding and capital distress for many developed-market banks during the global financial crisis, contributing to the sharp global economic slowdown.

As another example, the oversupply of credit to the eurozone in the aftermath of the global crisis allowed already high levels of public debt to balloon to unsustainable levels, precipitating the eurozone crisis of 2012.

Policy makers, investors, forecasters and credit-rating agencies underestimated these and other imbalances. Although plenty of research has been written on the reasons for the 2007-08 global crisis, and rating agencies are reviewing their analytical approaches, neither the latter nor other market participants have produced an alternative model that captures countries' economic risks in a sufficiently comprehensive and objective fashion.

Why? Because the models for analyzing country risk currently on the market rely on the subjective judgment of analysts rather than systematic, quantitative analysis. These models cannot ensure consistency and comparability across either time or countries and are prone to human bias—for example, a rating change may occur due to analysts' changing roles rather than an alteration in underlying fundamentals.

The Roubini Country Insights™ team has been working since 2007 on a systematic, computable tool that addresses these analytical weaknesses.

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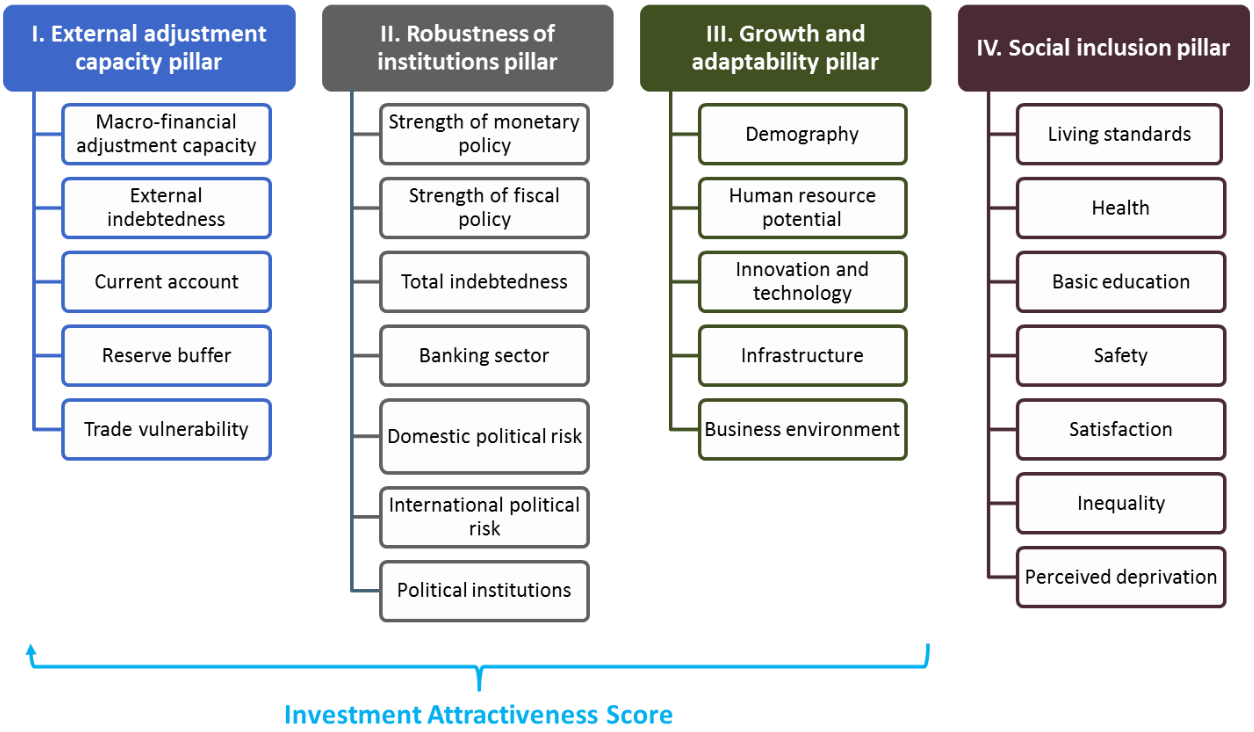
How the Country Insights™ Model Assesses a Country's Fundamental Attractiveness

The Country Insights™ Model is a comprehensive quantitative tool for assessing country and sovereign risk that scores a country's risk of external and domestic financial shocks and its ability to grow. At the Model's core is a "national balance sheet approach" to assessing macroeconomic and financial risks associated with the balance sheets of a country and its sectors, supported by an assessment of medium-term growth potential, the quality of political institutions, and social inclusion. All of this is systematically implemented through heuristic algorithms that transparently produce quantitative scores.

The Model relies on frequent data updates to ensure it captures the most recent internationally recognized cross-country comparable data sources. The algorithms transform those publicly available data into risk scores by applying a predefined series of computations (derived from established academic and financial research), without any human intervention. This makes it easy to understand what is driving its conclusions, and offers predictive ability, analytical transparency and flexibility.

The Model ranks countries in a consistent and transparent fashion, which enables policy makers and investors to assess the relative strengths and weaknesses of developed, emerging and frontier economies with greater ease and confidence. It identifies potential patterns of economic and social weakness or strength, either within geographic regions or across specific areas of economic risk (for example, external vulnerabilities, overall debt problems and structural rigidities). As such, it can be used to improve research, to generate customized risk dashboards, to develop investment strategies and to benchmark and improve government policy.

Figure 1: The Structure of the Country Insights™ Model



Source: Roubini Global Economics

The Structure of the Country Insights™ Model

Country Insights™ scores display information on the economic vulnerabilities and strengths of individual countries across a selection of 25 critical economic, political and social factors, grouped into four "pillars" (Figure 1). These 25 factors can be further decomposed into 72 subfactors for even more in-depth analysis. Each country receives a score that is scaled from 0 to 10 for comparability across countries, with 0 being the worst and 10 the best.

Our Investment Attractiveness Score, which we have published since November 2009, is the simple average of the scores of the first three pillars.

The Country Insights™ factors comprise subfactor scores, which are also scaled from 0 to 10. The factors are weighted equally within each pillar, and each of the pillars respectively receives equal weight in the country score.

However, the score for the Growth and Adaptability Pillar reflects the GDP-adjusted simple average of the growth factors. This enables the score both to reflect room for "catching up" in less wealthy economies and allows it not to be distorted by the residual institutional and infrastructure legacy of past economic growth.

For example, Greece scores more strongly than Uganda on individual growth factors. However, this reflects past development and EU transfers, rather than a successful growth model. After adjusting for GDP per capita, it becomes clear that Greece significantly lags the statistical expectation for a country at ~$27,000 GDP per capita, while Uganda significantly outperforms the statistical expectation for a country at ~$500 GDP per capita. Given the catching-up effect, this indicates Uganda is likely to grow much more strongly than Greece—thus, Uganda accordingly receives a higher growth-pillar score than Greece.

Contact the authors

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I further certify that in the preparation and publication of this report I have at all times followed all relevant RGE compliance protocols including those reasonably seeking to prevent the receipt or misuse of material non-public information.

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