



The pricing of political risk in emerging markets

26 September 2016

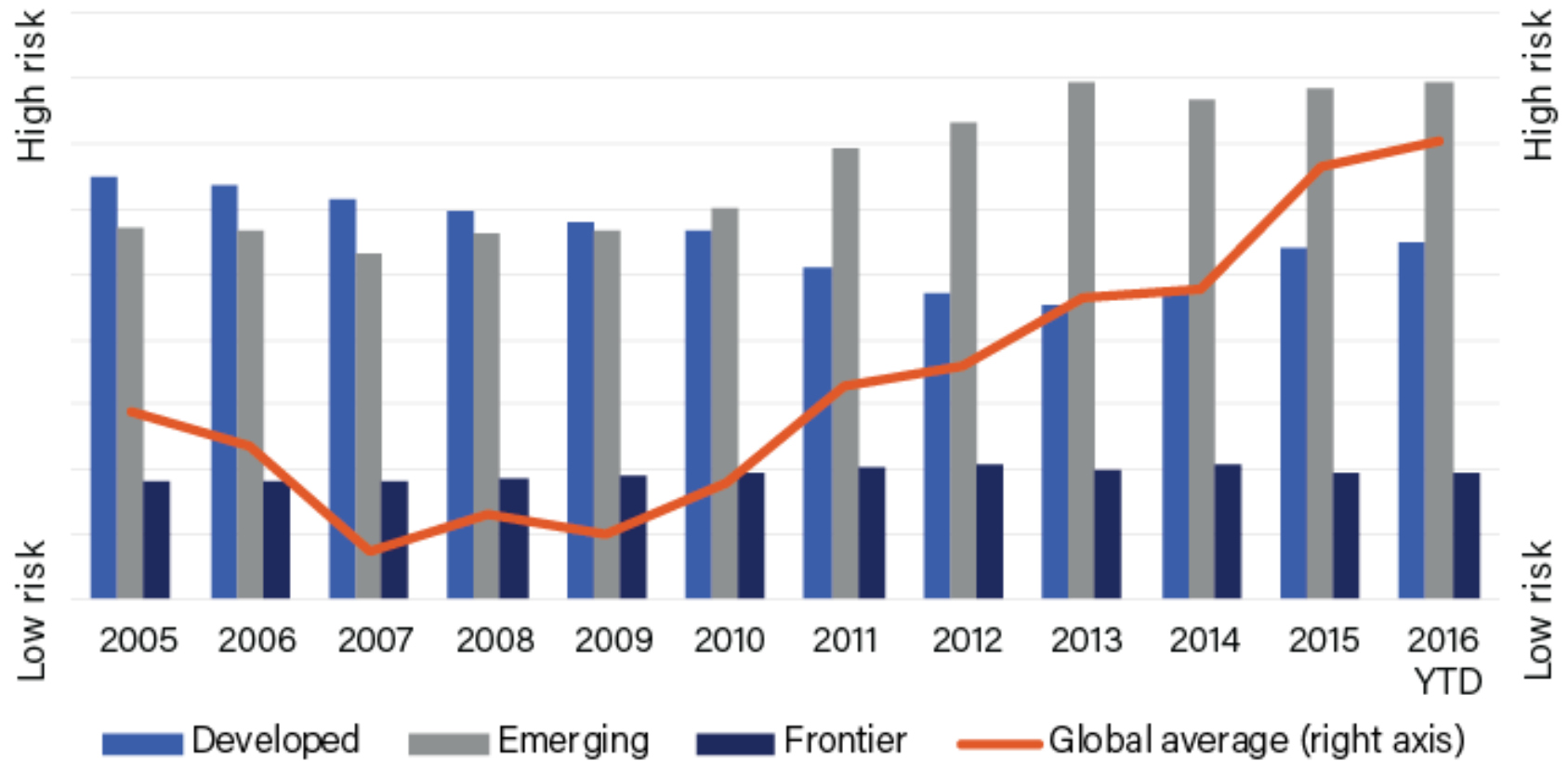
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Rising global economic exposure to political risk



* The global average is measured on a secondary axis and reflects a more narrow scale
 Source: Eurasia Group, IMF World Economic Outlook



Why less political stability now?

End of the commodity boom – China's fixed asset investment cycle

Political fragmentation – Populism/nationalism in US/Europe, larger more demanding middle classes in EM

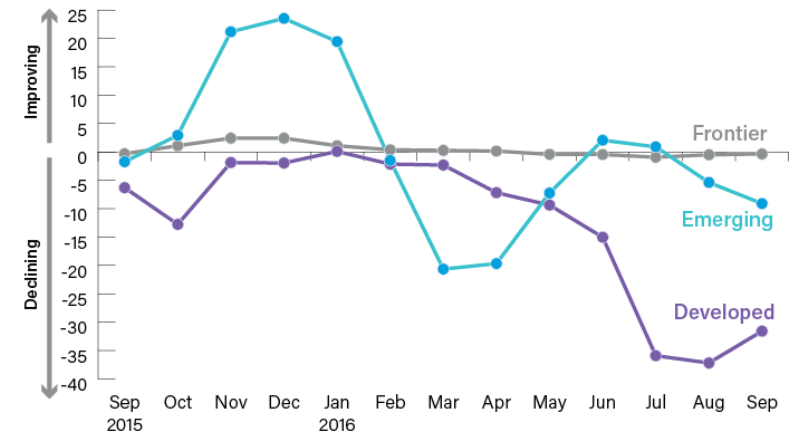
Geopolitics – the g-zero world



Divergence in EM-DM political risk

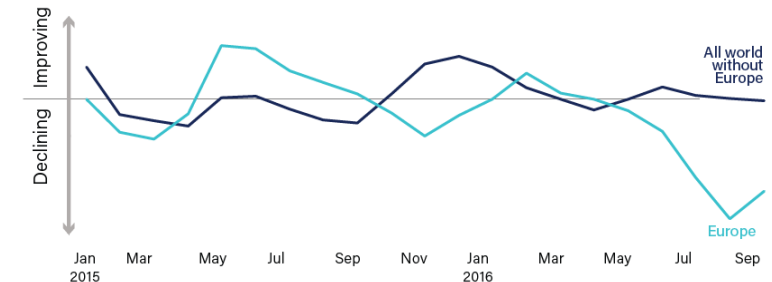
- We turned more positive on EM in April on positive inflection in EM political stability
- View was in near-term political stability would for first time in years not push against cyclical improvement in economic activity or higher asset prices
- EM political stability no longer improving – Turkey, S Africa
- But EMs still-supported by sharp recent EM-DM divergence in political stability
- This dynamic is fragile – a world in which DM political risks are rising at some point will create shocks that will spill over to EM
- Brexit not that shock...but Europe could be

Impact of politics on the global economy: 6-month forecast (3-mn rolling average, GDP-weighted)



Source: Eurasia Group

Political risk diffusion index: 6-month forecast (3-month rolling average)



These charts are based on diffusion indices of Eurasia Group's 6-month PoliticalTrajectories. At points above 0, the outlook for political risk is improving. Below 0, the outlook for political risk is declining.

Source: Eurasia Group

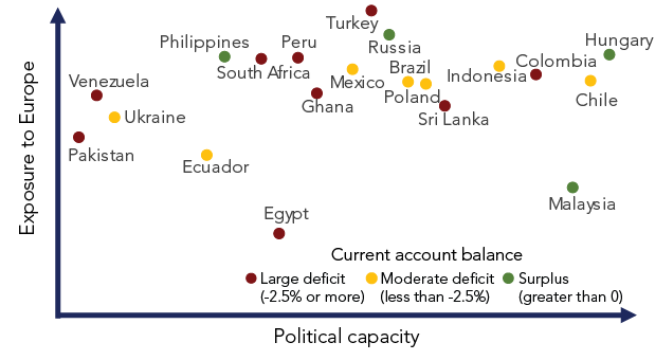


EMs and European financial risk: Beyond Brexit

A crowded political calendar for Europe

- Austrian presidential election (Oct.)
- Hungarian referendum on refugees (Oct.)
- Italian constitutional referendum (Oct.-Nov.)
- Portugal downgrade?
- EU-Turkey deal on migrants
- Greece
- French elections

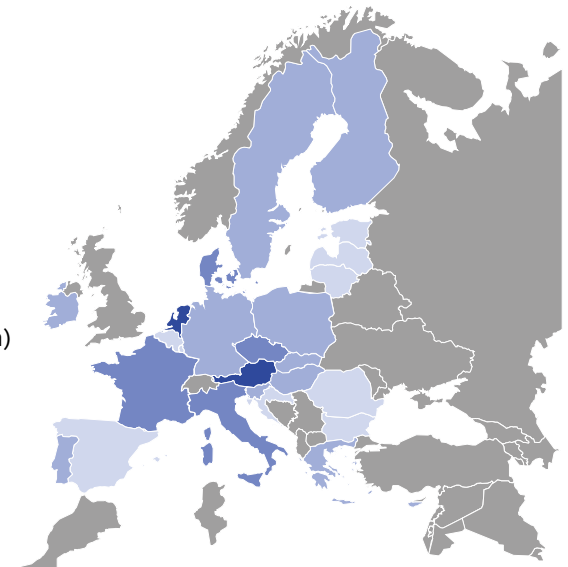
EM bond spread exposure to Europe and political capacity



Source: Eurasia Group, Bloomberg, IMF

- No significant euroskeptic parties, or limited impact on government policy
- Euroskeptic parties influence or constrain government policy (whether or not part of the ruling coalition)
- A referendum of EU/euro exit is a failure of the political debate but unlikely to take place
- A referendum of EU/euro exit is a real, if distant, prospect

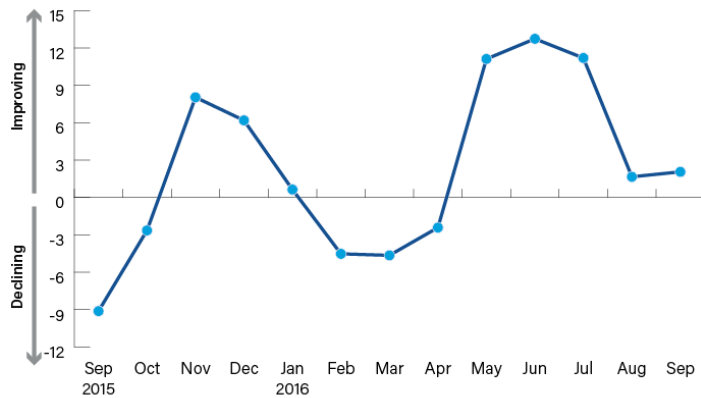
Source: Eurasia Group, IMF WEO



Where will political risk rise and fall?

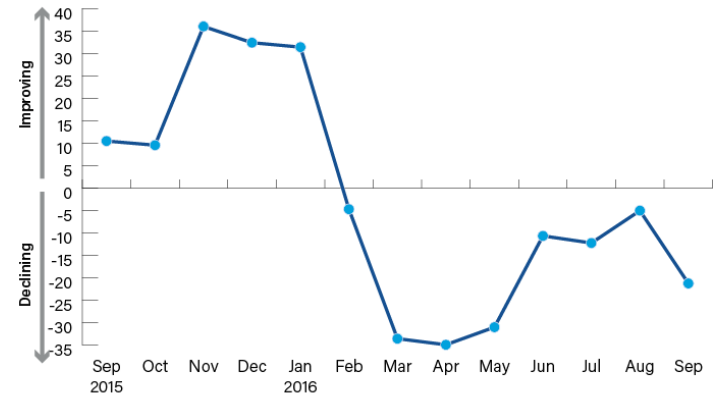
- Substantial regional variation within aggregates
- Latam more positive in 2016 – region shifting from populist left to center-right
- Outlook has slipped in Asia (although structurally more positive on region)
- Slightly negative outlook for Mena (structurally more negative)

Impact of politics on Latin America's economy: 6-month forecast (3-mn rolling average, GDP-weighted)



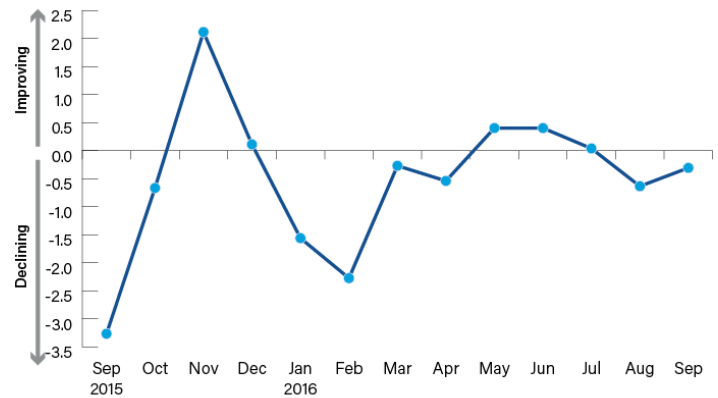
Source: Eurasia Group

Impact of politics on emerging Asia's economy: 6-month forecast (3-mn rolling average, GDP-weighted)



Source: Eurasia Group

Impact of politics on MENA's economy: 6-month forecast (3-mn rolling average, GDP-weighted)



Source: Eurasia Group





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