CA FINAL

Risk Management

Country Risk Case Study

Question

Case Study

Belvia has big aspirations. Although still a poor country, it has been growing rapidly, averaging 6% real and 10% nominal growth for the last five years. At the beginning of this period of growth, a centrist coalition gained a narrow majority over the authoritarian, fiscally irresponsible, anti-investor, anti-business party that had been in power for decades. The government has removed the old barriers to trade, including the signing of a regional free-trade agreement, and removed capital controls. Much of its growth has been fueled by investment in its dominant industry—natural resources—financed by debt and foreign direct investment flows. These policies have been popular with the business community, as has the relaxation of regulations affecting key constituencies. Meanwhile, to ensure that prosperity flows rapidly to the people, the government has allowed redistributive social payments to grow even faster than GDP, resulting in a large and rising fiscal deficit (5% of GDP this year, projected to be 7% in two years). The current account deficit is 8% of GDP. Despite the large current account deficit, the local currency has appreciated significantly since it was allowed to float two years ago. The government has just announced that it will issue a large 10-year local currency bond under Belvian law—the first issue of its kind in many years.

Bill Dwight has been discussing investment opportunities in Belvia with his colleague, Peter Valt. He is aware that Valt declined to buy the recently issued government bond, but he believes the country's equities may be attractive. He notes the rapid growth, substantial investment spending, free trade agreement, deregulation, and strong capital inflows as factors favoring a strong equity market. In addition, solid global growth has been boosting demand for Belvia's natural resources. Roughly half of the public equity market is represented by companies in the natural resources sector. The other half is a reasonably diversified mix of other industries. Many of these firms remain closely held, having floated a minority stake on the local exchange in the last few years. Listed firms are required to have published two years of financial statements conforming to standards set by the Belvia Public Accounting Board, which is made up of the heads of the three largest domestic accounting firms. With the help of a local broker, Dwight has identified a diversified basket of stocks that he intends to buy.

Multiple Choice Questions

2 × 5 = 10 Marks

1. Which of the following is not an index for Country Risk Analysis?

A. Democracy Index

B. Global Peace Index

C. Human Perception Index

D. Gini Coefficient

2. The following is not one of simplest techniques for country risk assessment to rank the countries:

A. Numeral Coding Method

B. Colour Coding Method

C. Event Driven Method

D. Taxation Method

3. Which index under country risk analysis is published by Vision of Humanity and is derived from key information such as level of crime, violence, etc.

A. Democracy Index

B. Human Development Index

C. Global Peace Index

D. Freedom in the world

4. **……………is one of the most popular index to gauge the rich-n-poor income countries.**

- **A.** Democracy Index
- **B.** Gini Coefficient
- **C.** Global Peace Index
- **D.** Human Development Index

5. **Which of the following is not a type of country risk?**

- **A.** Political Risk
- **B.** Financial and Economic Risk
- **C.** Credit Risk
- **D.** None of the above

Descriptive Questions

6. Despite a very strong relationship with the bank marketing the bond, Peter Valt has decided not to invest in it. When pressed for his reasoning, what risks is he likely to identify?

8 Marks

7. Discuss the risks Dwight might be overlooking.

7 Marks