



## Country Risk Quarterly



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### Top 10 Risks

Last June's Brexit decision and the US presidential election result came as shocks to businesses around the world. However, since those developments, markets have generally moved on and up with the Dow Jones reaching historic heights and London's FTSE 100 climbing well above pre-Brexit levels. Is the bullish outlook warranted? While we forecast accelerating global growth in 2017, we are concerned that the equity market uptrend is obscuring a difficult political backdrop. Our list of Top 10 country risks therefore seeks to highlight sources of volatility that would affect Canadian companies.

**Risk 1: Fortress America** - This scenario captures the risk of a trade dispute erupting between the US and China or Mexico. It also includes the possible implementation of a border tax that would impact exporters to the US. In its most extreme form, this scenario would see attempts by the US to materially renegotiate parts of NAFTA beyond minor "tweaks" – a low probability but high impact event.

**Risk 2: Global Protectionism** - Our Global Protectionism scenario, up from ninth place in 2016, envisions the spread of the fortress mentality. Under this scenario, countries around the world slow down trade negotiations and erect more tariff and non-tariff barriers to trade. As a nation whose trade accounts for nearly two thirds of GDP, Canada would be vulnerable.

**Risk 3: Quasi-Sovereign Default** - In addition to risks posed by trade restrictions, financial conditions in other countries could also emerge as challenges. Easy lending conditions have allowed state-owned enterprises (SOEs) in emerging markets to accumulate high external debt levels in recent years. As rates rise, companies could default on debt and fail to honour amounts outstanding to Canadian and other suppliers.

**Risk 4: China Credit Bubble** - Another financial risk involving SOEs is the risk posed by financial imbalances in China. The Chinese banking sector is heavily exposed to over-leveraged SOEs. While not our base case, a financial sector crisis due to bad debts would lead to a widespread economic slowdown and reduced demand for Canadian commodities.

**Risk 5: Japanese Debt Crisis** - At about 250 per cent of GDP, Japan's public debt is unsustainable. If the government's borrowing costs increase suddenly, this could lead to a full blown financial and fiscal crisis. Given Japan's place as the third largest economy in the world and one of the top export destinations for Canada, a crisis in Japan would be felt here and abroad.

**Risk 6: Eurozone Collapse** - Europeans are increasingly skeptical about traditional centrist governments, as evidenced by growing support for populist parties. A victory by a radical party in the upcoming Dutch, French, German and possible Italian elections would likely upend the political unity and financial sustainability of the euro area, putting at risk the gains Canada hopes to achieve from the landmark Canada-EU Comprehensive Economic and Trade Agreement (CETA).

**Risk 7: Terrorism 2.0** - The expanding reach of terrorism is another factor that has the potential to sap economic confidence. Non-state actors such as ISIS are increasingly likely to use sophisticated technology such as drones or cyber warfare to sow fear.

**Risk 8: European Sovereign Debt Crisis** - The risk of a sovereign debt crisis in Europe is back. Two scenarios are envisioned: a default by Greece due to renewed disputes with its international creditors; and a risk event in France should nationalist leader Marine Le Pen be elected and cause France to abandon the Euro. The implication for Canadian exporters would be similar to that of a Eurozone Collapse.

**Risk 9: Italian Banking Crisis** - Italy's banking sector stands out as one of Europe's most pressing economic challenges. If not resolved effectively, the Italian banking system's massive bad debt burden could threaten Italian banks and other vulnerable European banking sectors. Canadian exporters would feel the impact as a result of worsening prospects in Europe.

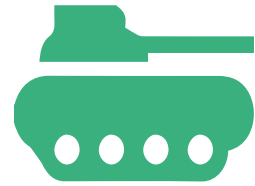
**Risk 10: Inter-State War** - Inter-state war risk rounds out our Top 10 list and remains a low probability that could nevertheless deal a major shock to the global economy. This entry includes such scenarios as a confrontation in the South China Sea, on the Korean peninsula, or in Eastern Europe. The impact on Canada would be a general decline in economic confidence that would hurt global demand for our exports.

**The bottom line?** Political developments are driving economic risks to a degree not seen in the recent past. Exporters should take heed of growing popular disenchantment with free trade and open economies. The Country Risk Quarterly will continue to cover political and economic risk to allow Canadian companies to prepare themselves to navigate this turbulent environment.

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# Top 10 Economic Risks

## Risks



Inter-State War  
(includes full-blown cyber war)



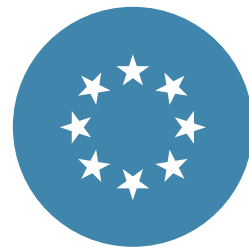
Italian Banking Crisis



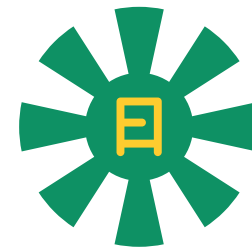
European Sovereign Debt Crisis



Terrorism 2.0



EU Collapses



Japanese Debt Bomb



China Credit Bubble



Quasi-Sovereign Default



Global Protectionism  
(trade war included)



Fortress America  
(includes border tax, NAFTA, TPP, trade dispute with China)

## Rank

