

Commentary for Clients

Talking Points on International Governance Research and Investing

November 2016

Country Ranking Trends

- Last month was another of those occasional periods where Magni Country Scores were unchanged. Forces ranging from populism to corruption scandals to practical governance challenges in fulfilling campaign promises conspired to stall progress and even created risks of weaker governance. As usual, we have summarized some of the most important situations.

Can Stalled South Korean Reforms be Completed with a new President?

- President Park Geun-hye has announced that she is willing to resign before her term ends ahead of a pending impeachment vote over an escalating corruption scandal. The scandal stems from her controversial relationship with a long-time acquaintance who allegedly extorted significant sums from top South Korean companies. With mass demonstrations against her and approval ratings in the low single digits, even her allies see resignation as preferable to prolonged political uncertainty. By law, if the president resigns, the country must promptly hold an election.
- Even before the latest political crisis, South Korea was facing security and economic challenges. Ms. Park campaigned in 2012 on a plan to revamp the economy and reform the large family-owned conglomerates. However, to date only a fraction of her pledged reforms have been implemented. Given her likely departure from office, the new government needs to be strong to push through the reforms needed to tackle the country's challenges.
- Magni ranks Korea as one of the emerging market countries with the best governance, though implementation of the reform plans is an important step in making the South Korean governance on a par with many developed countries.

Corruption Corroding Prior Progress in South Africa

- President Zuma has survived a recent challenge to his leadership following a string of corruption scandals, along with criticism of his handling of the economy. Further, weak growth is impeding South Africa's efforts to avert a downgrade to its sovereign debt to junk status which would raise borrowing costs and deter investment. In anticipation of the potential downgrade, the government has tried to push ahead with reform policies, but political uncertainty and widespread corruption call into question the durability of these efforts.
- South Africa has a relatively high Magni Country Score among emerging market countries, though the corruption and unimplemented reforms are major obstacles to an increased score. Magni will be watching to see if the corruption indicates previously unidentified weaknesses in the country's governance and hence should be a cause for reducing the country's score. The political uncertainty not only jeopardizes the improvements, there is a risk that the populace turns to a yet-to-be-identified populist who could undo previous reforms.

Can the IMF be a Useful Catalyst for Egypt?

- In exchange for a three-year, \$12 billion loan from the IMF, Egypt has agreed to significant economic changes, including allowing the currency to trade freely and

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reducing energy subsidies. The government floated the currency earlier this month, and it has since lost nearly 50 percent of its value. A weaker currency will improve Egypt's external competitiveness. However, already high inflation will likely get worse in Egypt's import dependent economy.

- The reform plans also include structural reforms to improve the business climate such as streamlining industrial licensing, and facilitating access to finance for small and medium-sized enterprises. These measures if effectively implemented should boost job creation and help to address Egypt's high unemployment. If Egypt successfully completes these structural economic reforms, then it will help its relatively low Magni Country Score. Magni will be paying particular attention to banking supervision and securities regulation which are the areas requiring the greatest improvement.

E tu Italy?

- The upcoming constitutional referendum in Italy aims to speed up lawmaking and produce more stable governments. Prime Minister Renzi says the project is necessary to make Italy governable enough to enact reforms needed to revive the stagnant economy. Opponents say it would reduce democratic checks and balances.
- Renzi has said he would resign if defeated, which has turned the referendum into a de facto vote on his 2-1/2 years in office. Opinion polls now predict Renzi's defeat; however large numbers of people are still undecided. Some are calling on Renzi to rethink his resignation pledge. If he does follow through with his threat, it would usher in political instability that would make much-needed economic reforms even more difficult. The primary beneficiary of Renzi's exit would likely be the populist Five Star movement. Five Star is a nationalistic movement who have called for Italy to leave the euro. The referendum is seen as precursor for elections in France and Germany next year that also have the potential to upset the status quo.
- While the proposed constitutional changes would not directly impact the Magni Country Score for Italy, the much-needed economic reforms would improve Italy's rather average score among developed countries. Conversely, election of a populist and nationalistic leader would place Italy's score at risk.

Dysfunctional Family Feud: EU Style

- Following Brexit, Netherlands may vote on leaving the European Union. Five Star, if it comes to power in Italy, will likely push for Italy to leave. Forces in France and Germany may also push to leave as well. As countries congregate around the exit door, Turkey still seeks to enter. There's the rub: the one country who wants to be part of the EU is not admitted.
- Countries in the EU receive favorable scores in key Economic Standards used in generating Magni Country Scores. As countries leave the EU, Magni will assess the impact and potential for downgrades. Conversely, should Turkey be admitted to the EU, it would likely result in some meaningful upgrades.