

# COLOMBIAN POLITICAL RISK: A CASE STUDY

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revised as needed.

# WHY STUDY POLITICAL RISK IN COLOMBIA?

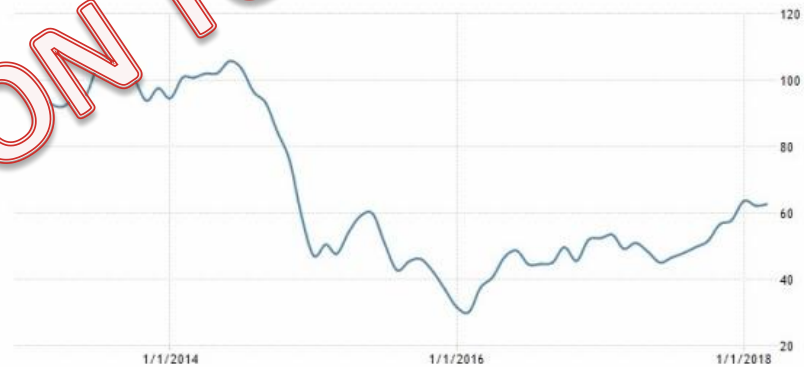
- COUNTRIES LIKE COLOMBIA ARE CAPITAL POOR
- HIGH POLITICAL RISK CAN BE A BARRIER TO NEEDED FOREIGN DIRECT INVESTMENT (FDI)
- HIGH POLITICAL RISK CAN LEAD TO HIGHER COST OF CAPITAL, LOWER GDP GROWTH
- POLITICAL RISK MEASURES HAVE LIMITATIONS

# COLOMBIA FDI /OIL PRICES

FOREIGN DIRECT INVESTMENT: 2015-2018



OIL PRICE : 2014-2018



HIGH CORRELATION TO OIL PRICES

<https://tradingeconomics.com/colombia/foreign-direct-investment> . Sourced April 30, 2018.

# MAIN OBJECTIVES

- PROVIDE A PRIMER ON COLOMBIA AS A COUNTRY INCLUDING DOUGLAS NORTH'S TAXONOMY
- EXAMINE AND EVALUATE THE POLITICAL RISK CONCEPT AND APPLY IT TO COLOMBIA (A CASE STUDY)
- REVIEW PUBLISHED STUDIES AND STATISTICS
- FORM SOME CONCLUSIONS AND RECOMMENDATIONS FOR FURTHER RESEARCH

# 2<sup>ND</sup> LARGEST IN SOUTH AMERICA



VITALS CAN BE FOUND IN:

<https://www.cia.gov/library/publications/the-world-factbook/rankorder/2004rank.html>

## BACKGROUND TO POLITICAL RISK

# BACKGROUND TO POLITICAL RISK


- Colombia broadly fits **Douglas North's** "Limited Access Orders" country taxonomy (North, et al., 2009)
  - Elite control of the political and economic systems
  - Limited violence;
  - Lack of competition and innovation; and,
  - Stunted economic growth
- Acemoglu, Daron and
- Jim Robinson. Why Nations Fail: The Origins of Power, Prosperity, and Poverty. 2012
- **However,**
  - Colombian elites failed to control economy
  - Violence has continually erupted further stunting economic growth
- Colombia path's to "open access orders, "the second stage, composed of advanced market economies, seems distant at best.

# BACKGROUND TO POLITICAL RISK II

- Is a middle (\$14,000 per capita) income country\*
- It's highly urbanized
- Has huge disparities in wealth and income but has reduced poverty levels according to World Bank
- Has a growing middle class
- Is being considered for Membership in OECD
- Undertook Plan Colombia and signed a peace agreement with the Revolutionary Armed Forces of Colombia, or FARC
- Borders on the world's largest river, the Amazon
- Illegal crops remain important
- Highly dependent on oil exports
- "Banana Republic" syndrome
- Huge "Informal" Economy

\*<https://www.cia.gov/library/publications/the-world-factbook/rankorder/2004rank.html> . Sourced March 15, 2018.

# BACKGROUND TO POLITICAL RISK III



OUTSIZED ACTORS INVOLVED  
PEACE ACCORD'S MAJOR AIMS  
ACCORD'S IMPLEMENTATION WILL  
INVOLVE GOVERNMENT PROGRAMS OF  
GIGANTIC PROPORTIONS, ALBEIT WITH  
SOME INTERNATIONAL ASSISTANCE  
MANY PLUSSES  
SOME NEGATIVES; PUSHBACKS

Colombian President (left); Raul Castro (center); Guerrilla leader (right)



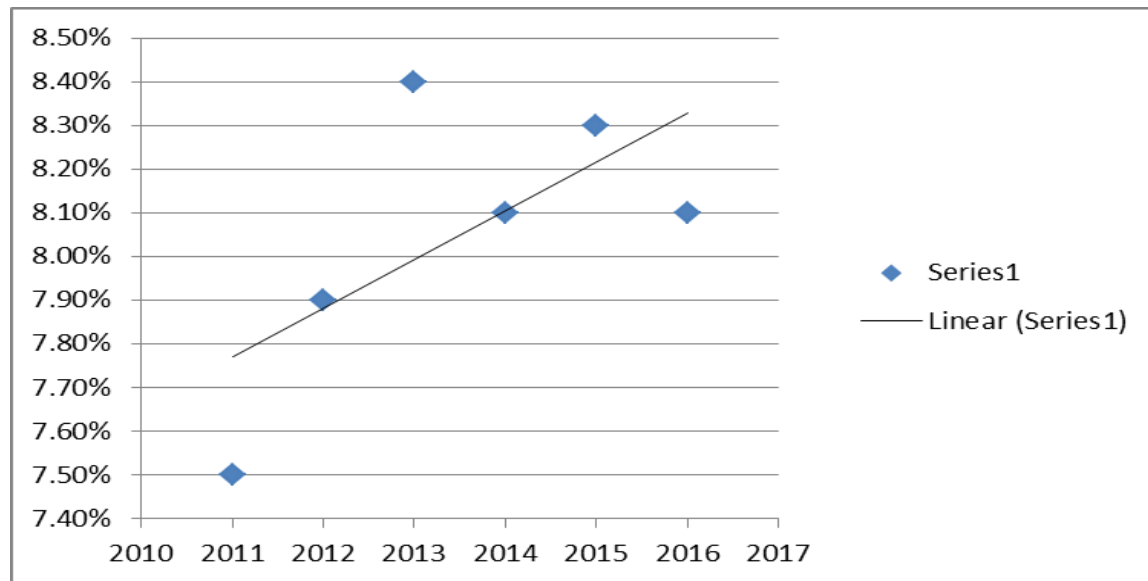


COLOMBIA

**MEASURES OF RISK: EQUITY RISK  
PREMIUM; CREDIT DEFAULT SWAP  
RATES; BONDS TERM PREMIA; OTHER**

# POLITICAL RISK AS MEASURED BY EQUITY RISK PREMIUM

- Colombian country risk premium over time is rising.



Equity Risk Premium is the difference between the expected return on a market portfolio and the risk-free rate. Market Risk Premium – Investopedia.

Equity risk premium taken from: Fernandez, Pablo et al., Market Risk by Analysts and Companies: A Survey. 2010-2017. Available at SSRN: <https://ssrn.com/abstract=1609563> or <http://dx.doi.org/10.2139/ssrn.1609563>. Sourced

## CREDIT DEFAULT SWAPS: DEFINITION, TYPES

Contracts where one party to the contract pays a small periodic premium to the other, in return for protection against a credit event (financial difficulty) of a known reference entity (company, or country).

<https://richnewman.wordpress.com/2007/12/09/a-beginners-guide-to-credit-default-swaps/> . Sourced April 18, 2018.

- **TYPES OF CREDIT DEFAULT SWAPS:**
- SENIOR, THE MOST SECURED;
- JUNIOR SUBORDINATED, THE LEAST SECURE

# Series of credit default swap rates for Colombia over time Republic of Colombia 1 Year Senior Credit Default Swaps



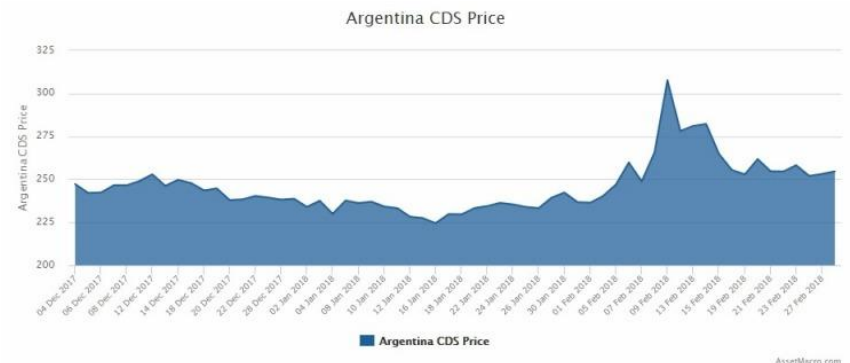
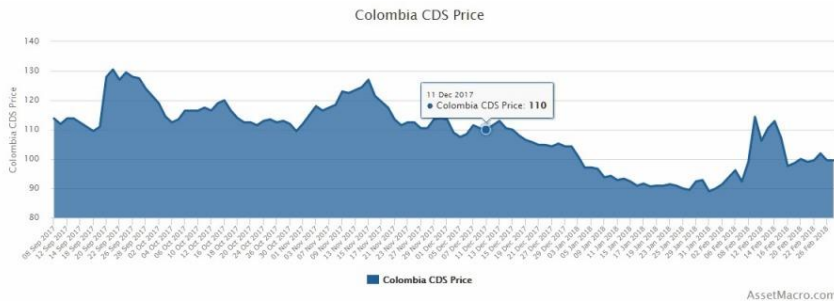
# Credit Default Swap (CDS) of Colombian Bonds After Peace Treaty

- Findings of rigorous study (Castañeda, Andrés & Juan F. Vargas, 2012) on the effect of Peace Treaty suggest that:
  - In general, the impact of conflict on the foreign perception of sovereign risk is **sizable** but rather **idiosyncratic**

# CDS PRICE (CREDIT DEFAULT): COLOMBIA VS. ARGENTINA, (Sep. '17-Feb. '18)

**COLOMBIA: LESS VARIATION, LOWER PEAKS**

**ARGENTINA: OVER 2X THE RISK**



<https://www.assetmacro.com/colombia/credit-default-swaps-cds/colombia-cds/> Sourced April 18, 2018

# L.A. Bonds Term Premia

- Study (Espinosa-Torres, Juan Andrés , et al., 2016) on the effect of shocks of the United States government bonds term premium on Latin American government bonds term premia found:
- Latin American countries' term premia respond permanently to changes in United States term premium.
- However, responses are:
  - Larger for Brazil and Colombia
  - Mexico exhibited the lowest response for the four economies in study

# COLOMBIA'S POLITICAL RISK: FAVORABLE TRENDS

- Risk has been trending lower; Colombia CDS are considerably cheaper than those for countries like Argentina
- One notch above investment grade  
”( <https://www.reuters.com/article/colombia-economy/colombia-tax-reform-delay-risk-premiums-spark-rating-fears-idUSL2N15C2MN> . Sourced, April 27, 2018)
- Sound macroeconomic policies are being followed
- Country negotiated (2016) peace with major, 50-yr old guerrilla group
- The Economist, among other publications, gives economy high marks
- Likely Presidential contender (center right) favored to win



# COLOMBIA'S POLITICAL RISK: UNFAVORABLE TRENDS, UNCERTAINTY

- IDIOSYNCRATIC EVENTS CAN HAVE SIGNIFICANT EFFECTS (BANCO DE LA REPUBLICA STUDY)
- GARGANTUAN TASK OF IMPLEMENTING PEACE AGREEMENT NOT MADE EASIER BY POLITICAL BICKERING; HEATED PRESIDENTIAL CAMPAIGN RHETORIC
- LARGE FOLLOWING FOR EX-GUERRILLA PRESIDENTIAL CONTENDER (PETRO)
- WEAK OIL PRICES AND REVENUES INCREASING DEFICITS AND TOTAL BORROWING;
- LITTLE PROGRESS IN NEEDED TAX REFORM
- MONETARY POLICY CHALLENGES
- RISING UNEMPLOYMENT; CRIMINAL GANGS; CONTINUED DRUG TRAFFICKING
- UNPREDICTABLE US TRADE POLICIES

TWO MAJOR PRESIDENTIAL CONTENDERS: PRIETO (LEFTIST); DUQUE (RIGHT WING)

# PRELIMINARY CONCLUSIONS

## CONTINUING DRAGS

### SOCIO-POLITICAL BARRIERS

- Slow advancement in reforms will result in slow growth; sustained violence
- Return to political strife and violence is possible

### REGIONAL/INTERNATIONAL SHOCKS POSSIBLE

- US Administration trade repeal
- World crises
- Over dependence on commodities

## MEDIUM TERM VIABILITY

- Economic fundamentals will be maintained
- Government scope and effectiveness should grow
- Slow integration of combatants should continue
- OECD ascension; Growing international confidence; Improvement in Political Risk assessment?
- Novel social science tools and policies for violence reduction

# Trump and Colombia?

- COLOMBIA'S POLITICAL RISK DEPENDS HEAVILY ON US FAVORABLE OR UNFAVORABLE STANDS
- COLOMBIA'S DRUG EXPORTS ARE A THORN ON HIS SIDE (Of course, the consumers are here!)
- FAVORABLE POLICIES TOWARDS COLOMBIA UNLIKELY

(TRUMP'S INTEREST IN COLOMBIA SEEMS TO HAVE BEEN IN PURCHASING A SOCCER TEAM (2016)!!)

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Any errors and maybe unpopular statements that remain are solely my responsibility.

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