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Rising political risks in developed countries: the sword of Damocles hangs over Europe's major economies

- Coface has created a political risk index for Western European countries
- Over the past year, political risks have escalated in Europe, rising by an average of 13 points in Germany, France, Italy, Spain and the UK
- A further political shock, on the same scale as that of the UK referendum, would affect European growth by around -0.5 points
- The impact of political uncertainty on European economies could be even greater, if Donald Trump wins the US presidential elections

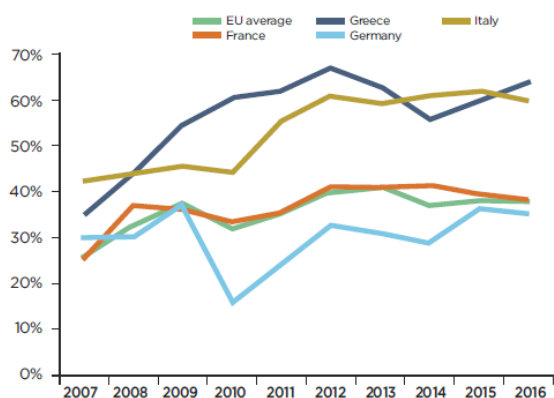
A decisive European political agenda over the next few months

Periods of economic crisis naturally lead to heightened political uncertainty and this aspect is crucial in assessing country risks. Europe has been showing clear signs of increasing political risks since 2011. Unemployment, inequalities and the repercussions of the deep financial crisis are among the factors which have spread discontent amongst voters. This has destabilised incumbent governments and led to the rise of nationalist and more conservative political parties. The political risk level has moved up a notch following the UK referendum in June 2016, which resulted in a vote to leave the European Union. From December 2016 to October 2017, the European political calendar will be packed with decisive political events including the referendum in Italy, the risk of Spain's third legislative election within one year, France's presidential election and Germany's legislative elections.

A new political risk indicator for European economies

Within this environment, it is essential to be able to gauge the impact of heightened political risks on growth, corporate investments and consumer confidence. Coface's economists have thus adapted their model for measuring political risks (which was created for emerging markets, following the events of the "Arab spring"). The political risk indicator for Western European countries does, however, use different criteria. Some of these criteria are economic (such as increases in unemployment rates, income inequalities and primary structural budgetary balances), while others are political and social (such as Euroscepticism, anti-immigration sentiment, fragmentation of the political landscape and corruption). Europe's political risk indicator has increased by 13 points in just under 10

Coface political risk index for western European countries



Source: Coface

years, with a peak in 2013 during the sovereign debt crisis. Unsurprisingly, Greece currently has the highest score at 64%, closely followed by Italy at 60% (up, respectively, from 35% and 42% in 2007). Greece and Italy are the countries with the highest score increases, due to the immigration crisis, budgetary austerity imposed by Europe and Euroscepticism. France is not far behind, with a score of 48% (up by 13 points since 2007), while Germany is at 35%. Although France and Germany have seen less sharp increases, their scores still reflect the underlying economic and social preoccupations in both countries.

A Brexit-type shock and a Donald Trump victory would damage European growth

Economic growth and political risks are interconnected. Political risks primarily spread through two channels: namely market volatility (which weighs on financing conditions within the broader economy) and lower confidence among households and companies (which leads to decisions to consume or invest being postponed). There are nonetheless some exceptions, such as Spain, which does not currently appear to be impacted by the instability of its government, ongoing since 2015.

To measure the consequences, Coface takes the Economic Policy Uncertainty index (EPU) into account.

- In the event of a major political shock triggering an increase in the EPU index (similar to the situation in the UK at the time of the referendum in June), Coface estimates that its impact on growth among the major Western European economies would be as follows:
 - The UK: -0.5 points (0.9% in 2017 p.)
 - Germany: -0.4 to -0.5 points (1.7% in 2017 p.)
 - France: -0.7 points (1.3% in 2017 p.)
 - Italy: -0.2 points (1% in 2017 p.)
 - Spain: -1.2 points (2.3% in 2017 p.)
- Paradoxically, if Donald Trump wins the US presidential elections, the economic shock could be more greatly felt in the European Union than in the US. Europe would effectively lose around 2 growth points after one year, whereas the US would lose 1.5 points. The intensity of this shockwave would reflect the systemic role of the US economy.

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