Country Sustainability Ranking Update - October 2015

Sweden remains in the lead

- **Denmark moves up to the top-5**
- **Brazil the big loser among emerging economies**
- **ESG performance of EMs: missed opportunities**

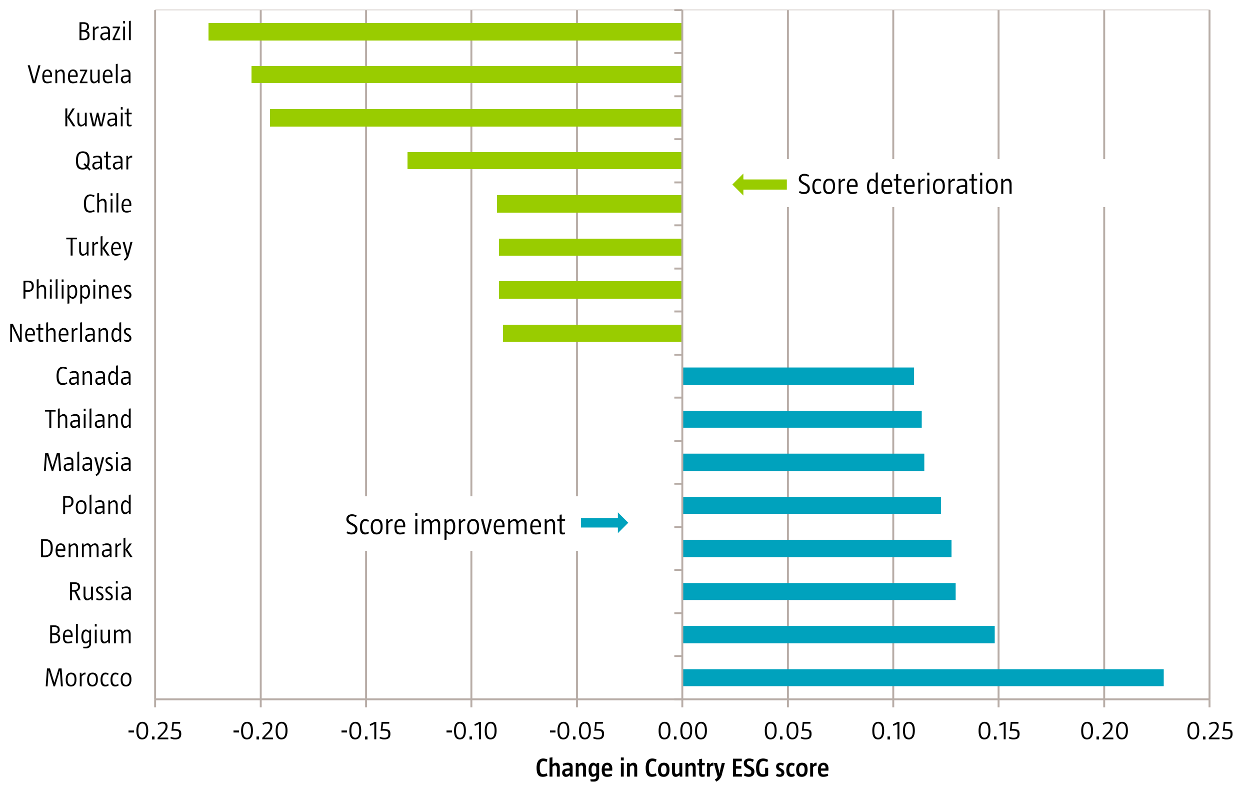
RobecoSAM's country sustainability framework evaluates 60 countries – 22 developed and 38 emerging markets – on a broad range of Environmental, Social and Governance factors that we consider to be key risk and return drivers relevant for investors. This analysis complements findings gained from the more traditional country risk assessment and is particularly focused on integrating long-term perspectives. For a more detailed outline of the methodology please refer to our brochure "Measuring Country Intangibles"[1].

Once again, the October 2015 update of the Country Sustainability Ranking reveals some interesting trends: within developed economies, Belgium (+0.15) and Denmark (+0.13) have registered the biggest improvements in their score, while only Denmark was able to climb up the ranking from #8 to #5. The three frontrunners – Sweden, Switzerland and Norway – maintained their firm lead, even though all three suffered small declines in their overall score, while Ireland continues to lead the ranking among euro area countries, slightly ahead of Germany.

Within the emerging markets universe, Brazil is the big loser, as its score declined the most (-0.22), followed by Venezuela, Kuwait and Qatar. The rankings for BRIC countries remained low, with Brazil dropping 4 spots to #42, but remaining ahead of China, India and Russia, all of which are among the bottom 10 performing countries. Morocco (+0.23) stands out among the emerging market winners, largely ahead of Poland, Russia, Malaysia and Thailand, which registered also showed slight improvements to their scores.

[1] "Measuring Country Intangibles", June 2015, available on the RobecoSAM website: http://www.robecosam.com/en/sustainability-insights/about-sustainability/country-sustainability-ranking.jsp

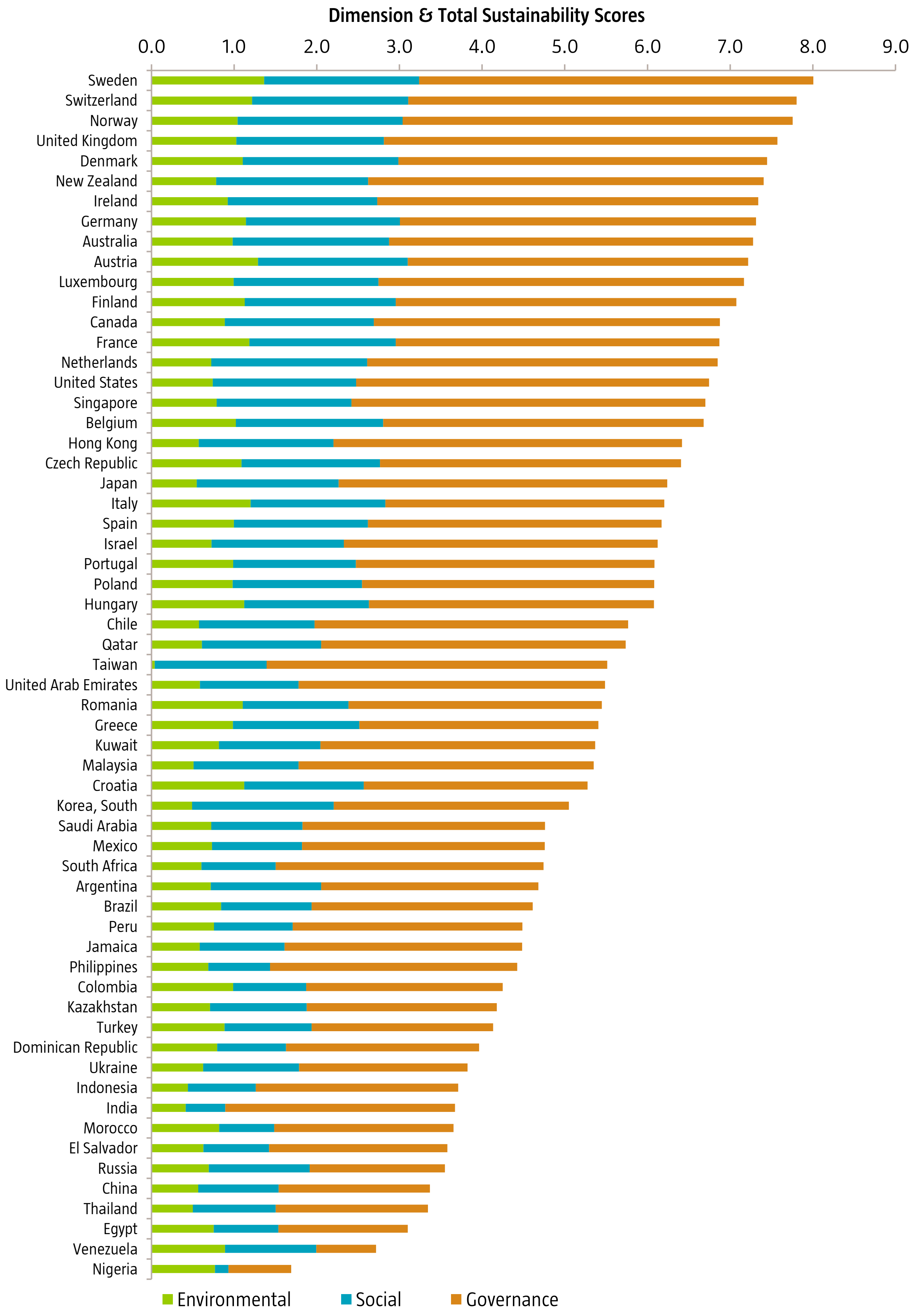
Figure 1: Major changes in country ESG scores – Oct 2015 vs Apr 2015



Source: RobecoSAM

Looking at the global universe, the ranking confirms that countries with a stronger ESG profile also tend to enjoy a healthier macroeconomic performance and a more robust creditworthiness. This is particularly true for the governance dimension, as countries with a more robust governance structure and institutional framework are usually more resilient to shocks. Thus, it is no coincidence that countries such as Brazil, Russia or Venezuela, all with poor governance profiles, are struggling the most to cope with the economic shock brought about by the abrupt fall in commodity prices and political troubles. But even an economically much stronger country such as China has also exhibited astonishing weaknesses in policymaking when undertaking some abrupt, erratic and partially panicky moves to counter the economic slowdown and the deflating stock market bubble. It is especially unfortunate that, during the years of high commodity prices and rapid growth, many of the bigger emerging market economies missed the opportunity to introduce deeper structural reforms and reinforce their ESG profile, or at least consolidate any positive achievements. Such an omission weighs heavy particularly now that these countries are faced with a more challenging external environment and weakening growth prospects.

Figure 2: Country sustainability ranking – October 2015

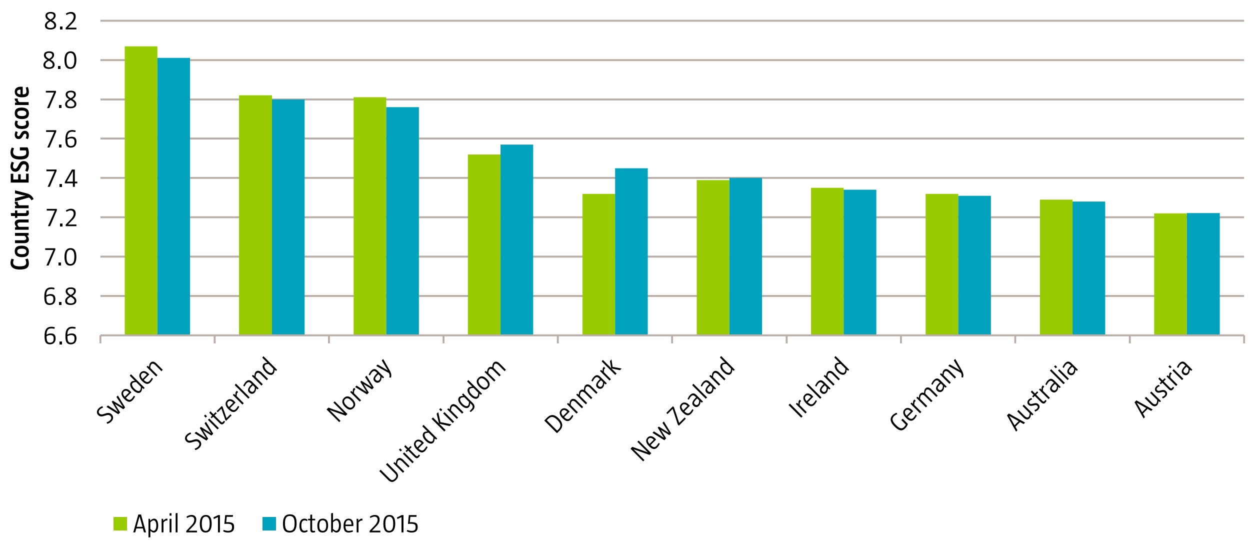


Source: RobecoSAM

Sweden still in the lead

As in April 2015, the same solid trio of top performers leads the ranking, with Sweden at the top, closely followed by Switzerland and Norway. All three countries have consistently scored well on most of the 17 ESG indicators, even though their overall scores declined slightly. They remain ahead of the fourth-ranked UK, and Denmark, which has moved up to the fifth position thanks to improvements in its environmental status, aging and competitiveness scores, and in spite of a slight drop in its liberty & inequality score.

Figure 3: Top 10 country ESG scores

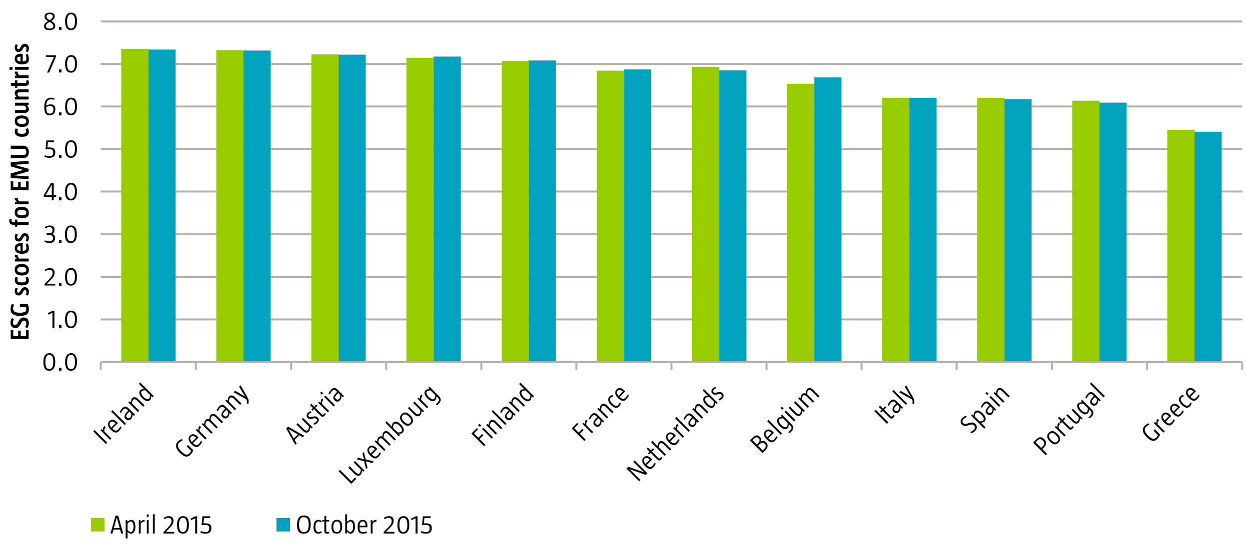


Source: RobecoSAM

Little change in the ESG profiles of Euro area economies

With the exception of Belgium (+0.15) and the Netherlands (-0.08), the ESG profiles of EMU countries have not changed significantly. Belgium is the only EMU economy whose overall score improved markedly, largely due to its improved environmental status score. However, the rise in the score was not sufficient to lift the country up from its current rank (#18). The Netherlands, on the other hand, has dropped two positions (from #13 to #15), mainly the result of a lower environmental status score. The other EMU countries' ESG scores remained more or less stable, including for Ireland, following the country's steady ascent in recent years. After an improvement over 2012-14, Southern European economies, which continue to lag other countries, did not make any additional improvements to their sustainability profiles. This is particularly true for Greece, where Alexis Tsipras' Syriza party won the snap election on September 20th and formed another coalition with its former partner, the Independent Greeks. However, as the new government is likely to face considerable difficulties implementing more austerity and unpopular reforms under the new three-year bailout deal, the risk of a "Grexit" has not completely disappeared and remains a real possibility in the medium term.

Figure 4: ESG scores for EMU countries



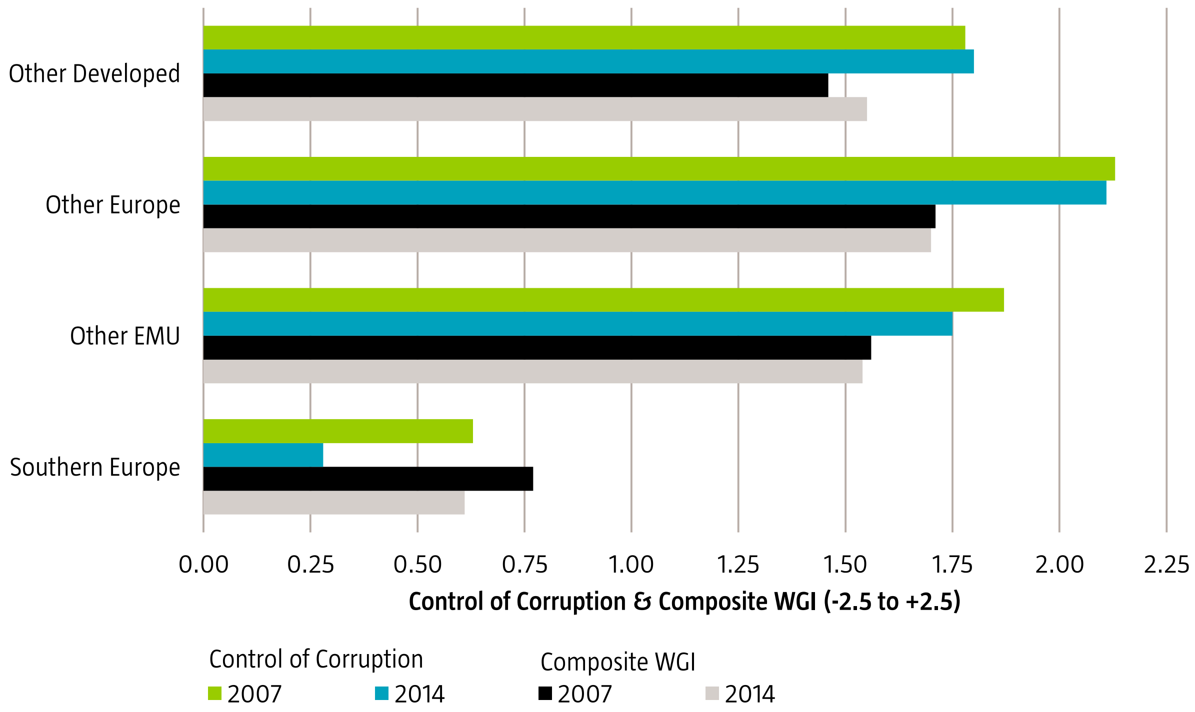
Source: RobecoSAM

Governance in developed economies: diverging trends

The importance of healthy governance for a country's economic performance and development is widely recognized and industrialized countries generally reveal higher scores for this dimension than emerging markets. However, within the universe of advanced economies, the quality of governance as well as its trend over recent years varies across countries. As shown in figure 5, the Southern European peripherals (4 countries) still exhibit a weaker governance profile than the rest of EMU members (8), other Europe (5) and developed markets outside of Europe (5). Except for the latter group, the overall governance profile as measured by the composite of the six World Governance Indicators (all of which are also part of our governance dimension) has worsened when compared to the end of 2007. Southern Europe reveals the weakest profile in comparison and the progress that has been observed in these countries' overall ESG scores over 2012-14 has ceased more recently. Worsening corruption (as illustrated by the scandals in Spain involving the royal family or various politicians, including Rodrigo Rato, former IMF head and Economy Minister) has been an important driver of this deterioration, but in some cases also the rule of law, regulatory quality, government efficiency and political stability indicators have shown a negative development.

It is likely that the global financial crisis and the ensuing economic hardship have had an adverse impact on the quality of governance and the institutional framework of these countries. In this context, it would come as no surprise to see that the hardest-hit economies in Southern Europe have also experienced the biggest setback. On the other hand, the EMU-led support programs and pressure from capital markets also require these countries to push ahead with structural reforms, which may contribute to a gradual improvement in their governance structure over time, as already seen in Ireland. In Spain, Prime Minister Rajoy's government has implemented some reforms that have helped to kick-start the recovery, although it has also been supported by external factors. However, it remains to be seen whether the economic improvement will prove to be sustainable, in light of the threats to political stability. The first of these comes from separatist forces, such as in Catalonia where Catalan pro-independence parties won a majority in regional elections in September. The other threat comes from the increasing fragmentation of the of the political system resulting from the rise of the left-wing anti-establishment Podemos party and the smaller centrist Ciudadanos party in the run-up to the general elections scheduled for late December this year.

Figure 5: Developed economies: diverging governance trends



Source: RobecoSAM, World Bank

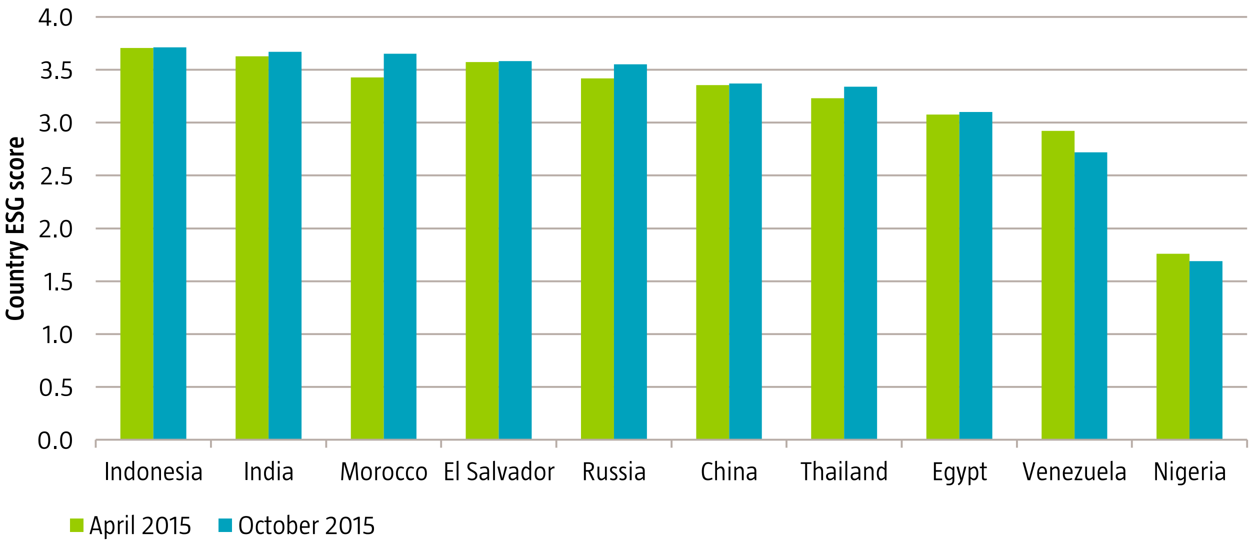
Emerging Markets ESG developments: a mixed picture

Within the emerging markets universe, Morocco (+0.23 to 3.65) stands out among the winners, with the improvement to its overall score largely stemming from higher environmental status and social indicator scores. This increase marks a trend reversal after a decline in its score over the past two years. However, it was not sufficient to lift it up to above rank #53 and pull it out of the bottom-10 group. Poland, Russia, Malaysia and Thailand are the other EM countries whose overall scores have increased. With the exception of Poland, these countries' improvement may seem surprising given the negative news flow regarding their economic performance, political developments, and corruption scandals (1MDB in Malaysia) over the past six months since the last update to the country sustainability ranking. However, these countries' improved scores are primarily the result of improvements in the scores for competitiveness, aging (for Russia) and environmental status (for Thailand), which have compensated for the declines in the scores for voice & accountability as well as liberty & inequality (in the case of Russia and Thailand). Poland's improvement is a continuation of its positive ESG developments since 2012. Within the last few years, the country has gradually strengthened its governance structure and institutional framework and has expanded the quantity and quality of education. This progress is reflected in the improved business climate – Poland jumped from #62 in the World Bank Ease of Doing Business Ranking in 2012 to #30 in 2015, but also boasts one of the highest economic growth rates within the EU, making it a role model for Central- & Eastern Europe. However, in view of the opposition Law and Justice

Party's (PiS) victory under the leadership of Beata Szydlo in the October 25 parliamentary elections and the prospect of a more leftist and interventionist policy course, it remains to be seen whether these positive achievements will be preserved under the new national-conservative government.

Among the poor performers, Brazil is the biggest loser, as its score declined the most (-0.22), followed by Venezuela, Kuwait and Qatar. In case of the latter two, a significantly lower score for energy was the key driver for the decline. As for Venezuela, the deterioration of the overall score resulted from a combination of lower environmental status, competitiveness, aging and institutions scores, which were not compensated for by a better score for energy. The overall score for the Philippines – one of the bright spots in the past couple of years – also dropped. Lower social indicators and aging scores led to a decline of 0.08 in its overall score. Still, ranked 45th (down from #44 in April 2015), the Philippines remains ahead of its low-income peers and also remains well above much richer economies such as China or Russia, which, together with India, are still ranked among the bottom-10, pointing to the persistently poor ESG profile of BRIC countries.

Figure 6: Bottom 10 country ESG scores

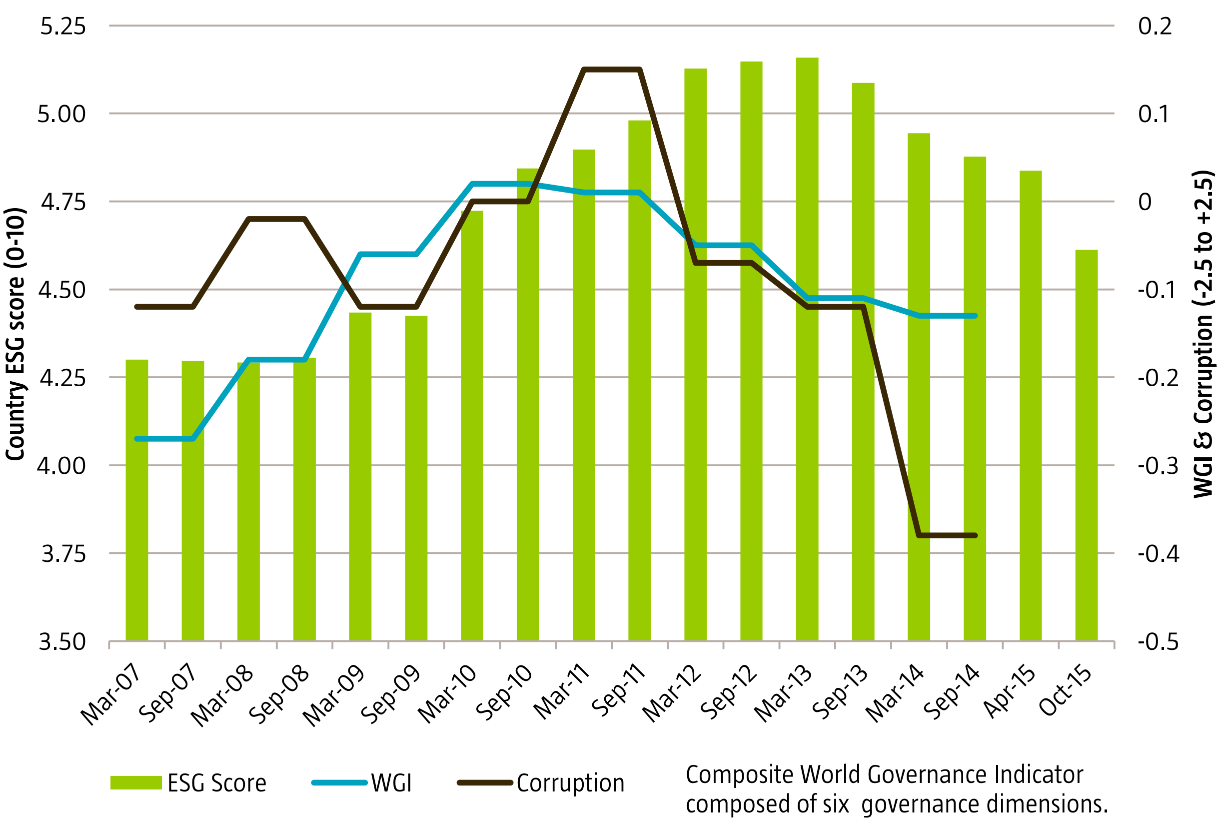


Source: RobecoSAM

Brazil as the big loser in emerging markets

As already indicated above, Brazil has suffered the biggest setback since the most recent country ESG update in April. The deterioration is the result of lower environmental status, political risk, aging and institutions scores, which cancelled out an improved score for energy. In part, Brazil's weakened ESG profile has been the driver for the country's economic and political woes, which were highlighted in the April update and which have since become even more accentuated. The economy has been engulfed by a deep recession, weighed down by weaker commodity prices, the slowdown in China, a relatively restrictive policy mix and the corruption scandal at state-owned oil company Petrobras. After several attempts by members of congress to launch an impeachment against president Dilma Rousseff, Brazil's electoral court has recently agreed to open an investigation into the way Rousseff financed her re-election campaign. The court decision poses another threat to her political survival, as she is already struggling to contain fallout from an ailing economy and a wave of corruption probes into some of her close allies. Growing political headwinds could paralyze policymaking and further darken economic prospects. It comes as no surprise that Brazil has been downgraded by S&P on 9 September to speculative grade (BB-) and to just one notch above junk (BBB-) by Fitch on October 15, exacerbating the risk of capital outflows and putting additional pressure on the exchange rate, with the Brazilian real already about 50% lower versus the USD since the beginning of the year.

Figure 7: Brazil – ESG score & governance indicators sliding backwards



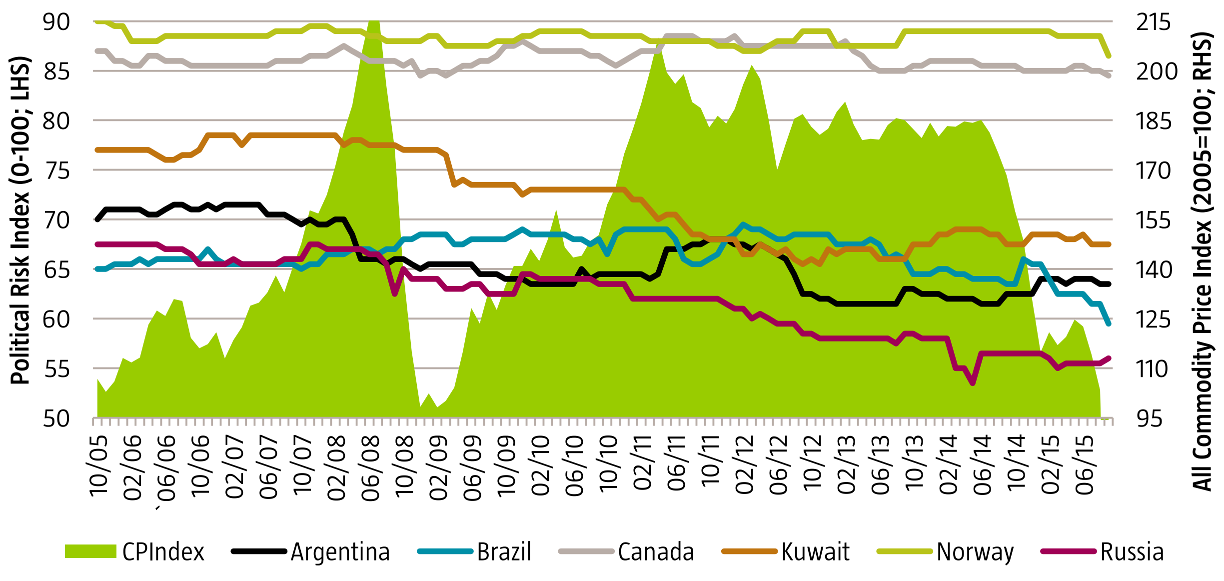
Source: RobecoSAM, World Bank

Mounting political headwinds in key emerging markets

The change in emerging markets' fortunes resulting from a reversal of the favorable external environment has become even more accentuated in recent months, as reflected in the stock market turbulence in China, the deepening recessions in Brazil and Russia, and the intensified outflow of capital. After a prolonged period of economic and social progress, emerging economies are once again facing some severe challenges, raising the possibility of a sudden outbreak of political instability. Indeed, political stability had increased in many of these countries during the commodity price boom. However, in some countries the commodities windfall has allowed governments to pursue populist but unsustainable policies, helping populist leaders in the short run, as witnessed in Argentina and Venezuela. The two countries are also notable examples of authoritarian regimes that have become even more authoritarian as a result of natural resource windfalls, confirming the findings of a study by Francesco Caselli and Andrea Tesei.[2]

Looking back through history, there are many examples in which a surge in revenues from natural resources has hindered the economic and political development of a country. During the most recent commodities boom many of the main emerging market economies largely missed the opportunity for reform afforded to them by strong growth and favorable external conditions. Now that the wind has turned, emerging markets across the board are under increasing strain, raising the threat of growing political instability, with countries whose regimes depend on economic growth for political survival appear most at risk. As shown in figure 8, political risk is indeed on a downward trend (here reflected by the declining political risk score from the PRS group) in some of the main commodity producers among emerging markets. On the other hand, the slump in commodity prices does not seem to have a noticeable effect on the political situation in advanced economies and mature democracies such as Canada or Norway.

Figure 8: Political stability suffering from the commodity price slump?



Source: IMF, PRS Group

A prolonged period of low commodity prices and associated economic woes could very well lead to increased public discontent, political and social tensions, which in turn are having an adverse impact on investment and limiting the scope for reforms, further exacerbating the drag on the economy. After all such developments may not always cause the economic and political breakdown of a country but they could also be the trigger for reform. In this respect, the surprising outcome of the recent elections in Argentina could prove to be a glimmer of hope. Not only did the Cristina Kirchner's ruling party fail to dominate the presidential vote, it also lost its congressional majority and its bid to take over the office of the governor of Buenos Aires province. Buenos Aires mayor Mauricio Macri from the "Let's Change" alliance might even have a chance of

[2] Caselli, Francesco and Tesei, Andrea: "Resource Windfalls, Political Regimes, and Political Stability", September 2014

winning the run-off on November 22 against presidential candidate Scioli, which would provide the prospect for more business-friendly policies and a departure from "kirchnerismo." Nonetheless, because they usually lack the ability to adapt, authoritarian regimes often tend to collapse as demonstrated by the Arab Spring. And in this regard it is worrisome to observe increasing authoritarian trends in countries such as Hungary, Malaysia, Russia, Thailand, Turkey or Venezuela as already reflected in the deteriorating voice and accountability governance indicator provided by the World Bank. This, compounded with the current low commodity prices, moderate global growth, increased risk aversion, capital flight and an impending increase in US interest rates, does not point to a swift reversal of this situation.

"The country sustainability ranking provides additional insights into a country's underlying risk drivers that we believe are critical to making balanced investment decisions."

Max Schieler
Senior Country Risk Specialist

Data Sources

Environmental Status	EIRIS; Country Sustainability Ratings Report, July 2015 http://www.eiris.org/
Energy	EIA; International Energy Statistics http://www.eia.gov/ World Bank; World Data Bank http://databank.worldbank.org/data/ UN, UN Data http://data.un.org/
Environmental Risk	Bündnis Entwicklung Hilft; World Risk Report 2015 http://www.entwicklung-hilft.de/home.html
Social Indicators	EIRIS; Country Sustainability Ratings Report, July 2015 http://www.eiris.org/
Human Development	UNDP; Human Development Report 2014 http://hdr.undp.org/en
Social Unrest	Fund for Peace; Fragile States Index 2015 http://fsi.fundforpeace.org/
Liberty & Inequality	EIRIS; Country Sustainability Ratings Report, July 2015 http://www.eiris.org/
Competitiveness	World Economic Forum; The Global Competitiveness Report 2014-2015 http://reports.weforum.org/global-competitiveness-report-2014-2015/
Political Risk	PRS Group; Political Risk Services (PRS) http://www.prsgroup.com/
Accountability	World Bank; Worldwide Governance Indicators http://info.worldbank.org/governance/wgi/index.aspx#home
Stability	World Bank; Worldwide Governance Indicators http://info.worldbank.org/governance/wgi/index.aspx#home
Effectiveness	World Bank; Worldwide Governance Indicators http://info.worldbank.org/governance/wgi/index.aspx#home
Regulatory Quality	World Bank; Worldwide Governance Indicators http://info.worldbank.org/governance/wgi/index.aspx#home
Rule of Law	World Bank; Worldwide Governance Indicators http://info.worldbank.org/governance/wgi/index.aspx#home
Corruption	World Bank; Worldwide Governance Indicators http://info.worldbank.org/governance/wgi/index.aspx#home
Aging	World Bank; World Bank Data http://data.worldbank.org Standard & Poor's; Global Aging 2013: Rising to The Challenge http://www.mhfigi.com/societal-trends/global-aging-2013-rising-to-the-challenge/ Help Age International; Global AgeWatch Index 2015 http://www.helpage.org/
Institutions	World Economic Forum; The Global Competitiveness Report 2014-2015 http://reports.weforum.org/global-competitiveness-report-2014-2015/

As for the data on the sub-indicators "Energy Use" and "Renewables" new data sources – World Bank and EIA, respectively – have been used for the October 2015 update, which has improved the score for the "Energy" indicator for a number of countries and resulted in a sharper differentiation in the scores across countries.

About RobecoSAM

Founded in 1995, RobecoSAM is an investment specialist focused exclusively on Sustainability Investing. It offers asset management, indices, engagement, voting, impact analysis, sustainability assessments, and benchmarking services. Asset management capabilities cater to institutional asset owners and financial intermediaries and cover a range of ESG-integrated investments (in public and private equity), featuring a strong track record in resource efficiency theme strategies. Together with S&P Dow Jones Indices, RobecoSAM publishes the globally recognized Dow Jones Sustainability Indices (DJSI). Based on its Corporate Sustainability Assessment, an annual ESG analysis of 2,900 listed companies, RobecoSAM has compiled one of the world's most comprehensive databases of financially material sustainability information.

RobecoSAM is a member of the global pure-play asset manager Robeco, which was established in 1929 and is the center of expertise for asset management within the ORIX Corporation. As a reflection of its own commitment to advocating sustainable investment practices, RobecoSAM is a signatory of the UNPRI and a member of Eurosif, ASrIA and Ceres. Approximately 130 professionals work for RobecoSAM, which is headquartered in Zurich. As of June 30, 2014, RobecoSAM had assets under management, advice and/or license in listed and private equity* of approximately USD 10.7 billion. Additionally, RobecoSAM's Governance & Active Ownership team** had USD 85.1 billion of assets under engagement and USD 53 billion of assets under voting.

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