GCR affirms the Zimbabwean Financial Institutions' Sector Risk Score of '1.0' balancing profitability and foreign currency liquidity pressure with stable funding

Johannesburg, 17 July 2020 – GCR Ratings ("GCR") has affirmed the Zimbabwean Financial Institutions' sector risk score of '1.0'.

The Financial Institutions Sector Risk Scores are available for download at https://gcrratings.com/risk-scores/.

The GCR Financial Institutions Sector Risk Assessment

The Financial Institutions sector risk score (ranging from 0 to 15) is a key factor in the operating environment component score. The core of the GCR Ratings Framework is based on GCR's opinion that an entity's operating environment largely frames its creditworthiness. As a result, the operating environment analysis anchors the underlying risk score for the GCR rating methodology. GCR combines elements of the country risk and sectoral risk analysis, blended across countries for entities operating across multiple jurisdictions, to anchor an issuer to its current operating conditions. For more details on any of the above, please read the related criteria and research listed below.

GCR will periodically publish updated "Financial Institutions Sector Risk Scores", which will supersede previous publications. The publication titled "GCR Financial Institutions Sector Risk Scores, 17 July 2020", available at https://gcrratings.com/risk-scores/ supersedes the article published on 24 June 2020.

Financial Institutions Sector Risk Scores

Zimbabwean Financial Institutions Sector Risk score: '1.0'. Country Risk Score 0.0, Mapping Table 0.0 to 1.0

Zimbabwe's financial institution sector risk of '1' is restrained by rising hyperinflation and the unquantified ramifications of the on-going COVID-19 pandemic posing major risks to the banking industry's operations and performance. Furthermore, severe local currency devaluation, volatile monetary policy, and a long-term weak fiscal position are a material risk to business stability and the already weak banking sector consumer confidence. In the majority of Zimbabwean banks, monetary assets make the bulk of net assets. As a result, in a hyperinflationary environment, monetary losses will erode performance gains and nominal capital. Furthermore, yields are under threat from rising YoY inflation to 785.55% at May 2020. The traditional banking model is already at risk, the next 12 months will further catalyst the holding of illiquid fixed assets over loans or liquid assets. Due to the significant local currency devaluation, some banks may not be able to attain the regulatory minimum Tier 1 capital equivalent of USD30m by December 2020. The new capital requirements are considered a step in the right direction to ensure stability and soundness of the banking sector provided the central bank takes a firm stance on non-compliant institutions. However, there is higher likelihood of policy revision opposed to license revocation. We expect the hyperinflationary environment will persist driven by high local money supply growth in the wake of the COVID-19 pandemic. Despite the sound loan book performance of the banking sector, initial assessments indicate that banks' operations may face additional challenges with credit extension and loan repayment. Local currency liquidity is sound, however, GCR expects foreign currency ("FX") liquidity challenges to persist and high probability of default on FX debt. GCR also believes that promoting exchange rate stability, will remain extremely taxing given continued foreign exchange shortages and persistent monetary instability in 2020. Regulation is viewed relatively weaker than the regional average, improvement efforts are constrained by political interference resulting in an unstable operating environment. Failure by regulatory and monetary authorities to arrest regulation, governance & policy certainty may result in the sector score being negatively impacted. The score also takes into account the somewhat fragmented sector, which has created stiff competition, but the banks in the top tier are generally profitable and adequately capitalized. Funding is largely deposit based, spread between corporate and retail deposits. However, we expect large concentrations in the funding base due to erosion of household incomes and moderate probability corporate closures.

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Related criteria and research

Criteria for the GCR Ratings Framework, May 2019
Criteria for Rating Financial Institutions, May 2019
GCR Ratings Scales, Symbols & Definitions, May 2019
GCR Country Risk Scores, May 2020