Fitch Credit Rating for Zambia

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Fitch, a renowned global credit rating agency and one of the top three statistical rating organizations in the world recently maintained Zambia's sovereign credit risk rating of 'B+' at its second rating of the country's sovereign risk that began in 2011.

Unlike during the debut rating, the agency now warned that the outlook for credit risk in Zambia is negative. This has led to public speculation and varied sentiments on what this statement implies in as far as the maintenance of investor confidence and that of credit issuers is concerned.

In today's column, we would like to share our reflections on this matter. Before we proceed, it is important to understand why credit risk ratings exist and the type of information they transmit to investors or international lenders.

The general assignment of ratings and definitions by Fitch Ratings is as follows:

Fitch Ratings of Long term Obligations

Grade	Rating	Explanation of rating
Investment Grade	AAA	Highest grade, lowest risk
	AA	High grade, low risk
	A	Above average grade, relatively low risk
	BBB	Average grade, medium risk
Speculative Grade	BB	Payment likely, but uncertain
	B	Currently able to pay, risk of future default
	CCC	Poor liquidity and clear risk of default
	CC	Very doubtful liquidity; frequent default
	C	Lowest grade; extremely poor outlook for repayment
	D	In default

Generally, credit rating agencies do assign borrowers with a credit score which has a significant impact on the lending terms they can be offered in the market. The Sovereign credit ratings reflect a government's ability to fulfil its obligations fully and punctually. For each government assessed, the Fitch Ratings also publish their findings on the probable direction that the risk rating is likely to take over the medium term (one to three years). This indicator is known as an outlook which can be positive, negative, stable or developing. A symbol of "+" or "-" is usually appended on Fitch ratings that range between AA-CCC. A symbol of '+' indicates that the rating is in the top category within that level, and '-' means that the rating is in the bottom category of any level.

Therefore, the current Sovereign Credit rating of 'B+' for Zambia on Long-term foreign and local currency Issuer Default Ratings (IDR) reported by Fitch indicates that the country is currently able to meet its obligations with a notable risk of future default. The rating also entails that there is scope to further reduce the cost of financing from the capital markets. However, the negative outlook is an indicator that unless the fundamental drivers of the credit rating are addressed, the rating is likely to deteriorate in the medium term.

The negative outlook has potential to adversely affect the expectations of future investors who are willing to invest in Government securities in the medium term in Zambia. This is particularly so because their expected return on these investments is rather pessimistic.

So what do these ratings mean for Zambia? Before we provide some probable intuition to this question, it is important to mention that the current rating of Zambia's sovereign risk has been released at a time when Fitch and its peers, Moody's and Standard and Poor's, are being criticized for fuelling the financial meltdown in 2008. The criticism which is widespread in the developed world relates to the inaccurate ratings these agencies published on toxic mortgage backed financial securities.

Without prejudice, there is ample evidence that sovereign ratings continue to shape the perceptions of investors and lenders in the global markets albeit with caution. According to the economist magazine of the month of July in 2012, sovereign risk ratings seem to have little or no impact on investor perceptions regarding the risk developments in developed countries but remain critical in influencing investor perceptions regarding developing countries that lack prior credit history.

Given that mobilisation of domestic resources still remains a challenge to Zambia in view of a stagnation in the tax to gross domestic product ratio at between 15% and 20% in the last 15 years and the decline in official development assistance to gross national income which is now below 18% of the national budget from over 33% in the 1990 decade, borrowing from the international market remains an avenue for easing the financing gap of national development projects at the moment. This situation means that instituting conditions that will easy the access to international capital markets and will enable the country to borrow at lower rates need to be prioritized.

At all reasonable costs, it is in the interest of any Government to cautiously avoid stirring sentiments that may stifle investor confidence. In this manner, Zambia needs not to jeopardize conditions that may affect its favourable credit rating by any credit rating organisation in the world.

A strong credit rating is virtuous and self-re-enforcing. Therefore, what can Zambia do to enhance its Sovereign Rating? Clearly, sovereign credit ratings are computed based on various components that include: foreign-currency liquidity, potential output growth; monetary policy, political risk; public financial management; public debt management and private sector debt position. An improvement in these areas has the effect of improving the country's rating while poor performance deteriorates it.

The Fitch report highlights some of the short comings in the various categories listed above the led to a 'B+' score and the associated negative outlook. Notably, the report identifies continued uncertainty regarding the business environment and wider microeconomic policies that could undermine macroeconomic stability and the business and investment climate as some of the areas of much concern. Therefore, it is recommended that the country should consider addressing these downside risks identified in the report to improve public policy management climate towards global recommended practises that guarantees conducive environment for doing business. Up-take of this recommendation is particularly critical if the current rating is to be preserved or indeed improved.

In addition, Government could make deliberate efforts to ensure that policy

formulation is informed through wider engagement with the private sector. The government could continue to play the leadership role in the formulation of policy while encouraging ownership through deliberate consultation with stakeholders. This would certainly reduce uncertainty in the business environment and enhance stability among the private sector on matters relating to micro economic policy that affect investment, medium-term growth prospects and macroeconomic stability.

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