FitchRatings

RATING ACTION COMMENTARY

Fitch Revises German Coop Banks' Outlook to Negative on Deteriorating Environment

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Fitch Ratings - Frankfurt am Main - 27 Mar 2020: Fitch Ratings has revised Genossenschaftliche FinanzGruppe's (GFG) Outlook to Negative from Stable, while affirming the Long-Term Issuer Default Rating (IDR) at 'AA-'.

Fitch has also revised the Outlook of GFG's central institution, DZ BANK AG Deutsche Zentral-Genossenschaftsbank, and of more than 800 local bank members of GFG's mutual support scheme, to Negative from Stable.

A full list of rating actions is detailed below. A full list of rated GFG members is available at www.fitchratings.com.

The ultimate economic and financial market implications of the coronavirus outbreak are still unclear, but Fitch views the risks to banks' credit profiles as clearly skewed to the downside, which has driven today's rating actions. Fitch's sector outlook for German banks was revised to negative in December 2019, and the coronavirus outbreak will put additional pressure on the banks' earnings and asset quality. These are exacerbated by the structural weaknesses of the domestic banking sector, where most banks have been unable to generate adequate returns during periods of strong economic growth. To reflect this structural weakness, Fitch has lowered its operating environment score for the domestic German banks to 'aa-' from 'aa' and sees further pressure on the operating environment.

Fitch may lower its assessment of the operating environment further if there are signs that the domestic economy suffers longer-term from the current crisis, or if the banking sector is unable to restore its profitability, which is likely to require greater pricing discipline and consolidation to remove excess capacity in the sector.

Fiscal support measures for the private sector and financial markets have mixed first-order implications for banks. The German government's measures and additional budget of EUR150 billion for 2020 will support borrowers' viability and hence banks' asset quality. Mortgage loan relief programmes will have negative first-order implications for banks, but compensation by the state for direct coronavirus-related losses appears to have the endorsement of EU state-aid authorities, so it is likely that the full financial impact for banks will be mitigated.

GFG is not a legal entity but a cooperative banking network whose cohesion is ensured by a mutual support scheme managed by the National Association of German Cooperative Banks (BVR). Its IDRs apply to each member bank, in accordance with Annex 4 of Fitch's criteria for rating banking structures backed by mutual support schemes. The ratings are underpinned by the scheme's high effectiveness given a long and successful record of ensuring GFG's cohesion, monitoring members' risks and enforcing corrective measures when needed. The scheme has effectively protected its members' viability and averted losses by their creditors since its inception.

KEY RATING DRIVERS

Unless otherwise stated below, the key rating drivers for GFG and its members are those outlined in our Rating Action Commentary published in September 2019 (Fitch Affirms Genossenschaftliche FinanzGruppe at 'AA-'; Outlook Stable).

We have revised the Outlook on GFG's and its members' IDRs to Negative to reflect that a potential prolonged deterioration of the German operating environment is likely to exacerbate in the medium-term the erosion of the group's profitability, which has already been under pressure from prevailing low interest rates.

At the same time, we have affirmed the IDRs and GFG's VR as we believe that the group, similarly to its German savings banks peers, is in a stronger position than its German commercial banking peers to absorb a short-term shock at the current rating level, due to its robust earnings, strong capitalisation and focus on granular retail clients. We also believe that the group's funding would benefit from a flight to quality if confidence in the overall financial sector weakens significantly as a result of an escalation of the crisis. Similar to peers, we expect loans classified as Stage 3 under IFRS 9 in the group's SME portfolio and at DZ BANK to rise but to remain manageable.

We have maintained certain debt and the long-term deposit ratings of DZ BANK and its subsidiaries as well as Muenchener Hypothekenbank eG and Deutsche Apotheker- und Aertztebank eG Under Criteria Observation until further analysis is completed.

RATING SENSITIVITIES

Unless otherwise stated below, the key rating sensitivities for GFG and its members are those outlined in our Rating Action Commentary published in September 2019 (Fitch Affirms Genossenschaftliche FinanzGruppe at 'AA-'; Outlook Stable).

The Long-Term IDRs may be downgraded if the economic disruptions caused by the pandemic intensifies, making a sharp recovery in global growth in 2021 more remote. This would impair the group's relative resilience, and increase risks to the group's VR and financial metrics in the short-term rather than in the medium-term.

Persistently low interest rates could also eventually trigger a downgrade of GFG's ratings. Low interest rates are increasingly likely to erode GFG's profitability below levels that we view as being commensurate with the group's VR. At the same time, the VR remains sensitive to deterioration of the group's capital ratios due to continued strong balance-sheet growth or credit losses, although the latter would need to be exceptionally high to exceed the group's robust pre-impairment profits.

We could revise the Outlook to Stable if the economic disruptions turn out to be short-lived, if the group maintains its superior ability to navigate this severe external shock as it did during the last 2008 financial crisis, or if regulatory intervention aimed at alleviating the impact of the crisis on the financial sector effectively neutralises the threat to GFG's financial position. An upgrade is unlikely given the already high ratings and in light of the adverse interest-rate environment expected in the medium term. An upgrade would also require better cost efficiency, which is likely to necessitate a protracted streamlining of the group's structure, especially at the local banks' level. The member banks' IDRs and the senior non-preferred debt ratings of DZ BANK and its subsidiaries are subject to the same sensitivities as GFG's IDRs.

The key rating sensitivities for the ratings Under Criteria Observation are those outlined in our Rating Action Commentary published on 4 March 2020 (Fitch Places German Coop Banks' Debt Ratings Under Criteria Observation).

ESG CONSIDERATIONS

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VIEW ADDITIONAL RATING DETAILS

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

Bank Rating Criteria (pub. 28 Feb 2020)

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