

**Rating Action: Moody's downgrades 20 financial institutions in Turkey**

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28 Aug 2018

**Negative outlook assigned**

London, 28 August 2018 -- Moody's Investors Service ("Moody's") today downgraded 18 banks and two finance companies in Turkey.

This action concludes the review for downgrade initiated on 7 June 2018 on 17 banks and two finance companies in Turkey. Prior to today's action, the long-term issuer ratings of Nurol Investment Bank had a stable outlook.

The standalone baseline credit assessments (BCA) of 14 banks were downgraded by one notch, while the BCAs of four banks (Denizbank A.S., Odea Bank A.S., Turkiye Is Bankasi A.S., Turkiye Sinai Kalkinma Bankasi A.S.), were downgraded by two notches; the Corporate Family ratings (CFR) of the two finance companies were downgraded by one notch.

The downgrades primarily reflect a substantial increase in the risk of a downside scenario, where a further negative shift in investor sentiment could lead to a curtailing of wholesale funding. The rating agency also notes that Turkey's operating environment has deteriorated beyond its previous expectations, and it expects it will continue to so. Moody's has captured these challenges by lowering Turkey's Macro Profile to Weak- from Weak.

This rating action follows Moody's recent decision to downgrade Turkey's government bond rating to Ba3 from Ba2 and assign a negative outlook, and the resulting lowering of the ceiling for foreign currency deposits to B1 from Ba3. For further information on the sovereign rating action, please refer to Moody's press release published on 17 August 2018: [https://www.moodys.com/research/--PR\\_387786](https://www.moodys.com/research/--PR_387786).

Please click on this link [http://www.moodys.com/viewresearchdoc.aspx?docid=PBC\\_200461](http://www.moodys.com/viewresearchdoc.aspx?docid=PBC_200461) for the List of Affected Credit Ratings. This list is an integral part of this Press Release and identifies each affected issuer.

**RATINGS RATIONALE**

**SUBSTANTIAL INCREASE IN TAIL RISKS FOR FUNDING**

There is a heightened risk of a downside funding scenario, where a deterioration in investor sentiment limits access to market funding. Moody's also recognises the potential risk of a parallel deterioration in confidence in US dollar domestic deposits.

Turkish banks are highly reliant on foreign currency funding and had market funds of around USD186 billion denominated in foreign currency as of June 2018, equivalent to 75% of their total wholesale funds. This makes the banking system particularly sensitive to potential shifts in investor sentiment, as these foreign currency liabilities must be refinanced on an ongoing basis.

In the next 12 months around USD77 billion of foreign currency wholesale bonds and syndicated loans, or 41% of the total market funding, needs to be refinanced. The Turkish banks hold around USD48 billion of liquid assets in foreign currency and have USD57 billion compulsory reserves with the Central Bank of Turkey, which would not be entirely available.

In a downside scenario, where investor sentiment shifts, the risk of a prolonged closure of the wholesale market would lead most banks to materially deleverage, or to require external funding support from the government, or the Central Bank.

Such a scenario could also impact the local deposit base, which has large deposits in foreign currency. Turkish households, corporates, and small and medium enterprises (SME) hold around USD196 billion of deposits in foreign currency, or around 40% of total deposits in the system. In the event of a shift in domestic confidence in foreign currency, the Turkish authorities would subsequently be faced with challenging decisions to address the stability of US dollar deposit bases.

## DETERIORATION OF THE OPERATING ENVIRONMENT

The Turkish operating environment has deteriorated in recent months and the rating agency expects this deterioration to continue beyond its previous expectations.

Moody's notes that, after years of credit-fuelled growth (GDP growth in 2017: 7.4%), the combination of tighter financial conditions, and a weaker exchange rate (the Turkish lira to US dollar exchange rate has weakened by around 40% since 1 January 2018) that is associated with high and rising external financing risks, are fuelling inflation and undermining growth. Moody's forecasts GDP growth of just 1.5% in 2018 and 1% in 2019, and an inflation rate of 20% in 2018 and 14% in 2019. However, there is considerable uncertainty and further downside risks to Turkey's growth prospects, both short- and medium-term remain. Lower growth, and a weaker Turkish lira, will have a negative impact on banks' asset quality, profitability, and capital, beyond the rating agency's previous expectations.

The solvency of Turkish banks will be weaker than reported figures suggest due to regulatory forbearance. For example, banks are reporting problem loans and performing loans with severe deterioration since origination (the so-called Stage 2 loans under IFRS9 classification) in an inconsistent manner and the Turkish regulator has suspended the mark-to-market calculations on capital adequacy ratio. It has also imposed restrictions on swap transactions to reduce market participants' ability to take positions against the Turkish lira.

## LOWER MACRO PROFILE

These funding challenges, and to a lesser extent the more negative economic scenarios, drove Moody's to lower Turkish banks' Macro Profile by one notch to Weak- from Weak, which, in turn, led Moody's to downgrade 18 banks and two finance companies based in Turkey. For 14 banks and two finance companies, the downgrade of their BCAs or CFRs was limited to one notch. For four banks (Denizbank, Odea Bank, Turkiye Is Bankasi and Turkiye Sinai Kalkinma Bankasi), BCAs were downgraded by two notches, to reflect the banks' already weaker positioning in their rating category. Denizbank A.S., Odea Bank A.S., and Turkiye Is Bankasi A.S., reported a higher level of problem loans, lower tangible common equity in percent of their risk-weighted assets, or lower returns on tangible assets compared with their peers. Turkiye Sinai Kalkinma Bankasi A.S. is constrained by the weaker standalone profile of its parent Turkiye Is Bankasi A.S.

## AFFILIATE SUPPORT IS UNCHANGED

Moody's expectations of affiliate support, and the related notches of uplift, remain unchanged. The downgrade of Turkish banks' adjusted BCAs therefore had the same magnitude as the downgrade of the standalone BCAs.

The adjusted BCAs of eight banks benefit from uplift from affiliate support. The adjusted BCA of Alternatifbank A.S. and ING Bank A.S. (Turkey) benefit from three notches of uplift; the adjusted BCA of QNB Finansbank AS, HSBC Bank A.S. (Turkey), and Turk Ekonomi Bankasi A.S. benefit from two notches of uplift; and the adjusted BCA of Denizbank A.S., Turkiye Garanti Bankasi A.S., and Yapi ve Kredi Bankasi A.S. benefit from one notch of uplift. The difference in uplifts reflects the differences in relative creditworthiness between parents and subsidiaries, as well as the rating agency expectations of extraordinary support in case of need.

The rating agency's assessment of affiliate support for Odea Bank A.S. from its parent Bank Audi S.A.L. remains high. However, because Odea Bank and Bank Audi have the same BCA of b3, Odea Bank's adjusted BCA does not receive any uplift from affiliate support. Similarly, for Turkiye Sinai Kalkinma Bankasi A.S., which has a b3 BCA, the moderate probability of affiliate support coming from parent Turkiye Is Bankasi A.S., which also has a BCA of b3, does not provide any uplift.

## GOVERNMENT SUPPORT IS UNCHANGED

Moody's has kept the uplift to the long-term deposit and senior unsecured ratings from the banks' adjusted BCA unchanged. The long-term deposit and issuer rating of seven banks benefit from uplift from government support.

The lower rated government-owned Turkiye Halk Bankasi and Turkiye Vakiflar Bankasi TAO continue to receive two notches of uplift. The long-term deposit and senior unsecured debt rating of state-owned T.C. Ziraat Bankasi, Turkey's official export credit agency Export Credit Bank of Turkey AS (Turk Exim), the development bank Turkiye Sinai Kalkinma Bankasi A.S., and large privately-owned Akbank TAS and Turkiye Is Bankasi, which do not benefit from uplift from affiliate support, continue to receive a one-notch uplift from

government support.

For the other banks and for the two finance companies, the rating agency maintains moderate or low probability of government support, which does not provide any uplift.

#### FOREIGN CURRENCY DEPOSIT RATINGS ARE IN SOME CASES CONSTRAINED BY THE FOREIGN CURRENCY DEPOSIT CEILING

Reflecting reduced institutional strength, Moody's lowered the long-term foreign currency ceiling for Turkish banks to B1 from Ba3 on 17 August 2018: [https://www.moody.com/research/--PR\\_387786](https://www.moody.com/research/--PR_387786). As a consequence, the long-term foreign currency deposit ratings of Alternatifbank A.S., ING Bank A.S. (Turkey), QNB Finansbank AS, and Turk Ekonomi Bankasi A.S. were capped at B1.

#### NATIONAL SCALE RATING

Moody's also took action on the National Scale Ratings (NSR) of Turkish banks, reflecting the downgrade of the ratings, and Moody's updated NSR map for Turkey that it published on 17 August 2018.

#### NEGATIVE OUTLOOK

The long-term deposit and senior unsecured debt ratings of all Turkish financial institutions is negative. This reflects the risk that prolonged volatility of the foreign currency exchange rate, or a sudden drop in investor confidence, could lead to significant stress on the banks' foreign currency funding and deposits. The negative outlook also incorporates increasing financial stress, as well as a more severe downward scenario that would lead to further negative implications for the solvency of Turkish banks.

#### FACTORS THAT COULD LEAD TO AN UPGRADE/DOWNGRADE

An upgrade is unlikely, given the current negative outlook. However, the outlooks could stabilise should the Turkish lira become more stable, if there were a structural reduction of the reliance of Turkish banks on foreign currency funding, the banks' stock of problem loans stabilized, and returns on tangible assets stabilized in line with recent years.

A downgrade could be driven by a persistence of high market volatility, a spike in corporate defaults, lower capital ratios, or a material reduction in banks' profitability beyond Moody's expectations.

#### PRINCIPAL METHODOLOGIES

The principal methodology used in rating Turkiye Is Bankasi A.S., T.C. Ziraat Bankasi, Turkiye Garanti Bankasi A.S., Akbank TAS, Yapi ve Kredi Bankasi A.S., Turkiye Vakiflar Bankasi TAO, Turkiye Halk Bankasi A.S., Turk Ekonomi Bankasi A.S., ING Bank A.S. (Turkey), Sekerbank T.A.S., Turkiye Sinai Kalkinma Bankasi A.S., Alternatifbank A.S., Export Credit Bank of Turkey A.S., QNB Finansbank AS, HSBC Bank A.S. (Turkey), Denizbank A.S., Odea Bank A.S. and Nuro Investment Bank was Banks published in August 2018. The principal methodology used in rating Optima Faktoring A.S. and Ekspo Faktoring A.S. was Finance Companies published in December 2016. Please see the Rating Methodologies page on [www.moody.com](http://www.moody.com) for a copy of these methodologies.

Moody's National Scale Credit Ratings (NSRs) are intended as relative measures of creditworthiness among debt issues and issuers within a country, enabling market participants to better differentiate relative risks. NSRs differ from Moody's global scale credit ratings in that they are not globally comparable with the full universe of Moody's rated entities, but only with NSRs for other rated debt issues and issuers within the same country. NSRs are designated by a ".nn" country modifier signifying the relevant country, as in ".za" for South Africa. For further information on Moody's approach to national scale credit ratings, please refer to Moody's Credit rating Methodology published in May 2016 entitled "Mapping National Scale Ratings from Global Scale Ratings". While NSRs have no inherent absolute meaning in terms of default risk or expected loss, a historical probability of default consistent with a given NSR can be inferred from the GSR to which it maps back at that particular point in time. For information on the historical default rates associated with different global scale rating categories over different investment horizons, please see [https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC\\_1113601](https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_1113601).

The local market analyst for Alternatifbank A.S., ING Bank A.S. (Turkey), Nuro Investment Bank, Turk Ekonomi Bankasi A.S. and QNB Finansbank AS ratings is Nitish Bhojnarwala, +971.4.237.9563.

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