FitchRatings

# Fitch Downgrades 20 Turkish Banks; Outlook Negative

**Link to Fitch Ratings' Report(s):** Fitch Downgrades 20 Turkish Banks; Outlook Negative (https://www.fitchratings.com/site/re/10046735)

Fitch Ratings-London-01 October 2018: Fitch Ratings has downgraded the Long-Term Foreign-Currency Issuer Default Ratings (LTFC IDRs) of 20 Turkish banks and their subsidiaries. The agency has also downgraded the Viability Ratings (VRs) of 12 banks. A full list of rating actions is available at www.fitchratings.com or by clicking the link above.

The downgrades of the banks' VRs reflect increased risks to their stand-alone credit profiles over the rating horizon since the last review of these institutions on 20 July 2018. In Fitch's view, the banks' performance, asset quality, capitalisation and liquidity and funding profiles are now more likely to come under pressure as a result of the further depreciation of the Turkish lira (by about 20% against the US dollar since the last rating review), the spike in interest rates (driven by the increase in the policy rate to 24% from 17.75% on 13 September) and the weaker growth outlook (Fitch has revised downwards its forecasts for GDP growth to 3.8% in 2018 and 1.2% in 2019).

At the same time, Fitch believes that near-term pressure on the banks' ratings has moderated as a result of the eventually orthodox monetary policy response, the stabilisation of the lira exchange rate, recent evidence of external market access - albeit at a higher cost - and the absence of significant deposit outflows since mid-August.

The downgrades of foreign-owned banks' LTFC IDRs to 'BB-' from 'BB', one notch below the sovereign rating, reflect our revised assessment of the risk of a marked deterioration in Turkey's external finances, and therefore of the risk of government intervention in the banking sector. We now view the risk of restrictions that would prevent banks from servicing their obligations to be slightly higher than that of a sovereign default.

The downgrades and revisions of the LTFC IDRs and Support Rating Floors (SRFs) of state-owned commercial banks, state-owned Vakif Katilim Bankasi AS and the private development bank Turkiye Sinai Kalkinma Bankasi A.S. (TSKB) to 'B+' from 'BB-' reflect Fitch's view of greater risks to the ability of the Turkish authorities to provide support in FC given the increased potential for stress in the country's external finances.

The affirmation of the LTFC IDRs and SRFs of two state-owned development banks, Turkiye Ihracat Kredi Bankasi A.S. (Turk Eximbank) and Turkiye Kalkinma Bankasi A.S. (TKB), at 'BB-' and 'BB', respectively, reflect the banks' ownership, policy roles and, in the case of TKB, almost entirely treasury-guaranteed funding base.

Fitch plans to resolve the outstanding Rating Watch Negatives (RWNs) on the VRs of smaller foreign-owned and participation banks at a further review in the coming weeks.

KEY RATING DRIVERS
VRs OF ALL BANKS
The 'b+' VRs of T.C. Ziraat Bankasi A.S. (Ziraat), Turkiye Halk Bankasi A.S. (Halk), Turkiye Vakiflar Bankasi T.A.O. (Vakifbank), TSKB, Akbank T.A.S., Turkiye Garanti Bankasi A.S. (Garanti), Yapi ve Kredi Bankasi A.S. (YKB), Turkiye Is Bankasi A.S. (Isbank), Turk Ekonomi Bankasi A.S. (TEB), ING Bank A.S., QNB Finansbank A.S. and Denizbank A.S. reflect their exposure to the high-risk Turkish operating environment. They also reflect, to varying degrees, the banks' solid franchises, and in most cases records of stable and sound performance and moderate non-performing loans (NPLs).

However, the banks' risk profiles have deteriorated significantly as a result of local-currency depreciation and higher interest rates, which have, and will continue to, put pressure on asset quality, margins and capitalisation. In addition, there is a material risk of a reduction in access to foreign funding markets, and of volatility in deposit levels, resulting in heightened refinancing and liquidity pressures. Risks to financial stability remain significant, given potential unpredictability in the policy framework and Turkey's large external financing requirements.

Asset-quality risks for banks have increased given the weaker growth outlook, generally high FC lending (equal to about 45% of sector loans as of mid-September 2018, up from 39% at end-1H18 due to the impact of local-currency depreciation) and the potential impact of depreciation on often weakly hedged borrowers' ability to service their debt. Significantly higher interest rates following the increase in the policy rate are likely to negatively affect lira borrowers' debt service capacity, and also weigh on loan performance. Exposures to the construction and energy sectors and high borrower concentrations are also significant sources of risks at many banks.

The banks' reported NPL ratios have remained broadly stable in recent quarters and at manageable levels. The sector NPL ratio (loans overdue by 90+ days; unconsolidated basis) was a still moderate 3% as of mid-September 2018. However, NPLs have grown in absolute terms and the emergence of some big-ticket problematic exposures, growth in Stage 2 loans (partly explained by banks' transition to IFRS 9 in 1Q18) and the loan restructuring framework agreement being implemented in Turkey suggest the potential for NPL increases. Reserves coverage of NPLs is reasonable, but taking into account Stage 2 loans - which averaged 8% at the larger banks in the sector at end-1H18 - is significantly weaker.

Fitch expects sector profitability to weaken in 2019 due to higher funding costs following the increase in the policy rate, slower credit growth and higher impairment charges. Performance could deteriorate significantly in case of a marked weakening of asset quality. FY18 performance should remain reasonable, notwithstanding slower growth in 2H18, supported by a strong performance in 7M18 (return on average equity of 15.6%), loan repricing, expected gains on CPI-linked securities at some banks and some flexibility in impairment recognition and provisioning.

Capital ratios have come under pressure from lira depreciation (which inflates FC risk-weighted assets) and higher interest rates (which result in negative revaluations of government bond portfolios). Potential asset-quality deterioration also represents a risk to capital positions. Pre-impairment profit (7M18 annualised: equal to about 5% of average sector loans) provides a moderate buffer to absorb losses through income statements, although this is likely to fall as a result of tighter margins. A number of banks also hold small amounts of free provisions.

The sector's average total capital ratio (on a solo basis) was 16.1% at end-July 2018, comfortably above the 12% recommended regulatory minimum. This is down only moderately from 16.9% at end-2017 as solid internal capital generation and the hedge offered by FC Tier 2 instruments have partially offset the impact of a weaker lira and higher rates. However, further sharp lira depreciation, and the interest-rate hike in August 2018, will have eroded banks' capital positions further. Nonetheless, forbearance measures introduced by the Banking Regulation and Supervision Authority to alleviate the impact on reported regulatory capital metrics reduce the risk of regulatory capital breaches, in our view.

Refinancing risks for the banks remain high given the sector's significant short-term maturing FC wholesale funding liabilities, and in light of the recent heightened market volatility and tightening global financing conditions (driven mainly by an increase in dollar interest rates). Banks typically have access to sufficient FC liquidity (comprising mainly cash and interbank placements, FC reserves held under the reserve option mechanism (ROM) and FC swaps) to cover their FC wholesale funding liabilities maturing with a year, mitigating the refinancing risk. Refinancing risks are less pronounced at most foreign-owned banks, given potential FC liquidity support from shareholders.

We consider recent monetary policy action, along with Akbank's latest USD980 million syndicated loan rollover (albeit at a significantly higher cost), to be mildly positive for investor sentiment. Nevertheless, FC wholesale funding rollover rates could decline given the weaker growth outlook, subdued investor sentiment and the rise in funding costs.

The sector loans/deposit ratio was a high 132% as of mid-September, and banks' external debt was USD183 billion at end-1H18, of which USD102 billion matured within 12 months. However, as some of the latter represents more stable funding (for example, from parent banks, subsidiary banks or offshore Turkish corporate entities), Fitch estimates banks' external debt servicing requirement over one year, in case of a complete market shutdown, at about USD50 billion-USD55 billion.

Available FC liquidity of approximately USD86 billion (comprising mainly FC placed with the central bank under the ROM and short-term currency swaps with foreign counterparties) provides solid coverage of the banks' potential refinancing requirement. However, a scenario in which Turkish borrowers have to pay down foreign debt would result in a reduction in central bank's foreign-exchange reserves and add to pressures on the exchange rate, interest rates and economic growth. In addition, outflows of FC deposits, which fell by USD12 billion or 6% in July-August 2018, represent a further potential risk to banks' liquidity positions.

The RWN on Halk's VR reflects Fitch's view of a still material risk of the bank becoming subject to a fine or other punitive measures as a result of the US investigation, which resulted in the conviction of its deputy general manager for violation of US sanctions. Such measures could materially weaken solvency, increase refinancing risks or negatively affect other aspects of the bank's credit profile.

IDRS, SENIOR DEBT RATINGS AND NATIONAL RATINGS DRIVEN BY VRS
Akbank T.A.S (LTFC IDR: 'B+'/Negative)
Turkiye Is Bankasi A.S. (LTFC IDR: 'B+'/Negative)
The downgrades of Akbank and Isbank's IDRs are driven by the downgrades of their VRs. The banks' higher Long-Term Local-Currency (LTLC) IDRs, one notch above the LTFC IDRs, reflect potential state support for the banks in local currency. The Negative Outlooks on the banks' IDRs reflect the potential for further deterioration in the operating environment, which could place greater pressure on their financial metrics. The downgrades of the National Ratings of the two banks reflect the downgrades of their LTLC IDRs.

The affirmation of the banks' 'B' SRFs, three notches below the sovereign's LTFC IDR, reflects the banks' systemic importance, but also the Turkish authorities' limited ability to provide support in FC in case of need, in light of its only moderate level of FC reserves. The sovereign's greater ability to provide support in local currency drives the banks' higher LTLC IDRs.

IDRs, SUPPORT RATINGS, SENIOR DEBT RATINGS AND NATIONAL RATINGS OF STATE-OWNED COMMERCIAL BANKS AND DEVELOPMENT BANKS
T.C. Ziraat Bankasi A.S. (LTFC: IDR 'B+'/Negative)
Turkiye Halk Bankasi A.S. (LTFC: IDR 'B+'/Negative)
Turkiye Vakiflar Bankasi T.A.O (LTFC: IDR 'B+'/Negative)
Vakif Katilim Bankasi AS (LTFC IDR: 'B+'/Negative)
Turkiye Sinai Kalkinma Bankasi A.S. (LTFC: IDR 'B+'/Negative)
Turkiye Ihracat Kredi Bankasi A.S. (LTFC: IDR 'BB-'/Negative)
Turkiye Kalkinma Bankasi A.S. (LTFC: IDR 'BB'/Negative)
The LTFC IDRs, FC debt ratings and SRFs of the state-owned commercial banks (Ziraat, Halk, Vakifbank, Vakif Katilim) and of development bank TSKB have been downgraded by one notch to 'B+', reflecting greater risks to the ability of the sovereign to provide support in FC. At end-July 2018, the central bank's foreign-exchange reserves were a moderate USD101 billion, while net reserves (adjusted for USD71 billion of banks' placements with the central bank, including under the ROM) were low at around USD30 billion.

The downgrades of the LTLC IDRs of the five banks to one notch below the sovereign LTLC IDR, reflect our view of a higher risk of government intervention in the banks than of a sovereign default, in the event of a stress in Turkey's external finances. The downgrades of the National Ratings of these banks reflect the downgrades of their LTLC IDRs.

Fitch continues to view the government's propensity to support the state-owned commercial and development banks as high, in case of need, based on their majority state ownership (except for TSKB), systemic importance and significant state-related funding (state-owned commercial banks) and policy roles (Ziraat, Halk and the development banks).

The LTFC IDRs and SRFs of Turk Eximbank and TKB are affirmed at 'BB-' and 'BB', respectively, reflecting the banks' full state ownership and policy roles. The higher rating of TKB, which is in line with the sovereign rating, reflects its small size and largely treasury-guaranteed funding. The banks' LTLC IDRs are equalised with the sovereign rating.

The Negative Outlooks on the IDRs of the state-owned commercial banks and development banks mirror those on the sovereign ratings. In the case of Ziraat, Halk, Vakifbank, and TSKB, it also reflects the potential for their VRs to be lowered in case of further deterioration in the operating environment, which could place greater pressure on the banks' financial metrics.

IDRs, SUPPORT RATINGS, SENIOR DEBT RATINGS AND NATIONAL RATINGS OF FOREIGN-OWNED BANKS
Turkiye Garanti Bankasi A.S. (LTFC IDR: 'BB-'/Negative)
Yapi ve Kredi Bankasi A.S. (LTFC IDR: 'BB-'/Negative)
Turk Ekonomi Bankasi A.S. (LTFC IDR: 'BB-'/Negative)
QNB Finansbank A.S. (LTFC IDR: 'BB-' /Negative)
ING Bank A.S. (LTFC IDR: 'BB-'/Negative)
Kuveyt Turk Katilim Bankasi A.S (Kuveyt Turk; LTFC IDR: 'BB-'/Negative)
Alternatifbank A.S. (Alternatifbank; LTFC IDR: 'BB-'/Negative)
Turkiye Finans Katilim Bankasi A.S. (TFKB; LTFC IDR: 'BB-'/Negative)
Burgan Bank A.S. (Burgan Bank Turkey; LTFC IDR: 'BB-'/Negative)
ICBC Turkey Bank A.S. (LTFC IDR: 'BB-'/Negative)
BankPozitif Kredi ve Kalkinma Bankasi A.S. (LTFC IDR: 'BB-'/Negative)
Denizbank A.S. (LTFC IDR: 'BB-'/Negative)
The IDRs, Support Ratings (SRs), FC senior debt ratings and National Ratings of these banks are driven by potential support from their shareholders. This reflects Fitch's view that the banks constitute strategically important subsidiaries, to varying degrees, for their parents. It also considers ownership stakes, integration, the subsidiaries' roles within their respective groups and, for some, common branding.

The one-notch downgrade of the banks' LTFC IDRs and FC senior debt ratings, to one notch below the level of the sovereign LTFC IDR, reflects our view that, in case of a marked deterioration in Turkey's external finances, the risk of government intervention in the banking sector would be higher than that of a sovereign default. The banks' LTLC IDRs are also downgraded by one notch to reflect intervention risks. The Negative Outlooks on the banks' IDRs reflect those on the Turkish sovereign.

Fitch continues to view the risk of capital controls being imposed in Turkey as remote given Turkey's high dependence on foreign capital (and ensuing strong incentive to retain market access) and the eventually orthodox policy response to recent market pressures. Nevertheless, in case of a marked deterioration in Turkey's external finances, some form of intervention in the banking system that might impede the banks' ability to service their FC obligations would become more likely, in Fitch's view.

The downgrades of the banks' National Ratings reflect the downgrades of their LTLC IDRs.

GUARANTEED DEBT RATING
Alternatifbank's guaranteed debt rating of 'A' is equalised with the rating of its Qatari guarantor, The Commercial Bank (P.Q.S.C.) (A/Stable).

SUBORDINATED DEBT RATINGS
The subordinated notes ratings of YKB, Kuveyt Turk, Garanti and Alternatifbank - which are notched down one level from their support-driven IDRs - and the subordinated notes ratings of Isbank, Akbank, Vakifbank and TSKB - which are notched down one level from their VRs - have been downgraded in line with the downgrades of their respective anchor ratings.

The notching in each case includes one notch for loss severity and zero notches for non-performance risk (relative to the anchor ratings).

SUBSIDIARY RATINGS
Akbank AG (LTFC IDR: 'B+'/Negative)
Ak Yatirim Menkul Degerler AS (LTFC IDR: 'B+' /Negative)
Ak Finansal Kiralama A.S. (LTFC IDR: 'B+' /Negative)
Alternatif Finansal Kiralama AS (LTFC IDR: 'BB-'/Negative)
Deniz Finansal Kiralama A.S. (LTFC IDR: 'BB-'/Negative)
Joint-Stock Company Denizbank Moscow (LTFC IDR: 'BB-'/Negative)
Garanti Faktoring A.S. (LTFC IDR: 'BB-'/Negative)
Garanti Finansal Kiralama A.S. (LTFC IDR: 'BB-'/Negative)
Is Faktoring A.S. (LTFC IDR: 'B+'/Negative)
Is Finansal Kiralama A.S. (LTFC IDR: 'B+'/Negative)
Is Yatirim Menkul Degerler A.S. (Long-Term National Rating: 'A+(tur)'/Stable)
QNB Finans Finansal Kiralama A.S. (LTFC IDR: 'BB-'/ Negative)
QNB Finans Faktoring A.S. (LTFC IDR: 'BB-'/ Negative)
Yapi Kredi Finansal Kiralama A.O. (LTFC IDR: 'BB-'/ Negative)
Yapi Kredi Faktoring A.S. (LTFC IDR: 'BB-'/ Negative)
Yapi Kredi Yatirim Menkul Degerler A.S. (LTFC IDR: 'BB-'/Negative)
Ziraat Katilim Bankasi A.S. (LTFC IDR: 'B+' /Negative)

The downgrades of the IDRs of the subsidiaries of Akbank, Alternatifbank, Denizbank, Garanti, Isbank, QNB Finansbank, YKB and Ziraat mirror those of their respective parents. Subsidiary ratings are equalised with those of their parents, reflecting their strategic importance to, and integration with, their respective groups.

Akbank AG's Deposit Ratings are downgraded in line with the bank's LTFC IDR. In Fitch's opinion, debt buffers do not afford any obvious incremental probability of default benefit over and above the support benefit factored into the bank's IDRs.

RATING SENSITIVITIES
VRs OF ALL BANKS, AND IDRS, SENIOR DEBT RATINGS AND NATIONAL RATINGS OF AKBANK AND ISBANK
Further downgrades could result from a further marked deterioration in the operating environment, as reflected, in particular, in negative changes in the lira exchange rate, domestic interest rates, economic growth prospects and external funding market access; bank-specific deterioration of asset quality; marked erosion of capital ratios; a weakening of the banks' FC liquidity positions (without this being offset by shareholder support); or deposit instability that lead to pressure on banks' liquidity and funding profiles.

Downgrades of state-owned banks' VRs would only result in negative action on their IDRs if at the same time Fitch believes the ability or propensity of the Turkish authorities to provide support - as reflected in their SRFs - has also weakened.

Halk's VR could be downgraded if a fine or other punitive measures resulting from the US investigation materially weaken solvency, increase refinancing risks or negatively affect other aspects of the bank's standalone credit profile.

The Outlooks could be revised to Stable if economic conditions stabilise and bank financial metrics do not deteriorate significantly.

IDRs, SUPPORT RATINGS, SUPPORT RATING FLOORS, SENIOR DEBT RATINGS AND NATIONAL RATINGS OF STATE-OWNED COMMERCIAL BANKS AND DEVELOPMENT BANKS
The SRs and SRFs of Ziraat, Halk, Vakifbank, Vakif Katilim, TSKB and Turk Eximbank could be downgraded and revised lower if Fitch concludes that the stress in Turkey's external finances is sufficient to materially reduce the reliability of support for these banks in FC from the Turkish authorities.

Downward revision of the SRFs of Ziraat, Halk, Vakifbank and TSKB will only result in downgrades of their LTFC IDRs and FC senior debt ratings if their VRs are also downgraded.

The ratings of these banks, and of TKB, could also be downgraded if the Turkish sovereign is downgraded or if Fitch believes the sovereign's propensity to support the banks has reduced (not Fitch's base case). TKB's ratings could also be downgraded by one notch, to the level of Turk Eximbank, if the proportion of non-guaranteed funding increases materially.

The introduction of bank resolution legislation in Turkey aimed at limiting sovereign support for failed banks could also negatively affect Fitch's view of support, but Fitch does not expect this in the short term.

IDRS, SUPPORT RATINGS, SUPPORT RATING FLOORS, SENIOR DEBT RATINGS AND NATIONAL RATINGS OF FOREIGN-OWNED BANKS
The LTFC IDRs, FC senior debt ratings and SRs of foreign-owned banks could be downgraded if the Turkish sovereign is downgraded, or if there is a sharp reduction in a parent bank's ability or propensity to support its Turkish subsidiary.

SUBORDINATED DEBT RATINGS
Subordinated debt ratings are primarily sensitive to changes in anchor ratings, namely the VRs of Isbank, Akbank, Vakifbank and TSKB, and the Long-Term IDRs of YKB, Garanti, Kuveyt Turk and Alternatifbank.

The ratings are also sensitive to a change in notching from the anchor ratings due to a revision in Fitch's assessment of the probability of the notes' non-performance risk or of loss severity in case of non-performance.

GUARANTEED DEBT RATING
Alternatifbank's guaranteed debt rating of 'A' is sensitive to a change in The Commercial Bank (P.Q.S.C)'s Long-Term IDR.

SUBSIDIARY RATINGS
The ratings of these entities are sensitive to changes in the Long-Term IDRs of their parents.

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Additional information is available on www.fitchratings.com

**Applicable Criteria**

Bank Rating Criteria (pub. 22 Jun 2018) (https://www.fitchratings.com/site/re/10034713)
National Scale Ratings Criteria (pub. 18 Jul 2018) (https://www.fitchratings.com/site/re/10038626)
Non-Bank Financial Institutions Rating Criteria (pub. 22 Jun 2018) (https://www.fitchratings.com/site/re/10034715)
Sukuk Rating Criteria (pub. 25 Jul 2018) (https://www.fitchratings.com/site/re/10039109)

**Additional Disclosures**

Dodd-Frank Rating Information Disclosure Form (https://www.fitchratings.com/site/dodd-frank-disclosure/10046676)
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