FitchRatings

Fitch Places Turkish Banks' Ratings on Watch Negative

Link to Fitch Ratings' Report(s): Fitch Places Turkish Banks’ Ratings on Watch Negative (https://www.fitchratings.com/site/re/10033168)

Fitch Ratings-London-01 June 2018: Fitch Ratings has placed 25 Turkish banks' Long-Term Foreign-Currency (FC) Issuer Default Ratings (IDRs) and 25 banks' Viability Ratings (VRs) on Rating Watch Negative (RWN). A full list of rating actions is available at www.fitchratings.com or at the link above.

The RWNs placed on all Turkish banks' VRs reflect risks to their performance, asset quality, capitalisation and, in most cases, liquidity and funding profiles following a recent period of increased market volatility. This has seen the Turkish lira depreciate against the US dollar-euro basket by about 20% this year with the authorities responding by raising the key policy rate by 300bp to 16.5%.

The RWNs on the IDRs of state-owned commercial banks and two development banks additionally consider the greater potential for stress in Turkey's external finances, which could hinder the authorities' ability to provide support in FC.

The RWNs on foreign-owned banks' 'BBB-' IDRs reflect Fitch's intention to reassess whether it remains appropriate to rate these institutions above the sovereign (BB+/Stable), given potential intervention in the banking system if there is marked deterioration in Turkey's external finances.

Fitch will resolve the RWNs based on both an analysis of the impact on banks' credit profiles of the deterioration in the operating environment that has already been observed and the extent to which the operating environment deteriorates further or stabilises in the near term. Unless there is further marked worsening of economic and financial market conditions, any downgrades are likely to be limited to one notch, in most cases. Fitch expects to resolve the RWNs in the next six months.

KEY RATING DRIVERS

VRs OF ALL BANKS

Turkish banks' VRs, which range from 'bb+' to 'b', reflect their exposure to the relatively high-risk Turkish operating environment, but also their largely satisfactory financial metrics, reflected in moderate non-performing loans (NPLs), solid profitability, reasonable capitalisation and acceptable liquidity buffers. Banks rated 'bb+' or 'bb' have stronger franchises and in most cases longer records of stable and sound performance. Banks rated 'bb-', 'b+' or 'b' have narrower franchises and, to varying degrees, have exhibited greater volatility in their results.

The RWNs on all 25 Turkish banks' VRs reflect increased risks to their asset quality, profitability and capitalisation given heightened operating environment pressures resulting from currency and interest-rate volatility. It also considers risks to most banks' funding and liquidity profiles given the reliance, to varying degrees, on external FC wholesale funding and pressure on lira funding costs.

Fitch believes that immediate risks to Turkey's macroeconomic and financial stability have reduced following the increase in the policy rate, the announced simplification of the monetary policy framework and the resulting moderate recent recovery of the exchange rate. However, the still significant fall in the exchange rate, the rise in the interest rate (and the stated readiness of the Turkish authorities to raise this further if needed) and the negative impact of both of these on economic growth are likely to result in deterioration in banks' financial metrics. Risks to financial stability also remain significant, given the possibility that policy predictability will come under pressure after June's presidential elections, and in view of Turkey's need to meet a large external financing requirement in tougher global financial conditions.

Asset-quality risks for banks have increased due to generally high FC lending (equal to about 37% of sector loans) and the potential impact of local-currency depreciation on often weakly hedged borrowers' ability to service their debt. Higher interest rates (which could affect lira borrowers' debt service capacity) and weaker economic growth could also weigh on loan performance. Fitch had expected GDP growth of 4.1% in 2018 and 4.7% in 2019, but anticipates revising downwards these forecasts following the recent volatility. Exposures to the construction and energy sectors and high borrower concentrations are also significant sources of risks at many banks.

NPL ratios have in most cases remained broadly stable in recent quarters, but the emergence of some big-ticket problematic exposures (notably on the books of the largest banks in the sector) and growth in group 2 watch list loans (partly explained by banks' transition to IFRS 9 in 1Q18) suggest the potential for future increases in NPLs. The sector NPL ratio (loans overdue by more than 90 days) was 2.9% at end-1Q18, with reserve coverage of 119%.

Fitch expects sector profitability to moderately weaken in 2018 due to higher funding costs (following the policy rate rise), slower credit growth (reflecting the reduction in Credit Guarantee Fund (CGF) stimulus, the snap elections and lower

GDP growth) and higher impairment charges. Performance could deteriorate more significantly in case of a marked weakening of asset quality. The sector return on average equity was a solid 14.7% in 2017 and 15.9% in 1Q18, supported by CGF-driven loan growth (21% for the sector in 2017) solid margins and manageable impairment charges.

Capital ratios are under pressure from lira depreciation (which inflates FC risk-weighted assets) and higher interest rates (which will result in negative revaluations of government bond portfolios). Potential asset-quality deterioration also represents a risk to banks' capital positions, but strong pre-impairment profit provides most banks with a considerable buffer to absorb credit losses through income statements.

The sector average total capital ratio was 16.1% at end-1Q18. Capital ratios increased in 2017 on the back of solid internal capital generation, capital relief from regulatory measures (including lower risk weightings on CGF loans and FC reserve requirements) and due to Tier 2 capital notes issuance at some banks. Capital comprises predominantly common equity Tier 1 at most banks, although increased issuance of FC Tier 2 instruments provides a partial hedge against Turkish lira depreciation in respect to total capital ratios.

Turkish banks' refinancing risks have increased as a result of recent market volatility and tightening global financing conditions driven mainly by an increase in US dollar interest rates. However, the banks have a proven record of accessing external funding even in adverse market conditions, and typically have access to sufficient FC liquidity to cover their FC wholesale funding liabilities maturing within a year. Risks are less pronounced at most foreign-owned banks, which can rely on FC liquidity support from shareholders, and some smaller lenders which have limited FC wholesale funding.

The sector loans/deposits ratio was a high 127% at end-1Q18, and banks' external debt stood at USD186 billion, of which USD103 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 USD55 billion - USD60 billion. Available liquidity of about USD90 billion (comprising mainly FC placed with the central bank under the reserve option mechanism (ROM) and short-term currency swaps with foreign counterparties) provides solid coverage. However, a scenario in which Turkish borrowers had to pay down foreign debt would result in a reduction in central bank FC reserves and add to pressures on the exchange rate, interest rates and economic growth.

IDRS, SENIOR DEBT RATINGS AND NATIONAL RATINGS DRIVEN BY VRS

Akbank T.A.S. (Long-Term FC IDR BB+/RWN; VR bb+/RWN)
Turkiye Is Bankasi A.S. (Isbank; BB+/RWN, bb+/RWN)
Anadolubank A.S. (BB-/RWN, bb-/RWN)
Fibabanka Anonim Sirketi (BB-/RWN, bb-/RWN)
Odea Bank A.S. (BB-/RWN, bb-/RWN)
Arap Turk Bankasi A.S. (ATB, BB-/RWN, bb-/RWN)
Sekerbank T.A.S. (B+/RWN, b+/RWN)

The RWNs on the Long-Term IDRs, senior debt ratings and National Ratings of these banks reflect the RWNs on their VRs.

The Support Rating Floors (SRFs) of Akbank and Isbank have been affirmed at 'B+', and their Support Ratings at '4', reflecting Fitch's view that there is a limited probability of support for these banks. This takes into account the banks' systemic importance and solid market shares, but also the sovereign's modest ability to provide support in FC considering its only moderate level of FC reserves.

The 'No Floor' SRFs and '5' Support Ratings of the other five banks listed above reflect Fitch's view that support cannot be relied upon given their limited market shares and systemic importance.

IDRs, SUPPORT RATINGS, SENIOR DEBT RATINGS AND NATIONAL RATINGS OF STATE-OWNED COMMERCIAL BANKS AND DEVELOPMENT BANKS

T.C. Ziraat Bankasi A.S. (Ziraat; LT FC IDR BB+/RWN; VR bb+/RWN)
Turkiye Halk Bankasi A.S. (Halk; BB+/RWN, bb+/RWN)
Turkiye Vakiflar Bankasi T.A.O. (Vakifbank; BB+/RWN, bb+/RWN)
Vakif Katilim Bankasi AS (BB+/RWN, b+/RWN)
Turkiye Sinai Kalkinma Bankasi A.S. (TSKB; BB+/RWN, bb/RWN)
Turkiye Ihracat Kredi Bankasi A.S. (Turk Eximbank; BB+/RWN)
Turkiye Kalkinma Bankasi A.S. (TKB; BB+/Stable)

The IDRs, Support Ratings, SRFs, FC senior debt ratings and National Ratings of state-owned commercial banks (Ziraat, Halk, Vakifbank and Vakif Katilim) and development banks (TKB, Turk Eximbank, TSKB) are aligned with those of the Turkish sovereign. This reflects Fitch's view of the government's likely high propensity to support the banks, 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 RWNs on the Long-Term FC IDRs and FC senior debt ratings of these banks (with the exception of TKB) reflect increased risks to the authorities' ability to provide support in FC given the greater potential for stress in Turkey's external finances. At end-April 2018, the central bank's FC reserves were a moderate USD112 billion, while net reserves (adjusted for USD63billion of banks' placements with the central bank, including under the ROM) were lower.

The ratings of TKB have been affirmed, rather than placed on RWN, due to its small size and the fact that nearly all of its funding is guaranteed by the Turkish treasury.

The RWN on the ratings of Halk also continue to reflect uncertainty surrounding the sufficiency and timeliness of state support in case a material fine or other punitive measures being imposed on the bank as a result of the U.S. investigation which resulted in the conviction of its deputy general manager for violating U.S. sanctions.

The affirmation of the Local-Currency IDRs and National Ratings of the state-owned commercial banks and the development banks reflects Fitch's view that there is unlikely to be any material weakening in the ability or propensity of the authorities to support these entities in local currency.

IDRs, SUPPORT RATINGS, SENIOR DEBT RATINGS AND NATIONAL RATINGS OF FOREIGN-OWNED BANKS

Turkiye Garanti Bankasi A.S. (Garanti; LT FC IDR BBB-/RWN; VR bb+/RWN)
Yapi ve Kredi Bankasi A.S. (YKB; BBB-/RWN; bb+/RWN)
Turk Ekonomi Bankasi A.S. (TEB; BBB-/RWN, bb+/RWN)
QNB Finansbank A.S. (BBB-/RWN, bb/RWN)
ING Bank A.S. (BBB-/RWN, bb/RWN)
Kuveyt Turk Katilim Bankasi A.S. (Kuveyt Turk; BBB-/RWN, bb-/RWN)
Turkiye Finans Katilim Bankasi A.S. (TFKB; BBB-/RWN, bb-/RWN)
Alternatifbank A.S. (ABank; BBB-/RWN, b+/RWN)
Burgan Bank A.S. (BBB-/RWN, b+/RWN)
ICBC Turkey Bank A.S. (BBB-/RWN, b+/RWN)
BankPozitif Kredi ve Kalkinma Bankasi A.S. (BBB-/RWN, b+/RWN)
Turkland Bank A.S. (B+/Stable, b/RWN)

The IDRs, Support Ratings, 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 Long-Term FC IDRs and FC senior debt ratings of these banks (with the exception of Turkland) are one notch above the Turkish sovereign. The RWNs on these ratings and on the banks' Support Ratings reflects Fitch's intention to reassess whether it remains appropriate to rate these institutions above the sovereign, given potential intervention in the banking system in case of a marked deterioration in Turkey's external finances.

In Fitch's view, the risk of capital controls being imposed in Turkey remains remote given Turkey's high dependence on foreign capital and strong incentive to retain market access, the eventually orthodox policy response to recent market pressures, statements by senior Turkish officials (including Deputy Prime Minister Mehmet Simsek) that such controls would not be introduced and reduced immediate risks to macroeconomic and financial stability.

However, in case of a marked deterioration in Turkey's external finances, some form of intervention in the banking system that may impede banks' ability to service their FC obligations cannot be ruled out, in Fitch's view. While such intervention is a remote risk, the agency will reconsider whether it is sufficiently remote to be regarded as less likely than a sovereign default, as is implied by its ratings.

The affirmation of the Local-Currency IDRs and National Ratings of the foreign-owned banks reflects Fitch's view that there is less likely to be any form of government intervention that would impede their ability to service obligations in local currency. The banks' 'BBB-' Long-Term Local-Currency IDRs are at the same level as, rather than above, the sovereign Local-Currency IDR.

Turkland's support-driven Long-Term IDRs (BB-/Stable) have been affirmed as these are below the sovereign ratings.

SUBORDINATED DEBT RATINGS
The subordinated notes ratings of YKB, Garanti, ABank and Kuveyt Turk are notched down once from their support-driven IDRs, as Fitch believes support from foreign shareholders would likely be available to support these obligations. The subordinated notes ratings of Isbank, Akbank, Vakifbank, Sekerbank, Odea, Fiba, and TSKB are notched down once from their VRs.

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

GUARANTEED DEBT RATING

Alternatifbank's guaranteed debt rating of 'A' is equalised with the rating of the guarantor, The Commercial Bank (P.Q.S.C.) (A/Negative).

SUBSIDIARY RATINGS

Akbank AG (Long-Term FC IDR BB+/RWN)
Ak Yatirim Menkul Degerler AS (BB+/RWN)
Ak Finansal Kiralama A.S. (BB+/RWN)
Akbank AG (BB+/RWN)
Alternatif Finansal Kiralama AS (BBB-/RWN)
Garanti Faktoring A.S. (BBB-/RWN)
Garanti Finansal Kiralama A.S. (BBB-/RWN)
Is Faktoring A.S. (BB+/RWN)
Is Finansal Kiralama A.S. (BB+/RWN)
Is Yatirim Menkul Degerler A.S. (AA+(tur)/RWN)
QNB Finans Finansal Kiralama A.S. (BBB-/RWN)
Yapi Kredi Finansal Kiralama A.O. (BBB-/RWN)
Yapi Kredi Faktoring A.S. (BBB-/RWN)
Yapi Kredi Yatirim Menkul Degerler A.S. (BBB-/RWN)
Ziraat Katilim Bankasi A.S. (BB+/RWN)

The ratings of the subsidiaries of Akbank, Garanti, Isbank, YKB, Ziraat, Alternatifbank, and QNB Finansbank are equalised with those of their respective parents, reflecting their strategic importance to, and integration with, their respective groups. Consequently, the RWNs on their ratings mirror those on their parents and indicate a possible weakening of their parents' ability to provide support, in case of need.

Akbank AG's Deposit Ratings are aligned with the bank's IDRs. 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 DRIVEN BY VRS
Fitch will resolve the RWNs on all banks' VRs, and on the IDRs, senior debt ratings and National Ratings of Akbank, Isbank, Anadolubank, ATB, Fibabanka, Odea and Sekerbank, based on an analysis of the impact of the deterioration in the operating environment on individual banks' performance, asset quality, capitalisation and liquidity and funding profiles and the extent to which the operating environment deteriorates further or stabilises in the near term, as reflected in particular in the lira exchange rate, domestic interest rates, economic growth prospects and external

funding market access.

Ratings are more likely to be downgraded at banks that have experienced significant increases in NPLs or in problematic loans not categorised as NPLs, have higher proportions of FC loans and FC wholesale market funding, or have suffered a more critical reduction in their capital ratios without this being offset by shareholder support. Already-observed deterioration of asset-quality ratios at Turkland and Odea Bank, and of capital ratios at Fibabanka and Alternatifbank, increases risks for these banks' VRs.

Ratings could stabilise at their current levels where Fitch views asset quality, capital ratios and foreign currency liquidity as less exposed to the deterioration in the operating environment, in particular if economic conditions stabilise in the near term.

IDRs, SUPPORT RATINGS, SUPPORT RATING FLOOR, SENIOR DEBT RATINGS AND NATIONAL RATINGS OF STATE-OWNED COMMERCIAL BANKS AND DEVELOPMENT BANKS

The Long-Term FC IDRs, FC senior debt ratings and SRFs of Ziraat, Halk, Vakifbank, Vakif Katilim, TSKB and Turk Eximbank could be downgraded if Fitch concludes that the greater potential for stress in Turkey's external finances is sufficient to materially reduce the reliability of support for these banks in FC from the Turkish authorities.

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. 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 we do not expect this in the short term.

Halk's support-driven ratings could also be downgraded if the bank does not receive sufficient and timely support to offset the impact of any fine or other punitive measures imposed as a result of the case in the US.

IDRs, SUPPORT RATINGS, SENIOR DEBT RATINGS AND NATIONAL RATINGS OF FOREIGN-OWNED BANKS

The FC IDRs, FC senior debt ratings and Support Ratings of foreign-owned banks rated 'BBB-' could be downgraded if Fitch concludes that it is no longer appropriate to rate these institutions above the sovereign, given potential intervention in the banking system in case of a marked deterioration in Turkey's external finances. These ratings are also sensitive to a downgrade of Turkey's Country Ceiling.

A sharp reduction in a parent bank's ability or propensity to support its Turkish subsidiary could also result in a downgrade.

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

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's (P.Q.S.C.) Long-Term IDR (A/Negative).

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

A full list of rating actions is available on www.fitchratings.com or by clicking the link above.

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Additional information is available on www.fitchratings.com

Applicable Criteria
Bank Rating Criteria (pub. 23 Mar 2018)
(https://www.fitchratings.com/site/re/10023430)
Non-Bank Financial Institutions Rating Criteria (pub. 22 Mar 2018)
(https://www.fitchratings.com/site/re/10023420)

Additional Disclosures
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