

Rating Action: Moody's downgrades Halkbank's local currency deposit and foreign currency senior unsecured debt ratings to Ba2, maintains negative outlook

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Standalone BCA downgraded to b1

London, 15 December 2017 -- Moody's Investors Service (Moody's) has today downgraded Turkiye Halk Bankasi A.S. (Halkbank's) long-term foreign-currency senior unsecured debt and long-term local-currency deposit ratings to Ba2 from Ba1 and affirmed the long-term foreign currency deposit rating at Ba2, which remains constrained by the country ceiling. The outlook was maintained at negative.

Halkbank's standalone Baseline Credit Assessment (BCA) was downgraded to b1 from ba2.

The bank's long and short-term Counterparty Risk Assessment (CRA) was affirmed at Ba1(cr)/NP(cr) respectively.

A full list of affected ratings can be found at the end of this press release.

RATINGS RATIONALE

DOWNGRADE OF THE BCA

The downgrade of the bank's standalone BCA to b1, from ba2, was driven primarily by: 1) higher funding costs, which reduced the bank's net interest margin (NIM) and profitability in Q3 2017 and are expected to continue into 2018; 2) heightened reliance on shorter-term liabilities as a percentage of the bank's wholesale liabilities, and 3) pressure on capital ratios, partly due to rapid lending growth.

At the same time Moody's notes that the bank's BCA continues to be supported by its leading franchise in the Turkish banking system, particularly in the SME segment, and its ability to access customer deposits via its established branch network, albeit at higher cost. The bank's BCA is also supported by solid non-performing loan and provisioning coverage ratios in line with the peer group average.

The bank's earnings for the first nine months of 2017 remain strong, however Q3 net income as reported declined by 22.5% compared to Q2 results, principally due to a contraction in Halkbank's net interest margin (NIM) as well as higher operating expenses and a trading loss, despite improvements in fee and commission income. The NIM declined to 3.2% as at Q3 2017 from 3.6% as at Q2 2017, as per Moody's calculation, partly due to the bank's increased reliance on costly Turkish lira customer deposits to fund loan growth of 22.5% in 2017. Moody's expects the bank's higher funding costs to continue to impact its profitability into 2018, as authorities raise interest rates in response to inflationary pressures.

Since Q1 2017, Halkbank increased its reliance on shorter-term funding, including secured funding from the Central Bank of the Republic of Turkey, having repaid its maturing Eurobonds in July 2017. As of Q3 2017, the bank's reliance on wholesale funds with the contractual maturity of up to 3 months increased to 70% of wholesale liabilities, from 60% in Q1 2017.

Finally, the BCA downgrade also takes into account that the bank's core capitalisation has been declining and is relatively weak compared to its peer group of leading Turkish banks. As a result of a very rapid loan growth, the bank's Tangible Common Equity (TCE) to total assets, as per Moody's calculation, stood at 7.9% as at Q3 2017 compared to 8.3% as at end-2016. Moody's notes that despite the TL1 billion of Tier 2 capital issued in October 2017, which is expected to improve the total capital adequacy ratio by 50 bps, the bank's total capital adequacy ratio will remain below its Turkish peers. Moody's does not expect any significant improvement in the bank's core capitalisation in the near-term, given the rapid growth of its assets and volatility in the operating environment.

DOWNGRADE OF LONG-TERM RATINGS

Moody's continues to assume a very high probability of government support for Halkbank, which is 51% owned by the government, unchanged from previous assumptions. This support results in a two notch uplift for the bank's senior unsecured debt and deposit ratings at Ba2, from the bank's b1 standalone BCA. The affirmation of the bank's long-term foreign-currency deposit rating was due to the fact that it is constrained at Ba2, similar to other Turkish banks.

RATIONALE FOR NEGATIVE OUTLOOK

The negative outlook on Halkbank's long-term senior unsecured debt and deposit ratings reflect the negative outlook on the Turkish government rating, as well as the downside risk of the bank's standalone BCA in light of the increased cost of funding and heightened reliance on shorter-term liabilities.

Moody's will also continue to monitor potential downside risks from the ongoing trial by the US authorities of the bank's former deputy-CEO, which relates to alleged transactions with prohibited parties. The potential direct involvement of the bank in future legal proceedings, or the emergence of any indirect repercussions on the bank's operations, could exert further downward rating pressure on the bank's ratings.

WHAT COULD MOVE THE RATINGS UP/DOWN

Given the negative pressures on the bank's standalone performance, an upgrade is unlikely in the short-term.

The standalone BCA could be adjusted downward if there is evidence that restricted market access leads to a worsening liquidity position, if there are sizeable losses due to operational or legal issues, and/or if capitalisation declines materially below similarly rated peers. The need of any external involvement to support the bank's solvency and/or liquidity would also be considered as negative for the bank's standalone rating.

Long-term deposit or debt ratings, which incorporate uplift from government support, could be affected by changes in the sovereign rating, Moody's views on the government's willingness to provide support, or changes to sovereign ceilings.

LIST OF AFFECTED RATINGS

Issuer: Turkiye Halk Bankasi A.S.

Downgrades:

- ...LT Bank Deposits (Local Currency), Downgraded to Ba2 from Ba1, Outlook Remains Negative
- ...Senior Unsecured Regular Bond/Debenture, Downgraded to Ba2 from Ba1, Outlook Remains Negative
- ...Subordinate, Downgraded to (P)B3(hyb) from (P)B1(hyb)
- ...Adjusted Baseline Credit Assessment, Downgraded to b1 from ba2
- ...Baseline Credit Assessment, Downgraded to b1 from ba2

Affirmations:

- ...LT Bank Deposits (Foreign Currency), Affirmed Ba2, Outlook Remains Negative
- ...ST Bank Deposits, Affirmed NP
- ...LT Counterparty Risk Assessment, Affirmed Ba1(cr)
- ...ST Counterparty Risk Assessment, Affirmed NP(cr)

Outlook Actions:

- ...Outlook, Remains Negative

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in September 2017. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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