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Various Rating Actions Taken On Five UAE-Based Banks On Increasing Credit Risk

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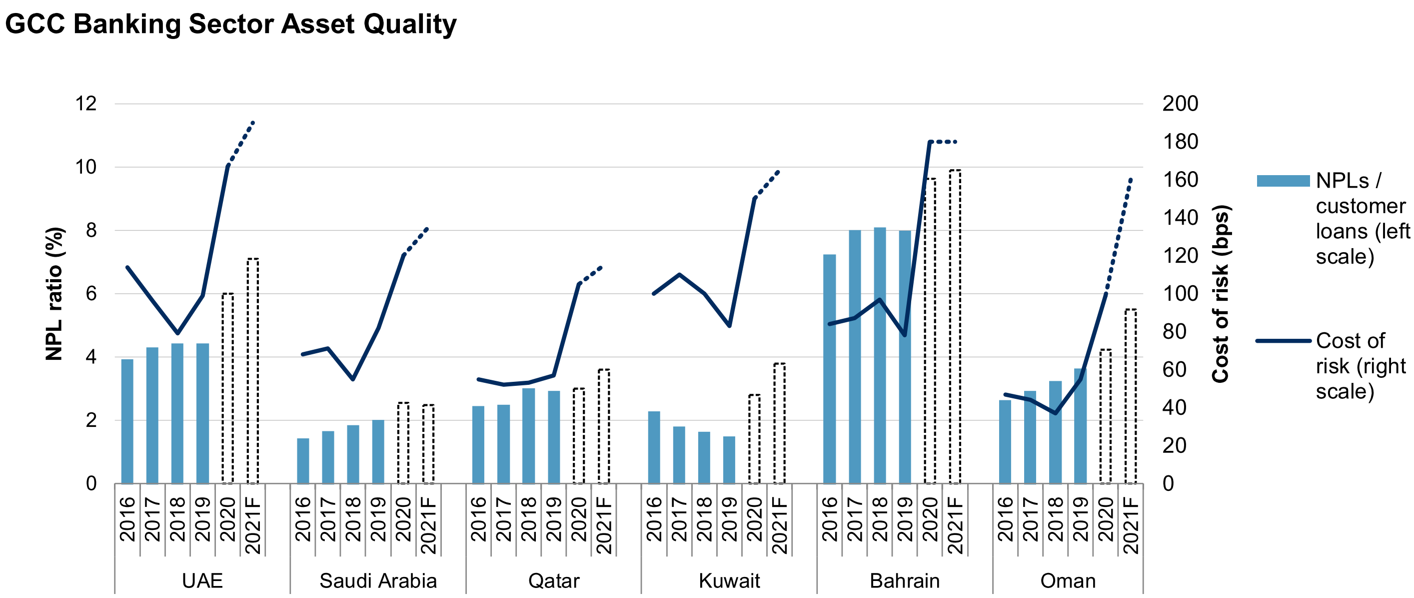
- The COVID-19 pandemic, lower oil prices, and continued pressure on the real estate sector have increased risks for United Arab Emirates (UAE) banks.
- However, the UAE banking authorities' response to the pandemic and reporting requirements have reinforced oversight and transparency.
- We expect rated UAE banks' asset-quality indicators to deteriorate further once regulatory forbearance measures are lifted, although some will be protected by their strong capitalization and earning capacity.
- We therefore revised down our assessment of economic risk for the UAE's banking sector to '6' from '5' and revised our economic and industry risk assessment trends to stable from negative.
- We affirmed the ratings on First Abu Dhabi Bank, Abu Dhabi Commercial Bank, Sharjah Islamic Bank, and Mashreqbank and lowered our long-term rating on National Bank of Fujairah to 'BBB' from 'BBB+'. The outlooks on all the banks were revised to stable.

DUBAI (S&P Global Ratings) March 25, 2021--S&P Global Ratings today affirmed its ratings and revised its outlooks to stable from negative on First Abu Dhabi Bank P.J.S.C. (FAB), Abu Dhabi Commercial Bank PJSC (ADCB), Sharjah Islamic Bank (SIB), and Mashreqbank (Mashreq). We lowered the long-term issuer credit ratings on National Bank of Fujairah PJSC (NBF) to 'BBB' from 'BBB+' and revised the outlook on the bank to stable from negative (see the Ratings List for full details).

The sharp economic contraction in 2020--and prospects of a protracted recovery in 2021 and beyond--will have varying effects on rated UAE banks. We expect the residential real estate sector will remain under pressure for at least another year or two because of continuous oversupply, while demand-driven weaknesses will hamper the tourism, hospitality, and aviation sectors, as well as some trading sectors. We therefore expect UAE banks' asset-quality indicators will continue to deteriorate in the next 12-24 months, as regulatory forbearance measures are gradually lifted, and that credit losses will likely remain elevated (see chart 1).

As a result, we revised down our assessment of economic risk and revised the trend to stable from negative. UAE banks' exposure to the real estate sector--about 28% of total loans (assuming one-third of retail loans are channeled through real estate)--relatively high average loan to value ratios after limits were increased by the central bank (CBUAE), and significant exposure to other risky sectors, such as struggling government-related entities (GREs), have contributed to our decision. Our estimates of risk-adjusted capitalization (RAC) among rated UAE banks have weakened commensurately but generally remain strong. We also expect banks will remain profitable with an average return on assets of 1.0% in 2021, despite the sharp increase in cost of risk and lower interest rates.

Chart 1



NPL--Nonperforming loan. bps--basis point.Source: S&P Global Ratings.

When the pandemic started, the CBUAE acted swiftly and extended a targeted economic support scheme (TESS) to banks. This included, among other measures, a UAE dirham (AED) 50 billion zero-cost funding facility and the requirement to defer some corporate exposures to preserve these companies' productive capacity during stressed market conditions. The CBUAE subsequently asked banks to be transparent and disclose the amount of deferred lending on their books, grouping it into two categories: One with a minimal impact on the activity of the corporate and another with a material impact. At year-end 2020, about 14% of total loans were deferred, including 12% in Group 1 and 2% in Group 2 (based on the data disclosed by the top 10 banks). The swift action by the central bank and the transparency around the deferred exposures underpin our decision to revise our BICRA industry risk trend to stable. Although forbearance measures could be extended from their current mid-year 2021 expiry date, we expect their removal to be gradual and managed.

Despite this support, banks with a structural orientation to sectors where prospects remain weakest are expected to book further significant credit losses. This comes in addition to their relatively weak asset-quality indicators compared with the system average. Given the sectors are key spurs of economic growth, real estate and construction exposure is relatively commonplace. But exposure to weaker parts of the market and counterparty risk within sectors, will likely differentiate losses. We have observed a significant weakening of NBF and ADCB's asset-quality indicators. Such weakening was also underpinned by their exposure to a major fraud case where the prospects for recovery are uncertain. We therefore downgraded NBF to 'BBB' from 'BBB+' and revised our assessment of the stand-alone credit profile (SACP) on ADCB to 'bbb' from 'bbb+'. We affirmed the rating on ADCB, incorporating an additional notch of support given the bank's GRE status and our view of a high likelihood of support. In addition, we affirmed the ratings on FAB, Mashreq, and SIB. Although we expect asset quality at these banks to deteriorate in the next 12-24 months as regulatory forbearance measures are gradually lifted, their still-strong capitalization and good earning capacity should help them withstand these headwinds.

National Bank of Fujairah

NBF's asset quality has deteriorated materially, in our view. At year-end 2020, the bank's stock of Stage 3 loans increased to 10.1% of gross loans from 5.4% at year-end 2019, while Stage 2 loans rose to 12.2% from 9.2% and coverage by provisions (including impairment reserves) reached 92% from 107% over the same period. We expect NBF's cost of risk will remain elevated after increasing to 4.5% in 2020, versus 2.1% in 2019. We expect further asset-quality deterioration in 2021, primarily spurred by the bank's significant exposure to sectors affected by the pandemic, including trade finance and real estate and construction. We believe some loans will transition to Stage 3 in the next two years, inflating the bank's provisioning needs.

The bank's capacity to withstand additional shocks has also reduced. The RAC ratio reached 10.7% at year-end 2020 and we expect it will stabilize at about 10.0%-10.5% in the next 12-24 months. Combined with our views on the bank's asset quality, this led us to revise down the SACP and lower the long-term issuer credit rating by one notch.

Outlook

The stable outlook on NBF reflects our view that the bank's business and financial profiles are likely to remain unchanged over the next 12-24 months.

Downside scenario: We could lower the rating over the next 12-24 months if NBF's capitalization declines significantly, with the RAC ratio dropping durably below 10%. This could happen because of weaker-than-expected profitability or higher dividend payouts. We could also take a negative rating action if we observe a higher-than-expected deterioration in asset-quality indicators.

Upward scenario: We could upgrade NBF if the bank restores its asset-quality indicators to levels comparable with those of peers, or in the unlikely scenario that the bank significantly strengthens its capitalization with a RAC ratio durably above 15%.

Mashreqbank

We expect Mashreq will recover and show a modest profit in 2021, after a significant loss in 2020 due to a sharp increase in cost of risk. The bank set aside a larger amount of provisions than most peers to cover some old problem loans and prudently built up provisions for some exposures impacted by the pandemic. This resulted in cost of risk spiking to 4.2% in 2020, up from 1.5% in 2019. At year-end 2020, the bank's nonperforming loans (NPLs; net of interest in suspense) increased to 5.1% of gross loans, from 3.6% in 2019, while Stage 2 loans remained stable at 7.2%, with coverage by provisions improving to 130% versus 117%. In addition, the bank wrote-off 1.5% of its bad loans in 2020, most of which were from the corporate portfolio. At year-end 2020, 15% of the bank's loans were in Group 1 and another 1% in Group 2, some of which might move to Stage 2 or Stage 3 in 2021.

We expect further asset-quality deterioration in 2021, because more than 50% of Mashreq's loan book is exposed to Dubai's economy, which has been severely hit by the pandemic. Nevertheless, we expect the bank to aggressively write-off problem loans after fully providing for them, keeping the NPL ratio at about 5% and coverage of NPLs above 100%. In addition, Mashreqbank's capitalization supports its creditworthiness. The bank's RAC ratio stood at 10.8% at year-end 2020, and we expect it to remain at 10.5%-11.0% over the next 12-24 months.

Outlook

The stable outlook on Mashreq reflects our view that the bank's business and financial profiles will remain broadly unchanged over the next 12-24 months, despite pressure on its operating environment and our expectation that asset-quality indicators will weaken slightly.

Downside scenario: We could consider a negative rating action if we see materially higher-than-expected deterioration in asset-quality indicators and if we observe weaker-than-expected capitalization, with the RAC ratio dropping durably below 10%.

Upward scenario: An upgrade appears remote but could occur if Mashreq unexpectedly strengthens its capitalization, with the RAC ratio sustainably exceeding 15%.

Sharjah Islamic Bank

SIB's capitalization remains a positive factor, underpinned by our forecast that our RAC ratio before concentration adjustments will remain at 11.5%-12.0% over the next 12-24 months. Although the bank significantly expanded its lending in 2020, most of the growth was spurred by lending to government authorities, in particular the government of Sharjah. We expect SIB will continue expanding at a faster pace than its peer group, with financings expanding by 7%-8% per year as it captures market share from other Sharjah-based banks.

SIB's focus on the public sector helped it to navigate market pressure in 2020. We nevertheless expect some deterioration in asset-quality indicators as regulatory forbearance measures are progressively lifted. At year-end 2020, about 25% of SIB's loan book benefitted from deferrals, which is by far the largest among rated banks, although we understand that most borrowers continued to service their debt. We factor an average cost of risk of above 100 basis points over the next two-to-three years in our baseline forecast and expect the share of Stage 3 loans will revert to the 5.5% range. We also expect the bank will maintain Stage 3 coverage by specific provisions of about 60%--broadly on par with UAE market average.

Outlook

The stable outlook on SIB reflects our view that the bank's business and financial profiles will remain broadly unchanged over the next 12-24 months despite pressure on its operating environment and our expectation that asset-quality indicators will weaken slightly.

Downside scenario: We could consider a negative rating action if we observe higher-than-expected deterioration in asset quality or weaker-than-expected capitalization, signaled by the RAC ratio dropping below 10%, which may come from faster-than-expected growth. We may also take a negative rating action if the creditworthiness of Sharjah's government, the bank's largest counterparty, comes under further pressure.

Upward scenario: Although remote in the next 12-24 months, we could raise our ratings if SIB strengthens its capitalization unexpectedly, with the RAC ratio sustainably exceeding 15%.

Abu Dhabi Commercial Bank

ADCB's asset-quality metrics deteriorated at a fast pace over 2020 and the NPL ratio increased to approximately 8% at year-end. We project it to increase to close to 11% in 2021. We also expect credit losses to increase and coverage of problem loans by provisions (including purchased or originally credit impaired and reported expected credit losses) to remain relatively low at 57%. In our view, this is symptomatic of the higher structural risks facing the bank.

As a result of greater risks posed by the UAE economy, the bank's capacity to withstand additional shocks has also reduced. Although our capital measure, adjusted for risks is still strong and expected to be 11.5%-12.0%, system risks emanating from the UAE's economy have reduced ADCB's ability to absorb further shocks. We are therefore revising down ADCB's SACP to 'bbb' from 'bbb+', in line with a moderate risk profile assessment, but affirming the ratings after accounting for our view of the high likelihood of support from the Abu Dhabi government.

Outlook

The stable outlook balances our expectations that operating risks and further credit losses from weaker sectors of the UAE economy will be absorbed by ADCB's strong capital buffers and expected stable earnings performance over the next 12-24 months.

Downside scenario: We could take a negative rating action if capital pressure build-up exceeds our current expectations. We could also lower the ratings if ADCB's business performance materially undershoots expectations. For example, if revenue or profitability fall materially below our forecasts it could indicate a weakening business position, although we view this scenario as less likely.

Upside scenario: A positive rating action over the next 12-24 months is unlikely. However, we could raise our ratings on ADCB if it unexpectedly strengthens its capital position, with our RAC ratio sustainably exceeding 15%.

First Abu Dhabi Bank

We expect the deterioration of FAB's asset quality to be contained because its exposure to the frailest sectors of the UAE's economy is more limited than that of peers.

We also expect FAB's earnings will recover relatively quickly, with new growth likely bolstered by less-risky government-related projects. Furthermore, we project that FAB's capitalization will remain strong with the RAC ratio hovering at about 11.5%-12.0% in the next 12-24 months.

Outlook

The stable outlook reflects our expectation that, over the next 12-24 months, the bank will contain further credit losses and problem loan accumulation while recovering profitability, thereby supporting strong capitalization and bolstering its ability to absorb losses.

Downside scenario: Should FAB's ability to cover unexpected losses diminish materially, for example through weaker earnings metrics or higher growth in riskier sectors, we could take a negative rating action over the next 12-24 months.

Upside scenario: A positive rating action on FAB over the next 12-24 months is remote since it requires a two-notch improvement in the bank's intrinsic creditworthiness.

BICRA Snapshot

	To	From
BICRA Group	5	5
Economic risk	6	5
Economic resilience	Low risk	Low risk
Economic imbalances	High risk	High risk
Credit risk in the economy	Very High Risk	High risk
Trend	Stable	Negative
Industry risk	5	5
Institutional framework	Intermediate risk	Intermediate risk
Competitive dynamics	High risk	High risk
Systemwide funding	Intermediate risk	Intermediate risk
Trend	Stable	Negative

*Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores are on a scale from 1 (lowest risk) to 10 (highest risk). For more details on our BICRA scores on banking industries across the globe, please see "Banking Industry Country Risk Assessment Update," published monthly on RatingsDirect.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Methodology For Rating Sukuk, Jan. 19, 2015
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 20, 2013
- Criteria | Financial Institutions | Banks: Assessing Bank Branch Creditworthiness, Oct. 14, 2013
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013

- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- Criteria | Financial Institutions | Banks: Commercial Paper I: Banks, March 23, 2004

Related Research

- Stress Scenarios: How GCC Banks Will Perform Amid Further Potential COVID-19 Shocks, March 21, 2021
- Abu Dhabi Commercial Bank Likely To Take On More Impairments To Meet COVID-19 Impacts, Feb. 1, 2021
- Pressure On Mashreqbank's Asset Quality Will Continue, Feb. 10, 20201
- National Bank Of Fujairah's Net Loss In 2020 Is Largely Due To Non-Recurring Items, Jan. 28, 2021
- First Abu Dhabi Bank P.J.S.C., Dec. 15, 2020
- Abu Dhabi Commercial Bank PJSC, Dec. 21, 2020
- Mashreqbank, Aug. 13, 2020
- Sharjah Islamic Bank, Aug. 18, 2020
- National Bank of Fujairah PJSC, July 2, 2020

Ratings List

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Ratings Affirmed; Outlook Action		
	To	**From**
Abu Dhabi Commercial Bank PJSC		
Issuer Credit Rating	A/Stable/A-1	A/Negative/A-1
Ratings Affirmed		
Abu Dhabi Commercial Bank PJSC		
Senior Unsecured	A	
Commercial Paper	A-1	
ADCB Finance (Cayman) Ltd.		
Senior Unsecured	A	
Subordinated	A-	

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Ratings Affirmed; Outlook Action		
	To	**From**
First Abu Dhabi Bank P.J.S.C.		
First Abu Dhabi Bank USA N.V. (WA Branch)		
First Abu Dhabi Bank USA N.V.		
Issuer Credit Rating	AA-/Stable/A-1+	AA-/Negative/A-1+
Ratings Affirmed		
First Abu Dhabi Bank P.J.S.C.		
Certificate Of Deposit		
Local Currency	AA-	
Foreign Currency	AA-/A-1+	
Senior Unsecured	AA-	
Commercial Paper	A-1+	
First Abu Dhabi Bank PJSC (London Branch)		
Commercial Paper	A-1+	
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Ratings Affirmed; Outlook Action		
	To	**From**
Mashreqbank		
Issuer Credit Rating	A-/Stable/A-2	A-/Negative/A-2
Ratings Affirmed		
Mashreqbank		
Certificate Of Deposit	A-2	
Senior Unsecured	A-	
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Downgraded; Outlook Action; Ratings Affirmed		
	To	**From**
National Bank of Fujairah PJSC		
Issuer Credit Rating	BBB/Stable/A-2	BBB+/Negative/A-2
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Ratings Affirmed; Outlook Action		
	To	**From**
Sharjah Islamic Bank		
Issuer Credit Rating	A-/Stable/A-2	A-/Negative/A-2
Ratings Affirmed		
SIB Sukuk Co. III Ltd.		
Senior Unsecured	A-	