



Fitch Upgrades BRI's VR; Affirms Other Indonesian State-Owned Banks

Fitch Ratings-Jakarta-31 July 2018: Fitch Ratings has upgraded the Viability Rating (VR) of Indonesian state-owned bank, PT Bank Rakyat Indonesia (Persero) Tbk (BRI), to 'bbb-' from 'bb+'. Fitch has also affirmed BRI's Issuer Default Ratings (IDRs), which are now driven by its VR, and the IDRs of four other Indonesian state-owned banks - PT Bank Mandiri (Persero) Tbk (Mandiri), PT Bank Negara Indonesia (Persero) Tbk (BNI), Lembaga Pembiayaan Ekspor Indonesia (Indoexim) and BRI's subsidiary, PT Bank BRIsyariah Tbk (BRIS).

At the same time Fitch Ratings Indonesia has affirmed the National Ratings on BRI, Mandiri, BNI, PT Bank Tabungan Negara (Persero) Tbk (BTN), BRIS and the ratings of two of Mandiri's subsidiaries - PT Bank Mandiri Taspen (Bank Mantap) and PT Mandiri Tunas Finance (MTF). The rating Outlooks are Stable. A full list of rating actions is at the end of this rating action commentary.

'AAA(idn)' Long-Term National Ratings denote the highest ratings assigned by Fitch on its national rating scale for that country. This rating is assigned to issuers or obligations with the lowest expectation of default risk relative to all other issuers or obligations in the same country.

'AA(idn)' Long-Term National Ratings denote expectations of very low default risk relative to other issuers or obligations in the same country. The default risk inherently differs only slightly from that of the country's highest rated issuers or obligations.

'F1(idn)' Short-Term National Ratings indicate the strongest capacity for timely payment of financial commitments relative to other issuers or obligations in the same country. Under the agency's National Rating scale, this rating is assigned to the lowest default risk relative to others in the same country. Where the liquidity profile is particularly strong, a "+" is added to the assigned rating.

KEY RATING DRIVERS

IDRS, NATIONAL RATINGS, SUPPORT RATINGS AND SUPPORT RATING FLOORS

The IDRs and National Ratings of Indoexim, Mandiri, BNI and BTN are support driven, while those of BRI are underpinned by our expectations of sovereign support.

The banks' Support Ratings and Support Rating Floors reflect a high probability that the banks will receive state support in time of need. BTN's Support Rating and Support Rating Floor reflect a moderate prospect for sovereign support. Fitch's assessment is based on the banks' respective relative systemic importance in the Indonesian economy, the degree of their commercial operations and the state's majority ownership.

The National Long-Term Ratings on BNI and BTN - which had a market share at around 9.5% and 3.5%, respectively, of total system assets at 1Q18 - are lower than those of Mandiri and BRI - which have around 15% share of total assets - to reflect Fitch's view of their lower systemic importance.

Fitch equalises Indoexim's IDR and Support Rating Floor with the Sovereign Rating of Indonesia (BBB/Stable), as the bank is fully state-owned and plays an important policy role in supporting and developing the country's export industry, an area of strategic importance to Indonesia's economic development.

The IDR and National Ratings of BRIS and National Ratings of Bank Mantap and MTF reflect Fitch's expectation of a strong probability of extraordinary support from their respective parents, if needed. Fitch views BRIS, Bank Mantap and MTF as strategically important subsidiaries that have key roles in expanding their parents' sharia banking, pension lending and consumer finance businesses, respectively. The subsidiaries' importance to their parents is also reflected in their operational alignment in key areas, common branding and majority ownership.

VRS

The upgrade of BRI's VR reflects Fitch's view that the bank will build on its position as Indonesia's largest bank and sustain its above-peer profitability and satisfactory capital as the operating environment strengthens. Its distribution network is the most extensive in the industry and it has an unchallenged franchise in rural micro-lending that supports its higher margins. Asset quality slightly weakened during 1Q18, but it is still better than that of most peers and will remain supported by strong credit fundamentals that are underpinned by the bank's diversified credit exposure.

The affirmation of Mandiri's and BNI's VR considers the improving operating environment and the bank's satisfactory capitalisation and profitability, which are among the best in the industry. However, the two banks' profitability is weaker

compared with that of BRI, as evidenced in consistently lower return on assets over the previous few years stemming from a greater proportion of lower-yielding corporate lending in their portfolios. The VRs also reflect risk controls that, although acceptable, Fitch deems as less robust than those of some peers.

Fitch expects Mandiri's asset quality to continue to gradually improve in line with the domestic economy. Its non-performing loan ratio of 3.3% at end-1Q18 (end-2016: 4.0%) remained higher than the 2.8% industry average, as the bank suffered from a more prolonged downturn in the economic environment than Fitch had expected. BNI's higher-than-industry loan growth target of 13%-16% in 2018 (industry: 10%-12%) could weigh on its capital strength.

BRI, Mandiri and BNI are among Indonesia's largest commercial banks and their funding profiles benefit from their state-ownership, industry-leading franchises and broad distribution networks. This helps the banks maintain lower funding costs than most peers.

All banks face risks from potential volatility from interest-rate hikes by the US Federal Reserve, rising domestic interest rates and lower commodity prices. Fitch expects rate hikes to remain gradual rather than sharp and the state-owned banks should be well placed to mitigate associated risks. A sharp decline in commodity prices is not Fitch's base case.

No VR is assigned to Indoexim, as Fitch does not believe it is meaningful to analyse the policy-related institution on a standalone basis.

SENIOR DEBT RATINGS

The banks' rupiah and foreign-currency denominated senior bonds and bond programmes are rated at the same levels as their IDRs and National Long-Term Ratings in accordance with Fitch's rating criteria.

SUBORDINATED DEBT RATING

BRIS's subordinated sukuk securities are rated three notches below its National Long-Term Rating of 'AA+(idn)', which results in the same rating had they been issued by the parent bank. There is a one-notch difference for loss-severity risk to reflect the sukuk's subordination relative to senior unsecured instruments, the presence of a non-viability clause and the partial or full write-down feature at the point of non-viability. Two additional notches are for non-performance to reflect the risk that distributions must be deferred and accumulated if they could cause BRIS's capital ratios to not comply with minimum regulatory requirements. Fitch believes these

going-concern loss-absorption features significantly increase risk of non-payment prior to any point of non-viability trigger.

RATING SENSITIVITIES

IDRS, NATIONAL RATINGS, SUPPORT RATINGS AND SUPPORT RATING FLOORS

A change in the government's ability and willingness to provide extraordinary support would affect these banks' IDRs, National Ratings, Support Ratings and Support Rating Floors. BRI's IDR would only be affected by a downgrade of its Support Rating Floor if, at the same time, Fitch also downgraded its VR.

The rating differential between the National Ratings of BRI and Mandiri and those of BNI and BTN could be eliminated or narrowed if we deemed BNI and BTN's systemic importance as closer to that of the two larger banks.

The National Ratings of Bank Mantap, MTF and BRIS are sensitive to changes in their parent's ratings. A perceived weakening of support, most likely indicated through a change in their contribution to their parents' business targets, would be negative for the subsidiaries' National Ratings. Conversely, a significantly greater contribution and stronger control could lead to an upgrade.

A change in the state-owned banks' and subsidiaries' creditworthiness relative to the universe of issuers within Indonesia, including the Indonesian sovereign, could also lead to a change in their National Ratings.

VRS

Rating upside on the VRs may result from further improvement in the operating environment, such as evidence of greater resilience to economic shocks or the adverse effects of higher interest rates, and continued development of the capital markets, which could lead to better and stable financial performances by the banks. Upside could also stem from enhanced corporate governance and a more visible improvement in the banks' risk-management cultures. Rating downside may result from an unexpected sharp and protracted downturn or significant increase in risk appetite, which in turn leads to heightened potential for rapid asset-quality deterioration and weakened loss-absorption buffers.

A downgrade of Indonesia's sovereign rating would not necessarily lead to a downgrade of the banks' VRs.

SENIOR DEBT RATINGS

Any changes in the IDRs and National Long-Term Ratings would affect the ratings on the banks' rupiah and foreign-currency denominated senior bonds and bond programmes.

SUBORDINATED DEBT RATING

Any changes in the standalone credit profile of the parent, BRI, would affect the issue's rating.

The full list of rating actions is as follows:

BRI:

- Long-Term Foreign-Currency IDR affirmed at 'BBB-'; Outlook Stable
- Short-Term Foreign-Currency IDR affirmed at 'F3'
- Support Rating Floor affirmed at 'BBB-'
- Support Rating affirmed at '2'
- Viability Rating upgraded to 'bbb-', from 'bb+'
- National Long-Term Rating affirmed at 'AAA(idn)'; Outlook Stable
- National Short-Term Rating affirmed at 'F1+(idn)'
- Senior unsecured rating affirmed at 'BBB-'

Mandiri:

- Long-Term Foreign-Currency IDR affirmed at 'BBB-'; Outlook Stable
- Long-Term Local-Currency IDR affirmed at 'BBB-'; Outlook Stable
- Short-Term Foreign-Currency IDR affirmed at 'F3'
- Support Rating Floor affirmed at 'BBB-'
- Support Rating affirmed at '2'
- Viability Rating affirmed at 'bb+'
- National Long-Term Rating affirmed at 'AAA(idn)'; Outlook Stable
- National Short-Term Rating affirmed at 'F1+(idn)'

BNI:

- Long-Term Foreign-Currency IDR affirmed at 'BBB-'; Outlook Stable
- Long-Term Local-Currency IDR affirmed at 'BBB-'; Outlook Stable
- Short-Term Foreign-Currency IDR affirmed at 'F3'
- Support Rating Floor affirmed at 'BBB-'
- Support Rating affirmed at '2'
- Viability Rating affirmed at 'bb+'
- National Long-Term Rating affirmed at 'AA+(idn)'; Outlook Stable
- National Short-Term Rating affirmed at 'F1+(idn)'

BTN

- National Long-Term Rating affirmed at 'AA(idn)'; Outlook Stable
- National Short-Term Rating affirmed at 'F1+(idn)'
- National senior unsecured rating affirmed at 'AA(idn)'
- National senior unsecured bond programme rating withdrawn, as it has expired

Indoexim

- Long-Term Foreign-Currency IDR affirmed at 'BBB'; Outlook Stable
- Short-Term Foreign-Currency IDR affirmed at 'F2'
- Support Rating Floor affirmed at 'BBB'
- Support Rating affirmed at '2'
- Senior unsecured euro medium-term note programme and bonds issued under the first tranche of the programme affirmed at 'BBB'

BRIS

- Long-Term Foreign-Currency IDR affirmed at 'BB+'; Outlook Stable
- National Long-Term Rating affirmed at 'AA+(idn)'; Outlook Stable
- National Short-Term Rating affirmed at 'F1+(idn)'
- National subordinated sukuk rating affirmed at 'A+(idn)'

Bank Mantap

- National Long-Term Rating affirmed at 'AA(idn)'; Outlook Stable
- National senior unsecured rating affirmed at 'AA(idn)'

MTF

- National Long-Term Rating affirmed at 'AA(idn)'; Outlook Stable
- National Short-Term Rating affirmed at 'F1+(idn)'

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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>)

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