Rating Action: Arab Banking Corporation B.S.C.

Moody's downgrades Arab Banking Corporation to D+; changes outlook on A3/P-2 deposit ratings to negative

Limassol, January 29, 2009 -- Moody's Investors Service today downgraded the bank financial strength rating (BFSR) of Arab Banking Corporation (ABC) to D+ from C-. Moody's also changed the outlook on the bank's A3/Prime-2 deposit ratings to negative from stable.

Moody's said that the downgrade of the BFSR to D+, mapping to a baseline credit assessment (BCA) of Baa3, was driven by a revised, less favourable view of ABC's wholesale banking franchise in the Gulf Cooperation Council (GCC) states. This view takes into account the deteriorating economic environment in the GCC, coinciding with sharply lower oil prices and a global recession. Moody's expects that, within this context, business volumes in the bank's core wholesale lending and project financing activities will decline and the risk of delinquency will rise.

"The downgrade also reflects the continuation of very difficult wholesale funding conditions in the GCC -- reflecting the collapse in global credit markets -- that are pushing up the cost of financing ABC's wholesale lending operations. The combination of a cyclical economic downturn and a structural deterioration in funding conditions is sufficiently severe and expected to be durable enough to have a negative impact on the risk-return characteristics of the bank's franchise," explained George Chrysaphinis, lead analyst for the bank at Moody's.

The downgrade of the bank's BFSR also takes into account ABC's renewed emphasis on growing its retail banking operations in the Middle East and North Africa (MENA) region. In Moody's view, although this reflects a sound strategic direction, it is unlikely to have a material impact on the bank's overall franchise over the short-to-medium term.

Moody's decision to change the outlook on the A3/Prime-2 deposit ratings to negative reflects continuing pressure on ABC's financial position, driven by: (i) the risks of further impairment charges on its international securities portfolio, totalling US$10.9 billion at the end of September 2008, (ii) the challenges the bank faces in financing its wholesale lending operations and its international securities portfolio, within the context of stressed international wholesale funding markets, and (iii) the deteriorating credit environment in the GCC and the impact this may have on the bank's asset quality metrics.

In relation to these pressures, Moody's notes that ABC's outstanding international investment balances are primarily invested in some of the more secure asset categories, such as US agency-guaranteed securities, and that the bank has already taken US$974.0 million in provisions against its riskier exposures. Moody's also recognises that while the bank faces no immediate liquidity pressures in financing its securities portfolio, the availability of interbank funding and repos is becoming increasingly scarce, leading to greater reliance on shareholder funding. The rating agency added that, although recent asset quality on the bank's wholesale lending portfolio had been strong, falling oil and asset prices in the GCC and reduced liquidity are likely to increase the level of credit risk in the bank's operations.

Over the next few months, Moody's will be assessing the extent to which funding and asset quality pressures affect the bank's financial position. To the extent that the bank's core wholesale banking business is disrupted by funding challenges, or solvency is affected by further provisioning requirements or rising loan delinquencies, Moody's could take negative action on the deposit ratings.

In assessing future developments at ABC, Moody's will also take into account the funding resources that the bank's major shareholders can provide in case of need. Moody's considers that the Abu Dhabi Investment Authority, which has a stake of 27.6%, the Kuwait Investment Authority, which has a stake of 29.7%, and the Central Bank of Libya, which has a stake of 29.5%, will jointly be able to provide liquidity to the bank within the current context of stressed international credit markets.

The rating agency also clarified that these factors impact the bank's standalone financial strength, as represented by the BFSR, which is now at the upper end of the D+ category, mapping to a BCA of Baa3. As the BCA is one of the components of the deposit ratings, any weakening in the BFSR towards the lower end of the D+ category, mapping to a BCA of Ba1, would likely have an impact on the bank's deposit ratings.

The bank's A3/Prime-2 deposit ratings incorporate a three-notch uplift, reflecting external support considerations, and take into account: (i) the bank's D+ BFSR, mapping to a BCA of Baa3, (ii) a very high likelihood of support from shareholders and (iii) the A1 weighted average foreign currency debt rating of its three major shareholders.

Moody's previous rating action on ABC was taken on April 30, 2008 when the outlook on the bank's C- BFSR was changed to negative.

The principal methodologies used in rating Arab Banking Corporation are "Bank Financial Strength Ratings: Global Methodology" and "Incorporation of Joint-Default Analysis into Moody's Bank Ratings: A Refined Methodology, published in February and March 2007, respectively, and available on www.moodys.com in the Credit Policy & Methodologies directory, in the Ratings Methodologies sub-directory. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found in the Credit Policy & Methodologies directory on Moody's website.

Arab Banking Corporation is headquartered in Manama, Bahrain, and at the end of September 2008 its assets totalled US$30.43 billion.

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