S&P Global Ratings

RatingsDirect®

Research Update:

Inter-American Development Bank 'AAA/A-1+' Ratings Affirmed Under Revised Criteria; Outlook Stable

Primary Credit Analyst:
Alexander Ekbom, Stockholm (46) 8-440-5911; alexander.ekbom@spglobal.com

Secondary Contact:
Constanza M Perez Aquino, Buenos Aires (54) 544-891-2167; constanza.perez.aquino@spglobal.com

Table Of Contents

Research Update:

Inter-American Development Bank 'AAA/A-1+' Ratings Affirmed Under Revised Criteria; Outlook Stable

Overview

- Following a review under our revised criteria for multilateral lending institutions, we assess the Inter-American Development Bank's (IADB's) stand-alone credit profile at 'aaa', owing to its extremely strong enterprise risk profile and very strong financial risk profile.
- We believe the IADB, through continuous improvements in its governance and risk management framework, can adequately manage the borrowing member majority.
- We are therefore affirming our 'AAA/A-1+' ratings on IADB and removing them from under criteria observation (UCO).
- The stable outlook reflects our expectation that the IADB's strengths, particularly its relationship with its member countries, will remain unchanged in the next two years.

Rating Action

On Feb. 13, 2019, S&P Global Ratings affirmed its 'AAA' long-term and 'A-1+' short-term issuer credit ratings on the Inter-American Development Bank (IADB). The outlook remains stable.

At the same time, we removed the ratings from UCO, where we placed them on Dec. 14, 2018, after publishing the revised criteria.

Rationale

We base our ratings on the IADB's extremely strong enterprise risk profile and very strong financial risk profile. Previously, the long-term rating included uplift for extraordinary support in the form of callable capital. However, after reviewing IADB under our revised criteria "Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology," published Dec. 14, 2018, we assess IADB's stand-alone credit profile at 'aaa' rather than 'aa+'.

In our view, IADB's governance and risk management framework has strengthened, and measures it has implemented are starting to build a more conscious risk-based culture in the organization. We think this was recently demonstrated in the bank's approach to the situation in Venezuela. Unlike some regional multilateral lending institutions (MLIs), the IADB did not grant any emergency financing to the country, in line with its established risk and governance principles, although Venezuela is a borrowing member.

The IADB's governance and risk management improvements encompass its capital adequacy framework, liquidity policy, investment authority, asset and liability management, and income management model. In addition, the IADB can increase earnings capacity as needed. Unlike many other MLIs, it can adjust charges on its entire sovereign-guaranteed loan book to receive additional interest revenue and, in essence, generate capital internally. In 2014, the bank further updated its capital adequacy framework, which mandates the creation and building of capital buffers to facilitate its ability to lend countercyclically in times of stress, while preserving a 'AAA' rating.

Nevertheless, the IADB's borrowing member countries have slightly more than 50% of the voting power on the bank's board. Their potential influence (although this risk is reducing) over the bank's lending decisions is therefore a source of uncertainty, since the interests of borrowing members could differ from those of IADB's creditors.

Higher geographic-diversification benefits as well as a larger risk-weight reduction due to PCT in our revised capital framework strengthened IADB's capital position by some 50 basis points (bps), resulting in a risk-adjusted capital (RAC) ratio of 24.4% as of Feb. 4, 2019, based on input data from 2017. Following the incorporation of IADB's concessional window into the bank in 2017, the RAC ratio increased by about 300 bps. We expect the bank will use some of this additional capital in its core operations. Therefore we assume its RAC ratio could decrease below 23% but remain comfortably above 15%, which would indicate a very strong capital base.

In May 2018, Venezuela's payment arrears with the IADB surpassed 180 days after the country defaulted on its commercial debt in November 2017. Venezuela has continued making payments to other multilateral lending institutions, which gave it further loans, whereas the IADB did not grant any additional financing. We believe Venezuela has demonstrated its willingness to repay IADB but has run out of capacity to keep its payments up to date. U.S. sanctions and mounting pressure from the international community contribute to a very difficult environment in Venezuela, in our view. However, we don't believe they are the main reason for the non-accruals with IADB. With Venezuela in default, 2.4% of IADB's loan portfolio is in non-accrual status.

We believe the ultimate impact on IADB's financials and business performance will be limited, given the bank's small exposure to Venezuela. This was the first time an IADB member country has been in non-accrual since December 2000, when Suriname was overdue on its payments. This non-accrual frequency is in line with that of some of IADB's main peers. We expect the rest of IADB's sovereign borrowers will continue to afford it preferred creditor treatment (PCT).

Furthermore, under our liquidity stress scenario, at all horizons up to one year, IADB would fully cover its balance-sheet liabilities without market access. Using year-end 2017 data and incorporating our updated liquidity haircuts, our 12-month liquidity coverage ratio is 1.4x including scheduled loan disbursements, while the six-month ratio is 2.9x. IADB's liquidity has recently been higher as measured by our additional stress scenario, which takes into account 50% of all undisbursed loans coming due in the next 12 months. But we believe this liquidity might reduce and that IADB may need to spread out potential disbursements in a stress scenario.

Founded in 1959, IADB is the oldest regional multilateral development finance institution. It has 48 country members--26 borrowing member countries in Latin America and the Caribbean, and 22 nonborrowing members (the U.S., Canada, and 20 nonregional countries). The bank lends mostly to central governments in Latin America and the Caribbean to promote economic development and expand opportunities for the poor. IADB's role in Latin America is unparalleled, as shown by its outstanding loan portfolio, which in 2017 represented approximately 50% of total MLI loans and 75% of net flows in the region. We don't believe IADB can be replaced by another MLI or by a commercial bank.

IADB's shareholders have been supportive since its inception, and IADB concluded its ninth general capital increase in 2017. This comprised $1.7 billion of paid-in capital and $68.3 billion of callable capital. Two of the 48 member countries (the Netherlands and Venezuela) did not participate in the capital increase, and their shares were reallocated to other members.

We no longer factor extraordinary support in the form of callable capital into the rating because IADB, on its own, can achieve our highest assessment. This notwithstanding, callable capital from IADB's highly rated shareholders would enhance our RAC ratio and mitigate the impact on the bank's financial profile in the event that its capital adequacy were to deteriorate. IADB's largest 'AAA' and 'AA+' rated shareholders include the U.S., Canada, Germany, and the Nordic countries combined.

Outlook

The stable outlook reflects our expectation that Venezuela's payment arrears will not have material adverse effects on IADB and that other sovereign borrowing members will continue to treat IADB as a preferred creditor. Moreover, we expect that IADB will retain its role as the main supplier of developmental financing in the region while applying sound governance. We also assume IADB will have sufficient liquidity to remain independent from the markets for 12 months.

We could downgrade IADB if other borrowers fall into non-accrual status, indicating weaker PCT. A significant deterioration in IADB's funding and liquidity could also have a negative impact on the ratings. That said, significant erosion of the RAC ratio would most likely be mitigated by the existing callable capital provided by IADB's highly rated sovereign shareholders.

Ratings Score Snapshot

Issuer credit rating	AAA/Stable/A-1+
SACP	aaa
Enterprise risk profile	Extremely strong
Policy importance	Very strong
Governance and management	Strong
Financial risk profile	Very strong
Capital adequacy	Very strong
Funding and liquidity	Strong
Extraordinary support	0
Callable capital	0
Group support	0
Holistic approach	0

Related Criteria

- Criteria | Governments | General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Dec. 14, 2018
- 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: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Criteria Guidance: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Dec. 14, 2018
- Ratings On 32 Multilateral Lending Institutions And Supranationals Placed Under Criteria Observation On Criteria Update, Dec. 14, 2018
- Supranationals Special Edition 2018, Oct. 11, 2018

Ratings List

Ratings Affirmed

Inter-American Development Bank	
Issuer Credit Rating	
Foreign Currency	AAA/Stable/A-1+
Senior Unsecured	AAA

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.