27 Nov 2018 | Affirmation

Fitch Affirms Inter-American Development Bank at 'AAA'; Outlook Stable

Fitch Ratings-London-27 November 2018: Fitch Ratings has affirmed Inter-American Development Bank's Long-Term Issuer Default Rating (IDR) at 'AAA' with a Stable Outlook.

A full list of rating actions is at the end of this rating action commentary.

KEY RATING DRIVERS

IaDB's ratings are driven by its intrinsic credit quality. IaDB's 'excellent' capitalisation and 'low' risk profile result in a solvency assessment of 'aa+'. The bank's liquidity profile is assessed at 'aaa'. The bank's low-risk business environment translates into a one-notch adjustment over the lower of its solvency and liquidity assessments, resulting in a Long-Term IDR of 'AAA'.

IaDB's equity/adjusted assets and guarantees ratio improved to 25.2% in 1H18, compared with 24.1% in 2016. The bank's equity base was strengthened by the transfer of its concessional lending arm's net assets, the Fund for Special Operation (FSO) in 2017, whose USD5.8 billion paid-in capital was consolidated into the bank's ordinary balance sheet. The improvement in IaDB's equity/adjusted assets and guarantees ratio was hampered by a material increase in the bank's stock of treasury assets in 2017 and 1H18, which accounted for 30% of total assets in June 2018 (2016: 24.6%).

We expect IaDB's capitalisation ratio to stabilise above 25% by 2021, an excellent level as per Fitch's criteria, reflecting the expected moderate growth in IaDB's total banking exposures (4% per year on average by 2021). In addition, Fitch considers that the bank's sizeable treasury assets will partially serve to finance future loan disbursements, which will limit IaDB's recourse to debt and therefore contribute to weaker growth in the bank's balance sheet.

Fitch projects IaDB's internal capital generation to remain in excess of 2.0% in the coming years (2017: 2.1%). Our forecast is supported by the bank's ability to effectively adjust its margins on its predominantly floating rate portfolio. In addition, we anticipate higher gross returns on its sizeable treasury asset books, in line with the expectation of rising interest rates, although net returns may not be impacted.

IaDB's overall risk profile remains low. On 14 May 2018, USD88.3 million of loans extended by IaDB to Venezuela (RD) fell into arrears by more than 180 days. In line with its internal policy, the bank placed the entirety of its USD2 billion loan outstanding to this country in non-accrual status. It had also suspended any new disbursement to this country after loans to Venezuela were in arrears for 30 days (in November 2017). This did not have a material impact on our assessment of IaDB's risk profile given the limited size of exposure to Venezuela (2.3% of total banking exposure in 1H18). At end-November, USD114 million of payments due by

Venezuela to the bank were in arrears for more than 180 days.

The non-performing loan (NPL) ratio is low, in our view. Fitch accounts for the full Venezuela exposures as non-performing, which differs from IaDB's approach. In our view, the bank's NPL ratio is expected to decrease to 2.4% of gross loans by 2021 from 2.7% in 1H18 (and 0.5% in 2017 before placement of loans to Venezuela under non-accrual status). The projection is in line with the gradual dilution of the non-performing exposure to Venezuela within its growing loan book. Fitch notes that IaDB does not consider its exposures to Venezuela as impaired as it expects full recovery of payment by this country. Since placement in non-accrual status, loan payment collections received from Venezuela amounted to USD11 million, which in our view evidences some willingness from Venezuela to undertake payments due to the bank.

Fitch's assessment of IaDB's preferred-creditor status (PCS) remains excellent. This primarily reflects the bank's very strong track-record of loan repayment from sovereign borrowers, including from those which were in default to at least one official or private creditor for the past 20 years. Venezuela is IaDB's first sovereign borrower to fall into arrears by more than 180 days since December 2000. Fitch's PCS assessment also factors in the high share of sovereign exposure (93% of total banking portfolio as of 1H18).

In Fitch's view, concentration is a moderate risk for the bank. When taking into account exposure exchange agreements (off-balance sheet loan exposure swaps) with other multilateral development banks (MDBs), IaDB's five largest borrowers account for 57% of its banking exposures as of June 2018. Fitch understands that IaDB has recently initiated discussion with other MDBs to execute additional exposures swaps. IaDB's expected concentration risk ratio of 55% in 2021 could improve more significantly if these transactions materialise.

In our view, IaDB's excellent risk management policies are a rating strength. In particular, the bank abides by conservative capital management rules, which ensure that the bank gradually builds countercyclical capital buffers while maintaining capitalisation metrics commensurate with its 'AAA' rating. Its liquidity management policy targets full coverage of its 12-month cash outflow, which is in line with similarly rated peers.

IaDB's liquidity profile is one of the strongest among Fitch-rated MDBs, with a coverage of short-term debt by liquid assets of 2.2x as of 1H18. Despite our expectation that the bank will partially use its sizeable liquidity cushion to finance future loan disbursements, we expect IaDB's liquidity profile to remain comfortably in excess of 1.5x, which is excellent, in our view.

IaDB's business environment is assessed as low risk, which translates into a one-notch positive adjustment from Fitch's solvency assessment. IaDB's low-risk business profile is mainly driven by its low-risk strategy, characterised by a strong focus on sovereign lending and moderate lending growth targets. In addition, our assessment captures the bank's very important policy mandate. IaDB operates in a medium-risk environment, considering the credit quality, political risk and business climate of the countries in which it operates.

Although this is a secondary rating driver, Fitch assesses shareholders' support at 'a'. IaDB's shareholders support capacity is based on the coverage of net debt by callable capital. In the absence of a capital increase, callable capital pledges from 'AAA' rated shareholders will no longer suffice to provide full coverage of IaDB's net debt after 2018. This indicator will gradually deteriorate to 'A' by 2021. Fitch views shareholders' propensity to support as strong, in line with IaDB's importance for development finance in the Latin American and Caribbean regions, as well as the track record of timely capital increases.

RATING SENSITIVITIES
- A prolonged and significant decline in the bank's equity/adjusted assets and guarantees, resulting from a marked decline in internal capital generation or from higher-than-expected lending growth, would be negative for the rating.

A significant deterioration in the bank's risk profile, stemming from deteriorated credit risk metrics and/or worsening concentration risk, would be negative for the rating.

KEY ASSUMPTIONS
Fitch assumes that IADB will continue maintaining a cautious prudential framework on capitalisation, liquidity and credit risk.

The full list of rating actions is as follows:

Long-Term IDR affirmed at 'AAA'; Outlook Stable
Short-Term IDR affirmed at 'F1+'
Issue ratings on long-term senior unsecured bonds affirmed at 'AAA'

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In addition to Fitch's Supranationals rating criteria dated 24 May 2018, this action was additionally informed by information from Inter-American Development Bank's annual report and financial statements and other information provided by Inter-American Development Bank.

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Additional information is available on www.fitchratings.com

Applicable Criteria

Supranationals Rating Criteria (pub. 24 May 2018)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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