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

Tue 24 Nov, 2020 - 2:29 PM ET

Fitch Ratings - London - 24 Nov 2020: Fitch Ratings has affirmed Inter-American Development Bank's (IADB) Long-Term Issuer Default Rating (IDR) at 'AAA' with a Stable Outlook and Short-Term IDR at 'F1+'.

KEY RATING DRIVERS

IADB's 'AAA' Long-Term IDR reflects the bank's intrinsic credit profile, underpinned by its solvency assessment of 'aa+', liquidity assessment of 'aaa' and a one-notch positive adjustment to the solvency assessment to reflect a 'low' risk business environment.
The Stable Outlook reflects our expectation that the bank's intrinsic credit profile will remain consistent with its 'AAA' rating despite negative pressures on the bank's solvency metrics. In Fitch's view, the bank has sufficient capital to absorb the recent rise in leverage and deterioration in Latin American sovereign creditworthiness. However, capitalisation buffers are expected to diminish in light of the bank's pandemic response, sovereign credit trends, and weaker internal capital generation prospects.

The IADB has responded to the coronavirus pandemic by redirecting and increasing its lending envelope for 2020 from USD13.0 billion to a record level of USD15.5 billion. The financing will primarily be directed towards sovereigns to help mitigate public health pressures and ameliorate the economic impact. As of end-September 2020, the bank had approved and disbursed loans totaling USD 11.3 billion and USD8.6 billion, respectively, with a significant level of disbursements expected in 4Q20.

In order to finance the increase in lending, the bank has also raised the funding programme for 2020 to USD27 billion (compared with USD20 billion in 2019). This has led to a rise in leverage, as measured by debt-to-equity, from 2.8x at end-2019 to 3.3x as of end-September 2020. Similarly, the bank’s equity-to-adjusted-assets (e/a) ratio has deteriorated to 22.6% at end-September 2020 (from 25.2% at end-2019), below the 25% 'excellent' capitalisation threshold as outlined in our criteria. We expect the e/a ratio to remain close to current levels in the coming years as internal capital generation will not be sufficient to return the ratio to above 25%, given projected lending growth.

However, we expect the bank's overall capitalisation assessment to remain 'excellent' as the Fitch usable capital to risk-weighted assets (FRA) ratio is expected to remain above the 35% threshold for an 'excellent' assessment (53% at end-September 2020). Fitch expects the FRA ratio to decline in the near term as the bank rotates treasury assets to loans in 4Q20 and Negative Outlooks on sovereign ratings materialise into downgrades. Combined with a 'strong' but close to 'excellent' e/a, the overall capitalisation assessment is unchanged.

We also expect the bank's internal capital generation prospects will be lower than in previous years as lower US dollar interest rates and higher ongoing provisions
negatively impact profitability. The former negatively affects the bank's net interest margin while the latter relates to coronavirus-related credit quality deterioration and the adoption of the US GAAP expected credit loss provision standard, which will entail a higher level of provisions for undisbursed commitments and private sector exposures. However, provisions for private sector operations will decline in future years as the bank is transferring these operations to its sister entity, IDB Invest (AAA/Stable).

The bank's capital adequacy mandate and income management model allow IADB to increase lending spreads across the entire non-concessional sovereign loan portfolio and adjust lending volumes to balance the growth in risk-weighted assets and equity. The agency assumes the bank would increase lending spreads or use its flexibility to revise lending volumes downward to prevent capitalisation from falling below Fitch's current expectations.

Fitch assesses IADB's solvency risks as 'low', given the bank's sovereign lending focus, 'excellent' preferred creditor status (PCS), 'very low' exposure to market risk, and 'excellent' risk management policies. Concentration risk has historically been a rating weakness, but has improved in recent years with the five-largest banking exposures accounting for 55.5% of the total as of end-September 2020 (compared with 64.0% in 2014).

The bank's exposure to credit risk is assessed as 'low' and is primarily driven by the 'low' nonperforming loan (NPL) ratio as reported by the bank (2.3% as of end-September 2020), which has historically been below 1.0%. The weighted average rating of loans and guarantees is unchanged at 'BB-' ('BBB-' after PCS uplift) compared with a year prior, despite recent downgrades of a number of key sovereign borrowers.

NPLs primarily relate to Venezuela (2% of total loans) while the balance comprises non-sovereign NPLs. The bank has granted payment deferrals on certain non-sovereign loans (0.2% of total loans), which the bank does not consider as impaired. In line with Fitch's supranationals rating criteria that consider non-sovereign exposure with a three-month payment delay as 'non-performing', and to reflect the risk that the temporary payment relief may, in
Fitch's view, only delay loan impairments, the agency treats these exposures as 'non-performing'.

We expect the NPL ratio to remain close to current levels (1%-3%), despite our expectation of an uptick in non-sovereign NPLs as we assume the bank's PCS will insulate it from any new sovereign borrower falling into non-accrual with the bank. Similarly, we expect the average rating of the portfolio to remain unchanged at 'BB-' in coming years.

However, there are significant downside risks to credit quality projections, given the large number of Latin American sovereigns with Negative Outlooks. Fitch estimates that about 40% of loan and guarantee exposures are to sovereigns with Negative Outlooks. A further 13% relates to sovereigns rated 'CCC' or below. As such, the risk of further credit quality deterioration and new sovereign arrears has increased markedly since the last review.

IADB's 'aaa' liquidity assessment reflects the bank's 'excellent' liquidity buffers, the credit quality of its treasury portfolio, and its access to capital markets, all of which compare favourably with 'AAA' rated peers. The ratio of liquid assets-to-short-term debt is expected to remain well above the 1.5x threshold for an 'excellent' assessment through 2023 (2.2x at end-September 2020).

IADB's overall 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 a low-risk strategy, characterised by a strong focus on sovereign lending and moderate lending growth targets. In addition, our assessment captures IADB's very important policy mandate as the largest multilateral lender for many of the bank's member countries. The importance of the bank's policy mandate has been further evidenced during the coronavirus pandemic as the bank has played a key role in supporting sovereigns with limited market access and growing financing needs. This assessment balances the medium-risk environment in which IADB operates.

Fitch assesses shareholders' support at 'a-', which is based on the weighted average rating of key shareholders (WARKS) as its medium-term forecast for coverage of net debt by callable capital is expected to fall below this level by end-
2023 (full coverage from shareholders rated above 'A' at end-September 2020). The WARKS is sensitive to a downgrade of the sovereign rating of the US (AAA/Negative), the bank's largest shareholder. Fitch views shareholders' propensity to support the bank as strong.

**RATING SENSITIVITIES**

Factors that could, individually or collectively, lead to positive rating action/upgrade:

The rating is at the highest level on Fitch's scale and cannot be upgraded.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Solvency (Capitalisation): Decline in capitalisation metrics with an equity to assets and guarantees ratio sustained at a level well below 25% and closer to the 15% threshold for a 'strong' assessment, and/or a FRA ratio below 35% that affect our 'excellent' capitalisation assessment. This could be driven by further rise in leverage or significant increase in risk-weighted assets, potentially caused by faster than expected loan growth and/or sovereign downgrades.

- Solvency (Risk): A revision of our 'low' credit risk assessment, caused by either a decline in the average rating of loans and guarantees below 'BB-' or a new breach of PCS on sovereign loans.

- Solvency (Risk): An increase in concentration risk metrics above the 60% 'high' risk threshold as outlined in our criteria, could lead to an overall revision of the 'low' solvency risk assessment.

**BEST/WORST CASE RATING SCENARIO**
International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579].

KEY ASSUMPTIONS

Fitch assumes that IADB will abide by its prudential framework and internal limits.

We also assume that the global economy evolves in line with its most recent update of the Global Economic Outlook published on 6 November 2020.

SOURCES OF INFORMATION

The sources of information used to assess these ratings were IADB's financial statements and other information provided by IADB.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.
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<td>Inter-American Development Bank</td>
<td>LT IDR</td>
<td>AAA Rating Outlook Stable</td>
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**RATING ACTIONS**

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**VIEW ADDITIONAL RATING DETAILS**

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APPLICABLE CRITERIA
Supranationals Rating Criteria (pub. 30 Apr 2020) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES
Dodd-Frank Rating Information Disclosure Form
Solicitation Status
Endorsement Policy

ENDORSEMENT STATUS
Inter-American Development Bank EU Issued

ADDITIONAL DISCLOSURES FOR UNSOLICITED CREDIT RATINGS
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With Rated Entity or Related Third Party Participation Yes
With Access to Internal Documents Yes
With Access to Management Yes

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**UNSOLICITED ISSUERS**

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**Sovereigns**  Supranationals, Subnationals, and Agencies  North America

United States