Research Update:

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

July 24, 2019

Overview

- In our view, the Inter-American Development Bank's (IADB) enterprise risk profile is supported by its strengthened governance and risk management framework and very strong policy importance.
- Strong levels of capital and a robust liquidity position underpin IADB's financial risk profile.
- We are therefore affirming the 'AAA/A-1+' ratings on IADB.
- The stable outlook reflects our expectation that over the next 24 months IADB will continue to adhere to sound governance and manage the institution to high financial risk standards while shareholders remain supportive and borrowers treat the institution as a preferred creditor.

Rating Action


Rationale

We affirmed our ratings on IADB based on our assessment of its extremely strong enterprise risk profile and very strong financial risk profile. We assess the stand-alone credit profile for IADB at 'aaa'. We therefore do not factor extraordinary support in the form of callable capital into the rating because IADB, on its own, can achieve our highest assessment.

IADB's enterprise risk profile captures our view of its strengthened governance and risk management framework, given that the institution has built up a track record based on its implemented financial and risk measures that began in 2013, which has translated in a more conscious risk-based culture in the organization. This largely counterbalances, in our view, the potential agency risk stemming from IABD's borrowing member countries having slightly more than 50% of the voting power on the bank's board. Their potential influence (although this risk is declining) over the bank's lending decisions is therefore a source of uncertainty because the
interests of borrowing members could differ from those of IADB’s creditors.

We think that the strengthened governance and risk management framework was recently demonstrated in the bank’s approach to the situation in Venezuela. Unlike some regional multilateral lending institutions (MLIs), 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. Furthermore, while IADB canceled its 60th annual meeting in China given political dynamics stemming from Venezuela’s opposition leader Juan Guaido’s appointment of a government representative to IADB, we believe this incident will not undermine shareholder support, nor is reflective of potential governance conflicts as the recognition of the interim government in Venezuela was approved by a supermajority of governors. The postponement of the bank’s annual meeting (that took place on July 16-17 in Guayaquil, Ecuador) resulted in no operational consequences.

We view IADB’s role in Latin America as unparalleled, supported by continued growth in its outstanding loan portfolio, which reached $93 billion as of year-end 2018. We don’t believe IADB can be replaced by another MLI or by a commercial bank. IADB’s shareholders have also 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.

Our calculated preferred creditor treatment (PCT) ratio of 2.3% reflects Venezuela’s payment arrears with IADB, which surpassed 180 days in May 2018, after the country defaulted on its commercial debt in November 2017. Venezuela has continued making payments to other MLIs, which gave it further loans, whereas 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 nonaccruals with IADB.

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 nonaccrual since December 2000, when Suriname was overdue on its payments. This nonaccrual 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 PCT.

IADB’s risk-adjusted (RAC) ratio as of year-end 2018 declined to 23.3% from 24.4% in 2017. We expect the bank will use some of its 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. This notwithstanding, callable capital from IADB’s highly rated shareholders would enhance our RAC ratio and mitigate the impact on the bank’s financial risk profile in the event that its capital adequacy were to deteriorate.

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 2018 data, 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 decline and that IADB may need to spread out potential disbursements in a stress scenario.
Outlook

The stable outlook reflects our expectation that over the next 24 months IADB will apply sound governance and risk management and prudently manage its capital and liquidity. We do not expect Venezuela's payment arrears to have material adverse effects on IADB and believe 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.

We could downgrade IADB if other borrowers fall into nonaccrual 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
- 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

<table>
<thead>
<tr>
<th>Ratings Affirmed</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Issuer Credit Rating</strong></td>
</tr>
<tr>
<td><strong>Foreign Currency</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Inter-American Development Bank</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Senior Unsecured</strong></td>
</tr>
</tbody>
</table>

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.
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