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Update

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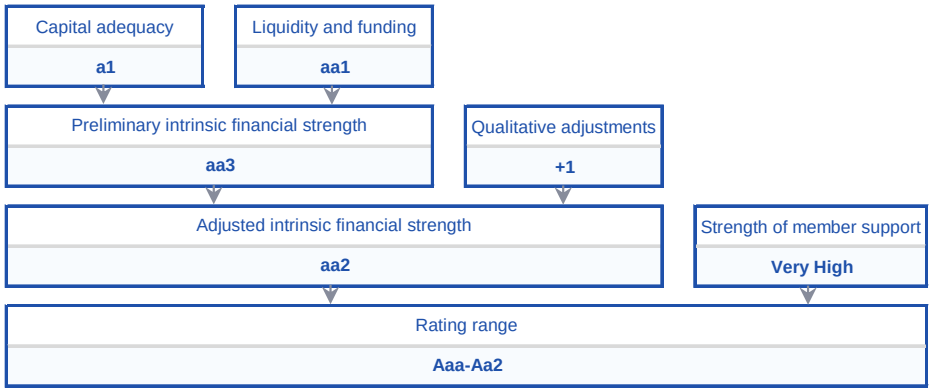
Inter-American Development Bank – Aaa stable

Regular update

Summary

The Inter-American Development Bank (IADB) is one of the premier development institutions focused on Latin America. The Bank's credit profile is underpinned by outstanding fundamentals, including a strong capital base, solid commitment from shareholders, prudent financial management and preferred creditor status. The IADB's loan book is subject to concentration risk, given its lending focus on Latin American countries, although this risk is partially offset through an exposure exchange program.

Exhibit 1
Inter-American Development Bank's credit profile is determined by three factors



Source: Moody's Investors Service

Credit strengths

» A solid capital base and preferred creditor status

» Strong commitment from non-borrowing shareholders

» Sound financial management

Credit challenges

» Credit concentration in high-risk countries with volatile macroeconomic environments

» Balancing a development mandate with sound financial practices and reasonable profitability

Rating outlook

The stable outlook reflects our view that the IADB's credit profile will remain supported by the credit quality and support of its shareholders, the institution's ample capital base and its preferred creditor status.

Factors that could lead to a downgrade

Downward pressure on the credit profile could emerge if (1) asset quality were to deteriorate should a large number of the IADB's sovereign-guaranteed loans go into nonaccrual status, or (2) in the case of severe financial stress, member countries were perceived to be unable or unwilling to provide aid to the Bank in the form of contractual or other extraordinary support to preserve its financial health. We consider these low probability outcomes.

Key indicators

Exhibit 2

IADB	2013	2014	2015	2016	2017	2018
Total Assets (USD million)	97,007.0	106,299.0	111,139.0	113,325.0	126,240.0	129,459.0
Development-related Assets (DRA) / Usable Equity [1]	303.8	315.8	312.6	310.6	277.3	284.9
Non-Performing Assets / DRA	0.2	0.2	0.2	0.3	0.3	0.3
Return on Average Assets	1.4	0.5	0.9	0.8	0.5	0.7
Liquid Assets / ST Debt + CMLTD	181.7	184.9	201.6	197.0	190.8	191.5
Liquid Assets / Total Assets	21.9	25.6	25.2	24.2	26.5	24.2
Callable Capital / Gross Debt	180.3	179.7	191.1	205.3	186.5	183.4

[1] Usable equity is total shareholder's equity and excludes callable capital

Source: Moody's Investors Service

Detailed credit considerations

We assess **capital adequacy** to be "a1," reflecting the Bank's strong asset coverage and performance, and preferred creditor status. The IADB's capital position, measured by the leverage ratio, has been improving over the past few years. Development-related assets represented 285% of equity in 2018. While this is slightly higher than the median for Aaa-rated MDBs of 248%, IADB compares favorably to large peers such as the World Bank (IBRD, Aaa stable) and the European Investment Bank (Aaa stable) at 450% and 632%, respectively. The IADB's capital adequacy mandate aims to ensure that the Bank has sufficient equity to enable it to maintain its Aaa rating status during times of economic distress.

The Bank's asset performance has been very strong throughout its history, curently scoring "aaa". As of year-end 2018, the nonperforming assets (NPA) ratio was 0.3%. Historically, NPLs have corresponded to the Bank's non-sovereign guaranteed loan book. However, in May 2018, the IADB announced that Venezuela had missed payments on its loans for over 180 days, placing the sovereign in nonaccrual status. This was the first sovereign to hold that designation since Suriname (B2 stable) cleared its arrears with the Bank in 2001. The IADB's extraordinary repayment record is explained by the special relationship that it enjoys with its borrowing countries, reflected by its preferred creditor status. Historically, borrowing countries have been less likely to default on IADB loans than on their financial obligations with commercial or private creditors, with only five sovereigns ever going into nonaccrual status.

We score the IADB's development asset credit quality "baa". The initial basis of our assessment is a weighted average borrower rating of Ba3. We consider that the IADB's preferred creditor status vis-à-vis its sovereign borrowers strengthens the portfolio's credit quality. Additionally, the IADB participates in an exposure exchange agreement (EEA) with the IBRD and the African Development Bank (AfDB, Aaa stable). The EEA is designed to address the IADB's main credit challenge – namely, the high degree of concentration in its lending portfolio. Ten countries consistently account for around 80% of the total (closer to 70% including the EEA), including Brazil (Ba2 stable), Mexico (A3 negative) and Argentina (Caa2 RUR-), which have historically been the Bank's largest public sector borrowers. However, the Bank has shown a declining trend in concentration levels, particularly in terms of the top three largest borrowers. The

EEA synthetically exchanges risk between the IADB, the IBRD and the AfDB, helping decrease the IADB's geographic concentration. Overall, strong capital levels on the IADB's balance sheet and active management of its concentration risks combined with the largely sovereign-guaranteed nature of its loan portfolio places the Bank's capital adequacy in a strong position.

Our assessment of **liquidity** is "aa1," recognizing the Bank's strong liquidity position as a result of a conservative liquidity risk management policy and its ample market access. We assess IADB's liquidity coverage to be strong in case of a stress scenario, which would include the Bank not being able to tap financial markets and also exclude scheduled cash inflows from shareholders. IADB's liquid resources ratio, which sizes its high-quality liquid assets relative to its net outflows from uninterrupted net loan disbursements, debt repayment and administrative costs, shows that the Bank holds enough assets to sustain its functioning for 18 months.

We consider that IADB's market access is one of the strongest within the supranational universe, scored at "aaa". The IADB maintains a relatively large borrowing program, can access market funding at low costs, has a diversified investor base by type and geography and is able to issue in over 20 currencies.

Combining capital adequacy and liquidity and funding scores, we position IADB's intrinsic financial profile at "aa3", among the highest in our rated universe. The qualitative factors that we additionally consider include an MDB's operating environment and the quality of its management. We do not apply an adjustment for the operating environment. We assign a "+1" adjustment due to the quality of management, to reflect IADB's very strong willingness and capacity to adopt best-in-class practices, and also its practice of proactive update of risk policies to adapt to changing financial and economic conditions affecting its own credit profile and that of its borrowing members

Finally, we assess **strength of member support** to be "Very High", above the scorecard indicated "High". Our score reflects the Bank's favorable member base profile, which counts as members both borrowing and non-borrowing countries. Members' willingness to provide support is very strong. Contractually, the IADB has an ample callable capital buffer in the very unlikely event of significant asset deterioration. We also consider that members have demonstrated a track record of willingness to provide extraordinary support to the Bank, through several capital increases, and also the Bank's unique ability to modify the loan charge's structure – members, including borrowing ones, have to agree to reprice the lending spread on its portfolio – to support the Bank's capital base. We also consider that members, including the United States (Aaa stable) as the largest member, have a very strong sense of ownership and assign a high economic importance to the IADB. Finally, we assess members' willingness to provide extraordinary support as very high, as reflected in members' recent capital increases and the economic scale of key member countries. This compensates for a moderate ability to support from the whole member base as reflected by a weighted average shareholder rating of Baa3.

ESG considerations

How environmental, social and governance risks inform our credit analysis of IADB

Moody's takes account of the impact of environmental (E), social (S) and governance (G) factors when assessing supranational issuers' credit profile. In the case of the Inter-American Development Bank, the materiality of ESG to the credit profile is as follows:

Environmental considerations are not material for IADB's rating. However, we note that as part of its mission, the IADB has committed to increase its lending for projects that look to address or mitigate climate change risks in the Latin American region, with a target approved by the Governors which states that 30% of the Bank's projects should have a climate change component.

Social considerations are not material for IADB's rating. We do not expect that social risks affecting its borrowers will affect IADB's capital adequacy or liquidity.

Governance is very strong and a key driver of IADB's Aaa rating. We have adjusted the quality of management upwards by one notch from the level indicated by the scorecard to reflect the IADB's superior institutional strength and best-in-class practices.

All of these considerations are further discussed in the "Detailed credit considerations" section above. Our approach to ESG is explained in our cross-sector methodology General Principles for Assessing ESG Risks. Additional information about our rating approach is provided in our Rating Methodology for Multilateral Development Banks and other Supranational Entities.

Recent developments

Balance sheet developments during H1 2019

As of 30 June 2019, loans outstanding were $94.6 billion, of which 94% corresponded to sovereign-guaranteed exposures. The bank also maintained a $18 million debt security holding for development purposes (non-sovereign guaranteed exposure), and guarantees outstanding were $559 million. These developments assets represented 283% of equity as of June 2019.

During the first half of the year, the IADB issued bonds for a total of $10.8 billion, compared to $12.6 billion in the same period last year. The average life of new issues was 5.8 years in 2019, up from 4.3 years in 2018. Total borrowings after swaps were $97.0 billion, up from $95.9 billion in June 2018.

Equity rose $656 million to $33.6 billion from December 2018, reflecting net income of $769 million, minus a $50 million distribution to the Bank's shareholders for concurrent contribution to the Inter-American Investment Corporation (IIC Aa1 stable) on behalf of the Bank's shareholders recorded as a dividend, and a $70 million reclassification of net fair value adjustments on borrowings.

Operating income during H1 2019 was $531 million ($411 million in H1 2018). This increase was mainly due to higher net interest income of $81 million (attributable to changes in instrument-specific credit risk), an increase in net investment gains of $38 million, as well as lower net non-interest expense of $14 million, which were offset by an increase in the provision for loan and guarantee losses of $31 million.

Nonaccrual status of Venezuela has very little impact

The IADB announced in May 2018 that it had placed Venezuela on nonaccrual status after the sovereign had accrued missed payments of over 180 days. The last sovereign borrower to hold nonaccrual status with the Bank was Suriname in 2001. Although Venezuela's non-payment is credit negative for the IADB, we believe the credit impact is very small given the strong policies the Bank has in place, such as not allowing disbursements or the approval of new loans until all past due amounts are fully repaid, to ensure that this type of event does not materially affect capital adequacy and liquidity metrics.

The Bank's full exposure to Venezuela ($2,011 million) was placed in nonaccrual status per its treatment of nonperforming sovereign-guaranteed loans. However, as of 30 June 2019 only $359 million (interest and principal) had been overdue by more than 180 days. Thus if we take the full exposure amount, Venezuela only accounts for 2.1% of total loans and 6.1% of equity. The Bank has $22 million in a specific loan impairment reserve to account for the potential losses on missed interest payments. Furthermore, the IADB cannot make any additional disbursements to Venezuela until all past due amounts are repaid.

Inaugural SOFR linked bond issued

On 10 September, the IADB issued its first Secured Overnight Financing Rate (SOFR) linked bond. The instrument had a size of $600 million, and a tenure of 3 years. The issue priced at par, with a coupon equivalent to SOFR + 26bps. In terms of the investor base, 86% were from the Americas, and 14% from the EMEA region. Banks (54%) were the largest investors, followed by fund managers & pension funds (25%) and central banks & official institutions (21%).

Rating methodology and scorecard factors

Rating factor grid - Inter-American Development Bank	Initial score	Adjusted score	Assigned score
Factor 1: Capital adequacy (50%)		a1	a1
Capital position (20%)		baa1	
Leverage ratio	baa1		
Trend	0		
Impact of profit and loss on leverage	0		
Development asset credit quality (10%)		baa	
DACQ assessment	baa		
Trend	0		
Asset performance (20%)		aaa	
Non-performing assets	aaa		
Trend	0		
Excessive development asset growth	0		
Factor 2: Liquidity and funding (50%)		aa1	aa1
Liquid resources (10%)		a1	
Availability of liquid resources	a1		
Trend in coverage outflow	0		
Access to extraordinary liquidity	0		
Quality of funding (40%)		aaa	
Preliminary intrinsic financial strength			aa3
Other adjustments			1
Operating environment	0		
Quality of management	+1		
Adjusted intrinsic financial strength			aa2
Factor 3: Strength of member support (+3,+2,+1,0)		High	Very High
Ability to support - weighted average shareholder rating (50%)		baa3	
Willingness to support (50%)			
Contractual support (25%)	aaa	aaa	
Strong enforcement mechanism	0		
Payment enhancements	0		
Non-contractual support (25%)		Very High	
Rating range			Aaa-Aa2
Rating			Aaa

Note: While the information used to determine the grid mapping is mainly historical, our ratings incorporate expectations around future metrics and risk developments that may differ from the ones implied by the rating range. Additional considerations that may not be currently captured by the metrics used in the scorecard can be reflected in differences between the adjusted and assigned factor scores. Thus, the rating process is deliberative and not mechanical, meaning that it depends on peer comparisons and should leave room for exceptional risk factors to be taken into account that may result in an assigned rating outside the indicative rating range.
For more information please see our Multilateral Development Banks and Other Supranational Entities rating methodology.

Moody's related publications

» **Rating Action:** Moody's affirms the Inter-American Development Bank's Aaa rating; maintains stable outlook, 22 March 2019

» **Credit Analysis**: Inter-American Development Bank, 26 March 2019

» **Rating Methodology**: Multilateral Development Banks and Other Supranational Entities, 25 June 2019

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