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Update

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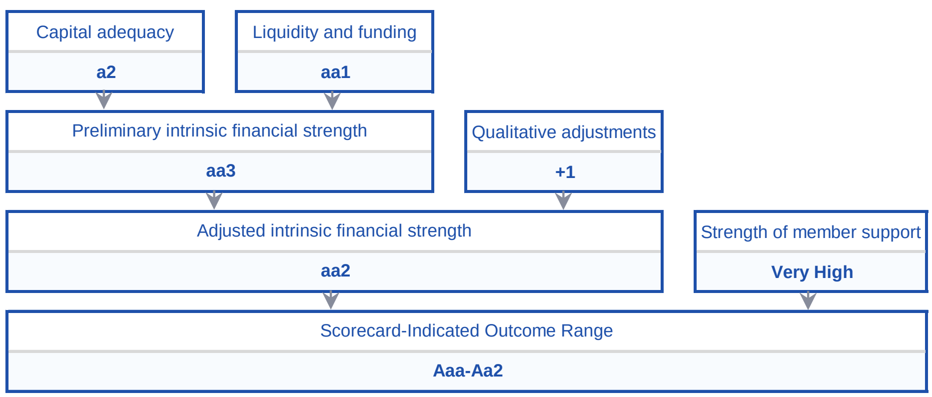
Inter-American Development Bank – Aaa stable

Update following rating affirmation, outlook unchanged

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 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 regional lending focus, although this risk is partially offset through exposure exchange programs.

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 derived from regional mandate

» Exposure to high-risk countries with volatile macroeconomic environments

Rating outlook

The stable outlook reflects our expectation that the IADB will maintain its robust financial metrics over the coming years by continuing to adhere to its capital and liquidity risk policies. Additionally, we believe the bank's shareholders will continue to support the IADB's role as a promoter of economic and social development in Latin America and the Caribbean, and that its borrowing members will continue to grant the IADB preferred creditor status.

Factors that could lead to a downgrade

Downward pressure on the rating 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 form of support to preserve its financial health. We consider these to be low-probability outcomes.

Key indicators

Exhibit 2

IADB	2015	2016	2017	2018	2019	2020
Total Assets (USD million)	111,139.0	113,325.0	126,240.0	129,459.0	136,358.0	151,737.0
Development-related Assets (DRA) / Usable Equity [1]	312.6	310.6	277.3	284.9	287.0	313.4
Non-Performing Assets / DRA	0.2	0.3	0.3	0.3	0.4	0.6
Return on Average Assets	0.9	0.8	0.5	0.7	1.0	0.4
Liquid Assets / ST Debt + CMLTD	201.6	197.0	190.8	191.5	187.9	203.5
Liquid Assets / Total Assets	25.2	24.2	26.5	24.2	25.2	23.7
Callable Capital / Gross Debt	191.1	205.3	186.5	183.4	170.0	150.0

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

Source: Moody's Investors Service

Detailed credit considerations

On 26 March, we affirmed IADB's Aaa ratings and maintained the stable outlook. The key drivers were: IADB's ability to maintain strong capital adequacy and liquidity metrics through the coronavirus pandemic and the crucial role that its policies play in allowing it to build buffers to ensure it has the capacity to support the Latin America and Caribbean region with higher lending to sovereigns in times of stress.

We assess **capital adequacy** to be "a2" reflecting the bank's strong asset coverage and performance, and preferred creditor status. The IADB's capital position, measured by the leverage ratio, deteriorated slightly on account of lending growth in response to the coronavirus pandemic. Development-related assets represented 314% of equity in 2020 up from 287% of equity in 2019 – slightly above the median for Aaa-rated MDBs of 299% in 2019. IADB's leverage is below that of large peers such as the World Bank (IBRD, Aaa stable) and the European Investment Bank (Aaa stable) at 519% and 643% (2019 figure), respectively. The IADB's capital adequacy mandate aims to ensure that it has sufficient equity to enable it to maintain its Aaa rating during times of economic distress.

The bank's asset performance has been very strong throughout its history, currently scoring "aa1." As of year-end 2020, the nonperforming assets (NPA) ratio was 0.6%. 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 (Caa3 negative) 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 in 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 at “baa.” The initial basis of our assessment is a weighted average borrower rating of B3. 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 exposure exchange agreements (EEA) with the IBRD, the African Development Bank (AfDB, Aaa stable) and the Asian Development Bank (Aaa stable). The EEAs are 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 (Baa1 negative) and Argentina (Ca negative), 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 and IBRD, AfDB and ADB, 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.

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 “aa2” after taking into account qualitative adjustment factors. At this level, IADB's intrinsic financial strength is 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 outcome of “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 take into account 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. Moreover, members, including the US (Aaa stable) as the largest member, have a very strong sense of ownership and assign 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 Ba1.

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 Latin America, with the bank's governors having approved a target of 30% of the bank's projects to include a climate change component.

Social considerations are not material for IADB's rating. While we regard the coronavirus outbreak as a social risk under our ESG framework given the substantial implications for public health and safety worldwide, we do not expect these considerations to materially affect IADB's capital adequacy or liquidity.

Governance is very strong and a key driver of IADB's Aaa rating. We recognize the IADB's quality of management to reflect its 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

IADB's coronavirus response led to higher loan approvals and leverage

The IADB's response to the pandemic involved primarily a redeployment of the existing envelope of planned lending for 2020 and a more rapid execution of undisbursed balances. Gross disbursements last year reached $14.8 billion – with a direct response of $7.9 billion – the bank's largest disbursements package since the global financial crisis. Net disbursements in 2020 reached $7.9 billion, more than double the 2019 amount and higher than in 2009 ($6.9 billion). The direct response to the pandemic prioritized both social protection as well as support for economic activity and development.

The expansion of the DRAs in 2020 contributed to an increase in the leverage ratio to 314% from 284% on average in 2017-19. Consequently, IADB's capital position now scores 'baa2' instead of the prior 'baa1' score. The IADB's capital policies have a maximum leverage limit of 400% debt/equity (and an operational one at 380%). Although the IADB still has some space to increase its operations, we expect that it will maintain the practice of growing its loans in line with its equity. This would allow the IADB's leverage to remain stable at moderate levels compared to other Aaa-rated peers.

Despite some deterioration in borrowers' credit quality, asset performance remains strong

The rating downgrades of Argentina, Mexico and Ecuador (Caa3 stable), among others, in 2020 weighed on the average quality of IADB's loan portfolio. The weighted average borrower rating fell by one notch to B3 last year. Nevertheless, despite some sovereign borrowers facing high financial stress during 2020, loan repayments were still on track, supporting IADB's preferred creditor status.

The one exception remains Venezuela. As of year-end 2020, $533 million had been overdue for more than 90 days ($492 million in 2019), out of a total exposure of $2,011 million. Even if we take the full exposure amount, Venezuela only accounts for 1.9% of total loans and 6.0% of equity. Combined with non-sovereign-guaranteed loans with payments late by 90+ days of $59 million, IADB's nonperforming assets ratio was 0.6% in 2020, up from 0.4% in 2019. At this level, IADB's asset performance now scores 'aa1' from 'aaa' previously, but is in line with the median for Aaa-rated MDBs.

IADB had record borrowing program in 2020

In the context of the pandemic, IADB's 2020 borrowing program consisted of 83 total transactions in 13 different currencies that generated proceeds of $26.8 billion, above the $20.5 billion raised in 2019. The weighted average maturity of bond issuances was 4.8 years and the overall cost was 17.2 basis points above the reference 3-month Libor rate.

IADB enjoys a diversified investor base by geography and type, which allows it to benefit from favorable funding costs. The bank has also issued in market segments, including a 5-year SOFR index-linked global bond for $1 billion and its largest ever 10-year fixed rate global sustainable development bond for $4 billion.

Rating methodology and scorecard factors

Rating factor grid - Inter-American Development Bank	Initial score	Adjusted score	Assigned score
Factor 1: Capital adequacy (50%)		a2	a2
Capital position (20%)		baa2	
Leverage ratio	baa2		
Trend	0		
Impact of profit and loss on leverage	0		
Development asset credit quality (10%)		baa	
DACQ assessment	baa		
Trend	0		
Asset performance (20%)		aa1	
Non-performing assets	aa1		
Trend	0		
Excessive development asset growth	0		
Factor 2: Liquidity and funding (50%)		aa1	aa1
Liquid resources (10%)		a2	
Availability of liquid resources	a2		
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%)		ba1	
Willingness to support (50%)			
Contractual support (25%)	aaa	aaa	
Strong enforcement mechanism	0		
Payment enhancements	0		
Non-contractual support (25%)		Very High	
Scorecard-Indicated Outcome Range			Aaa-Aa2
Rating Assigned			Aaa

Note: Our ratings are forward-looking and reflect our expectations for future financial and operating performance. However, historical results are helpful in understanding patterns and trends of an issuer's performance as well as for peer comparisons. Additional considerations that may not be captured when historical metrics are used in the scorecard may be reflected in differences between the adjusted and assigned factor scores. Furthermore, in our ratings we often incorporate directional views of risks and mitigants in a qualitative way. For more information please see our Multilateral Development Banks and Other Supranational Entities rating methodology.

Moody's related publications

- **Sector In-Depth:** Supranationals – Global: Stress-testing confirms broad resilience of MDB ratings, 1 September 2020
- **Sector Comment:** Sovereigns – Global: Rising multilateral development bank climate financing will support climate-vulnerable sovereigns' resiliency, 21 August 2020
- **Rating Methodology**: Multilateral Development Banks and Other Supranational Entities, 25 June 2019

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