Research Update:

Inter-American Development Bank 'AAA' Rating Affirmed On Institutional Strategy And Solid Capital; Outlook Still Stable

July 17, 2024

Overview

- In March 2024, the board of governors of the Inter-American Development Bank (IADB) approved a new institutional strategy for 2024-2030 aimed at expanding the IADB Group's scale and impact in development finance.

- Because it's the largest multilateral lending institution (MLI) in Latin America and a leader in innovating products and technical assistance, IADB is well placed as a cornerstone of this strategy, underscoring its unparalleled role in the region.

- We affirmed our 'AAA/A-1+' ratings on IADB.

- The stable outlook reflects the bank's sound governance and risk management, as well as our expectation that it will continue to prudently manage its capital and liquidity as it implements its new institutional strategy and expands its product mix.

Rating Action


Outlook

The stable outlook reflects our expectation that IADB will, in the next 24 months, apply sound governance and risk management as well as prudently manage its capital and liquidity, particularly as it implements its new institutional strategy and undertakes new products.

At the same time, we believe sovereign borrowing members will continue to treat IADB as a preferred creditor since it remains the main supplier of developmental financing in the region.
Downside scenario

We could downgrade IADB if other borrowers fall into nonaccrual status, indicating weaker preferred creditor treatment. A deterioration in IADB's funding and liquidity could also weaken the ratings. That said, the existing callable capital provided by IADB's highly rated sovereign shareholders would most likely mitigate erosion of the risk-adjusted capital (RAC) ratio.

Rationale

Established in 1959, IADB is a keystone member of the IADB Group. During its 2024 annual meeting, the board of governors approved a new institutional strategy for the IADB Group for 2024-2030 that underscores lending with impact, rather than volume, and emphasizes synergies among members of the group and with other MLIs.

The new strategy has three core objectives: reducing poverty and inequality, addressing climate change, and bolstering sustainable regional growth. In our view, the new strategy augments IADB's irreplaceable role and long record of fulfilling its countercyclical policy mandate.

IADB remains the largest provider of multilateral financing in the region. Loans outstanding stood at $116.2 million for 2023, and 97% of that amount is sovereign guaranteed. Approvals were $12.5 billion, and gross disbursements stood at $11.1 billion, with net disbursements of $2.9 billion. These approvals and disbursements reflected predominantly public-sector loans; new private-sector loans are now fully booked at IDB Invest.

Management expects approvals of $16.6 billion and disbursements of $10.3 billion in 2024 as lending volumes adjust upward following IADB's first full year of operation under President Ilan Goldfajn. In 2023, 95% of new approvals supported gender equality, 72% supported productivity and innovation, and 90% supported climate change mitigation and adaptation.

IADB's value proposition goes beyond lending, and the institution has looked at ways to enhance value for its members. Notably, it has introduced features in its lending products to cover financial risk caused by natural disasters. This includes Principal Payment Option clauses in $1.9 billion of its Flexible Financing Facility loans--now taken up by six countries--and it’s also exploring Principal Insurance Options.

IADB continues to work on expanding its suite of hedging services for foreign exchange, capitalizing on the favorable terms at which it can access markets and pass that on to members. The institution provides hedging solutions for commodity price risk on oil, and it’s considering additional underlying commodities like copper and gold. And it’s expanding its CAsA pilot program (capacity building, asset management, and advisory services), within which asset management operations have started for the Central Bank of Honduras. We view these initiatives at IADB as complements to its traditional business lines, and at these volumes, we think they're being managed prudently, within the confines of its risk limits.

We think shareholders will remain supportive of IADB. No major shareholder has withdrawn from IADB, and we don't expect any to do so. IADB's last capital increase--its ninth general capital increase--was approved in 2010, lifting its ordinary capital resources to roughly $170 billion from $100 billion. The recent capital increase approval for IDB Invest, in our view, doesn't signal a weakening of support for IADB given IADB's much larger size, the global focus on private-sector mobilization, and the expectation of enhanced synergies across the entire IADB Group.
The institution has a track record of conservative financial and risk measures, which strengthens its enterprise risk profile. In our view, this more than counterbalances the potential agency risk stemming from borrowing member countries having slightly more than 50% of the voting power on the bank’s board. In line with its mandate, the bank has established capital buffers to facilitate countercyclical lending.

We expect IADB’s capital ratio to remain stable, anchored in its capital management approach. Our RAC ratio for IADB was 23.1% as of December 2023 (using parameters as of July 8, 2024), up slightly from 22.1% in 2022. The increase primarily reflects improvements to sovereign ratings, and to a lesser degree, it reflects improvements to capital and a decline in operational risk; offsetting them was an increase in lending exposure. We don’t expect a RAC ratio meaningfully above 23% since IADB manages the RAC ratio above the 15% threshold.

IADB continues to implement capital optimizations to reduce sovereign exposure on its balance sheet. This includes, recently, another guarantee from the Swedish International Development Cooperation Agency (SIDA), bringing the total to $350 million; various Exposure Exchange Agreements with other MLIs, now totaling $8.1 billion; and a $300 million credit risk transfer transaction with private insurance companies. We expect further optimizations, in line with the G20 capital adequacy framework discussions. That, combined with its capital management approach via its income management model, will enable IADB to keep expanding its lending reach despite credit pressures in the region, and without downside risk to capital.

We expect IADB’s sovereign borrowers to continue to afford it preferred creditor treatment. We calculate that the sovereign arrears ratio is 1.8%, which relates to Venezuela’s entire loan balance of $2.0 billion in nonaccrual status since May 2018. We expect other members to continue treating IADB as preferred. Nonaccruals from legacy non-sovereign-guaranteed loans were $123 million at the end of March 2024, $193 million in December 2023, and $163 million in December 2022.

IADB’s funding stands out as being well diversified, both by geographic market and by type of investor, with frequent issuances in multiple markets and currencies. It issued 65 bonds in 2023 worth $18.8 billion; that activity included tapping markets with sustainable development bonds and continuing Education, Youth and Employment (EYE) bonds. While 74% of the total debt stock as of year-end 2023 was denominated in U.S. dollars, the bank has outstanding borrowings, before swaps, denominated in 10 different currencies, supporting our view that it has a global investor base. We estimate that IADB is structurally able to cover its scheduled short-term debt liabilities without recourse to new issuances.

Liquidity is prudently managed to ensure sufficient coverage of at least 12 months of debt repayments and loan disbursements with no access to capital markets. Using year-end 2023 data, our 12-month liquidity coverage ratio for IADB is 1.2x (including scheduled loan disbursements), while our six-month ratio is 2.2x. IADB’s liquidity is lower under our additional stress scenario, which takes into account 50% of all undisbursed loans coming due in the next 12 months.

We don't factor extraordinary support in the form of callable capital into our rating on IADB because it can achieve our highest assessment on its own. Nonetheless, callable capital from the bank’s highly rated shareholders would enhance our RAC ratio for IADB and mitigate the impact on the bank’s financial profile in the event its capital adequacy deteriorated. Our measure of eligible callable capital includes sovereigns rated at least equal to an MLI’s stand-alone credit profile. For IADB, this would include shareholders rated ‘AAA’, which would be equivalent to $11.9
billion.

Ratings Score Snapshot

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<tr>
<th>Issuer credit rating</th>
<th>AAA/Stable/A-1+</th>
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<tr>
<td>Stand-alone credit profile</td>
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<td>Enterprise risk profile:</td>
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<td>Policy importance</td>
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<td>Group support:</td>
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<td>Holistic approach</td>
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Related Criteria

- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, April 30, 2024
- Criteria | Governments | General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Jan. 31, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Abridged Supranationals Interim Edition 2024: Multilateral Lending Institutions Sector Updates, July 12, 2024
- Abridged Supranationals Interim Edition 2024: Comparative Data For Multilateral Lending Institutions, July 12, 2024
- Sustainability Insights: Shareholders Are Calling On Multilateral Lending Institutions To Increase Private-Sector Capital Mobilization For Climate And Development, May 28, 2024
- Credit FAQ: How Would MLIs’ Participation In Sovereign Debt Restructurings Affect Our Preferred Creditor Treatment And Ratings?, Nov. 28, 2023
- Supranationals Special Edition 2023, Oct. 12, 2023
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- Introduction To Supranationals Special Edition 2023, Oct. 11, 2023
- Inter-American Development Bank, July 28, 2023

Ratings List

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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.spglobal.com/ratings for further information. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings.