FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms CAF at 'AA-'; Outlook Stable

Wed 10 Jan, 2024 - 1:54 p. m. ET

Fitch Ratings - London - 10 Jan 2024: Fitch Ratings has affirmed Corporacion Andina de Fomento's (CAF) Long-Term Issuer Default Rating (IDR) at 'AA-' with a Stable Outlook.

A full list of rating actions is detailed below.

KEY RATING DRIVERS

SCP Drives Rating: CAF's 'AA-' rating is driven by its Standalone Credit Profile (SCP), reflecting the lower of our solvency (aa-) and liquidity (aa) assessments, and the 'medium risk' business environment in which the bank operates. CAF's 'aa-' solvency assessment balances its 'excellent' capitalisation and 'moderate' risk profile. Shareholders' ongoing capital injections under the general capital increase (GCI) programmes will support the bank's lending growth and portfolio diversification in the coming four years, supporting its ratings despite the challenging dynamics in some of its large countries of operations.

Excellent Capitalisation: CAF's 'excellent' capitalisation metrics underpin the 'aa-' solvency assessment. Fitch's usable capital to risk-weighted assets (FRA) ratio declined to 45% at end-3Q23, from 48% a year earlier, primarily due to the weakening credit quality of its loan book. CAF's leverage has remained broadly stable, with the equity-to-assets (E/A) ratio at around 30% over the past two years. In 2023, the expansion of its balance sheet was broadly matched by capital payments and internal capital generation (3.7% at end-3Q23). Capital payments also compensated a reduction in paid-in capital due to CAF's share repurchase scheme with Venezuela.

Fitch expects the FRA and E/A ratios to remain above their respective 35% and 25% 'excellent' thresholds over 2024-2026. Our projections assume an annual growth of about 5% in lending and a capital increase in line with the bank's ninth and 10th GCI programmes.

Membership Expansion: In 2023, Chile (A-/Stable), Dominican Republic (BB-/Positive) and Honduras became full members of the bank. Mexico (BBB-/Stable) and Costa Rica (BB-/Stable) are in the process of ratifying their conversion to full membership. We see CAF's expansionary strategy beyond South America and incorporation of new full members as having a positive influence on its solvency metrics via increased capital contributions and loan portfolio diversification.

Weaker Average Rating of Loans: The weighted average rating of loans and guarantees (WARLG) has declined to 'B' from 'B+' over the last 12 months. This follows the rating downgrades of the three largest borrowers, Argentina (CC; 14% of total loans as of end-3Q23), Bolivia (B-/Negative; 9%) and Ecuador (CCC+; 13%).

Fitch forecasts the WARLG to remain stable despite CAF's strategy to diversify the portfolio and reduce the Venezuelan exposure. The WARLG is resilient to potential downgrades of sovereigns whose ratings are on Negative Outlook (accounting for 21% of the bank's country exposures). CAF's 'excellent' preferred creditor status (PCS), based on its very strong record of loan repayments and its low exposure to the non-sovereign sector (6% of loans), translates into an uplift of three notches above the WARLG to 'BB'.

Reducing Non-Performing Loans (NPLs): NPLs have continued to decline moderately in 2023, with Fitch's own measure of the NPL ratio decreasing to 7.4% at end-3Q23 from 8.6% at end-2022 (and 10.1% at end-2021). The declining trend is driven by an increase in the size of its loan book and a reduction in its exposure to Venezuela as per the share repurchase transaction in lieu of principal and interest payments. Although CAF does not consider the Venezuelan exposure as non-performing, Fitch treats it as an NPL as we believe the transaction reduces the bank's equity in a way similar to a write-off. Fitch expects the NPL ratio to fall towards the 'moderate' threshold of 6% over the medium term.

Concentration to Lowly-Rated Sovereigns: The concentration of CAF's loan portfolio to a few lowly-rated sovereigns has been a rating weakness for the bank, although diversification is improving. The five largest exposures accounted for 55% of the banking portfolio as of end-3Q23 (versus 58% a year ago, and 56% in 2021).

Strong Liquidity: CAF's 'aa' liquidity assessment reflects its 'strong' liquidity buffers and 'moderate' quality of treasury assets. The coverage of short-term debt by liquid assets was 117% at end-3Q22, up from 106% a year ago, but remaining below the 'excellent' threshold (150%). The credit quality of the treasury portfolio improved with the share of 'AAA' and 'AA' rated assets rising to 48% at end-3Q23 from 34% at end-3Q22. Fitch expects the share of 'AAA' and 'AA'-rated treasury assets to remain consistent with a 'strong' assessment (below 40%) over the medium term. CAF's liquidity profile is enhanced by its 'strong' access to capital markets.

Medium Risk Business Environment: Fitch's 'medium' risk business environment assessment for CAF balances the importance of the bank's public mandate, as evidenced by the large capital increase (10th GCI of USD7 billion paid-in capital) approved in 2022, and the 'high' credit and political risks in its countries of operations. Initially focused on the Andean region, CAF has expanded its scope of operations to include most Latin American countries, with outstanding loan operations in 17 countries.

No Support Uplift: CAF's rating does not benefit from a credit uplift for shareholder support. Fitch assesses extraordinary support from shareholders at 'bb-', reflecting the weighted average rating of key shareholders (BB-) and the 'strong' propensity from shareholders to support the bank. The latter is underlined by the importance of the bank for its shareholders and regular capital increases.

National Scale Rating: CAF's Long-Term IDR is materially above Mexico's sovereign rating, therefore the bank's issue rating on the Mexican national rating scale is 'AAA(mex)'.

RATING SENSITIVITIES

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

Solvency (Risks): A weakening in our assessment of the bank's 'moderate' risk profile, which could stem from a deterioration in credit risk. This could result from a default by one of CAF's sovereign borrowers, which would be a breach of the bank's PCS and could lead the NPL ratio above the 6% 'high risk' threshold on a sustained basis. This could also result from the WARLG falling below 'B-'.

Solvency (Capitalisation): A decline in capitalisation ratios that could affect our 'excellent' capitalisation assessment. This could be due to delays on capital payments leading to either the FRA or the equity-to-assets ratios falling close to or below their respective 35% and 25% 'excellent' thresholds.

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

Solvency (Risks): A significant improvement in CAF's 'credit risk' profile, as reflected in a WARLG above 'B+' and a material reduction in the NPL ratio towards the 3% 'low risk' threshold.

Solvency (Risks): Continued improvement in the bank's concentration risk metrics, as reflected in lower exposure to distressed sovereigns and greater diversification in the loan book. A decline in the five largest exposures as a share of total banking exposure closer to the 'low' risk threshold of 40%, from 55% currently, would be positive for the rating.

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.

ESG CONSIDERATIONS

CAF has an ESG Relevance Score of '4' for 'Governance Structure'. A high share of capital ownership by borrowing countries (above 90%) have influenced the bank's lending strategy towards large shareholders with weak credit fundamentals at the expense of diversification and prudent lending growth. This has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

CAF has an ESG Relevance Score of '4' for 'Rule of Law, Institutional and Regulatory Quality'. All supranationals attract a score of '4' as they are neither subject to bank regulation nor supervised by an external authority. Instead, supranationals comply with their own set of prudential limits. Fitch pays particular attention to these internal prudential policies, including the bank's compliance with them. This has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation of the materiality and relevance of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY / DEBT	RATING	PRIOR

Corporacion Andina de Fomento (CAF)	LT IDR AA- Rating Outlook Stable Affirmed		AA- Rating Outlook Stable
	ST IDR F1+ Affirmed		F1+
senior unsecured	LT AA- Affirmed		AA-
senior unsecured	ST F1+ Affirmed		F1+
senior unsecured	Natl LT AAA(mex) Affirmed		AAA(mex)

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

National Scale Rating Criteria (pub. 22 Dec 2020)

Metodología de Calificaciones en Escala Nacional (pub. 22 Dec 2020)

Supranationals Rating Criteria (pub. 11 Apr 2023) (including rating assumption sensitivity)

Metodología de Calificación de Supranacionales (pub. 12 May 2023)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Corporacion Andina de Fomento (CAF)	UK Issued, EU Endorsed

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