FitchRatings

Fitch Downgrades Corporacion Andina de Fomento to 'A+'; Outlook Negative

Fitch Ratings - London - 22 January 2020:

Fitch Ratings has downgraded Corporacion Andina de Fomento's (CAF) Long-Term IDR to 'A+' from 'AA-'. The Outlook is Negative.

Fitch has affirmed CAF's Long- and Short-Term IDRs on the Venezuelan national scale at 'AAA(ven)/Stable' and 'F1+(ven)', respectively, and withdrawn the ratings. Fitch is withdrawing CAF's Venezuelan national-scale ratings of CAF as it is no longer considered by Fitch to be relevant to the agency's coverage.

Key Rating Drivers

The downgrade and Negative Outlook reflects Fitch's view that CAF's risk profile is deteriorating. Venezuela continues to experience payment delays on its obligations to CAF and has been overdue on its capital commitments since 2018. The credit quality of the loan portfolio has deteriorated since the last review, as evidenced by the downgrades of the sovereign ratings of Argentina ('CC' from 'B' at the last review) and Bolivia ('B+'/Negative from 'BB-'), CAF's largest and fourth-largest sovereign exposures, respectively. The Negative Outlooks on four of CAF's sovereign borrowers (accounting for 20% of the loan portfolio) with no offsetting borrowers on Positive Outlooks highlights the risk of further deterioration in the risk profile.

CAF's 'A+' Long-Term IDR reflects its intrinsic credit quality. The downgrade to 'A+' has been driven by a revision of the bank's solvency assessment to 'aa-' from 'aa'. Fitch assesses CAF's intrinsic rating at 'a+', reflecting a solvency assessment of 'aa-' and a one-notch downward adjustment for a 'high-risk' business environment. CAF's liquidity assessment is 'aa+'.

In Fitch's view, CAF's overall risk profile is 'moderate', balancing the bank's excellent track record of preferred creditor status (PCS) on its sovereign loans against a concentrated exposure to a number of lowly-rated sovereigns. By Fitch's estimate, the weighted average rating of CAF's loan portfolio had deteriorated to 'B' as of end-September 2019 from 'B+' at the previous review. This was driven by several sovereign downgrades in Latin America (with no offsetting upgrades) and increased exposure to sub-investment grade sovereigns.

The strength of CAF's PCS, which has been maintained through various financial crises in the region since CAF's inception in 1970, and minimal non-performing private sector loans since 2006, mitigates the weaker credit quality of CAF's borrowers. Nevertheless, Venezuela (14.2% of the loan book as of end-September 2019) has periodically experienced payment delays since 2018.

Exposure to Argentina (14.5% of loans to the sovereign), Ecuador (B-/Stable; 13.4%) and Venezuela, continued to increase in nominal terms and as a percentage of the loan book during 2019 as CAF supported the IMF programmes of the former two and provided positive net disbursements to Venezuela. The five largest banking exposures represented 57% of the total as of end-September 2019. Fitch expects a gradual decline in concentration levels over the medium term as CAF incorporates new full members.

Fitch assesses CAF's capitalisation as 'excellent', which underpins the 'aa-' solvency assessment. CAF's equity/adjusted assets ratio averaged 29.7% over 2014-2018 as sustained capital contributions and steady internal capital generation kept pace with balance sheet growth. As of end-September 2019, this figure slightly increased to 31.3%. We expect it to remain around current levels through 2022, driven by broadly stable net loan growth (2014-2018: 6.9% per year), which will be supported by fresh capital from shareholders and internal capital generation.

In line with Fitch's updated Supranationals Rating Criteria, CAF's capitalisation is now also assessed via Fitch's usable capital to risk-weighted assets (FRA) ratio, at 41% as of end-September 2019, above the threshold for an 'excellent' assessment (35%).

CAF's risk management framework is assessed as 'strong' given the bank's operations are consistently well within its self-imposed capital adequacy, lending, borrowing and liquidity policy limits, which have recently been tightened and the risk management function further enhanced. CAF has limited exposure to market risk due to its extensive use of derivatives to hedge its interest rate and foreign currency risks.

Fitch assesses CAF's liquidity as 'aa+', underpinned by its strong liquidity buffer. CAF's liquidity cushion is in line with higher-rated multilateral development banks (MDBs) as liquid assets covered 2.7x of short-term debt at end-September 2019. By CAF's own estimates, the bank has sufficient liquidity to meet 24 months of net cash requirements. Fitch expects CAF's liquidity to remain at similar levels over the medium term. The bank's sound liquidity profile is also supported by its excellent access to capital markets.

The 'high risk' business environment primarily reflects the low credit quality and high political risk of in the countries of operations (based on the World Bank Governance indicators). This is somewhat offset by the high importance of CAF's public mandate, evidenced by regular subscription and payment of capital increases by member states and a stellar sovereign repayment record in the MDB's history. Governance standards are in line with those of other sub-regional MDBs.

Consistent with Fitch's Supranationals rating criteria, potential support from shareholders is not currently a factor in the overall rating. The weighted average rating of CAF's shareholders is 'BB-'. Although callable capital does not cover net debt, Fitch views propensity to support as strong, which is evidenced by recurring capital increases from shareholders.

CAF's Short-Term IDR of 'F1+' reflects our liquidity assessment of 'aa+' which is higher than 'aa-', the minimum liquidity assessment at which the higher of two Short-Term rating options (F1+ or F1) would apply for the 'A+' Long-Term IDR.

CAF's Long-Term IDR is materially above Mexico's sovereign rating (BBB/Stable), therefore the MDB's issue rating on the Mexican national rating scale is 'AAA(mex)'.

RATING SENSITIVITIES

The factors that could, individually or collectively, lead to a downgrade are:

- Continued deterioration in credit risk and/or a stress situation in a member country that significantly affects asset quality. This would occur if Venezuela's arrears reach 180 days or if the weighted average rating of CAF's loan portfolio declines;

- A prolonged and significant decline in capitalisation related to asset losses or fast growth in operations without offsetting increases in equity;

- A negative change in Fitch's assessment of CAF's business environment due to a lack of stabilisation in Venezuela's political environment, combined with weaker credit quality in CAF's countries of operations.

The factors that could, individually or collectively, lead to a stabilization of the Outlook on CAF's IDR include:

- Stronger than expected capitalisation levels over our forecast horizon;

- Improved confidence that Venezuela will continue to honour its debt service obligations on time;

- Positive rating action on CAF's main borrowers or increased diversification toward more highly rated sovereigns, which support an improvement in the bank's overall credit risk profile.

Key Assumptions

The ratings and Outlook are sensitive to a number of assumptions as follows:

- Member countries, even if experiencing severe difficulties, will continue to respect CAF's preferred creditor status in the context of their debt service payments.

- CAF will abide by its conservative risk management policies and limits.

Sources of Information

The sources of information used to assess these ratings were CAF's financial statements and other information provided by CAF.

RATING ACTIONS

ENTITY/DEBT	RATING		PRIOR
Corporacion Andina de Fomento (CAF)	LT IDR A+ Downgrade		AA-
	ST IDR F1+ Affirmed		F1+
	Natl LT AAA(ven) Affirmed		AAA(ven)
	Natl LT WD(ven) Withdrawn		AAA(ven)
	Natl ST F1+(ven) Affirmed		F1+(ven)

	Natl ST WD(ven) Withdrawn		F1+(ven)
senior unsecured	LT A+ Downgrade		AA-
senior unsecured	ST F1+ Affirmed		F1+
senior unsecured	Natl LT AAA(mex) Affirmed		AAA(mex)

Additional information is available on www.fitchratings.com

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Applicable Criteria

National Scale Ratings Criteria (pub. 18 Jul 2018)
Metodología de Calificaciones en Escala Nacional (pub. 02 Aug 2018)
Supranationals Rating Criteria (pub. 23 May 2019)
Metodología de Calificación de Supranacionales (pub. 09 Aug 2019)

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