MOODY'S

Rating Action: Moody's affirms Corporacion Andina de Fomento's Aa3 rating; maintains stable outlook

17 May 2023

New York, May 17, 2023 -- Moody's Investors Service (Moody's) has today affirmed Corporacion Andina de Fomento's (CAF) Aa3 long-term issuer and foreign-currency senior unsecured ratings, and maintained the stable outlook.

Moody's also affirmed CAF's foreign-currency senior unsecured MTN program rating and the foreign-currency senior unsecured shelf rating at (P)Aa3. The other short-term rating, the foreign-currency commercial paper and backed commercial paper ratings have been affirmed at Prime-1 (P-1), while the foreign-currency short-term program rating has been affirmed at (P)P-1.

The decision to affirm the ratings reflects the following key drivers:

1) CAF's intrinsic financial strength remains robust with stable asset performance, and strong capital buffers and liquidity, despite continued challenges from low borrower quality and the likely incurrence of NPLs from Venezuela beginning in 2024.

2) An improved member support with the recent incorporation of Chile as a full member and the largest capital increase in CAF's history.

The stable outlook reflects Moody's expectation that CAF's capitalization and liquidity levels will remain consistent with its Aa3 rating, as CAF continues to expand its operations, balancing loan growth with adequate liquidity and capitalization buffers, while successfully managing operating and credit risks from its exposure to Venezuela.

RATINGS RATIONALE

RATIONALE FOR AFFIRMATION OF Aa3 RATING

FIRST DRIVER: CAF'S INTRINSIC FINANCIAL STRENGTH REMAINS ROBUST WITH STABLE ASSET PERFORMANCE, AND STRONG CAPITAL BUFFERS AND LIQUIDITY, DESPITE CONTINUED CHALLENGES FROM LOW BORROWER QUALITY AND THE LIKELY INCURRENCE OF NPLS FROM VENEZUELA BEGINNING IN 2024

CAF's robust intrinsic financial strength continues to reflect strong asset performance and high levels of paid in capital that underpin solid capital adequacy. Ample liquidity coverage and uninterrupted access to capital markets support Moody's assessment of CAF's very strong liquidity and funding.

CAF's leverage – measured as the ratio of its (development-related assets + treasury assets rated A3 or lower) to equity – at about 235% has remained stable and well in line with the median for Aa-rated multilateral development banks. In recent years, despite a deterioration in the credit quality of its development assets as Latin American sovereigns experienced higher credit challenges following the pandemic shock, CAF has continued to benefit from its preferred creditor status on its sovereign exposures even as some stressed borrowers restructured market debt. Consequently, CAF's asset performance has also remained strong with the exception of some non-performing loans (NPLs) from private sector borrowers and a small amount of equity impairments. Non-performing assets (NPAs) remain well below 1% of total assets at 0.4% as of end-2022.

CAF also maintains an ample liquidity buffer, which would cover over 24 months of net cash outflows even in a stress case in which the bank would be unable to access financial markets. The bank's liquidity is also supported by its stron market access, diversified investor base by type and geography, as well as the various markets it can tap and various types of bonds it issues, including sustainable instruments.

CAF's loan exposure to Venezuela (C senior unsecured) represented 8.1% of the total lending portfolio, the fifth larges behind Ecuador (Caa3 stable), Argentina (Ca stable), Colombia (Baa2 stable) and Bolivia (Caa1 RUR) and a strong decrease from 2019 when it represented 13.8% of the portfolio. In anticipation of the potential incurrence of NPLs from Venezuela, CAF devised a so-called Support Program for Liquidity Management in Exceptional Situations. The program allows CAF to repurchase Venezuela's shares in the corporation and apply those proceeds toward debt service owed by the sovereign to CAF. By the end of 2022 the plan had reduced Venezuela's shareholding in CAF to 5.4% from just under 16% in 2019. The Program has since been closed and is not available to any other borrowers.

Despite implementing the unconventional mechanism that reduces Venezuela's capital and loans, CAF's balance sheet has not compressed. This reflects CAF's continued profitability, inflow of fresh capital from its general capital increase programs and the expansion of the membership base. However, Moody's anticipates that Venezuela's capital will be exhausted in 2024, and that CAF will begin registering NPLs (defined as loans 90 days or more past due) from Venezuela in the second half of 2024. Moody's estimates that CAF's asset performance will deteriorate gradually from 2024 through 2030 as the bulk of the outstanding loans to Venezuela come due, with NPLs rising to just under 4% of the total loan portfolio by 2030, even as regular lending operations continue to expand at modest rates. The deterioration in asset performance will weigh on CAF's capital adequacy but is unlikely to lead to a deterioration of CAF's creditworthiness so long as CAF continues to maintain prudent financial and liquidity risk policies.

SECOND DRIVER: AN IMPROVED MEMBER SUPPORT WITH THE RECENT INCORPORATION OF CHILE A A FULL MEMBER AND THE LARGEST CAPITAL INCREASE IN CAF'S HISTORY

Member support has strengthened and is another element that backs CAF's credit profile. This is reflected by the continued expansion of the membership base and the $7 billion general capital increase approved in 2022, the largest in the institution's history, that will add to CAF's $9.8 billion paid-in capital. The general capital increase will be fully allocated to paid-in capital (as there is no callable capital allocation from the new capital) and will enable CAF to further expand its operations while maintaining balanced credit metrics. The vast majority of CAF's capital is paid in.

In March 2023, Government of Chile (A2 stable) became a full member of CAF, with the sovereign pledging $1.5 billion in paid-in capital and $122 million in additional callable capital. In addition to gradually buffering CAF's capital position and increasing its lending capacity as Chile pays in its pledged contributions over time, CAF adds what will be its highest-rated member with a strong ability to provide support.

RATIONALE FOR STABLE OUTLOOK

The outlook on the rating is stable, reflecting Moody's expectation that CAF will maintain its robust financial metrics over the coming years by continuing to adhere to its prudent capital and liquidity risk policies, such that CAF's capitalization and liquidity levels will remain consistent with its Aa3 rating. As CAF continues to expand its operations, Moody's expects that CAF will balance loan growth with adequate liquidity and capitalization buffers, while successfull managing operating and credit risks from its exposure to Venezuela.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE CONSIDERATIONS

CAF's credit impact score is neutral-to-low (CIS-2) reflecting a moderately negative environmental risk exposure as well neutral-to-low exposures to social and governance risks. CAF's mission is to support sustainable development and economic integration among its shareholders by helping them diversify their economies, making them more competitive and more responsive to social needs. The effectiveness in the fulfillment of CAF's development mandate within its operating region has led to strengthened member support in the form of various, continued, general capital increases reflecting the strong sense of ownership among members and the value that they derive from the institution in addressing environmental, social and governance challenges.

CAF's environmental issuer profile score is moderately negative (E-3) as a result of carbon transition risks through its lending exposure within hydrocarbon-producing countries in Latin America. These risks affect CAF's balance sheet indirectly given that CAF has had a longstanding commitment to developing sustainable projects, including hydroelectric generation and clean energy. Exposure to other environmental risks is neutral-to-low, reflecting CAF's diversified lending exposures throughout Latin America.

CAF's social issuer profile score is neutral-to-low (S-2) reflecting a strong track record of customer relations that has helped the institution grow its member base and lending portfolio substantially. CAF's public consultation processes are an integral part of its lending decision and include affected communities and key stakeholders, which supports our assessment of responsible production.

CAF's governance issuer profile score is neutral-to-low (G-2) reflecting its prudent risk management and the pro-active approach to dealing with problematic loan exposures.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

FACTORS THAT COULD LEAD TO AN UPGRADE

Upward credit pressure on CAF's rating is unlikely, save if CAF were to meaningfully reduce its exposure to its lowest rated borrowers, decrease its leverage, and if its capitalization and liquidity ratios improved significantly. The inclusion of new, highly rated non-borrowing members responsible for a significant amount of capital, which reduced the correlation between members and assets, would also support improved creditworthiness.

FACTORS THAT COULD LEAD TO A DOWNGRADE

Downward credit pressure would arise if asset quality were to deteriorate materially due to credit events involving borrowers other than Venezuela, given that if large borrowers were to fall into arrears on their obligations to CAF, this would challenge the notion of CAF's preferred creditor status. Additionally, negative credit pressures would arise if CAF were to experience an erosion of its capital and liquidity buffers due to a rapid expansion of its loan book not sufficiently compensated for by additional capital contributions.

The principal methodology used in these ratings was Multilateral Development Banks and Other Supranational Entities Methodology published in October 2020 and available at https://ratings.moodys.com/rmc-documents/69182. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

The weighting of all rating factors is described in the methodology used in this credit rating action, if applicable.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

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