FitchRatings

Fitch Affirms Caribbean Development Bank at 'AA+'; Outlook Stable

Fitch Ratings-London-05 March 2019: Fitch Ratings has affirmed Caribbean Development Bank's (CDB) Long-Term Issuer Default Rating (IDR) at 'AA+' with a Stable Outlook and Short-Term IDR at 'F1+'.

KEY RATING DRIVERS
The affirmation and Stable Outlook reflects CDB's intrinsic credit quality with solvency and liquidity assessed at 'aa+' and 'aaa', respectively. Fitch now assesses CDB's business environment as 'medium risk', comprising a 'medium risk' business profile and a 'medium risk' operating environment.

CDB's 'aa+' solvency assessment is underpinned by its 'excellent' capitalisation with an equity-to-adjusted-assets and guarantees ratio of 52% at end-2018 and its 'excellent' preferred creditor status (PCS). Fitch expects this metric to deteriorate to 40% by 2022, but to remain well above Fitch's 25% threshold for an 'excellent' capitalisation assessment. The rise in leverage is in line with the bank's projected loan growth (around 10% per year over the forecast period), which will largely be funded by debt.

Fitch considers CDB's overall exposure to risks as 'low', chiefly owing to the bank's 'very low' non-performing loan (NPL) ratio (0.4% at end-2018), 'very low' equity risk (no equity participations), 'very low' market risk, and excellent risk management policies. This balances the bank's 'moderate' concentration risk and weak credit quality of borrowers.

In our view, CDB benefits from 'excellent' PCS on sovereign exposures (96% of total banking exposure at end-2018). Our assessment is backed by the track record of borrowing member countries (BMCs) honouring their obligations to the bank when in default to other creditors. CDB manages various relatively large concessional funds, which are separate from its ordinary capital resources (OCR). These funds increase the bank's financing capabilities to BMCs, and ultimately increases BMCs' incentive to repay the bank on their OCR obligations. Further, CDB is an important source of financing for the region, especially for smaller Caribbean states with limited access to multilateral financing.

The PCS was recently tested successfully with Barbados (NR), when the sovereign agreed to honour the repayment of its loans to CDB while restructuring its debt to private creditors. In conjunction with the IMF and IADB (AAA/Stable) CDB agreed on a debt assistance package, which increased its exposure to the sovereign to 16.4% of total loans at end-2018 (from 10.0% a year ago), surpassing its exposure to Jamaica (B+/Stable /16.3% of total loans at end-2018). The agency expects a moderate rise in the bank's exposure to Barbados over the rating horizon, putting some pressure on the average rating of loans (B- at end-2018) and concentration risk metrics, although we expect the average rating of loans (pre-PCS adjustment) to remain at 'B-' over the forecast period.

Concentration risk represents the main rating weakness. CDB's top five borrowers accounted for 56.5% of total banking exposures at end-2018. This is a 'moderate' level based on Fitch's Supranational Rating Criteria. However, Fitch notes that concentration risk is inherently higher than peers with comparable metrics given the geographical proximity and correlation between BMCs' economies.

Fitch assesses CDB's liquidity at 'aaa'. This assessment is driven by the 'excellent' credit quality of the bank's treasury portfolio, conservative policies on asset-liability-management, and the long-term structure of its borrowings. Less than 20% of CDB's borrowings at end-2018 mature within the next three years, with no significant debt maturities until 2022.

Fitch now considers CDB's business environment as 'medium risk' in light of the situation in Barbados and the bank's more aggressive growth strategy, including further disbursements to Barbados, which remains in default to external creditors. The revision is specifically driven by a reassessment of the bank's business profile risk to 'medium' from 'low'. We expect Barbados to continue to honour the bank's PCS and this is captured in our assessment of the bank's PCS as 'excellent'. Our assessment of CDB's business profile also reflects the bank's sovereign focus, excellent quality of governance, and our 'low risk' assessment of the importance of its public mandate. The bank's relevance to shareholders is evidenced by the high share of sovereign financing relative to total financing of BMCs. CDB's operating environment is constrained by the relatively weak credit quality of borrowers in its countries of operations and the region's vulnerability to adverse weather events.

In line with Fitch's Supranationals Rating Criteria, Fitch now includes eligible 'A' rated treasury assets in its calculation of net debt in relation to callable capital. As of end-2018, CDB's net debt was covered by callable capital from shareholders rated at least 'AA-'. However, Fitch expects the coverage to fall to 'BBB-' by 2022 as debt increases and callable capital remains static, barring any potential capital increase. That said, the capacity and propensity of extraordinary support from shareholders is not currently a factor in the ratings.

RATING SENSITIVITIES
The Stable Outlook reflects Fitch's expectation that CDB's credit profile will remain commensurate with its 'AA+' rating.

Developments that could, individually or collectively, trigger positive rating action are:
- A material improvement in concentration risk or asset quality metrics, potentially driven by greater exposure to higher rated borrowers.

Conversely, developments that, individually or collectively, could trigger negative rating action are:
- Deterioration in the bank's solvency assessment. This could result from increased concentration risk, a breach of PCS, or an increase in the bank's risk profile driven by higher non-sovereign exposures.
- Deterioration of the bank's business environment.

KEY ASSUMPTIONS
The ratings and Outlook are sensitive to a number of assumptions:
- The bank's risk management policies will remain unchanged and no breach is expected.

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- Sources of information - The source(s) of information used to assess these ratings were the CDB's financial statements, and other information provided by CDB.

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Additional information is available on www.fitchratings.com
Applicable Criteria
Supranationals Rating Criteria (pub. 24 May 2018)

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