Research Update:
Eurasian Development Bank Affirmed At 'BBB-/A-3' And 'kzAAA'; Outlook Remains Stable

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Overview

• After several years of zero growth, Eurasian Development Bank (EDB)'s loan portfolio increased significantly in 2018, causing the bank's risk adjusted capital (RAC) ratio to significantly drop.

• The loan portfolio increase was financed by multiple placements in local capital markets, improving our view of EDB's ability to attract financing, particularly in Kazakh tenge, which balances the lower capital positon.

• We are therefore affirming our 'BBB-/A-3' issuer credit ratings on EDB.

• The stable outlook reflects our expectation that EDB's RAC ratio will remain at its new, still relatively robust, 15%-23% level in the next 12-24 months and that the loan portfolio will continue demonstrating some growth.

Rating Action

On Oct. 3, 2018, S&P Global Ratings affirmed its 'BBB-/A-3' long- and short-term issuer credit ratings on Eurasian Development Bank (EDB). The outlook remains stable. At the same time, we affirmed our Kazakhstan national scale rating on EDB at 'kzAAA'.

Rationale

Our ratings on EDB incorporate our view of the bank's financial profile as very strong and business profile as very weak. These assessments lead us to derive a stand-alone credit profile (SACP) of 'bbb-'.

EDB's current investment portfolio increased significantly, by 29%, in the first half of 2018 to $3 billion, driven by 11 new projects ($653 million) and increased disbursements to the existing projects. While we expected growth this year, the significant increase was clearly beyond our expectations. We note that it partly relates to other multilateral lending institutions (MLIs) having reduced activities in Russia. However, this increase in exposure and growing concentration has weakened the bank's risk-adjusted capital (RAC) ratio. EDB's RAC ratio after adjustments specific to MLIs decreased to 21% as of end-June 2018 from 27.6% as of end-June 2017 and we believe the loan portfolio remains limited in terms of geographic reach and concentrated in terms of industry and single names.
The criteria correction explained in "Criteria For Assessing Bank Capital Corrected," published on July 11, 2017, on RatingsDirect, is not factored into the RAC ratio after diversification. The impact of the correction on the ratio is not material to the rating.

While a significant increase in the loan portfolio is generally a negative for the RAC ratio, it can be accompanied by a positive consideration for an institution's business profile and more specifically its role and public policy mandate. Historically, in the case of EDB, we have observed a volatile development of the loan portfolio (the on-balance loan portfolio dropped by 30% in 2015 compared with 2014) and underperformance against targets in subsequent years. We have also taken note of the very limited geographic diversification outside Russia and Kazakhstan. We are therefore cautious to incorporate meaningful improvements until we have more solid evidence that the recent increase will rest on strong foundations and that EDB's role is cemented as an impactful provider of financing to private sector development projects. Nevertheless, when taking into consideration the ambitious pipeline, with a main focus on Russia, we project further moderate growth of the portfolio in the medium term, which could help EDB by strengthening its policy importance.

Our assessment of an improving funding position balances the deterioration of the RAC ratio. Over the past few years, we have seen a gradual increase in EDB's bond issuance. After a gap of more than a year due to a tenge (KZT) liquidity deficit in Kazakhstan's local bond market, on May 24, 2017, EDB issued KZT15 billion ($41 million) of three-year bonds. This was followed by another issuance of KZT20 billion in October 2017 and three more issuances of tenge-denominated three-year bonds with a total value of KZT50 billion in June 2018. While the Kazakh local bond market is narrow and shallow (representing less than 15% of GDP), we see the recent surge as relatively stable although we acknowledge the historical volatility of the tenge market. In addition EDB attracts funding in U.S. dollars and Russian ruble and we believe it will continue to be able to access funds in different currencies at reasonable rates.

EDB has historically maintained a conservative liquidity management policy. On June 30, 2018, liquid assets totaled $1.478 billion, or 42% of its balance sheet. This enabled the bank to meet its policy target, which stipulates that liquid assets should cover not less than one year’s projected net loan disbursements (loans disbursed less repayments) if greater than zero, less bilateral commitments, plus the annual cost of financial debt. Our stressed 12-month liquidity ratio indicates that EDB would be able to continue providing scheduled loans in the next year, even if market access closed.

We note that economic pressures on EDB's main shareholders, Russia and Kazakhstan, have abated. On Feb. 24, 2018, we raised the ratings on Russia to 'BBB-/A-3' from 'BB+/B' and on Sept. 8, 2017, we revised the outlook on Kazakhstan to stable from negative. We believe this should be positive for the quality of the loan book going forward. Over the past couple of years, EDB has
actively worked to improve the quality of its loan exposures and the situation has improved significantly. On June 30, 2018, nonperforming loans (NPLs, defaulted and overdue more than 90 days) stood at $28 million, representing 1.4% of EDB's on-balance portfolio, down from 6% at end-2016. In line with management's expectations, we don't anticipate this ratio will rise over the next 12-24 months.

We assess EDB's business profile as very weak, based on its limited policy importance, in our view.

Established in 2006 by an intergovernmental agreement, EDB is owned by the Russian Federation (66%), Kazakhstan (33%), Belarus (1%), Armenia (0.01%), Tajikistan (0.03%), and Kyrgyzstan (0.01%). It is the key MLI for the Eurasian Economic Union (EAEU) countries and manages a separate $8.5 billion fund for balance-of-payment support.

EDB manages the Eurasian Fund for Stabilization and Development (EFSD), which was established specifically to address the impact of the global financial crisis on member states of the EAEU. In our view, EDB's role as the manager of the EFSD, which has $8.5 billion under management, underscores its importance for member states, in particular for Russia, the dominant member. EDB had disbursed $4.6 billion in loans as of June 30, 2018, $4.2 billion of which was to Belarus. The EFSD, which provides budgetary and balance-of-payments support to member states, as well as financing national and regional projects, has its own balance sheet, managed separately from EDB's balance sheet.

Our ratings on EDB do not incorporate any uplift for callable capital. Although callable capital can, in principle, enhance an MLI's SACP and result in a higher issuer credit rating, we factor in no explicit uplift in EDB's case.

**Outlook**

The stable outlook reflects our expectation that EDB's RAC ratio will remain at its new, still relatively robust, 15%-23% level in the next 12-24 months and that the loan portfolio will continue demonstrating some growth. We also factor in continued stable access to funding markets that might underpin portfolio growth.

We could raise the ratings if EDB were to strengthen its mandate and policy importance through sustainable growth in its current investment portfolio, while the capital position remains very strong.

We could consider a negative rating action if EDB's asset quality deteriorates or if the RAC ratio falls below 15%, all else being equal.
Related Criteria

- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria - Governments - General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Nov. 26, 2012
- Criteria - Financial Institutions - Banks: Multilateral Lending Institutions Capital Methodology And Assumptions, Dec. 6, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Eurasian Development Bank National Scale Rating Raised To 'kzAAA' After Criteria Review; Removed From UCO, July 12, 2018
- Research Update: Russia Ratings Raised To 'BBB-/A-3' On Prudent Policy And Improved Monetary Transmission; Outlook Stable, February 24, 2018
- Research Update: Eurasian Development Bank Rating Affirmed At 'BBB-/A-3'; Outlook Remains Stable, October 12, 2017
- Research Update: Kazakhstan 'BBB-/A-3' Ratings Affirmed; Outlook Stable, Sep 07, 2018

Ratings List

Ratings Affirmed

Eurasian Development Bank
Issuer Credit Rating BBB-/Stable/A-3
Kazakhstan National Scale kzAAA/--/--
Senior Unsecured BBB-

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