Overview

- Although Eurasian Development Bank (EDB) has meaningfully slowed its loan portfolio growth, we continue to see persisting pressure on EDB's capitalization from the impacts of future sizable projects and concentration.
- This pressure could build up, leading us to negatively reassess EDB's capital position.
- We therefore maintained the outlook on EDB at negative, and affirmed our 'BBB/A-2' ratings.

Rating Action


At the same time, we affirmed our ‘kzAAA' Kazakhstan national scale rating on EDB and our ‘BBB' issue ratings on the bank’s senior unsecured bonds.

Rationale

The negative outlook continues to reflect our view of the persisting pressure on EDB's capital position. Significant growth of the lending book in 2019 led to a decline of the risk-adjusted capital (RAC) ratio to 18.2% as of end-2019 from 27.8% on June 30, 2018. EDB has a track record of uneven loan portfolio growth, and many projects over the past couple of years have been sizable, and increasing concentration squeezed capital. We understand that EDB’s slower lending growth in 2020 was part of the normal cycle, but we also believe management deliberately reduced the pace to offset pressure. However, we believe that past volatility continues to create pressure that could hurt the capital ratio should loan growth reignite amid economic recovery once the effects of the coronavirus pandemic subside.
We believe EDB's capital position remains very strong despite the amounting pressure. Our capital ratio (after making adjustments specific to multilateral lending institutions [MLIs]) stood at 18.5% as of year-end 2020; this is roughly at the same level as in 2019. The MLI adjustments put significant pressure on the RAC ratio mainly due to high concentration of the assets. A new loan to one of the largest borrowers in 2020 makes up almost 14% of the balance-sheet portfolio. Overall, Russia, Kazakhstan, and Belarus accounted for roughly 97% of EDB's loans as of March 2021. We note that continued fast growth, particularly if it remains concentrated by geography and single name, could weaken capitalization.

We believe that EDB's current work on its strategy for 2022-2026 could support our assessment of the bank's policy importance. The new plan is based on the four pillars: Focus on Trans-Eurasian Connectivity Projects; Unique Role of EDB as an International Financial Institution in the Member States; Facilitator of the Digitalization in the Eurasian Economic Union; and Streamlining of EDB Product Synergy. We understand management is strongly committed to EDB's mandate, clearly taking more integrative projects that will be beneficial for several bank members simultaneously. The current investment portfolio is set to double by end-2026, in line with the revised strategy driven by recovery and further growth of key industries like electric power and transport. In our base case, we assume that such growth will likely be supported by a capital increase and potential expansion of shareholders in the longer run.

EDB's efforts over the past years to improve the quality of its loan exposures is yielding positive results. On Dec. 31, 2020, nonperforming loan (NPLs; defaulted and overdue more than 90 days) stood at $24.9 million, representing 1.1% of EDB's gross on-balance portfolio, down from 6% at year-end 2016. We note that, as of year-end 2020, Stage 3 loans (under International Financial Reporting Standard 9) represented about 4% of EDB's gross on-balance portfolio (down from 9.3% as of year-end 2019). Several of these exposures have sovereign or quasi-sovereign guarantees, which reduces the likelihood of default, in our view.

We believe EDB has a well-diversified funding base and will continue to enjoy access to funds in different currencies at reasonable rates. Over the past few years, we have seen an increase in EDB's bond issuance. Recently in March 2021, EDB placed a €300 million bond at a yield of 1.2% maturing in five years. The last time EDB tapped the market was in 2013, when it issued a $500 million seven-year bond. We see positively the low interest rate of the new Eurobond placement, particularly given the current challenging market condition. This new issuance also received an excellent geographical distribution with vast majority of the volume going to European investors like Germany, France, Italy, and Switzerland, among others. Furthermore, the bank continues to attract funding in Russian rubles and Kazakhstani tenge.

We expect EDB's historically conservative liquidity management policy will help to offset potential risks associated with restricted market access. On Dec. 31, 2020, the bank's liquid assets totaled approximately $1.3 billion, comfortably above the minimum of $730 million set by the bank for fourth-quarter 2020. This enabled the bank to meet its policy target, which stipulates that liquid assets should cover at least one year's projected net loan disbursements (loans disbursed minus repayments) if greater than zero, minus bilateral commitments, plus the annual cost of financial debt. Our stressed 12-month liquidity ratio indicates that EDB would not need to access the market to continue providing scheduled loans over the next 12 months (with a liquidity ratio of 1.5x compared to 0.9x last year).
Our long-term rating does not incorporate extraordinary shareholder support from EDB's callable capital. This is because we rate all of EDB's sovereign shareholders lower than our 'bbb' assessment of EDB's stand-alone credit profile (SACP). In addition, our assessment of the bank's policy importance as moderate precludes the notion of extraordinary support.

EDB's enterprise risk profile is very weak, in our view. Our assessment rests on our view of its role and public-policy mandate, the strength and stability of its relationship with shareholders, and our governance and management expertise assessment. We also consider the constraint of the bank's limited geographical diversification compared with other supranational peers and its highly idiosyncratic ownership structure, with Russia and Kazakhstan accounting for 99% of shares.

EDB is the key MLI for the Eurasian Economic Union (EAEU) countries. Established in 2006 by an intergovernmental agreement, its purpose is to contribute to the development and growth of the market economy in member states and promote trade and economic integration among them by engaging in investment activities. EDB is improving its role and competitive position in its member countries, shown by the significant increase in the loan portfolio in 2018 and 2019, but it still remains very small compared with the economies of its members. EDB is owned by Russia (66%), Kazakhstan (33%), Belarus (1%), Armenia (0.01%), Tajikistan (0.03%), and Kyrgyzstan (0.01%).

We believe that EDB's role as manager of the resources of the Eurasian Fund for Stabilization and Development (EFSD) underscores its importance for member states. The EFSD, with $9.4 billion under management, provides budgetary and balance-of-payments support to its member states, as well as financing national and regional projects. EFSD was established specifically to address the effects of the global financial crisis on member states of the EAEU. The EFSD had disbursed $5.4 billion in loans as of Dec. 31, 2020. The fund has its own balance sheet, managed separately from EDB's.

EDB's private-sector focused mandate excludes it from being treated as a preferred creditor. This is because private-sector companies cannot selectively default to one group of creditors while paying others as sovereigns can. Hence, we do not incorporate preferred creditor treatment (PCT) in our assessment of the enterprise risk profile. However, given EDB's status as an MLI, we do consider PCT granted by the governments of countries in which it operates, and we incorporate this into our assessment of EDB's financial risk profile. EDB has been exempted from sanctions placed on Russia.

Outlook

The negative outlook reflects that we could negatively reassess EDB's capital position should reignite loan growth in the aftermath of the pandemic or large projects exert pressure through increased concentration of the loan book. Both of these scenarios could trigger a downgrade.

Downside scenario

If high lending growth to geographically concentrated customers continues without an offsetting increase in capital payments over the next 12-24 months, risks could heighten, alongside further erosion to EDB's capital strength.
Upside scenario

We could revise the outlook to stable if we observed a longer track record of more moderate growth supporting the current capital position or if shareholders backed the bank through a capital increase to enable a return to higher levels of asset accumulation. This support enabling a larger footprint could also benefit our view of policy importance in the medium term.

Ratings Score Snapshot

Issuer Credit Rating: BBB/Negative/A-2
Stand-alone credit profile: bbb
Enterprise Risk Profile: Very weak
  - Policy Importance: Moderate
  - Governance and management: Weak
Financial Risk Profile: Very strong
  - Capital Adequacy: Very strong
  - Funding and Liquidity: Strong
Extraordinary Support: 0
  - Callable Capital: 0
  - Group Support: 0
Holistic Approach: 0

Related Criteria

- Criteria | Governments | General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Dec. 14, 2018
- 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
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Eurasian Development Bank Outlook Revised To Negative On Weakening Capitalization; 'BBB' Ratings Affirmed, June 3, 2020
Research Update: Eurasian Development Bank 'BBB/A-2' Ratings Affirmed; Outlook Remains Negative

Ratings List

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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. A description of each of S&P Global Ratings' rating categories is contained in “S&P Global Ratings Definitions” at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 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 www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.
Research Update: Eurasian Development Bank 'BBB/A-2' Ratings Affirmed; Outlook Remains Negative