Eurasian Development Bank – Baa1 Stable

Regular Update

Summary
The Eurasian Development Bank's (EDB) credit profile incorporates its strong capital and liquidity positions. These factors are balanced against a challenging operating environment, relatively weak asset quality and uncertain access to funding. The strength of member support is low, due in large part to the high correlation between the bank's members' creditworthiness and its assets.

EDB's credit profile is determined by three factors

- **Capital Adequacy**: Medium
- **Liquidity**: Medium
- **Strength of Member Support**: Low

<table>
<thead>
<tr>
<th>Intrinsic Financial Strength (F1 + F2)</th>
<th>Medium</th>
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</thead>
<tbody>
<tr>
<td>Rating Range (F1 + F2 + F3)</td>
<td>A2-Baa1</td>
</tr>
</tbody>
</table>

Source: Moody's Investors Service

Credit strengths
- Very strong asset coverage
- Low leverage ratios
- Very high coverage of debt service by discounted liquid assets

Credit challenges
- A fragile operating environment
- Relatively illiquid funding markets
- High concentration of members and assets, and high economic linkages among members.
Rating outlook
The outlook on EDB’s Baa1 rating is stable, reflecting a tentative recovery in its operating environment balanced by potential further occurrence of non-performing loans (NPLs) given the bank’s lending decisions. An expansion in the balance sheet could pose risks to EDB’s asset quality and liquidity metrics, although we think it unlikely that EDB’s metrics would change significantly and suddenly.

Factors that could lead to an upgrade
Upward rating pressure could come from a reduction in risks to asset quality, including through a track record of sound lending policies resulting in lower NPLs. A diversification in the EDB’s funding profile towards more liquid markets, and indications of stronger member support than we currently assess would also be credit positive.

Factors that could lead to a downgrade
Downward pressure on EDB’s Baa1 rating could come from NPLs continuing to trend at current high levels, signaling a less vigilant lending policy than we currently assess; a deterioration in liquidity or capital adequacy, which could, for instance, be caused by a weakening of loan or treasury asset quality; or a significant weakening of the credit profiles of EDB’s major borrowers or shareholders.

Key indicators

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<tbody>
<tr>
<td>Total Assets (USD million)</td>
<td>3,884</td>
<td>4,594</td>
<td>3,915</td>
<td>2,881</td>
<td>3,255</td>
<td>3,320</td>
</tr>
<tr>
<td>Return on Average Assets (%)</td>
<td>0.4</td>
<td>-1.7</td>
<td>0.4</td>
<td>-4.2</td>
<td>5.3</td>
<td>1.3</td>
</tr>
<tr>
<td>Usable Equity/Gross Loans Outstanding + Equity Operations (%) [1]</td>
<td>76.0</td>
<td>59.0</td>
<td>67.3</td>
<td>87.5</td>
<td>97.2</td>
<td>106.1</td>
</tr>
<tr>
<td>Gross NPLs/Gross Loans Outstanding (%) [2]</td>
<td>0.0</td>
<td>4.6</td>
<td>4.5</td>
<td>4.0</td>
<td>5.9</td>
<td>2.9</td>
</tr>
<tr>
<td>ST Debt + CMLTD/Liquid Assets (%) [3]</td>
<td>3.1</td>
<td>29.4</td>
<td>17.2</td>
<td>21.8</td>
<td>7.0</td>
<td>14.0</td>
</tr>
<tr>
<td>Total Debt/Discounted Callable Capital (%) [4]</td>
<td>-</td>
<td>-</td>
<td>46.2</td>
<td>81.7</td>
<td>-</td>
<td>98.2</td>
</tr>
</tbody>
</table>

[1] Usable equity is total shareholder’s equity and excludes callable capital
[2] Non performing loans
[3] Short-term debt and currently-maturing long-term debt
[4] Callable capital pledged by members rated Baa3 or higher, discounted by Moody’s 30-year expected loss rates associated with ratings

Source: Eurasian Development Bank, Moody’s Investors Service

 Detailed credit considerations
Our assessment of the EDB’s capital adequacy is “Medium”, reflecting relatively strong ratios balanced by weak asset quality, the EDB’s allocation of loans that point to potential recurrent losses, and treasury assets invested in relatively weaker securities compared with some other Multilateral Development Banks (MDBs).

The EDB had a high ratio of usable equity to gross loans outstanding and equity operations, at 106% as of end-2017, and a low leverage ratio of 92%. Both ratios could deteriorate as lending operations pick up, although we do not expect such a deterioration to be sharp.

Against these relative strengths, EDB’s treasury assets are, for a significant part, invested in non-investment grade securities, a lower credit quality than for many other MDBs.

The EDB’s provisioning policy appears sound. Although non-performing loans (NPLs) most recently moderated to 2.9% of gross loans (which we define as loans and advances to banks and customers net of provisions) as of end 2017 from close to 6.0% at the end of 2016, it is not clear if this moderation will be sustained in the coming years.

Furthermore, a weak operating environment for the Commonwealth of the Independent States (CIS) economies will likely continue to be a drag on asset quality and overall capital adequacy. While these economies are on the mend driven in part by the recovery in commodity prices, we do not expect EDB’s largest borrowing members – Russia and Kazakhstan – to return to the growth rates experienced prior to the fall in oil prices.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.
The second factor in support of the rating is a “Medium” liquidity assessment. At 14.4% at the end of 2017, EDB has a relatively low ratio of short-term and currently maturing long-term debt to liquid assets. However, the bank’s Ba2 average bond-implied rating over the past 5 years indicates constrained funding options and weighs on our assessment of EDB's funding situation. In addition, although EDB prudently raises debt in several currencies to match the distribution of currencies in its loan portfolio, this results in funding exposure to relatively less liquid markets. For instance, obtaining long-term funds in Russia often requires issuing bonds with put options, which increases EDB’s liquidity risk. In Kazakhstan, the investor base is narrow, and in 2015 a shortage of tenge liquidity partly due to expectations of a depreciation of the currency, increased funding problems.

The third factor we consider in our rating analysis is strength of member support, which we assess as ‘Low’ because of the possibility that, in the unlikely scenario that financial support is needed, EDB’s key members would themselves be under financial stress.

Our assessment includes an estimate of contractual support, supported by a large coverage of EDB’s outstanding debt by callable capital, which was introduced in July 2014. In 2016, the ratio of callable capital by investment grade members to debt fell to zero, because the outlook on Kazakhstan’s Baa3 rating was changed to negative. With the stabilization of the outlook on Kazakhstan's rating in mid-2017, the ratio increased to 98.3% by year-end.

In addition, extraordinary support reflects our assessment of both willingness and ability by members to provide support. We assume high willingness by EDB’s shareholders to provide extraordinary support. Member support was evidenced when EDB was tasked with the management of the Eurasian Fund for Stabilization and Development, which was established in 2009 in response to the global economic downturn. However, ability to provide support is low, as reflected in a relatively low average median weighted shareholder rating, at Ba1.

Other credit weaknesses in this area include the high correlation of the bank’s members and assets as well as a small number of members and high economic and financial linkages between the shareholders. This may, in highly stressed scenarios, constrain members’ capacity to fulfill their callable capital commitments.

Recent developments

Balance sheet metrics point to a marginal expansion in 2017

The EDB’s balance sheet grew marginally by 2.0% to $3.3 billion by the end 2017 from a year ago. Gross loans moderated to around $1.6 billion, from $1.7 billion at the end of 2016. Balancing this decline was an increase in security holdings.

At end 2017, the EDB’s usable equity stood at $1.7 billion, flat from the end of 2016. Net profits moderated to $42.7 million, from $163.5 million at the end of 2016. This moderation was mainly due to losses on swap transactions.

The EDB’s profitability has been volatile historically, and much of this volatility can be attributed to currency movements. With the moderation in net profits in 2017, the return on average assets fell to 1.3%, from 5.0% at end 2016, and the return on equity to 2.5% from 10.3% in the previous year. We do not expect that the EDB’s profits will significantly support or deter capital accumulation. Hence, we view profitability as neutral for the capital adequacy assessment.

NPLs moderated in 2017, although this trend may not sustain over time

As of end 2017, EDB’s loan book was dominated by loans to mining (28.6% of the current investment portfolio) and energy (25.8%), while the transport sector had a share of 20.8%. The ratio of non-performing loans to total loans moderated to at end 2016. However, the concentration of the loan portfolio in energy and mining sectors, which are exposed to potentially sudden shifts in global prices, points to a risk of increase in NPLs in an adverse commodity price cycle.

As the loan book expands and seasons, additional risks to asset quality may materialize, a factor we consider in overall assessment of capital adequacy. That said, the EDB’s provisioning policy is generally sound, and stood at 3.5% of gross loans at end 2017. Proactive provision dents EDB’s profits at times but also gives rise to higher profits when recovery rates on bad loans are higher than implied in the provisioned amounts.

Debt service coverage weakened in 2017

EDB’s debt service coverage ratio, the sum of short-term debt and long-term debt maturing or amortizing over the next 12 months relative to the stock of discounted liquid assets, increased to 14.0% at end 2017 from 7.0% at end 2016 and 21.8% at end 2015. This
deterioration in the ratio was on account of an increase in debt maturities coming due from a relatively low base in 2016, even as the actual stock of debt and liquid assets has inched higher since end 2015.

At the same time, liquid assets edged higher to $1.7 billion at end 2017, from $1.6 billion at the end of 2016. This increase has been driven by higher treasury assets. Treasury assets are primarily denominated in US dollars, rubles, and tenge.

A shift in the quality of assets held in the treasury portfolio that began in 2015 extended into 2017, with the proportion of debt instruments rated Aa3 and above comprising 35% of the portfolio at end 2017, from 71% at the end the 2015. Those in the Ba1-Ba3 category increased to 50% of the portfolio, from 3% at the end of 2015. A part of this can be explained by increased investments in sovereign bond issuances by Russia in early 2016, and an increase in exposure to US bonds in the run-up to the anticipated US Federal Reserve (Fed) rate increase in 2016. Once the rate increase materialized, this exposure was pared.

The bank’s ability to attract local-currency denominated funds at attractive rates will influence its overall liquidity position. Following the issuance of two tenge-denominated bonds worth KZT15 billion and KZT20 billion last year, the EDB raised a ruble-denominated bond worth RUB5 billion in March 2018. Given that its borrowings are primarily denominated in currencies of its member states, the EDB is increasingly considering settlements in these currencies rather than the dollar or euro.
Rating methodology and scorecard factors

**Rating Factors - Eurasian Development Bank**

<table>
<thead>
<tr>
<th>Rating Factors</th>
<th>Factor Weight</th>
<th>Factor Score</th>
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<tbody>
<tr>
<td>Factor 1: Capital Adequacy</td>
<td>60%</td>
<td>Medium</td>
</tr>
<tr>
<td>Factor 2: Liquidity</td>
<td>40%</td>
<td>Medium</td>
</tr>
<tr>
<td>Intrinsic Financial Strength (F1 + F2)</td>
<td>Preliminary Rating Range</td>
<td>Medium</td>
</tr>
<tr>
<td>Factor 3: Strength of Member Support</td>
<td>+3, +2, +1, 0 notches</td>
<td>Low</td>
</tr>
<tr>
<td>Rating Range (F1 + F2 + F3)</td>
<td>A2-Baa1</td>
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<tr>
<td>Assigned Rating</td>
<td>Baa1</td>
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**Note:** While the information used to determine the grid mapping is mainly historical, our ratings incorporate expectations around future metrics and risk developments that may differ from the ones implied by the rating range. Thus, the rating process is deliberative and not mechanical, meaning that it depends on peer comparisons and should leave room for exceptional risk factors to be taken into account. For more information please see our Multilateral Development Banks and Other Supranational Entities rating methodology.

**Footnotes:**

1. **Rating Range:** Factor 1, Capital Adequacy, and Factor 2, Liquidity, combine according to the weights indicated into a construct we designate as Intrinsic Financial Strength (IFS). A notching system combines IFS and Factor 3, Strength of Member Support.
2. **5 Ranking Categories:** Very High, High, Medium, Low, Very Low.
Moody’s related publications

» Credit Analysis: Eurasian Development Bank – Baa1 stable: Annual credit analysis, 20 Nov 2017
» Rating Action: Moody’s affirms the Eurasian Development Bank’s Baa1 rating, stable outlook, 13 October 2017
» Rating Methodology: Multilateral Development Banks and Other Supranational Entities, 29 March 2017

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