

Rating Action: Moody's affirms the Eurasian Development Bank's Baa1 rating; maintains stable outlook

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Singapore, May 07, 2019 -- Moody's Investors Service ("Moody's") has today affirmed the long-term Baa1 issuer and senior unsecured ratings, the (P)Baa1 senior unsecured MTN program rating, the Prime-2 short-term issuer rating, and the (P)Prime-2 other short-term rating of the Eurasian Development Bank (EDB). The outlook remains stable.

The key drivers underpinning the Baa1 rating affirmation are:

- 1) High asset coverage and low leverage balanced by risks of potential losses posed by weak borrower quality, especially as EDB's lending grows;
- 2) Liquidity that will remain dependent on access to funding in shallow markets
- 3) Improving ability of members to provide extraordinary support

The decision to maintain the stable outlook reflects balanced risks, taking into consideration strong capital adequacy and debt service coverage metrics, offset by potential downside to asset quality, or shifts in funding conditions in the markets that the EDB operates in.

RATINGS RATIONALE

The Baa1 rating incorporates the EDB's "Medium" capital adequacy, liquidity, and strength of member support.

LOW LEVERAGE BALANCED BY RISK OF DETERIORATION IN ASSET QUALITY AS LOAN GROWTH RECOVERS

Moody's assesses EDB's capital adequacy as "Medium", reflecting its strong asset coverage and low leverage, offset by a relatively concentrated portfolio and weak asset quality on its treasury portfolio.

A high Asset Coverage Ratio (ACR), which compares the entity's usable equity with assets that can incur losses, supports the EDB's capital adequacy. EDB's ACR improved for four consecutive years and peaked at 103.5% in 2017 before moderating to 86.3% in 2018, driven by an acceleration in loan growth. Absent any increases in usable equity, continued loan growth will lower EDB's ACR, though it will remain high relative to peers.

Leverage, measured as outstanding debt relative to usable equity, stood at 99.8% as of end December 2018. Moody's expects EDB's leverage to edge higher as it borrows more to fund loan growth. However, EDB's leverage will remain in line with other A- and Baa-rated MDBs.

Improving operating conditions in the EDB's member states will support recovery of problem assets. While high levels of dollarization, susceptibility to lower oil prices, and weak commercial banking sectors will continue to pose risks in EDB's smaller markets, these constraints have declined in Russia and Kazakhstan, which are EDB's largest markets by far. The ratio of EDB's non-performing loans (NPLs, defined as loans overdue by 90 days or more) to gross loans improved to 1.2% in 2018 from a peak of 5.9% in 2016.

However, the new IFRS 9 accounting standard has caused the Bank to take higher provisions than its existing NPL classifications would require. In 2018, about 3.5% of total loans to customers were classified as impaired; but under the new IFRS 9 accounting standard, 21.3% are classified as Stage 3 loans, or those that are credit-impaired. Moreover, corporate governance and transparency remain relatively low in most borrowing countries, posing continued risks to EDB's asset quality. Furthermore, the Bank's lending strategy has not changed significantly compared with the periods of higher NPLs. NPLs may rise again as the loan book seasons, and a concentrated portfolio means that the proportion of bad loans can increase suddenly.

Exposures to mining, energy and transport sectors have increased over the years, raising EDB's vulnerability to cyclical sectors.

LIQUIDITY METRICS WILL REST ON ACCESS TO FUNDING IN SHALLOW MARKETS

Moody's assesses EDB's liquidity as "Medium", reflecting the Bank's very high debt service coverage, balanced by its reliance on relatively shallow funding markets.

The EDB's liquidity position, measured by the bank's maturing long-term debt and short-term debt relative to discounted liquid assets, is strong relative to peers, at 28% at end- 2018. Moody's considers a ratio of below 50% as very high debt service coverage.

However, the Bank remains highly reliant on relatively shallow funding markets because it borrows primarily in the ruble and tenge markets to match the currencies in its loan book. Although it has been able to issue more local currency bonds as these markets have climbed out of challenging funding conditions in 2015, average borrowing costs are likely to remain high. The weighted average cost of borrowing in fact increased slightly last year to 6.9%, from 6.7% in 2017. Similarly, while EDB's bond implied rating had significantly improved from lows in 2014-15, it has remained broadly unchanged since 2017, at around Ba1.

MEMBER SUPPORT HAS IMPROVED WITH UPGRADE TO RUSSIA

Following the upgrade of Russia's sovereign rating to Baa3 earlier this year, Moody's assesses the strength of member support for EDB as having improved to 'Medium', from 'Low'.

Russia is the EDB's largest shareholder, with authorized share capital of \$4.6 billion, or 66% of total share capital.

Russia and the other shareholders contribute callable capital. Moody's assessment of contractual support takes into account the callable capacity pledged by investment-grade shareholders, which in the case of EDB now includes Russia as well as Kazakhstan.

Moreover, Moody's assessment of the strength of member support also includes the shareholders' capacity and willingness to provide extraordinary support beyond their contractual obligations if the MDB experiences severe stress. Russia's sovereign rating upgrade denotes a greater ability of EDB's shareholders to provide extraordinary support.

However, strong correlation between members and borrowers, and linkages among the members themselves will continue to constrain their ability to provide support should the need arise.

RATIONALE FOR THE STABLE OUTLOOK

The stable outlook reflects broadly balanced risks.

The EDB's low leverage, high debt service coverage and improved capacity of its shareholders to provide financial support point to resilience to economic and financial shocks for its borrowers.

This is balanced by potential downside risks to asset quality given the narrow breadth of markets and sectors the bank operates in, and shifts in funding conditions in the region that can tighten suddenly and significantly. An expansion in the balance sheet could pose risks to EDB's asset quality and liquidity metrics, although any deterioration would occur from relatively strong levels.

WHAT COULD MOVE THE RATING UP

Upward rating pressure would likely come from a longer track record of asset quality improvements, including through prudent lending policies. Such developments would point to underlying improvements in governance and risk-management practices. Access to more diversified, deeper and as a result, more stable, funding markets would also likely put upward pressure on the rating.

WHAT COULD MOVE THE RATING DOWN

Downward pressure on EDB's rating could come from NPLs trending towards higher levels, signaling a less vigilant lending policy and less effective risk management than currently assessed; a deterioration in liquidity or capital adequacy, which could, for instance, be caused by a weakening of loan or treasury asset quality; and/or a significant weakening of the credit profiles of EDB's major shareholders.

The principal methodology used in these ratings was Multilateral Development Banks and Other Supranational

Entities published in September 2018. Please see the Rating Methodologies page on www.moody's.com for a copy of this methodology.

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