FitchRatings

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Fitch Affirms CAF at 'AA-'; Outlook Stable

Fitch Ratings - London - 09 Jan 2025: Fitch Ratings has affirmed Corporacion Andina de Fomento's (CAF) Long-Term Issuer Default Rating (IDR) at 'AA-' with a Stable Outlook.

A full list of rating actions is detailed below.

Key Rating Drivers

SCP Drives Rating: CAF's 'AA-' rating is driven by its Standalone Credit Profile (SCP), reflecting the lower of our solvency (aa-) and liquidity (aa+) assessments, and the 'medium risk' business environment in which the bank operates. Fitch has revised its assessment of the bank's liquidity to 'aa+' from 'aa', due to improvement in the credit quality of treasury assets.

CAF's 'aa-' solvency assessment is underpinned by its 'excellent' capitalisation, balanced with its 'moderate' risk profile, which is primarily driven by 'moderate' credit and concentration risks. Ongoing capital injections from shareholders under the general capital increase (GCI) programmes will support the bank's lending growth and portfolio diversification in the coming years, supporting its ratings despite continued large exposures to lowly-rated sovereigns.

Excellent Capitalisation: Fitch's usable capital/risk-weighted assets (FRA) ratio increased to 46% at end-3Q24 from 45% a year earlier. The rise in usable capital, due to capital payments and strong internal capital generation (ICG) in 2024, has more than offset an increase in risk-weighted assets. The equity/assets (E/A) ratio weakened to 28% at end-3Q24 from 29% in 2022-2023, as leverage growth outpaced shareholder capital payments (USD746 million in 9M24) and ICG (4.2% at end-3Q24).

Fitch expects the FRA and E/A ratios to remain above their respective 35% and 25% 'excellent' thresholds over 2025-2027. Our projections assume annual growth of about 5% in lending and shareholders' capital payments, in line with the bank's 9th and 10th GCI programmes.

Membership Expansion: In December 2024, Costa Rica became a full member after ratifying its conversion from partial membership. Fitch understands from CAF that several Caribbean countries are considering to join the bank, with some already signing incorporation agreements to become shareholders. Fitch views CAF's expansionary strategy beyond South America and the incorporation of new full members as having a positive impact on its solvency metrics through increased capital contributions and loan portfolio diversification.

Improving Asset Quality: The weighted average rating of loans and guarantees (WARLG), 92% sovereigns, has improved to 'B+' from 'B', due to increased exposure to highly-rated borrowers and reduced Venezuelan sovereign exposure. With CAF's increased disclosure, we have reassessed the credit quality of loans extended to non-sovereign entities to 'BB' on average, further strengthening the WARLG. CAF's 'excellent' preferred creditor status (PCS), based on its strong record of loan repayments and low exposure to the non-sovereign sector, results in an uplift of three notches above the WARLG to 'BB+'.

Reducing Non-Performing Loans (NPLs): Fitch's own measure of the NPL ratio decreased to 5.9% at end-3Q24 from 6.5% at end-2023 and 8.6% at end-2022. This was driven by CAF's loan book expansion and reduced Venezuelan exposure from 14.2% in 3Q19 to 5.8% in 3Q24 thanks to a share repurchase transaction in lieu of principal and interest payments by the sovereign. Venezuelan shares in the bank were depleted by mid-2024. Therefore, further NPL reduction will depend on loan book expansion, as Fitch expects Venezuelan exposure will remain non-performing over its forecast horizon. We expect the NPL ratio to remain within the 3%-6% 'moderate' range in the medium term.

Concentration to Lowly-Rated Sovereigns: The concentration of CAF's loan portfolio to a few lowly-rated sovereigns has been a rating weakness for the bank, although diversification is improving. The share of the five largest exposures in the total banking portfolio continued to decline to 52% at end-3Q24, from 55% at end-3Q23 and 58% at end-3Q22. Fitch anticipates a gradual reduction in portfolio concentration in the medium term, driven by membership-expansion strategies, the incorporation of new full members, and a higher proportion of approvals to these members in recent years.

Improving Liquidity: The credit quality of CAF's treasury assets continued to improve in 2024, with the share of 'AAA'-'AA' rated assets in the bank's treasury portfolio rising to 59% at end-3Q24, from 57% in 2023 and 49% in 2022. This was driven by the bank's strategy to increase investments in highly rated debt securities and deposits at top-rated financial institutions. Fitch now expects the share of 'AAA'-'AA' rated treasury assets to remain consistent with its 'strong' assessment (above 40%) over the medium term.

Short-Term Funding Higher than Peers': CAF's liquid assets covered 160% of its short-term debt at end-3Q24, up from 117% a year ago. This is lower than the 'AAA'-'AA' median and primarily reflects a higher share of short-term funding, due to CAF's recourse to deposits and commercial papers. Fitch expects the bank's liquidity buffers to remain below the 150% threshold for an 'excellent' assessment over the forecast period. Its liquidity profile is enhanced by its 'strong' access to capital markets. In 2024, the bank increased its capital markets issuance, leading to lower funding cost via tighter spreads on bonds.

Medium Risk Business Environment: Fitch's 'medium' risk business environment assessment for CAF balances the importance of the bank's public mandate, highlighted by a large capital increase (10th GCI of USD7 billion paid-in capital) approved in 2022, and the 'high' credit and political risks in its countries of operations. Initially focused on the Andean region, CAF has expanded its scope of operations to include most Latin American countries, with outstanding loan operations in 17 countries.

National Scale Rating: As CAF's Long-Term IDR is materially above Mexico's sovereign rating, the bank's issue rating on the Mexican National Rating scale is 'AAA(mex)'.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/ downgrade:

Solvency (Risks): A weakening in our assessment of the bank's 'moderate' risk profile, which could arise from a significant deterioration in the credit quality of the loan portfolio, with WARLG falling below 'B-'. This could result from a default by one of CAF's sovereign borrowers, leading to a breach of the bank's PCS and, potentially, driving the NPL ratio above the 6% 'high risk' threshold on a sustained basis

Solvency (Capitalisation): A decline in capitalisation ratios that could affect our 'excellent' capitalisation assessment. This could be due to higher-than-expected growth in the bank's lending operations or delays in capital payments, leading to either the FRA or the E/A ratios falling close to or below their respective 35% 'excellent' and 15% 'strong' thresholds

Factors that could, individually or collectively, lead to positive rating action/upgrade:

Solvency (Risks): An improvement in CAF's credit risk profile, as reflected in a WARLG above 'B+', a material reduction in the NPL ratio towards the 3% 'low risk' threshold, or further improvement in the bank's concentration risk metrics

Business Environment: Strengthening in our assessment of CAF's business profile supported by reduced strategy risk, due to further diversification of the bank's portfolio

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

CAF has an ESG Relevance Score of '4' for 'Governance Structure'. A high share of capital ownership by borrowing countries (above 90%) have influenced the bank's lending strategy towards large shareholders with weak credit fundamentals at the expense of diversification and prudent lending growth. This has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

CAF has an ESG Relevance Score of '4' for 'Rule of Law, Institutional and Regulatory Quality'. All supranationals attract a score of '4' as they are neither subject to bank regulation nor supervised by an external authority. Instead, supranationals comply with their own set of prudential limits. Fitch pays particular attention to these internal prudential policies, including the bank's compliance with them. This has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation of the materiality and relevance of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Corporacion Andina de Fomento (CAF)	LT IDR	AA-	Affirmed		AA-
	ST IDR	F1+	Affirmed		F1+

ENTITY/DEBT	RATING			RECOVERY	PRIOR
• senior unsecured	LT	AA-	Affirmed		AA-
• senior unsecured	ST	F1+	Affirmed		F1+
• senior unsecured	Natl LT	AAA(mex)	Affirmed		AAA(mex)

RATINGS KEY	OUTLOOK	WATCH
POSITIVE	⊕	⬘
NEGATIVE	⊖	⬙
EVOLVING	◎	◆
STABLE	▣	

Applicable Criteria

Metodología de Calificaciones en Escala Nacional (pub.22 Dec 2020)

Metodología de Calificación de Supranacionales (pub.12 May 2023)

National Scale Rating Criteria (pub.22 Dec 2020)

Supranationals Rating Criteria (pub.03 Oct 2024) (including rating assumption sensitivity)

Additional Disclosures

Solicitation Status

Endorsement Status

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. For more details on sector-specific best- and worst-case scenario credit ratings, please see Best- and Worst-Case Measures under the Rating Performance page on Fitch's website.

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