MOODY'S
INVESTORS SERVICE

Rating Action: Moody's affirms International Investment Bank's (IIB) A3 rating, outlook remains stable

15 May 2020

Frankfurt am Main, May 15, 2020 -- Moody's Investors Service ("Moody's") has today affirmed International Investment Bank's (IIB) A3 long-term issuer and senior unsecured rating. The rating outlook remains stable.

The affirmation of IIB's A3 rating reflects the following factors:

(1) A capital adequacy that remains in line with that of similarly-rated peers, despite a recently increased leverage;

(2) A robust liquidity situation which benefits from IIB's diversification of funding sources;

(3) A moderate strength of member support which is reflected in continued increases in IIB's paid-in capital.

The stable rating outlook is based on improvements in credit metrics over the past two years amidst new challenges and heightened uncertainty related to the coronavirus outbreak and the sharp correction in oil prices. The outbreak will weigh on growth in member states and borrowers' locations, and could affect member states' fiscal strength and ultimately their ability to support IIB.

RATINGS RATIONALE

RATIONALE FOR AFFIRMING THE RATING AT A3

FIRST FACTOR: IIB's CAPITAL ADEQUACY REMAINS IN LINE WITH PEERS, DESPITE INCREASED LEVERAGE

The first factor underpinning the rating affirmation is based on IIB's capital adequacy which remains in line with peers, despite a recently increased leverage. IIB's leverage ratio has trended up since 2014 as asset growth has outpaced growth in useable equity. For instance, lending growth (17% year-on-year) exceeded growth in useable equity growth (8.5% year-on-year) in 2019. However, IIB's leverage ratio is in line with the A-rated median and at levels comparable to peers like Black Sea Trade and Development Bank (BSTDB, A2 stable), Africa Finance Corporation (AFC, A3 negative), and Islamic Corporation for the Development of the Private Sector (ICD, A2 stable). Based on IIB's 2020-2022 business plan and assuming timely paid-in capital contributions from shareholders under the 2020-22 capitalisation programme, Moody's expects IIB's leverage ratio to gradually trend down over the coming two to three years.

Asset quality and performance has improved as the bank has successfully diversified its loan portfolio and further reduced concentration risks. IIB's non-performing loan (NPL) ratio has fallen further in 2019, to 1.6% of total loans from 1.9% in 2018, and is now in line with the median for A-rated MDBs. That said, the improvement in the NPL ratio in 2019 was strongly supported by strong loan growth, while no new NPLs have been reported since the beginning of 2019. IIB's risk management policies stipulate a maximum NPL ratio of 4%, and the bank expects a rise in the NPL ratio to around 3% over the coming years, factoring in the potential negative impact on asset quality from the coronavirus outbreak.

In addition to improved asset performance of development-related assets, IIB has also seen the credit quality of its treasury assets improve, which amounted to €385 million in 2019. 70% of its holdings were rated A3 or higher at the end of 2019, compared to 57% in the previous year. IIB exceeded its own target of 60% for 2019 and its 2020 target of 65%. Despite some negative pressure on the asset quality in 2020 stemming from the economic crisis related to the coronavirus outbreak, Moody's expects that IIB will also meet its 2021 target of 75% of treasury holdings being rated A3 or higher.

SECOND FACTOR: DIVERSIFICATION OF FUNDING SOURCES SUPPORTS THE RATING, WHILE LIQUIDITY RATIOS ARE WEAKER THAN PEERS'

The second factor of today's rating action relates to IIB's reasonably robust funding situation, supported by a diversification of funding sources. IIB has continued to diversify its funding sources and has seen further reduction in the cost of funding over the course of last year. In 2019, funding took place in CZK, HUF, RON local markets and, due to the unexpectedly strong demand, also included some pre-financing for 2020. IIB remained active during the first months of 2020, with total issuance of almost €260 million up until early May. A €1.5 billion MTN programme, registered at the Irish Stock Exchange, was established in March 2020, with a first issuance of 1-year RON110 million (€23 million) private placement concluded in mid-April. The share of funding sourced from more mature and liquid capital markets in EU member countries has been steadily increasing since the bank's re-launch in 2012 and reached 70% of total funding in 2019 from just 20% in 2014. However, Russia remains an important source, with ruble-denominated outstanding debt accounting for 28% of the total at the end of 2019, and most of the issuance activity in 2020 to date in the Russian market. In 2019, IIB's average cost of new funding (after swaps) was 0.49%, falling from 1.07% in 2018.

Despite an improvement compared to last year, liquidity remains weaker than peers'. Moody's own liquid resources ratio (liquid assets as a share of expected net cash outflows) currently stands at 41%, which -- despite an improvement relative to 29% the year before -- is relatively weak and significantly below the median of A-rated MDBs of 150%. Similarly, the debt service ratio which compares the stock of liquid assets against the stock of short-term and currently maturing long-term debt stood at 110% at the end of 2019 compared to 389% for AFC and 190% for BSTDB. Moreover, liquid assets over total debt has fallen to 46% in 2019 from 50% in 2018.

Moody's acknowledges IIB's commitment to maintaining strong liquidity. The bank's internal liquidity risk management focuses on the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR), adjusted to IIB's circumstances. The LCR covers a 30-day period and the NSFR a one-year period, and both ratios must remain at or above 100%.

THIRD FACTOR: CONTINUED INCREASES IN PAID-IN-CAPITAL REFLECT MODERATE STRENGTH OF MEMBER SUPPORT

The third factor supporting IIB's A3 rating is the continued increase in paid-in capital. Paid-in capital reached €340 million at the end of 2019 from €326 million in 2018, as Hungary (Baa3 stable) added €10 million in 2019. In addition, Romania (Baa3 negative) paid its remaining part of the 2013-2017 capitalisation programme of €3.65 million. Czech Republic (Aa3 stable) has still not paid the remaining €5.6 million due for the capitalisation programme for 2013-2017. Capital injections from member states continued in 2020: Hungary paid-in €15.5 million, and Russia €20.64 million, bringing total paid-in capital to €376 million. The new capitalisation programme for 2020-2022 aims to increase paid-in capital by €200 million by 2022.

The credit profile of IIB's shareholders improved in 2019, with the sovereign rating upgrade of Russia (Baa3 stable) back to investment grade lifting the weighted average shareholder rating to "Baa3" and raising the callable capital share of investment grade-rated shareholders to 96.2% from 43.3% before. However, the callable capital coverage relative to the banks' total debt has weakened over the past three years, against the background of the significant rise in IIB's debt and continued increases in paid-in capital, which in turn reduced callable capital. Thus, IIB's callable capital as a proportion of the bank's total debt dropped to 92% in 2019 from 117% in 2018 and over 500% in 2014. That said, the debt-to-callable capital ratio is still in line with the A-rated median.

In Moody's view -- given the still relatively short track record of less than ten years after the bank's relaunch -- in the unlikely event of substantial financial problems re-emerging at IIB, there is a risk that shareholders would choose to wind down the institution rather than inject additional funds. The slower-than-planned progress under the 2013-2017 capitalisation programme, which is still not fully completed, supports this view. Moody's considers the priority of support that IIB's shareholders would attach to the bank to be constrained by IIB's small, although growing, size and limited economic presence in their countries. This could be particularly relevant from the perspective of some of the IIB's EU shareholders, which Moody's believes could be more likely to support some other European MDBs, such as the EIB, rather than the IIB.

RATIONALE FOR THE STABLE OUTLOOK

The stable rating outlook balances the strengthening of some of IIB's credit metrics over the past two years against the challenges and heightened uncertainty related to the coronavirus outbreak and the sharp correction in oil prices. The outbreak will weigh on growth in member states and borrowers' locations, and could affect member states fiscal strength and ultimately ability to support in case of sovereign rating downgrades. Weighted average real GDP growth in IIB's member states will contract sharply in 2020 by 4-5% compared to an increase by 2.6% in 2019 and by more than 3% in prior years, and uncertainty remains high about the shape and pace of the post-crisis recovery.

Moody's takes comfort from IIB's strong risk management function, and the fact that concentration risks have been reduced in recent years. Given the relatively small size of the loan portfolio in terms of number of borrowers, payment difficulties at even only a few could have a sizable impact on IIB's asset performance metrics and thus the capital adequacy score. Moody's also notes that the improvement in the NPL ratio is flattered by the strong increase in lending.

However, IIB's performance during the first four months of 2020 suggests that the bank will be able to achieve most of its targets for this year, which will support broad stability in IIB's credit metrics. Also, the mid-2019 relocation of the bank's headquarters to Budapest, together with the recently established MTN programme will continue to support IIB's low funding costs and access to a more diversified pool of funding sources.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE CONSIDERATIONS

Environmental considerations are not material for IIB's rating. However, Moody's notes that IIB has significantly increased its treasury's green bond portfolio, currently amounting to 57% of the total securities portfolio. Also, issuance of a green bond is part of the bank's business plan for 2020-2022.

Social considerations are not material for IIB's rating. Having said that, some of its shareholder countries are facing long-term demographic changes from ageing populations, which could have a negative impact on sovereign credit profiles through increasing old-age related government spending, slower economic growth with negative repercussions for government revenues, and rising government debt burdens.

Moody's regards the coronavirus outbreak as a social risk under our ESG framework, given substantial implications for public health and safety. The rapid and widening spread of the coronavirus outbreak, deteriorating global economic outlook, falling oil prices, and asset price declines are creating a severe and extensive credit shock across many sectors, regions and markets. Moody's believes that the combined negative effect of these developments will lead to a temporary weakening of economic and fiscal strength in all of IIB's member states, but does not expect that the pandemic will lead to a significant weakening of IIB's credit profile.

Governance considerations are material. IIB's governance is relatively strong, reflected in prudent and robust risk management and a key factor underpinning the A3 rating.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

IIB's rating would face upward pressure if Moody's were to see continuation of stable asset quality despite the strong loan growth in previous years, an improvement in liquidity ratios, timely paid-in capital contributions and increases in useable equity, and execution of the bank's business strategy as planned. Further diversification of lending and funding, as well as the addition of new members would also be positive.

Conversely, the rating could face downward pressure if Moody's were to observe a material and sustained weakening in asset quality, and particularly if these adverse developments were to occur at a time of weakening capital buffers and a delay in anticipated payments of promised capital. A significant deterioration in the bank's strong risk management and in the strength of member support could also lead to a rating downgrade.

The principal methodology used in these ratings was Multilateral Development Banks and Other Supranational Entities published in June 2019 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1147813 . Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1133569 .

At least one ESG consideration was material to the credit rating action(s) announced and described above.

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