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Fitch Affirms African Development Bank at 'AAA'; Outlook Stable

Fitch Ratings - London - 13 Jul 2022: Fitch Ratings has affirmed African Development Bank (AfDB)'s Long-Term Issuer Default Rating (IDR) at 'AAA' with a Stable Outlook.

Key Rating Drivers

Extraordinary Support Underpins Ratings: AfDB's 'AAA' rating is driven by extraordinary support the bank receives from its non-regional shareholders, which we assess at 'aaa'. This is based on our expectation that the bank's net debt will be covered by callable capital from 'AAA' rated member states over the forecast period. The shareholders' 'strong' propensity to support the bank translates into a zero-notch adjustment to our assessment of the capacity to support ('aaa').

Fitch recently stabilised the Outlook on the LT IDR of the United States (AAA), the bank's second-largest shareholder, accounting for 6.5% of total capital and 38% of 'AAA' rated callable capital at end-2021. This rating action has eased pressures on the coverage of net debt by 'AAA' rated callable capital, which had been offset by a temporary increase in callable capital in spring 2021.

Improving Standalone Credit Profile (SCP): AfDB's rating is also supported by its SCP, which Fitch has revised to 'aa' from 'aa-'. The upward revision is driven by an improvement in the bank's solvency due to ongoing capital injections and a strengthening in our assessment of the bank's preferred creditor status (PCS). AfDB's 'aa' solvency assessment is underpinned by its 'strong' capitalisation metrics and 'low' risk profile. The bank's SCP also reflects its 'aaa' liquidity and 'medium-risk' business environment.

Strengthening Capitalisation: Our two capitalisation metrics, equity-to-assets (E/A) and usable capital-to-risk-weighted assets (FRA) ratios, markedly improved in 2021 owing to capital payments under the sixth and seventh General Capital Increase (GCI) plans. The E/A ratio was 24% at end-2021 (2020: 22%). The FRA ratio was 49% in 2021, from 37% at end-2020, mainly due to a marked increase in callable capital rated 'AA-' and above. Fitch expects the bank to operate with lower leverage in the medium term and the two ratios to remain consistent with an 'excellent' and 'strong' assessments, respectively.

Improving PCS: Fitch has revised its assessment of the bank's PCS to 'strong' from 'moderate' owing to a stronger record of sovereign loan performance, as evidenced by the recent full repayments of arrears by Somalia and Sudan in 2020 and 2021, respectively. Zimbabwe is now the only sovereign in default with the bank (out of 29 active sovereign borrowers) and the sovereign NPL ratio was 1.1% at end-2021 (from 1.4% at end-2020).

The stronger PCS assessment is also underpinned by the growing share of sovereign exposures in the total loan book (85% at end-2021, and 80% on average over the past five years). The strong PCS now enhances the weighted average credit quality of loans and guarantees by two notches, to 'BB'.

Rising Non-Sovereign NPLs: AfDB's NPL ratio rose in 2021, to 3.3% from 2.8% a year earlier. This was driven by deterioration in the non-sovereign NPL ratio, which increased significantly to 16% at end-1Q22 from 8.6% at end-2020, mainly due to the non-performance of the bank's largest private-sector loan (accounting for 0.8% of total loans, or 5.3% of non-sovereign loan portfolio).

Fitch expects the overall NPL ratio to remain in the 'moderate' category (3%-6%), owing to an expected increase in non-sovereign NPLs. The food crisis caused by the Russia-Ukraine conflict and rising yields add to downside risks to our NPL forecast.

Other Solvency Risks Limited: Fitch believes the bank's risk management policies are conservative and assessed as 'excellent', in line with its peers. Concentration risk is 'low' and benefits from the Exchange Exposure Agreement (EEA) with other MDBs. The five largest exposures accounted for 31% of total banking exposures after EEA (and 44% before EEA) at end-2021. Fitch expects equity participation to remain below 5% of the banking portfolio.

Medium-Risk Business Environment: Fitch assesses AfDB's business environment as 'medium risk', balancing the 'low risk' business profile against the bank's 'high risk' operating environment. The former primarily reflects the large size of the bank's portfolio (XDR22 billion, or USD31 billion at end-2021), the bank's governance and the importance of its public mandate. AfDB's 'high risk' operating environment is consistent with the low credit ratings, low income per capita and high political risk in the countries where it operates.

'Excellent' Liquidity Profile: AfDB's 'aaa' liquidity assessment reflects the bank's 'excellent' liquidity buffers, the high quality of liquid assets and its access to capital markets. At end-2021, liquid assets were 2.3x short-term debt. Around 80% of treasury assets were rated 'AA-' and above. The bank is a regular issuer in international capital markets.

RATING SENSITIVITIES

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

The ratings are 'AAA', which is the highest level on Fitch's scale and cannot be upgraded.

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

Support: Coverage of net debt by callable capital from members states rated 'AAA' falling below 100% due faster-than-expected growth in lending and debt.

A substantial weakening in the bank's solvency assessment leading to a downward revision of the SCP assessment below 'aa-' would result in negative rating action as the uplift above the SCP for extraordinary support is capped at three notches under Fitch's criteria.

Solvency (Risk): A weakening in asset quality for example if the weighted average rating of loans and guarantees fell below 'B-' or the NPL ratio exceeded 6%.

Solvency (Capitalisation): Markedly weaker capitalisation ratios due to delays in capital payments or significant losses on assets that affect the bank's own funds.

Best/Worst Case Rating Scenario

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

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

AfDB has an ESG Relevance Score (ESG.RS) of '4[+]' for 'Human Rights, Community Relations, Access & Affordability'. The AfDB is part of the African Development Bank Group, which extends concessional loans and grants to low-income countries through the African Development Fund. This supports AfDB's policy importance and shareholders' propensity to support the bank. This has a positive impact on the credit profile and is relevant to the ratings in conjunction with other factors.

AfDB has an ESG.RS of '4' for 'Governance Structure'. The high share of capital ownership by borrowing countries with weak credit fundamentals and limited access to external funding has led to pressure to increase the pace of operations, potentially at the expense of prudent lending growth. This has a negative impact on the credit profile and is relevant to the ratings in conjunction with other factors.

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

The ESG.RS assigned to 'Policy Status & Mandate Effectiveness' has been revised to '3' from '4', to reflect the strengthening in Fitch's assessment of the bank's PCS on its sovereign exposures. This issue no longer has a negative impact on the credit profile of the bank.

The ESG.RS assigned to 'Labour Relations and Practices' (SLB) has been revised to '2' from '3', given that restrictions on recruitment based on nationality or quotas is no longer considered to be relevant to multilateral development banks' ratings.

Except for the matters discussed above, the highest level of ESG credit relevance, if present, 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 to the way in which they are being managed by the entity. 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
African Development Bank	LT IDR	AAA	Affirmed		AAA
	ST IDR	F1+	Affirmed		F1+

ENTITY/DEBT	RATING			RECOVERY	PRIOR
• senior unsecured	LT	AAA	Affirmed		AAA
• subordinated	LT	AA+	Affirmed		AA+
• senior unsecured	ST	F1+	Affirmed		F1+

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Supranationals Rating Criteria (pub.11 Apr 2022) (including rating assumption sensitivity)

Additional Disclosures

Solicitation Status

Endorsement Status

African Development Bank	UK Issued, EU Endorsed

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