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Agencia Financiera De Desarrollo

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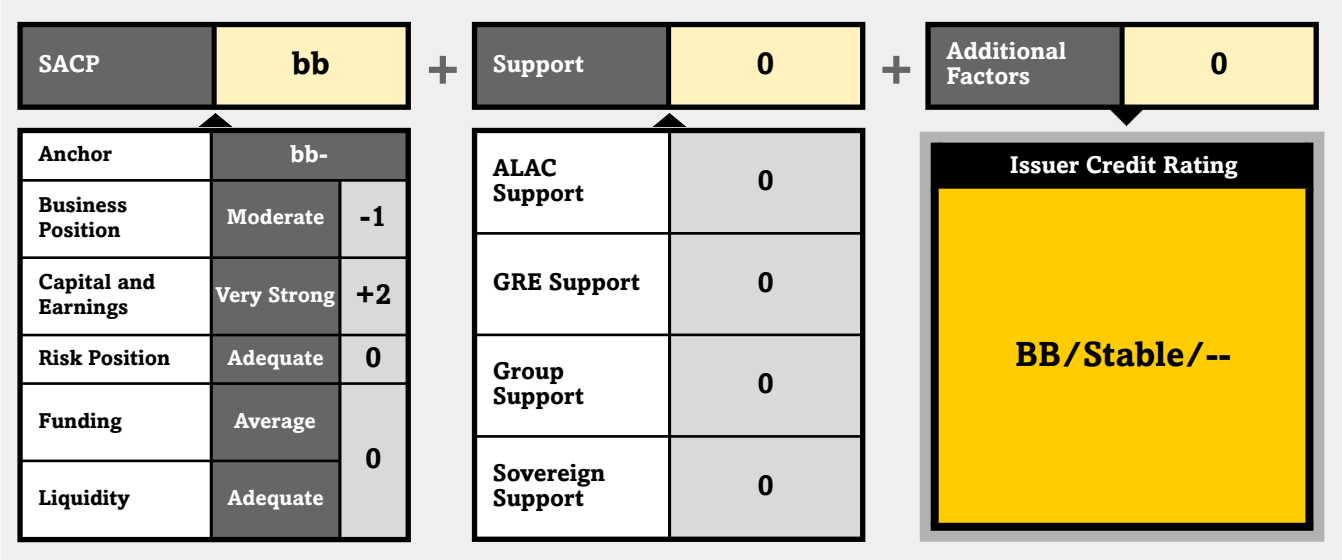
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Agencia Financiera De Desarrollo



Major Rating Factors

Strengths:	Weaknesses:
<ul style="list-style-type: none"> Very strong capital base supported by annual capitalizations from FONACIDE; and Healthy asset quality metrics supported by good underwriting standards and model as a second floor bank. 	<ul style="list-style-type: none"> Weaker corporate governance compared to other banks in the system and other government owned banks in the region; Although improving, still lagging regulatory framework in Paraguay's financial system; and Economic growth expected to slow this year due to adverse weather conditions, with sluggish growth in Brazil and an economic contraction in Argentina.

Outlook: Stable

The stable outlook on Agencia Financiera De Desarrollo (AFD) over the next 12 months reflects our expectation that it will maintain its competitive position in sectors that are relevant for the government, sound capitalization metrics with risk-adjusted capital (RAC) ratios consistently above 15% in the next 12-18 month, and low credit risk exposures.

Downside scenario

We could lower our rating on AFD in the next 12 months, if the high growth rate in the bank's loan portfolio isn't accompanied by internal capital generation or with capitalization from Fondo Nacional de Inversión Pública y Desarrollo (FONACIDE) a development fund created to allocate the revenues received for the transfer of energy from Itaipu Binational Entity to Brazil.

We could also lower the ratings on the bank following a similar action on the sovereign, or if we revise the Banking Industry Country Risk Assessment (BICRA) of Paraguay to a weaker category.

Upside scenario

Over the next 12 months, the likelihood of an upgrade is limited and would depend on the sovereign's upgrade as well as an upward revision of Paraguay's BICRA, while all other credit factors remain stable.

Rationale

Our rating on AFD reflects its good business position that results from its important role as the only second floor state-owned bank in Paraguay, which finances half of the total finance mortgages in the country. In our view, this allows the bank to maintain solid business stability and operating revenues. However, AFD's corporate governance, which compares less favorably with other development banks in the region and banks in the system, moderates our view of the bank's business position.

Since 2013, FONACIDE has used 7% of its resources each year to capitalize the bank for a 10-year period (approximately \$18 million-\$20 million annually). However, this year, FONACIDE did not provide capitalization to AFD, which lowered our expected capitalization for the bank this year. Nonetheless, we expect that FONACIDE will resume capitalizing AFD next year, and that our RAC ratio will remain above 15% in the next 12-18 months.

Furthermore, we believe AFD has a satisfactory risk profile that reflects its record of healthy asset quality metrics (with 0% nonperforming assets [NPAs] and net charge-offs). This is because the bank operates with low credit risk financial institutions. Additionally, AFD's lines to financial institutions are privileged liabilities, and AFD's resources don't go into the pool of liquidation of the financial institutions. All these factors mitigate AFD's loan portfolio concentration in terms of clients given its second-floor operations.

The rating also takes into account AFD's stable funding structure, despite its wholesale profile, because we believe that the bank benefits from the government's ongoing support. Finally, we consider that AFD's liquidity position (composed of mainly cash at the central bank) provides a comfortable cushion to meet short-term obligations over the next 12 months.

The long-term issuer credit rating on AFD is at the same level as its stand-alone credit profile (SACP) because the latter doesn't incorporate notching from external support from the government. The Paraguayan government owns 100% of AFD. In accordance with our criteria, we classify the bank as a government-related entity (GRE) with a high likelihood of extraordinary government support, due to the bank's important role and very strong link to the government. However, the bank doesn't gain any additional support because the long-term sovereign rating is 'BB', at the same level as the bank SACP and issuer credit rating.

Anchor: 'bb-' for banks operating in Paraguay

Our bank criteria use our BICRA economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. The anchor for banks operating only in Paraguay, where AFD operates, is 'bb-'.

Paraguay's economy has been resilient to the region's economic struggles, with real GDP growth of 3.7% in 2018 and inflation contained at 4%, within the central bank's target of 2%-6%. However, Paraguay continues to face institutional challenges that we don't think are likely to resolve in the near term, but policies will continue to support sustainable public finances and economic growth. Domestic credit increased 15.3% in nominal terms in 2018, following two years of sharp deceleration. We believe the current credit expansion, together with the low variation in real estate prices, signal a low likelihood of asset bubble imbalances. However, the rapid credit expansion amid still low GDP per capita, which is near \$5,800, could raise risks for the financial system, given that household and corporate debt is climbing. The banking sector has a high credit risk given its considerable exposure to foreign currency loans and to cyclical sectors such as agriculture and cattle.

The banking sector's industry risk reflects our view of Paraguay's regulatory framework that although improving, is still behind international standards. In our view, the government does not have a record of effective support to the banking sector. In terms of competitive dynamics, we believe that high profitability and rapid credit and asset growth in past few years reflect an aggressive risk appetite. Furthermore, we consider that the presence of relatively large unregulated cooperatives (credit unions) introduce market distortions. The banking system continues to rely mostly on deposits for funding.

Table 1

Agencia Financiera De Desarrollo Key Figures					
	--Year-ended Dec. 31--				
(Mil. PYG)	2019*	2018	2017	2016	2015
Adjusted assets	5,643,613.2	5,445,961.6	4,292,039.3	3,852,827.6	3,219,199.1
Customer loans (gross)	4,944,749.8	4,685,667.1	3,658,342.2	2,969,669.7	2,535,581.2
Adjusted common equity	1,445,638.4	1,405,782.4	1,236,263.7	1,011,612.0	870,199.8
Operating revenues	52,910.3	85,314.7	64,805.6	63,951.8	46,189.1
Noninterest expenses	12,079.4	27,663.6	23,679.8	20,696.8	19,373.5
Core earnings	39,857.2	48,929.5	34,059.1	37,029.6	21,813.1

*Data as of June 30. PYG--Paraguayan guarani.

Business position: Important role in the residential mortgage segment in Paraguay and as the sole state-owned second floor bank

Our business position assessment of AFD incorporates its good business stability, which stems from its status as the only second floor state-owned bank in Paraguay, which finances about half of total residential mortgages in the country. The bank's residential mortgages account for about 40% of its lending portfolio and 3.5% of total loans in the system. AFD also finances investment projects (related to agro-industrial, real estate, infrastructure, productions of goods and services to export, and to import working capital) through the PROCRECER product (that aims to finance a diverse range of projects such as rural development, production of goods and services to export, real estate developments, machinery imports, and tourism development, among others.). The investment projects segment accounts for 30% of AFD's loan portfolio.

AFD operates only as a second floor bank and has various lending programs to promote economic development and employment by providing long-term financing through 14 out of 17 commercial banks in Paraguay, six nonbank financial institutions (NBFIs), and 15 cooperatives. As of June 2019, AFD was the ninth largest bank in terms of loans with a market share of 5%. The bank has generated stable revenue in the past three years, with lending accounting for 96% of its operating revenues. The remaining 4% corresponded to fees generated by trustee administration.

However, this is partly offset by AFD's corporate governance factors that compare less favorably to those of other development banks in the region. This is because the same person acts the president of the board of directors and the bank's CEO, which could generate conflicts of interest.

For the next 12-18 months, we expect the bank to continue expanding its loan portfolio, aligned with its public mission and maintaining adequate revenue generation. We could revise our business position assessment on AFD if it strengthens its corporate governance factors.

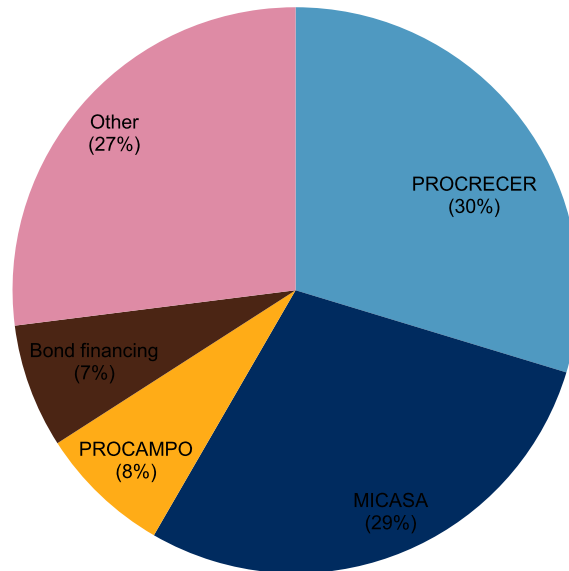
Table 2

Agencia Financiera De Desarrollo Business Position					
	--Year-ended Dec. 31--				
(%)	2019*	2018	2017	2016	2015
Return on average common equity	5.6	3.6	3.1	3.9	2.8

*Data as of June 30.

Chart 1

Funding Base Composition
As of December 2018



Source: S&P Global Ratings.
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Capital and earnings: Sound capitalization metrics supported by FONACIDE capitalization

We assess the bank's capital and earnings as a credit strength, based on our expectation that its RAC ratio will remain above 15% in upcoming years supported by the FONACIDE capitalization (that is expected to resume in 2020), which will mitigate AFD's high asset growth above its internal capital generation.

We expect that AFD will continue to expand its loan portfolio above the industry average. Nonetheless, we expect growth to be moderated by sluggish economic conditions in Paraguay, despite additional funding from the government to help the agricultural sector. In late June, Paraguay government announced a \$1.5 billion package to boost economic activity due to a weak performance during the first semester of the year. In this context, the government plans to provide \$100 million to AFD to grant loans as a new credit line to help boost the agricultural sector.

AFD has adequate quality of capital, with 100% of its total adjusted capital composed of adjusted common equity. Additionally, AFD has adequate quality of earnings, with most revenue generation coming from interest income, and profitability metrics in line with rated peers in Paraguay (AFD has a core earnings over assets of 0.9%) and development banks.

Table 3

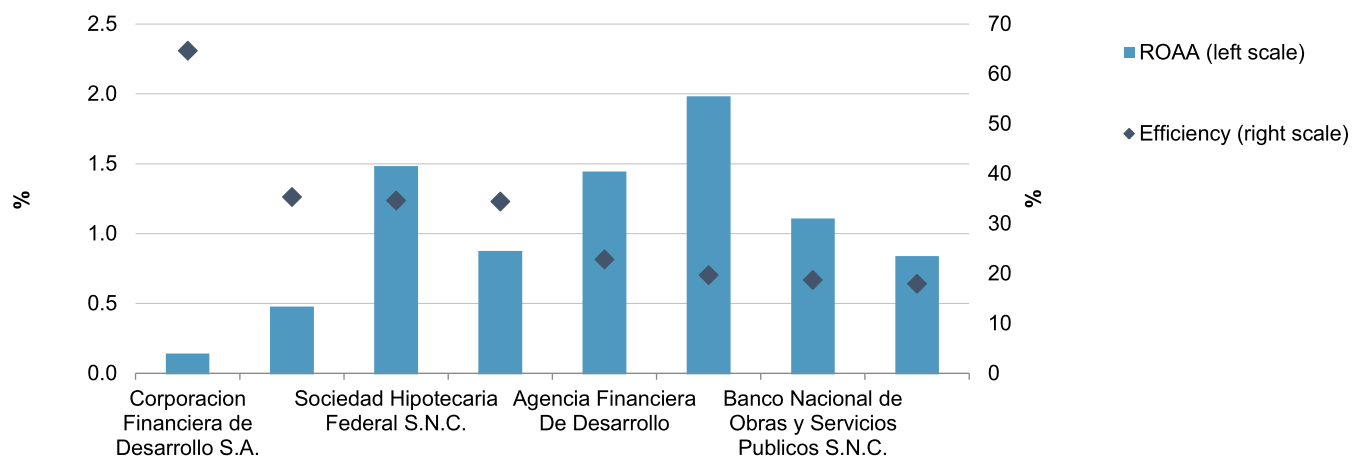
Agencia Financiera De Desarrollo Capital And Earnings					
	--Year-ended Dec. 31--				
(%)	2019*	2018	2017	2016	2015
S&P Global Ratings' RAC ratio before diversification	N/A	19.7	N/A	N/A	N/A
S&P Global Ratings' RAC ratio after diversification	N/A	10.9	N/A	N/A	N/A
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	95.7	95.2	95.0	95.0	93.3
Fee income/operating revenues	4.3	4.8	5.0	5.0	6.7
Noninterest expenses/operating revenues	22.8	32.4	36.5	32.4	41.9
Preprovision operating income/average assets	1.5	1.2	1.0	1.2	0.9
Core earnings/average managed assets	1.4	1.0	0.8	1.0	0.8

*Data as of June 30. N/A--Not applicable.

Chart 2

ROAA And Efficiency

As of June 2019



Source: S&P Global Ratings.

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Risk position: Sound asset quality history mitigates client concentration from second floor operations

In our view, the bank has prudent underwriting standards that have supported its historically healthy asset quality metrics, with no NPAs or net charge-offs. AFD also has a diversified lending portfolio by economic sectors--though given its second-floor operations it has client concentration--in line with other development banks in the region. The top 10 credits represent almost 79% of AFD's loan portfolio. Additionally about 82% of AFD's portfolio is granted to banks, 15% to cooperatives, and 2% to NBFIs.

Through its lending to financial institutions, AFD doesn't assume credit risk of the loans, given that the ultimate borrowers are clients of those financial entities, not of AFD.

Furthermore, AFD's lines to financial institutions are privileged liabilities. In case of the failure of a financial institution, the loans granted by the financial institutions with AFD lines are transferred back to AFD and the failing entity is suspended from operating with AFD for three years.

AFD's exposure to dollarization is low, with only 20% of its loan portfolio denominated in dollars--lower than the Paraguayan industry average of 49% as of December 2018--because the bank's bylaws establish that AFD can only lend to income generators in foreign currency.

Furthermore, AFD cannot use derivatives, and as a result it hedges its dollar position with a natural hedge. AFD uses its foreign currency-denominated funding to fund its US\$ portfolio and its local currency funding to fund its PYG portfolio.

For the next 12-18 months, we expect the bank's asset quality metrics to remain healthy, with no major shifts in its underwriting standards, loan portfolio composition, and credit concentration.

Table 4

Agencia Financiera De Desarrollo Risk Position					
	--Year-ended Dec. 31--				
(%)	2019*	2018	2017	2016	2015
Growth in customer loans	11.1	28.1	23.2	17.1	51.2
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	81.1	N/A	N/A	N/A
Total managed assets/adjusted common equity (x)	3.9	3.9	3.5	3.8	3.7
New loan loss provisions/average customer loans	0.0	0.1	0.1	0.1	0.1

*Data as of June 30. N/A--Not applicable.

Funding and liquidity: Funding profile incorporates ongoing support from the government

In our opinion, AFD's funding is stable, diversified, and in line with those of other development banks in the region. Although AFD's funding is 100% wholesale, it benefits from the government's ongoing support because all of its financial obligations have the explicit guarantee of the government. AFD can't receive deposits.

The bank's funding base is composed of senior debt issued in the local market (75%)— of which 21% is held by the Social Security Institute (IPS - Instituto de Prevision Social), 31% by the Deposit Guarantee Fund of the Central Bank of Paraguay, and 48% by the General Direction of Retirement and Pensions (Fiscal Fund). This entity can only invest in banking instruments, which gives it additional funding stability. The rest of AFD's funding consists of loans from multilateral credit agencies and development banks (24%).

AFD's stable funding ratio was 106% as of the end of June 2019 and 108% as of the end of 2018, in line with those of rated peers. For the next 12-18 months, we don't expect significant changes in AFD's funding structure.

The bank's liquidity can comfortably meet short-term obligations, with a broad liquid assets to short-term wholesale funding ratio of 1.8x as June 2019 and 2.0x as of December 2018. At the end of 2017, this ratio rose to 21.4x after the bank canceled a substantial maturity that year. We expect its liquidity ratio to remain stable this year at about 2.0x.

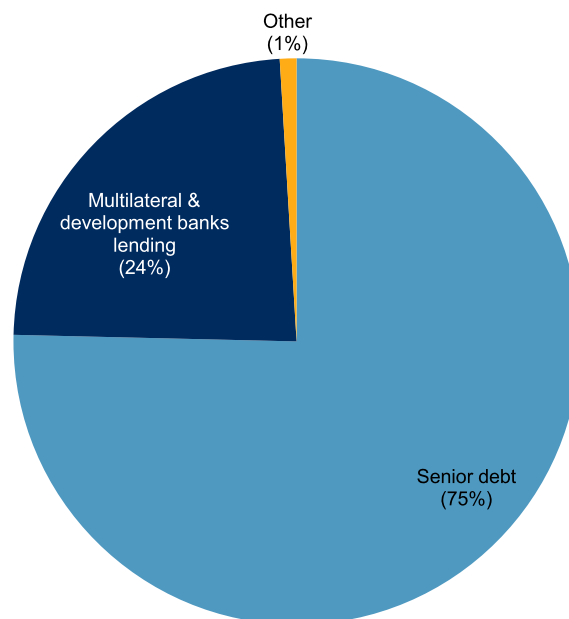
Table 5

Agencia Financiera De Desarrollo Funding And Liquidity					
	--Year-ended Dec. 31--				
(%)	2019*	2018	2017	2016	2015
Long-term funding ratio	93.2	93.2	99.3	90.9	92.9
Stable funding ratio	106.3	108.3	116.5	117.8	117.9
Short-term wholesale funding/funding base	9.2	9.2	1.0	12.3	9.8
Broad liquid assets/short-term wholesale funding (x)	1.8	2.1	21.5	2.5	3.0
Short-term wholesale funding/total wholesale funding	9.2	9.2	1.0	12.3	9.8
Narrow liquid assets/3-month wholesale funding (x)	36.0	40.8	48.1	66.1	50.9

*Data as of June 30.

Chart 3

Funding Base Composition
As of December 2018



Source: S&P Global Ratings.

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Support:

We classify the bank as a GRE with a high likelihood of extraordinary government support due to the bank's important role and very strong link to the government. However, the bank doesn't gain any additional support because the long-term sovereign rating is 'BB', at the same level of the bank SACP and issuer credit rating.

We believe AFD has an important role in Paraguay. As the only second floor bank, it channels resources to boost

economic development and employment in the private sector, through banks, financial institutions, and cooperatives.

Additionally, we believe that the link with the sovereign is very strong because we believe the government is a stable shareholder, doesn't contemplate AFD's privatization in the next few years, and guarantees all of AFD's financial obligations.

Related Criteria

- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Anchor Matrix										
Industry Risk	Economic Risk									
	1	2	3	4	5	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of September 19, 2019)*

Agencia Financiera De Desarrollo

Issuer Credit Rating

BB/Stable/--

Issuer Credit Ratings History

11-Sep-2018

BB/Stable/--

Ratings Detail (As Of September 19, 2019)*(cont.)

Sovereign Rating

Paraguay BB/Stable/B

Related Entities

Paraguay

Issuer Credit Rating BB/Stable/B

Transfer & Convertibility Assessment BB+

Senior Unsecured BB

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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