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CREDIT OPINION
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Update

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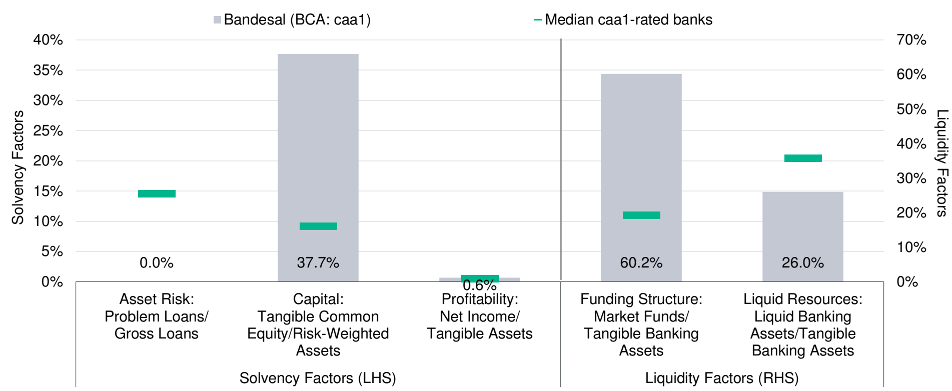
Banco de Desarrollo de El Salvador

Semiannual Update

Summary

Banco de Desarrollo de El Salvador (Bandesal)'s caa1 Baseline Credit Assessment (BCA) is in line with the Salvadoran government Caa1 long term rating, which reflects our view that the creditworthiness of the bank is intrinsically interlinked with that of the government, as its funding, liquidity position and market access are closely tied to El Salvador's own liquidity pressures. Similarly, its Caa1 long-term foreign currency issuer rating is at the level of the sovereign rating as well.

Exhibit 1
Rating Scorecard - Key Financial Ratios



Source: Moody's Financial Metrics

Credit Strengths

» Strong asset quality supported by Bandesal's preferred creditor status

» Robust core capitalization

Credit Challenges

» Reliance on wholesale market funds adds to refinancing risks

» Pressures on profitability due to rising credit costs amid low net interest margins

» Bandesal's BCA is constrained by El Salvador's "Very Weak +" Macro Profile

Rating Outlook

The outlook on Bandesal's long-term foreign currency issuer rating is stable in line with the stable outlook on El Salvador's government bond rating

Factors that Could Lead to an Upgrade

As Badesal's financial strength is limited by the creditworthiness of the Salvadoran government, upward pressures are limited as the Bank's BCA is already at the level of El Salvador's Caa1 sovereign rating.

Factors that Could Lead to a Downgrade

If El Salvador's government bond rating is downgraded further, Bandesal's ratings and assessments are likely to be downgraded again as well.

Key indicators

Exhibit 2

Banco de Desarrollo de El Salvador (Consolidated Financials) [1]

	6-17[2]	12-16[2]	12-15[2]	12-14[2]	12-13[2]	CAGR/Avg.[3]
Total Assets (USD million)	578	591	561	522	541	1.9[4]
Tangible Common Equity (USD million)	228	227	223	219	215	1.7[4]
Tangible Common Equity / Risk Weighted Assets (%)	37.7	39.4	40.7	41.8	34.4	38.8[5]
Net Interest Margin (%)	2.0	2.2	2.2	2.5	2.3	2.2[6]
PPI / Average RWA (%)	1.0	1.1	1.2	1.6	1.2	1.2[5]
Net Income / Tangible Assets (%)	0.6	0.8	0.9	0.9	0.9	0.8[6]
Cost / Income Ratio (%)	50.6	49.3	46.8	39.1	41.1	45.4[6]
Market Funds / Tangible Banking Assets (%)	60.2	61.2	59.7	57.5	59.3	59.6[6]
Liquid Banking Assets / Tangible Banking Assets (%)	26.0	28.0	28.8	28.4	35.2	29.3[6]

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel I; LOCAL GAAP [3] May include rounding differences due to scale of reported amounts [4] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime [5] Simple average of Basel I periods presented [6] Simple average of periods presented for the latest accounting regime.

Source: Moody's Financial Metrics

Profile

Bandesal is a Salvadoran development bank 100% controlled by the government. The bank is primarily focused on indirect lending via other financial institutions to micro and medium enterprises, while the share of direct lending in its loan book is low. In accordance with the Development Bank Law (Ley del Sistema Financiero para el Fomento del Desarrollo), Bandesal cannot take deposits.

As of June 2017 the bank reported $578 million of assets.

Detailed credit considerations

Reliance on wholesale market funds adds to refinancing risks

Bandesal depends entirely on wholesale funding as it cannot take deposits from the public according to the Development Bank Law. As of June 2017, lines from commercial banks and Central Reserve Bank of El Salvador comprised 58% of its total assets, while the bank did not have any debt issuances outstanding.

Funding is medium-term in nature, with the majority of it being due in more than one year as of June 2017. This allows an adequate match with the longer loan portfolio, as the majority if it also matures in more than one year. As a result, Bandesal shows positive cumulative tenor matches over the short term.

Liquid assets comprised 26% of total assets as of June 2017, down from 35% and 40% in 2013 and 2012 as the bank used them to fund growth in the past. Liquidity is largely invested in Salvadoran government securities as well as bank deposits and cash.

However, if the Salvadoran government continues to rely on short-term debt financing due to its inability to recur to long-term indebtedness, Bandesal's funding and liquidity profile could deteriorate as the bank's liquidity position and market access are closely tied to the government's own funding and liquidity profile.

Pressures on profitability due to rising credit costs amid low net interest margin

Bandesal's profitability has historically been modest, with return on assets consistently below 1%. This derives from thin net interest margins, which averaged a modest 2% since 2010, a by-product of the bank's developmental role and a loan book largely devoted to financial institutions.

As of June 2017, the net income to tangible assets stood at 0.64%, slightly up from 0.58% registered during the first half of 2016. Though NIMs stood at moderate 2% for both periods, the net income was 8% higher as of June 2017 than a year ago, supported by relatively volatile items such as higher fee and commission income as well as reserve reversals. These items helped offset increased credit cost, which jumped to 29% of pre privision income, from 16% year earlier.

At the same time, high operating costs continued to put pressure on returns. As of June 2017, Bandesal, despite not having a branch network, had a cost-income ratio of a high 51%.

Strong asset quality supported by Bandesal's preferred creditor status

Asset quality remains a strength for Bandesal given its preferred creditor status in El Salvador, coupled with prudent risk management and reserving practices. Per article 6 of the Development Bank Law, Bandesal can have access to the reserve accounts of regulated banks and some non-banks at the central bank, to ensure proper and timely payment of a given loan. The portfolio of loans to unregulated saving banks ("cajas"), cooperatives and direct lending is not covered by this mechanism. As of June 2017, Bandesal had a preferential creditor status on most of its portfolio. Nonperforming loans have been posted at zero since 2006.

Bandesal constitutes provisions for possible loan and investment losses. The loan-loss reserve policy includes a 1% voluntary reserve in addition to specific reserves, a policy based on forward-looking risk profiles. As of June 2017, loan loss reserves stood at 3.3% of gross loans, slightly above the last three-year average of 3%.

The five and ten largest borrowers comprised 46% and 74% of total gross loans. Largest exposures are largely devoted to government-owned banks and large domestic private commercial banks. Bandesal direct lending encompasses around 7% of its total gross loans.

Robust core capitalization

Historically, Bandesal has maintained strong risk-weighted capitalization that allows for a substantial cushion to absorb losses. As of June 2017, tangible common equity represented about 38% of adjusted risk-weighted assets.

Bandesal's BCA is constrained by El Salvador's "Very Weak +" Macro Profile

El Salvador has a small economy with weak growth prospects, weighed down by low investment and limited improvements in productivity. Although dollarization has helped keep inflation low, it has also limited the economic policy tools available to local authorities to spur greater economic growth. In addition, the country has a fragile rule of law and suffers from widespread security problems. Credit penetration is in line with the average across Latin America, although loan growth has lagged other regional peers as a result of the country's lackluster economic expansion. Asset risks related to exposures to short-term government securities (LETES) have risen this year as a result of the government's liquidity strains. Further, consumer lending growth has accelerated in recent years, leaving banks more susceptible to asset quality problems in the event of a more pronounced downturn in the economy, or a decline in remittances. The Salvadoran banking system is largely foreign owned and moderately concentrated.

Rating methodology and scorecard factors

Exhibit 3

Banco de Desarrollo de El Salvador

Macro Factors							
Weighted Macro Profile	**Very Weak +**	**100%**					
Factor		**Historic Ratio**	**Macro Adjusted Score**	**Credit Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency							
Asset Risk							
Problem Loans / Gross Loans		0.0%	ba1	←→	b3		
Capital							
TCE / RWA		37.7%	ba1	←→	b3		
Profitability							
Net Income / Tangible Assets		0.6%	caa1	←→	b3		
Combined Solvency Score			ba2		b3		
Liquidity							
Funding Structure							
Market Funds / Tangible Banking Assets		61.2%	caa3	←→	caa3		
Liquid Resources							
Liquid Banking Assets / Tangible Banking Assets		28.0%	b3	←→	b3		
Combined Liquidity Score			caa2		caa2		
Financial Profile					caa1		
Business Diversification					0		
Opacity and Complexity					0		
Corporate Behavior					0		
Total Qualitative Adjustments					0		
Sovereign or Affiliate constraint:					Caa1		
Scorecard Calculated BCA range					b3-caa2		
Assigned BCA					caa1		
Affiliate Support notching					0		
Adjusted BCA					caa1		

Instrument class	**Loss Given Failure notching**	**Additional Notching**	**Preliminary Rating Assessment**	**Government Support notching**	**Local Currency Rating**	**Foreign Currency Rating**
Senior unsecured bank debt	0	0	caa1	--	--	Caa1

Source: Moody's Financial Metrics

Support and structural considerations

Foreign currency issuer rating

Bandesal's Caa1 foreign currency issuer rating, with a stable outlook, is in line with El Salvador's Caa1 government bond rating, also with a stable outlook. It also reflects our assessment of a high probability of extraordinary public support to the bank in the case of need, though this assessment does not yield in a rating uplift at this time.

About Moody's bank scorecard

Our Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The Scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Ratings

Exhibit 4

Category	Moody's Rating
BANCO DE DESARROLLO DE EL SALVADOR	
Outlook	Stable
Baseline Credit Assessment	caa1
Adjusted Baseline Credit Assessment	caa1
Issuer Rating	Caa1

Source: Moody's Investors Service

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