SECTOR IN-DEPTH
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Multilateral Development Banks – Global

MDB default statistics confirm strength of preferred creditor status

Last year, for the first time, several multilateral development banks (MDBs) published data for their historical default and recovery rates, spanning several decades. In addition, the Global Emerging Markets Risk Database (GEMs), a consortium of multiple MDBs and development finance institutions, provided updated default rates and for the first time recovery rates of eleven MDBs on their sovereign and sovereign-guaranteed lending. The data now available provide additional insights into the credit benefit of MDBs' preferred creditor status, confirming its effectiveness.

New data confirm low sovereign default rates to MDBs. Data released by the International Bank for Reconstruction and Development (IBRD, Aaa stable), the Asian Development Bank (ADB, Aaa stable) and the Inter-American Development Bank (IADB, Aaa stable) confirm their lending's very strong performance over the past decades, with fewer sovereign defaults than commercial lenders and bond investors.

MDBs' recovery rates are typically also very high. The GEMs data show an average recovery rate of 94.9%. This reflects MDBs' practice to not write off a loan. The extent of their losses only reflects the length of time a loan stays in non-accrual and the prevailing interest rate during that period.

Data confirm significant credit benefit from preferred creditor status. MDBs are treated as preferred creditors in their lending to sovereigns. This means that the borrowers continue to pay their obligations to MDBs even as they default to other creditors. Preferred creditor status is important for our credit analysis of MDBs. We typically raise our assessment of an MDB's development asset portfolio's credit quality by three notches, to reflect an MDB's strong track record of preferred creditor status.

New data confirm low sovereign default rates to MDBs

Data released by the IBRD, the ADB and the IADB uniformly confirm their lending's very strong performance over the past decades, with much fewer sovereign defaults than commercial lenders and bond investors.[1] IBRD's average annual default rate - defined as new sovereign borrowers in non-accrual status in each year divided by the number of active borrowers at the start of that year - was 0.7% for the period 1981-2023, with the first default on an IBRD loan occurring in 1985. The highest number of defaults was recorded in fiscal year 1988, with a rate of 4.5%. It is the convention of most MDBs to place all loans made to a country into non-accrual status when a payment is overdue by more than six months. The bank recorded the highest new non-accrual amount in 1989, at 4.1% of its total portfolio.

IADB's default experience over a similar period is comparable, with an average annual default rate of 0.5% between 1980-2023. Its default rate peaked in 1989 at 9.1% with non-accrual amounts of 8.5% of the total loan portfolio. Both IBRD and IADB were affected by the defaults of several Latin American countries at the time, namely Peru (Baa1 stable), Panama (Baa3 negative), Nicaragua (B2 stable) and Honduras (B1 stable).

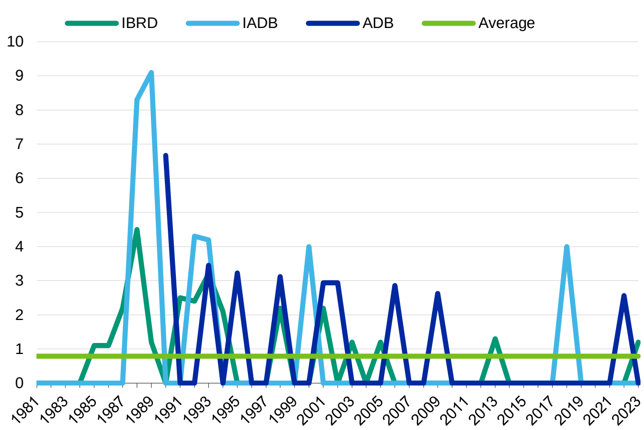
ADB's default rate averaged 0.9% for the period 1990-2023, including both ordinary and concessional lending.[2] ADB's default rate peaked at 6.7% in 1990, while outstanding loans to borrowers in default peaked at 1.3% of total loans in 1998.

Our sovereign default statistics point to a one-year default rate of speculative-grade sovereigns of 3.35% over the period 1983-2024, with our data reflecting defaults to private-sector creditors. The data is not strictly comparable to the MDB data, as it is based on a different sample of countries, a different definition of default and the default rates are calculated in a different manner to the MDBs or GEMs.[3] That said, sovereign defaults to MDBs have been much lower than those to other creditors, and despite a recent increase, remain lower than in the late 1990s and early 2000s (see Exhibits 1 and 2).

Exhibit 1

Sovereign defaults to MDBs are low and have declined since the 2010s

Sovereign borrowers in default, % of performing borrowers at the start of year

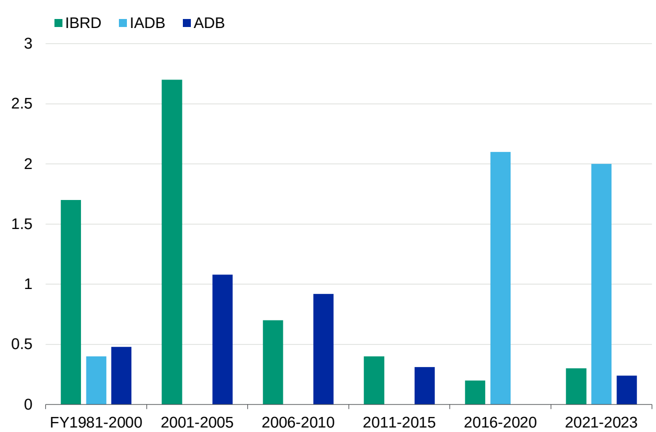


Sources: MDBs' default and recovery statistics and Moody's Ratings

Exhibit 2

Share of portfolio in non-accrual is also very low

% of loan portfolio in non-accrual



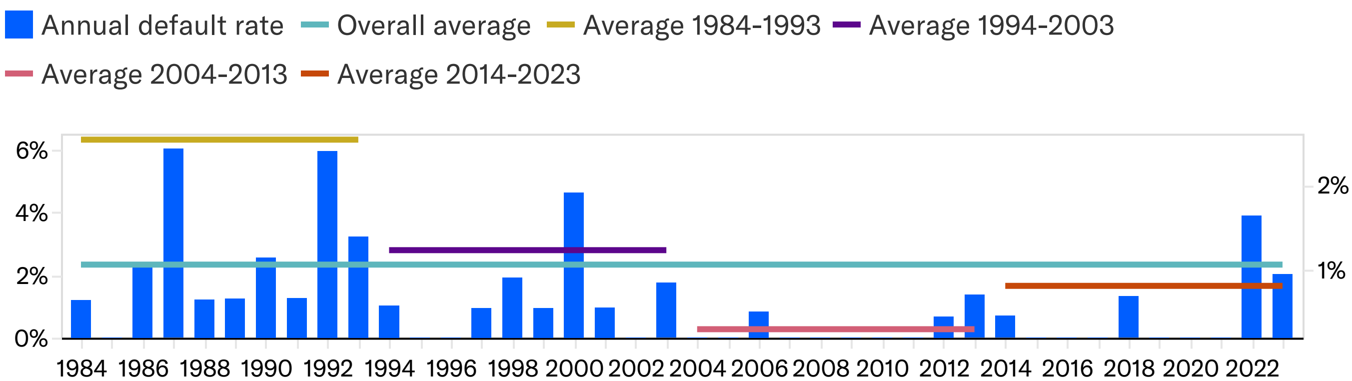
MDBs classify all loans to a sovereign borrower in non-accrual if a loan payment is overdue by more than 180 days. ADB only started reporting in 1990.
Sources: MDBs' default and recovery statistics and Moody's Ratings

The limited default experience of those MDBs, which is also fed into the GEMs consortium database, aligns with the broader pooled GEMs data set provided by 11 MDBs for sovereign and sovereign-guaranteed lending over a 40-year observation period up to 2023.[4]

Based on 50 reported default episodes, the average annual default rate is 1.06%. The average default rate for the combined data is higher than for individual institutions as a default is counted if a sovereign defaults to any of the reporting MDBs.

Relatively high annual default rates were recorded in the late 1980s and early 1990s, followed by lower rates until 2021. Since 2022 default rates have increased again, mainly reflecting international sanctions imposed on certain sovereigns due to geopolitical developments, as in the case of Russia and Belarus (C stable), as well as difficult domestic political conditions (see Exhibit 3). The disclosed data also highlight that sovereign defaults to MDBs are often driven by high political instability, sometimes culminating in conflict, and severe governance challenges.

Exhibit 3
Broader GEMs database similarly shows low default rates to MDBs



Source: GEMs Consortium

MDBs' recovery rates are typically also very high

MDBs' recovery rates are also strong, with the GEMs data showing an average recovery rate of 94.9%. Looking more closely into the distribution of recoveries, 59% of defaults have recovery rates above 98% and 43.6% have rates exceeding 99%. The data provided by the three MDBs individually point to similarly high recovery rates, ranging from an average rate of 90.4% for IBRD, 96.2% for ADB and nearly 98% for IADB.[5] All three MDBs currently have only one or two borrowers in default, and these ongoing defaults are excluded from the recovery calculations. IBRD has a large variation in recovery rates, ranging from a low of 41.5% to full recovery, because some defaults cover a long period of time. Moody's issuer-weighted recovery rate on sovereign debt stands at 53%, with a wide variation between 17% and 100%.[6]

The high recovery rates reflect MDBs' practice, in contrast to commercial creditors, to never write off a loan. Also different from commercial creditors, MDBs do not charge interest on overdue interest. Therefore, the size of their economic losses only reflects the lost interest on interest based on the length of time a loan stays in non-accrual and the prevailing interest rate during the period.

Data confirm significant credit benefit from preferred creditor status

MDBs are treated as preferred creditors in their lending to sovereigns, in that the borrowers continue to pay their obligations to MDBs even as they default to other creditors. Sovereign borrowers from MDBs have strong incentives to remain current on their obligations to them because MDBs are typically counter-cyclical lenders, often the only remaining source of affordable financing during crisis episodes. One illustration of preferred creditor treatment is the very strong asset performance of many MDBs, with very low non-performing exposure, despite the typically low credit quality of their borrowers, predominantly in emerging and frontier markets.

The strength of preferred creditor status was confirmed in a number cases of sovereign debt distress over the past few decades. For example, ADB did not suffer losses during Pakistan's (Caa2 positive) default in 1999, while IADB continued to be repaid during the 2001-02 Argentinian crisis and several default episodes of Ecuador (Caa3 stable) to commercial creditors. El Salvador's (B3 stable) exposure still performed for the Central American Bank for Economic Integration (CABEI, Aa3 stable) despite the sovereign's two buybacks in 2022, which we considered as distressed exchanges and defaults. More recently, IBRD, ADB and AIIB continued to receive payment during Sri Lanka's (Caa1 stable) default.

The large and long-established MDBs are also typically excluded from sovereign debt restructuring, a benefit explicitly granted by the official creditors organised under the Paris Club.

Preferred creditor status is an important consideration for our credit analysis of MDBs, even though it is not grounded in international law or included in loan contracts. [7] We raise our assessment of the credit quality of an MDB's development asset portfolio typically by three notches, to reflect a strong track record of preferred creditor status.

Depending on the starting point of our analysis – the weighted average borrower rating – an increase of three notches equates to a significant reduction in the probability of default. For example, IADB's weighted average borrower rating is B3 as of 2024. A one rating category increase for preferred creditor status moves our assessment to Ba2, equivalent to a reduction in the implied one-year probability of default from 11.62% to 1.56%.

Endnotes

1 The International Finance Corporation (IFC, Aaa stable) and the European Bank for Reconstruction & Development (EBRD, Aaa stable) published historic default and recovery statistics on their private-sector lending, and GEMs also published similar data. These are not covered in this report.

2 Concessional lending was done under the Asian Development Fund (ADF) until its lending operations were combined with ADB's ordinary capital resources as of 1 January 2017. The average is for the combined portfolio.

3 Our sample comprises only countries with a Moody's rating while GEMs default data includes those with exposure to at least one MDB. Our default definition includes distressed exchanges, which are not part of the MDB definition of default. Our default rate calculation includes particular treatment for rating withdrawals.

4 The following institutions participate in the data report: ADB, African Development Bank (AfDB, Aaa stable), Asian Infrastructure Investment Bank (AIIB, Aaa stable), CABEI, (CEB, Aaa stable), European Investment Bank (EIB, Aaa stable), IADB, IBRD, International Fund for Agricultural Development (IFAD), Islamic Development Bank (IsDB, Aaa stable), and New Development Bank.

5 The MDBs provide their loss given default (LGD) calculations. Recovery rates are defined as one minus LGD.

6 For sovereign defaults on bonds, which comprise most of our sovereign defaults, we typically measure the recovery as the average trading price in percent of the par value of the bonds around the time of the default.

7 The European Stability Mechanism (ESM, Aaa stable) is the only exception, as its preferred creditor status is explicitly stated in its loan agreements' general terms.

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