Rating-Agentur Expert RA GmbH confirmed at 'B+' the sovereign government and at 'B' the credit climate ratings of Armenia

Rating-Agentur Expert RA GmbH confirmed the sovereign government credit rating (SGC) of Armenia at 'B+' (Moderately low level of creditworthiness of the government) in national currency and at 'B+' (Moderately low level of creditworthiness of the government) in foreign currency.

Rating-Agentur Expert RA GmbH confirmed the country credit environment rating (CCE) of Armenia at 'B' (Moderately low quality of credit environment of the country) in national currency and at 'B' (Moderately low quality of credit environment of the country) in foreign currency.

MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

Positive factors:

- The structure of Armenia's debt is still positive. Despite an increase in short-term debt in 2016, it remained as low as 2,2% of GDP and amounted to 4% of total debt. Furthermore, foreign currency denominated debt declined further down to 80,7% of total debt in 2016, most of which is held by international institutions at favorable terms. In addition, the share of variable interest rate loans increased to 12,5% of total debt in 2016, 2p.p. higher than a year ago;
- The real economy is expected to grow around 2,4% in 2016, according to IMF projections, mainly driven by economic struggles in the CIS region;
- The Central Bank of Armenia (CBA) continues with its loose policy: it reduced FX reserve requirements and cut the refinancing rate by an additional 0,25% to 6,25% in December 2016. However, external factors caused deflationary conditions to persist.

Restricting factors:

- Armenia's international reserves have picked up towards the end of 2016 to stay at USD 2,2 bn due to a steep decrease in interventions by the CBA. Reserves as a percentage of government debt increased to 36% and they still cover short-term debt by a comfortable margin (9,1x) in 2016;
- The fiscal deficit widened more than expected in 2016. Official figures by the Ministry of Finance showed a balance of -5,3% of GDP given a dismal increase in revenues and higher capital expenditures. However, this indicator is likely to narrow in 2017 given the trigger of the fiscal rule as well as the introduction of the new tax code;
- The country's GDP per capita in PPP terms remains acceptable (projected by IMF at USD 8,9 th in 2016) when compared to the average of its regional non-oil dependent (RNOD) peers[1];
- Continued weak domestic demand coupled with low import prices and still high real levels of the policy rate translated in an inflation rate of -1,1% in 2016, the second year in a row with deflation;
- The banking sector recovered slightly towards year-end 2016. As of October 2016 ROA stood at 0,6%, regulatory capital to risk-weighted assets at 19,2% and liquid assets to total assets at 31,2%. At the same time, private credit recovered due to the loose monetary policy (we estimate that total loans to GDP grew by around 5p.p. as compared to 2015);

[1] Non-oil dependent peers include Georgia, Kyrgyzstan and Tajikistan.

- The fiscal policy effectiveness is expected to improve in 2017. Despite revenues and expenditures being off-target in 2016, a new tax reform in 2017 will help to reduce the debt burden and narrow the deficit;
- Acceptable level of institutional development in the country. There are good conditions in the country for business, nonetheless corruption remains a drag for economic growth.

Negative factors:

- Government debt continues to pile up as we anticipate it to end 2016 at around 55,8% of GDP and 261,4% of budget revenues, in line with the IMF, an increase of around 9p.p. and 41p.p. respectively from 2015. Despite this, given the government fiscal rule[2] and new tax code, we expect debt figures to increase more smoothly in the following years;
- The yield on the USD denominated 10Y government bond has remained quite stable in the past months (6,45% as of 30 January 2017) as long-term risks remain unchanged;
- Unemployment remained high and stable at around 18,1% as of end-2016;
- NPLs to total loans have slightly declined to 9,3%, almost 1p.p. since our last revision. However, this figure is still high, especially in regards to FX denominated loans;
- The stock and bond markets remain underdeveloped. The number of companies and bonds listed was still marginal (11 and 17 respectively) and stock market capitalization was as low as 2,6% of GDP as of October 2016;
- Economic competitiveness in Armenia remains subdued. The trade deficit was around 14,1% of GDP in 2016 and the country's position in the global competitiveness ranking of the World Economic Forum was 79th out of 138 countries.

Stress factors:

- Financial dollarization, despite easing in 2016, remains high; loans and deposits in FX were equivalent to 63% and 64,5% of total loans and deposits respectively as of December 2016 (weak stress factor);
- The conflict with Azerbaijan for the Nagorno-Karabakh remains unresolved (weak stress factor).

ADDITIONAL FACTORS THAT INFLUENCED CCE RATINGS:

Negative factors:

- High real interest rate estimated at 16% in 2016.

Positive factors:

- Spread between the interest rate on loans and deposits remained acceptable at 379 b.p. in December 2016;
- The external debt load of the private sector was moderate at 87% of GDP as of 3Q 2016.

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Long-term consolidation of the fiscal balance and stability of government debt levels;
- Sustained reduction in the external exposure combined with a steep decrease in dollarization levels.

[2] According to the IMF, Armenia's fiscal rule indicates that government debt cannot succeed 60% of GDP and that when it exceeds 50% of GDP, the fiscal deficit for the following year shall be lower than 3% of the average GDP for the last three years.

The following development could lead to a downgrade:

- Unsuccessful consolidation process which would result in constantly widening fiscal deficits and government debt increases.

"Armenia's ratings are still supported by the satisfactory structure of government debt and acceptable management of the monetary policy. In addition, economic growth remains positive despite adverse external conditions.

Nevertheless, the widened fiscal deficit and the increase in government debt, combined with high dollarization levels and the amount of NPLs in the banking system, still had a negative impact on the ratings. Furthermore, the country remains highly exposed to external factors, which affect the performance of the overall economy and the management of monetary and fiscal policies." – Clarified Hector Alvarez, Rating Associate of Rating-Agentur Expert RA GmbH.

Responsible expert: Hector Alvarez, Rating Associate of Rating-Agentur Expert RA GmbH

Reviewer: Gustavo Angel, Rating Associate of Rating-Agentur Expert RA GmbH

Research report on Armenia is available at:

http://raexpert.eu/reports/Research_report_Armenia_03.02.2017.pdf

Next scheduled rating publication: 28 July 2017. The full sovereign rating calendar can be found at http://raexpert.eu/sovereign/#conf-tab-5

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RATING HISTORY:

Date	Review reason	SGC		CCE	
		National currency	Foreign currency	National currency	Foreign currency
05.08.2016	Scheduled revision of both types of ratings for the country	B+	B+	B	B
04.03.2016	First assignment of both types of ratings for the country	B+	B+	B	B

Minute's summary

The rating committee for Armenia was held on 2 February 2017. The quorum for the rating committee was present. After the responsible expert presented the factors, which influenced the rating assessment, the members of the committee expressed their opinions and suggestions within the framework of the Sovereign methodology. The chairman of the rating committee ensured that every member of the committee expressed his/her opinion before proceeding to the voting.

The following methodology was used for the rating assessment: Methodology for Assigning Sovereign Government Credit Ratings and Country Credit Environment Ratings. Short Public Version (from April 2015) can be found under the following link: http://raexpert.eu/files/methodology/Methodology-Short-Sovereign.pdf. Descriptions and definitions of all rating categories can be found under the following link: http://raexpert.eu/sovereign.php under the "Rating scale" section. The user of the rating shall read the methodology in order to have a full understanding of the rating procedure.

These ratings are unsolicited. The rated entity did not participate in the rating process.

Main sources of information: International Monetary Fund, World Bank, World Economic Forum, Doing Business, United Nations, NASDAQ Armenia, Central Bank of Armenia (CBA), Ministry of Finance of Armenia, National Statistical Service of the Republic of Armenia, Transparency international.

Limits of the Credit Rating

During the rating assignment process, Rating-Agentur Expert RA GmbH (the Agency) used publicly available information that was considered to be reliable, complete and non-biased. The responsible expert performed the rating assessment of the country with information considered as the most reliable and up to date in accordance to the overall position of the country and the Agency's internal criteria for selecting data providers. The information and data used for this specific assessment can be considered as of sufficient quality.

Despite similar methodologies, credit ratings of Armenia from RAEX (Moscow) (both SGC and CCE) may be different from those assigned by Rating-Agentur Expert RA GmbH due to:

- Possible differences in expert assessments of individual factors;
- Some differences in methodologies (methodologies are similar but not identical);
- Differences in the date/period of assessment for individual factors.

Conflict of interest

The responsible expert was neither influenced nor biased by third parties during the rating assessment. All employees involved in the rating assessment and revision of the rated entity have reported absence of conflicts of interests before initiation of the rating process**.**

Rating-Agentur Expert RA GmbH is completely independent from the activities of other agencies of the RAEX group.

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This press-release represents the opinion of Rating-Agentur Expert RA GmbH and is not a recommendation to buy, hold or sell any securities or assets, or to make investment decisions.

Office responsible for preparing the rating

The office responsible for the preparation and issuance of this credit rating is the office of Rating-Agentur Expert RA GmbH in Frankfurt am Main, Germany.

Rating-Agentur Expert RA GmbH is a credit rating agency established in Germany and therefore shall comply with all applicable regulations currently in force in the European Union.

The European Securities and Markets Authority (ESMA), the EU's direct supervisor of credit rating agencies (CRAs), has registered Rating-Agentur Expert RA GmbH as a CRA under Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, with effect from 1 December 2015.

Rating-Agentur Expert RA GmbH applies the Code of Conduct Fundamentals for credit rating agencies issued by the International Organization of Securities Commissions (IOSCO Code) and includes the basic principles of IOSCO Code in its Code of Conduct.