

### **Rating-Agentur Expert RA confirmed at 'BB-' the ratings of Armenia. The rating outlook is positive.**

Rating-Agentur Expert RA confirmed the sovereign government credit rating (SGC) of Armenia at 'BB-' (Sufficient level of creditworthiness of the government) in national currency and at 'BB-' (Sufficient level of creditworthiness of the government) in foreign currency. The rating outlook is positive which means that in the mid-term perspective there is a high probability of upgrading the rating score.

#### MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

##### Positive factors:

- Fiscal underspending, as well as higher than expected budget income, caused the budget deficit to narrow further in 2019. Our estimation stands at 1,5% of GDP, which is 0,3p.p. lower than in 2018 and 0,7p.p. lower than the State Budget projections for the year. In order to boost economic activity and increase tax compliance in the country, a new tax reform effective from January 2020 has been introduced, reflecting noticeable corporate tax rates reduction. Therefore, in the mid-term perspective we expect the fiscal policy to remain prudent, with the budget deficit to GDP ratio around 2,3% and on the back of rising capital expenditures and stable current spending, according to the Medium Term Expenditure Framework for 2020-2022;
- The banking sector remains well-capitalized, with a strong liquidity, stable asset quality and subdued but positive profits. As of October 2019, the regulatory capital to risk-weighted assets was 17,5%, NPLs to total loans stood at 5,2%, ROA and ROE was 1,7% and 11,1%, while the ratio of liquid assets to demand deposits was 110,7%. Domestic credit provided by financial sector to GDP is expected to rise by 4% in 2019 until 67% as total loans grew by 13% since the beginning of the year; it is mostly related to the household sector. As of November 2019, household loans grew by 27% while loans to non-financial corporations barely grew at 5% since the end of 2018. The Central Bank of Armenia (CBA) has set additional capital buffers in the banking sector in order to be compliant with the Basel III regulation. Fully implementation of the new standards should positively impact banking sector stability;
- Government debt structure remains stable. As of November 2019, short-term debt accounted for 4,6% of total debt, 15% had floating interest rate and FX-denominated debt remained elevated at 78,6%; however, this type of debt remains mostly concessional;
- The economy showed remarkable growth in 2019 with more than 7% real GDP growth in 3Q reported by the national statistical service of Armenia as a result of solid private consumption and investment. On the production side, the largest growth belongs to the mining industry and accommodation and food service activities with 45,2% and 30% increase since the beginning of the year respectively;
- The inflation rate in 2019 is expected to be at 1%, well below the initial target of 4% from the CBA. In September 2019, the CBA cut the refinancing rate by 0,25p.p. for the second time in the year down to 5,5%. Monetary policy stimulus should bring inflation closer to the target in the medium term. In general, we continue to observe effective monetary policy with high credibility and an improved transmission mechanism, which has contributed to the fall of lending rates. Average interest rates on loans extended by

commercial banks in local currencies decreased by 0,8p.p. y-o-y in November 2019;

- The contractionary fiscal policy continued to be adequate and efficient in controlling the budget deficit. At the same time, we will carefully observe the effectiveness of the implementation of the new tax system;
- Armenia has a strong investment potential, however we expect the FDI inflows to GDP at 2% in 2019, similar to the previous year results.

#### Restricting factors:

- International reserves recovered after the slight decrease during the year up to USD 2,4 bn as of September 2019, the same figure was recorded at the end of 2018. The short-term debt to budget revenues coverage was 10x, which is considered as acceptable;
- Estimated GDP per capita in PPP terms for 2019 is expected to be at USD 11,1 th, remaining satisfactory when compared to the average of Armenia's regional non-oil dependent (RNOD) peers<sup>1</sup>;
- Despite an improvement in World Bank governance indicators in transparency of government policymaking and government effectiveness, institutional development in the country remains moderate, corruption remains a drag for economic growth;
- The spread between the 10Y U.S. government bond and the USD-denominated Armenian government bond maturing in 2029 was 2,3p.p.

#### Negative factors:

- The level of government debt continues to be significant with a positive declining trend in 2019. According to our estimations, gross government debt will be slightly higher than 50% of GDP and 212% of budget revenues. According to the current fiscal policy, the government will intend to maintain such level in the mid-term horizon;
- Levels of unemployment in Armenia remained high in 2019 and are expected to be close to 18%;
- The stock market continues to be underdeveloped, as total market capitalization in the country has remained practically unchanged for the last five years and stood at 2,3% of GDP as of November 2019. Moreover, the trades are highly concentrated in the 10 largest issuers of shares;
- Armenia is ranked 47<sup>th</sup> out of 190 countries in World Bank Doing Business report 2020, a 6 notches drop against 2019 results due to the very low score on protecting minority investors rights. External position remains the factor significantly constraining the creditworthiness of Armenia, as the country relies heavily on imports, and trade deficit is expected to expand further in 2019 up to 18% of GDP, 3p.p. higher than in 2018.

#### Stress factors:

- Financial dollarization remains high but stably declining; loans and deposits in FX were equivalent to 50% and 47,3% of total loans and deposits respectively as of November 2019 (weak stress-factor);
- The conflict with Azerbaijan for the Nagorno-Karabakh remains unresolved and escalation is still a latent risk (very weak stress-factor).

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<sup>1</sup> Non-oil dependent peers include Georgia, Kyrgyzstan and Tajikistan.

#### SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Consistency in the already evidenced favorable fiscal consolidation: narrowing of the fiscal balance and drop of government and public debt levels as well as successful implementation of tax policies;
- Consistent reduction in the dependence on external factors combined with a steep decrease in levels of financial dollarization.

The following developments could lead to a downgrade:

- Further deterioration of the external position;
- An increase on government debt in the mid- to long-term perspective, worsening the fiscal stance.

“The confirmation of sovereign government credit ratings of Armenia at ‘BB-’ with positive outlook reflects the continued high economic growth supported by stabilization of the fiscal balance and drop of public debt levels. Furthermore, the quality of the monetary and fiscal policies remains efficient and adequate.

Nevertheless, government debt levels continue to be elevated and exposed to currency risks. In addition, the economy is highly dependent on imports, remittances inflow and main trading partners. Finally, the current account remains negative, making the weak external position one of the key factors constraining the rating.” – Clarified Olena Kolokolova, Rating Analyst of Rating-Agentur Expert RA.

Research report on Armenia is available at:

[https://raexpert.eu/reports/Research\\_report\\_Armenia\\_10.01.2020.pdf](https://raexpert.eu/reports/Research_report_Armenia_10.01.2020.pdf)

Next scheduled rating publication: 10 July 2020. The full sovereign rating calendar can be found at [Sovereign Rating Calendar 2020](#)

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**RATING HISTORY:**

Date	Review reason	SGC		Outlook	
		National currency	Foreign currency	National currency	Foreign currency
12.07.2019	Scheduled revision of both types of ratings for the country	BB-	BB-	Positive	Positive
18.01.2019	Scheduled revision of both types of ratings for the country	BB-	BB-	Stable	Stable
20.07.2018	Scheduled revision of both types of ratings for the country	BB-	BB-	Stable	Stable
26.01.2018	Scheduled revision of both types of ratings for the country	BB-	BB-	NA	NA
28.07.2017	Scheduled revision of both types of ratings for the country	B+	B+	NA	NA
03.02.2017	Scheduled revision of both types of ratings for the country	B+	B+	NA	NA
05.08.2016	Scheduled revision of both types of ratings for the country	B+	B+	NA	NA
04.03.2016	First assignment of both types of ratings for the country	B+	B+	NA	NA

## Minute's summary

The rating committee for Armenia was held on 10 January 2020. 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 – Full Public Version \(from April 2019\)](#). Descriptions and definitions of all rating categories can be found 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.

The definition of default can be found on the Agency's website in the section for [Internal policies](#).

**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, Cbonds, Asian Development Bank.

## 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.

## Regulatory use

SGC ratings can be used for regulatory purposes according to the ESMA definition.

## 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.

## Risk warning

The Agency disclaims all liability in connection with any consequences, interpretations, conclusions, recommendations and other actions directly or indirectly related to the conclusions and opinions contained in the Agency's press-release and research report.

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.