

Rating-Agentur Expert RA GmbH confirmed at 'BB-' the ratings of Armenia. The rating outlook is stable.

Rating-Agentur Expert RA GmbH 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 stable which means that in the mid-term perspective there is a high probability of maintaining the rating score.

MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

Positive factors:

- We anticipate the fiscal balance to have narrowed down to about -2,7% of GDP in 2018. The deficit was lower than expected as a result of under-spending by the government due to the thorough review of the budget execution by the authorities. In 2019, the budget already includes the new fiscal rules aimed at managing public finances without affecting economic output negatively. Also, in the mid-term perspective we still expect the fiscal policy to be contractionary and to swap current expenditures for capital expenditures to propel growth;
- In 2018, the banking sector remained quite stable. After the tense political situation, which developed along part of last year, the banking system remained solid with good capitalization and liquidity metrics. As of September 2018, the capital adequacy ratio stood at 17,9% and the ratio of liquid assets to short-term liabilities was 126,5%. In addition, the ratio of NPLs to total loans, despite having slightly increased since 2017, was also low at 6,9%. Moreover, profitability was favorable as ROA stood at 1,5% and ROE at 9,5% as of the same date. Credit to the economy has picked up: as of November 2018, loans in Armenia had grown by around 20,3% y-o-y and we project domestic credit to GDP to be in the range between 60%-62% at the end of 2018;
- Government debt structure has remained nearly unchanged. As of November 2018, short-term debt accounted for 2,6% of total debt, 14,3% had floating interest rate and FX-denominated debt remained elevated at 80,7%; nevertheless, this type of debt is mostly concessional;
- Real GDP growth is expected to have slowed down in 2018 as compared to 2017, albeit remaining robust at about 5,3%. Robust private consumption and investment, higher copper prices, stable remittances and exports contributed positively to growth; however, public spending was weaker than anticipated. Moreover, toward the end of 2018 we have observed lower remittances inflow, which have hurt private consumption figures, and also a y-o-y decline in exports as a result of weaker external demand;
- As inflation remains stalled (expected at 2,7% by end-2018) mainly due to steep declines in food prices and as private consumptions has shown signs of slowing down towards the end of the year, the Central Bank of Armenia (CBA) has left the refinancing rate at 6% continuing with its expansionary monetary policy. Even though the inflation metric is well off the CBA target, the stability of the reading has been positive; between 2017 and 2018, the dynamic of the CPI index has been the smoothest in recent years. In general, we continue to observe a high quality of the monetary policy with high credibility and an improved transmission mechanism which has contributed to the fall of lending rates;

- Armenia has a strong investment potential as showed by a projected net FDI inflows to GDP at around 2% in 2018.

Restricting factors:

- After a rapid slide in international reserves in 1H 2018, these started to pick up again in 2H 2018 and reached USD 2,2 bn by year-end 2018. Thus, short-term debt remains well covered (13x);
- GDP per capita in PPP terms is expected to have finished 2018 at USD 10,3 th. The reading remains quite acceptable when compared to the average of Armenia's regional non-oil dependent (RNOD) peers¹;
- The inflation rate is expected to post a figure of around 2,7% in 2018; very close to the reading from 2017, reflecting stability in the price level;
- The quality of the fiscal policy remains quite favorable as we have seen narrowing budget balances and lower public debt confirming a positive path for the consolidation process. As already mentioned, the new fiscal rules were already implemented in the new budget for 2019. Moreover, the government plans a new tax policy where the profit and dividend tax rates will be reduced and sales tax rates will be increased to compensate for the cuts;
- Institutional development in the country remains bearable as there are good conditions in the country for business as shown by the Doing Business rating, with a moderate rule of law and government transparency. Nonetheless, 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 2025 remains acceptable at 3,3p.p.

Negative factors:

- Government debt is expected to have remained quite stable in 2018. We project this metric to have declined by around 2p.p. in the last year down to around 51% of GDP. Public debt, which includes obligations from the CBA, is also expected to have declined. Moreover, government debt to budget revenues, according to our projection, will stand at around 235% of GDP showing a decrease of about 17p.p. as compared to 2017. These figures support the strategy of the government to consolidate public finances and reduce debt;
- Levels of unemployment in Armenia are expected to remain fairly high in 2018 at around 18%;
- The underdevelopment of the stock markets is still a negative factor affecting the creditworthiness of Armenia. Market capitalization in the country declined slightly in 2018 down to 2,4% of GDP;
- The country's position in the global competitiveness ranking of the World Economic Forum improved slightly in 2018 as the country was ranked 70th of 140 countries (73rd in 2017). However, business remains dominated by oligopolies and the economy relies heavily on imports.

Stress factors:

- Financial dollarization remains high but stable; loans and deposits in FX were equivalent to 55,6% and 53% of total loans and deposits respectively as of November 2018 (weak stress factor);
- The conflict with Azerbaijan for the Nagorno-Karabakh remains unresolved and escalation is still a latent risk (very weak stress factor).

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

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Materialization of the consolidation efforts of public finances for a substantial period of time: narrowing of the fiscal balance and drop of government and public debt levels;
- 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:

- Opposite behavior in regard to our estimated fiscal expectations; i.e. further widening of the fiscal balance and a sustained increase on government debt in the mid- to long-term perspective.

“The confirmation of Armenia’s ratings at ‘BB-’ with a stable outlook reflects a well-managed, effective and credible monetary policy, successful consolidation efforts of public finances, as well as robust and stable economic growth. Moreover, the structure of government debt remains quite favorable despite most of the obligations being of external nature. Also, we consider that the political risk has been reduced as the new government won by a high margin in the past December elections.

Despite this, government debt is still elevated and the country remains highly exposed to external factors as the economy is still highly dependent on remittances inflows, imports and commodities’ exports. Moreover, despite financial dollarization and government debt having decreased, they remain fairly high.” – Clarified Hector Alvarez, Rating Associate of Rating-Agentur Expert RA GmbH.

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

Reviewer: Vladimir Gorchakov, Rating Associate of Rating-Agentur Expert RA GmbH

Research report on Armenia is available at:

https://raexpert.eu/reports/Research_report_Armenia_18.01.2019.pdf

Next scheduled rating publication: 12 July 2019. 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		Outlook	
		National currency	Foreign currency	National currency	Foreign currency
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 18 January 2019. 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 May 2018) can be found under the following link: https://raexpert.eu/files/methodology/Methodology_Full_Sovereign_V3.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, 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.