

## 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:

- In 2017, the fiscal deficit was 1,5p.p. higher than expected at 4,8% of GDP due to the utilization of a Russian provided defense loan. Even though this number was out of target, it still narrowed as compared to 2016 when the deficit was 5,6% of GDP showing improving consolidating efforts. Going forward, and given the introduction of the new fiscal strategy, we anticipate deficits to reduce below the 3% mark;
- The banking system remains fairly solid. Capitalization levels in the country are quite adequate as the capital adequacy ratio was 18,7% as of March 2018 and has remained stable. Moreover, as of the same date, NPLs to total loans stood at 5,4% showing a continued reduction for the last two years. Finally, profitability has also been steadily positive as shown by a ROA figure of 1,4% as of March 2018. Even though the amount of banks' assets to GDP remained unchanged, we did see an increase in domestic credit up to 58,2% of GDP in 2017;
- The structure of the government's debt remains stable as it has practically not changed since our last revision. As of May 2018, short-term debt accounted for 2,6% of total debt, 13,8% had floating interest rate and FX-denominated debt remained elevated at 81,8%; nevertheless, this type of debt is mostly at favorable conditions;
- Armenia's economy has remained resilient. By end-2017 real GDP grew by 7,5%, a figure substantially higher than what we previously anticipated. The strong growth was mainly supported by higher industrial production, growth in overall trade, a hike in the services sector and increase in construction. Growth momentum carried over into 1Q 2018; however, we anticipate positive but lower real output in 2018;
- The expansionary monetary policy of the government fueled the increase of inflation slightly toward the 4% target of the Central Bank of Armenia (CBA) in 2017. However, it has dipped down to 0,9% y-o-y as of June 2018. We anticipate a reduction in the refinancing rate of the CBA if this scenario were to persist. In general, we see a positive monetary policy with high credibility and an improved transmission mechanism which has contributed to the fall of lending rates, causing investment consumption to grow and the price level to increase.

#### Restricting factors:

- The spread between the 10Y U.S. government bond and the USD-denominated Armenian government bond maturing in 2025 is acceptable at 3,3%;
- International reserves have been in a rapidly declining trend since November 2017, despite this, they remain at adequate levels. As of May 2018, they stood at USD 2 bn which is equivalent to 32,6% of government debt and they cover short-term debt by more than

11x;

- GDP per capita in PPP terms is estimated at USD 9,5 th in 2017, a moderately favorable metric figure as compared to the average of its regional non-oil dependent (RNOD) peers<sup>1</sup>;
- The price level in Armenia increased by 2,6% in 2017. However, it has resumed a declining trend in 2Q 2018; the y-o-y inflation as of June was 0,9%;
- The quality of the fiscal policy is expected to improve substantially as a result of the introduction of the new fiscal framework aimed at improving fiscal discipline and augmenting flexibility with the aim to absorb potential unexpected shocks. The new fiscal rule should also keep government expenditures contained and prepare the authorities to reduce debt if needed;
- Institutional development in the country remains acceptable as there are good conditions in the country for business, with a moderate rule of law and government transparency. Nonetheless, corruption remains a drag for economic growth.

#### Negative factors:

- Government debt increased in 2017 up to 53,5% of GDP and 252,2% of budget revenues and public debt stood at around 59% of GDP as of the same date. These figures, however, have remained stable in the current year: as of May 2018, government and public debt figures have both declined in absolute terms. This is a positive sign that the authorities are following their debt management strategy. We anticipate government debt to GDP to remain below the 55% threshold going forward;
- The unemployment rate is still high and is estimated to have been 18,9% as of 2017;
- The Armenian stock market remains highly underdeveloped. The market capitalization was as low as 2,56% of GDP showing just marginal improvement for the past six years;
- Competitiveness in the economy remains low dominated by oligopolies. The country's position in the global competitiveness ranking of the World Economic Forum was 73<sup>rd</sup> out of 138 countries and the economy relies heavily on imports.

#### Stress factors:

- Financial dollarization remains high, however, it continues to gradually decline; loans and deposits in FX were equivalent to 60% and 53,2% of total loans and deposits respectively as of May 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).

#### SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Continued consolidation of fiscal metrics: narrowing of the fiscal balance a sustained long-term 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:

- Resumed political tensions which would have a material impact in macroeconomic indicators and investment in the country;
- 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.

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

“The confirmation of Armenia’s ratings at ‘BB-’ with a stable outlook is underpinned by a strong and resilient banking sector, consistent and solid economic growth, effectiveness of the monetary policy and improving fiscal consolidation efforts by the authorities.

However, the creditworthiness of the sovereign remains constrained by high levels of financial dollarization, elevated government debt levels and high exposure to potential external shocks given the country’s high dependence on remittances, imports and commodities’ exports. Moreover, even though we consider that the recent political turmoil will not have a material impact on the long-term creditworthiness, it could hurt investor confidence adversely affecting investment in the economy.” – 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:

[https://raexpert.eu/reports/Research\\_report\\_Armenia\\_20.07.2018.pdf](https://raexpert.eu/reports/Research_report_Armenia_20.07.2018.pdf)

Next scheduled rating publication: TBD in December 2018.

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**RATING HISTORY:**

Date	Review reason	SGC		Outlook	
		National currency	Foreign currency	National currency	Foreign currency
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 11 July 2018. 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](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.

## 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.