

## Rating-Agentur Expert RA upgraded to 'BB-' the sovereign government rating and to 'B+' the credit climate rating of Armenia

Rating-Agentur Expert RA upgraded the sovereign government credit rating (SGC) of Armenia from 'B+' (Moderately low level of creditworthiness of the government) to 'BB-' (Sufficient level of creditworthiness of the government) in national currency and from 'B+' (Moderately low level of creditworthiness of the government) to 'BB-' (Sufficient level of creditworthiness of the government) in foreign currency.

Rating-Agentur Expert RA GmbH upgraded the country credit environment rating (CCE) of Armenia from 'B' (Moderately low quality of credit environment of the country) to 'B+' (Moderately low quality of credit environment of the country) in national currency and from 'B' (Moderately low quality of credit environment of the country) to 'B+' (Moderately low quality of creditworthiness of the government) in foreign currency.

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

#### Positive factors:

- The fiscal balance is set to stand at -3,3% of GDP in 2017 showing the results of the consolidating efforts by the government. As of end-2017, an important increase in tax revenues and a slight decrease in current expenditures was registered which caused the deficit to shrink. We expect this trend to continue going forward;
- Banking sector metrics remain stable. Capital adequacy ratio was at 18,8%, NPLs to total loans ratio at 6,8% and ROA once again positive at 1,1% as of November 2017. Furthermore, despite a slightly slower credit growth pace by end-2017, we expect this metric to have grown once again to around 56% of GDP as well as the amount of banks' assets to 80,7% of GDP in 2017;
- The government debt structure remains favorable with short-term debt accounting for 3% of the total debt and floating interest rate debt representing 13,5% as of end-2017. Even though the amount of FX-denominated debt is high at 81,6%, it is mostly at concessional terms;
- We anticipate real GDP to grow at around 3,8% in 2017, a higher figure than initially expected. This positive reading is mainly due to strong growth in industrial production and the services sector as well as a hike in remittances causing better consumption figures; investment metrics were also positive in 2017;
- The loose monetary policy has helped to bring inflation towards the CBA's target of 4%. The improved transmission mechanism of the policy contributed to the fall of lending rates, causing investment consumption to grow and the price level to increase. Given the accommodative policy and currently high inflation expectations, we anticipate the inflation rate to continue in an upward trend;
- Armenia has a strong investment potential as showed by a projected net FDI inflows to GDP figure of 3,6% in 2017.

#### Restricting factors:

- International reserves stood at USD 2,17 bn by November 2017 which is 35% of gross government debt and they cover short-term debt by more than 11x;
- GDP per capita in PPP terms is projected to have finished 2017 at USD 9,1 th which is an

acceptable figure when compared to the average of its regional non-oil dependent (RNOD) peers<sup>1</sup>;

- After posting deflation figures in 2015 and 2016, inflation was positive in 2017 when it stood at 2,6% by year-end driven mostly by higher food prices;
- The fiscal policy effectiveness continues to progress. Even though the fiscal balance target was slightly missed, the deficit is expected to have shrunk substantially in 2017. At the same time, the government is planning more capital expenditures in 2018, which is key to the sustainable growth of their economy;
- 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:

- We anticipate government debt to have risen to 55,3% of GDP and to have slightly reduced down to 241% of budget revenues in 2017 given the increase in external loans and higher than expected tax income. Moreover, public debt, including debt from the Central Bank of Armenia (CBA), reached 60% of GDP. We still expect debt figures to stabilize in the mid-term perspective as outlined in the debt management strategy of Armenia;
- The yield on the USD denominated 10Y government bond has decreased to 4,6% as of January 2018;
- Unemployment rate is forecast to remain practically unchanged at around 18,9% in 2017;
- The market capitalization of the stock exchange remains low at 2,5% of GDP as of end-2017 with still highly concentrated trading among the top issuers;
- 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 has gradually declined; loans and deposits in FX were equivalent to 61,6% and 57,5% of total loans and deposits respectively as of November 2017 (weak stress factor);
- Conflict with Azerbaijan for the Nagorno-Karabakh remains unresolved (very weak stress factor).

#### ADDITIONAL FACTORS THAT INFLUENCED CCE RATINGS:

##### Positive factors:

- Spread between the interest rate on loans and deposits remained acceptable at 418b.p. in November 2017;
- The external debt load of the private sector is moderate estimated at around 92% of GDP by end-2017.

##### Negative factors:

- High real interest rate estimated at 10,9% in 2017; however it has been declining.

#### SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Lower than expected government debt levels in the mid-term perspective combined with a consolidated government balance sheet over the same period;

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

- 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.

“The upgrade of Armenia’s SGC ratings to ‘BB-’ and CCE ratings to ‘B+’ reflects the consistent and sustained improvement in fiscal metrics, better economic growth prospects and prolonged stability of the banking system. Moreover, the monetary policy has had better transition to the economy and the external sector metrics have slightly improved, despite the economy remaining highly dollarized.

However, government debt remains high, although expected to decline, the competitiveness of the economy remains subdued and the economy remains highly exposed to external shocks. Going forward, Armenia’s monetary policy effectiveness could be further harmed if the current levels of dollarization persist.” – 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\\_26.01.2018.pdf](https://raexpert.eu/reports/Research_report_Armenia_26.01.2018.pdf)

Next scheduled rating publication: 20 July 2018. The full sovereign rating calendar can be found at <http://raexpert.eu/sovereign/#conf-tab-5>

For further information contact:

**Rating-Agentur Expert RA GmbH**  
Walter-Kolb-Strasse 9-11,  
60594 Frankfurt am Main, Germany  
+49 (69) 3085-45-00  
E-mail: [info@raexpert.eu](mailto:info@raexpert.eu)  
[www.raexpert.eu](http://www.raexpert.eu)

**RATING HISTORY:**

Date	Review reason	SGC		CCE	
		National currency	Foreign currency	National currency	Foreign currency
28.07.2017	Scheduled revision of both types of ratings for the country	B+	B+	B	B
03.02.2017	Scheduled revision of both types of ratings for the country	B+	B+	B	B
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 25 January 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 and Country Credit Environment Ratings – Short Public Version (from April 2017) can be found under the following link: [http://raexpert.eu/files/methodology/Methodology\\_Short\\_Sovereign\\_v2.pdf](http://raexpert.eu/files/methodology/Methodology_Short_Sovereign_v2.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

Only SGC ratings can be used for regulatory purposes according to the ESMA definition. CCE ratings are not considered as credit ratings within the framework of Regulation (EC) No 1060/2009.

## 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.