Research Report on Armenia

7 January 2022

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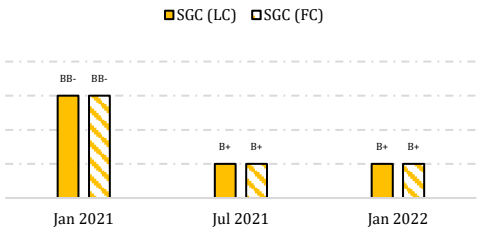
Ratings

Sovereign Government Credit (LC)	B+
Sovereign Government Credit (FC)	B+
Outlook (LC)	Stable
Outlook (FC)	Stable

* These ratings are unsolicited

Ratings dynamics



Main Economic Indicators of Armenia

Macro indicators	2019	2020	2021*
Gross gov. debt, AMD bn	3278	3924	4370
Nominal GDP, AMD bn	6543	6182	7031
Real GDP growth, %	7,6	-7,4	-5,5
Gross gov. debt/GDP, %	50,1	63,5	62,2
Deficit (surplus)/GDP, %	-1,0	-5,4	-4,0
Inflation rate, %	0,7	3,8	8,5
Current Account Balance/GDP, %	-7,2	-4,6	-6,7
External debt, USD bn	5,8	5,6	6,5

Development indicators	2021
Inequality adj. HDI	0,70**
GDP per capita, USD th	14,7

Default indicator	8.01.2021
10Y Gov Bond Yield, %	4,44***

Source: RAEX-Europe calculations based on data from the IMF, WB, UN, Armenia Ministry of Finance, CBA.
*Preliminary figures ** Figure from 2019 ***Maturity in 2029

RAEX-Europe confirmed at 'B+' the credit ratings of Armenia. The rating outlook is stable.

RAEX-Europe confirmed the sovereign government credit ratings (SGCs) of Armenia at 'B+' (moderately low level of creditworthiness of the government) in national and at 'B+' (moderately low 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.

Summary

The ratings of Armenia were confirmed at 'B+' and the outlook remains stable. It reflects a rebound of the economy after the initial effects of the COVID-19 outbreak and decrease in the budget deficit and debt levels by the end of 2021. On the other hand, growth of the inflation rate, slow progress of the vaccination campaign in 2021 and such inherent factors as demographic pressure and high level of dollarization are negatively affecting the rating assessment.

Armenian economy experienced a rebound in 2021. As of the end of 2021, the real GDP is forecasted to grow by 5,5% y-o-y which is a considerable increase after a 7,4% contraction of the economy in 2020 (see graph 1). The main reasons for that are increased remittances and strong recovery of agricultural and construction sectors as well as services. However, the unemployment rate remains elevated at around 18,5%.

The economy is expected to further recover to pre-pandemic level due to the higher private consumption, increase in exports and development of the tourism industry. Nevertheless, the economic growth will also depend on the development of the pandemic in the country and effectiveness of epidemiological measures and vaccination campaign, which is currently still progressing slowly and is constrained by the vaccine supply. As of the beginning of September 2021 only around 5% of Armenian population have received a vaccine, but the government plans to accelerate the vaccination campaign.

Situation around Nagorno-Karabakh conflict with Azerbaijan remains stable, but occasional minor incidents on the border indicate the persisting dependence on Russian Federation keeping security in the region.

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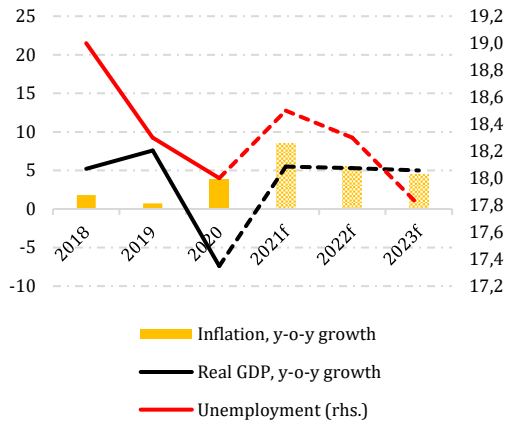
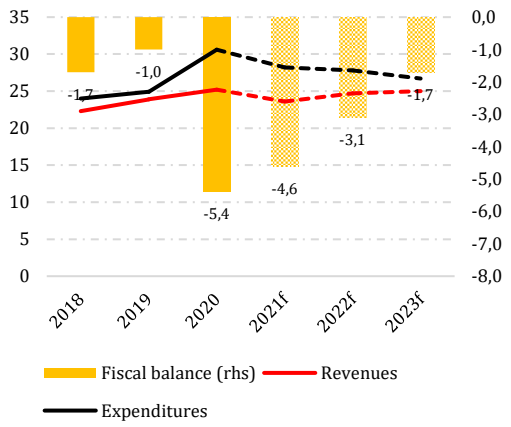
Graph 1: Macroeconomic indicators, %

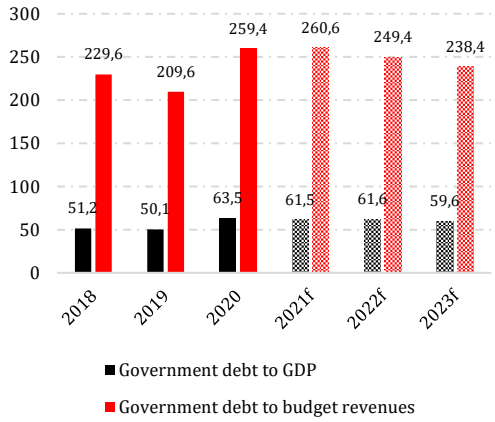


Source: RAEX-Europe calculations based on data from the IMF

Graph 2: Fiscal budget dynamics, % of GDP



Graph 3: Government debt dynamics, %



Source: RAEX-Europe calculations based on data from the IMF and Ministry of Finance of the Republic of Armenia

Fiscal deficit and debt load decreased by the end of 2021. By the end of 2021, government expenditures decreased to 28,2% of GDP and government revenues - to 23,6% of GDP which led to decline of the current account deficit by 0,8p.p to 4,6% of GDP. In February 2021, the government issued a USD 750 m Eurobond to finance the fiscal deficit. We expect the deficit to decrease further down to 3,1% of GDP in 2022 (see graph 2).

Additionally, the IMF has completed its fourth and fifth reviews of Armenia under the SBA which will help the government to raise about USD 72 m (SDR 51,32 m) bringing total disbursements to just below USD 400 m. These funds will help the Armenian economy recover from the heavy economic implications of the Covid-19 pandemic and advance the government's 2021-2026 economic program focused on the export orientation and investment drivers.

In 2021, the level of central government debt showed a minor decrease by 2,0p.p. to 61,5% of GDP. Relative to budget revenues it remained almost unchanged at around 260% and we expect it to decline down to 249% in 2022 (see graph 3).

The inflation rate is growing due to the elevated commodity prices on the international market. Inflation accelerated by the 3Q of 2021: CPI increased from 6,5% to 8,9% between 2Q and 3Q 2021. It is significantly higher than the CBA target of 4% and outside of the target interval of 4±1,5%. In this inflationary environment, the CBA is responding by gradually raising the refinancing rate: by 0.5p.p. to 7% in August, by 0,25p.p. to 7,25% in September, and by another 0.5p.p. to 7,75% in December 2021 (see graph 4). The level of financial dollarization in Armenia slightly decreased but remains high: as of October 2021, FX deposits constituted 42,6% of total deposits and FX loans – 44,5% of total loans (see graph 5).

The banking sector is showing slight signs of strengthening. The banking sector of Armenia remains sufficiently capitalized: capital adequacy ratio is stable: it slightly increased from 16,9% in 1Q 2021 to 17,2% in 3Q 2021 (see graph 6). However, starting from the 3Q 2020 ROA has been gradually declining from 1,6% to 0,8% in 2Q 2021 and then marginally grew to 0,9% in 3Q 2021. NPLs to total loans increased from 6,0% to 7,1% and since then have also been demonstrating a downward trend: the metric decreased to 6,1% in 2Q2021 and to 2,9% in 3Q2021. Concentration of the banking system on the three largest banks (Ameriabank, Armbusinessbank and Ardshinbank) remains high and exceeds 42,5% of total assets.

External position is still strongly affected by the pandemic. Both imports and exports experienced a significant contraction during 2020 as

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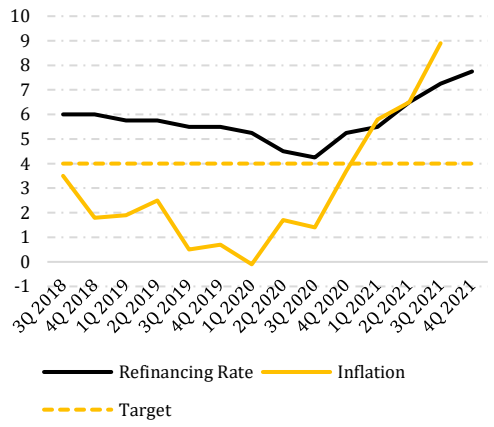
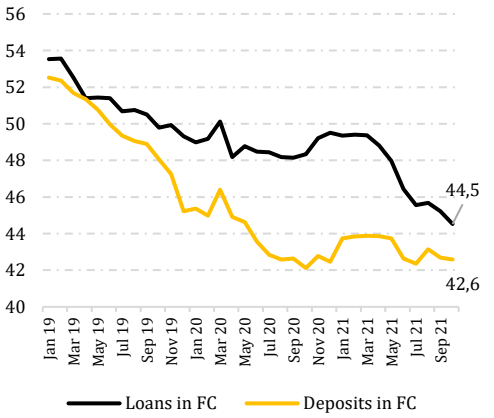
Graph 4: Target vs inflation rate, %



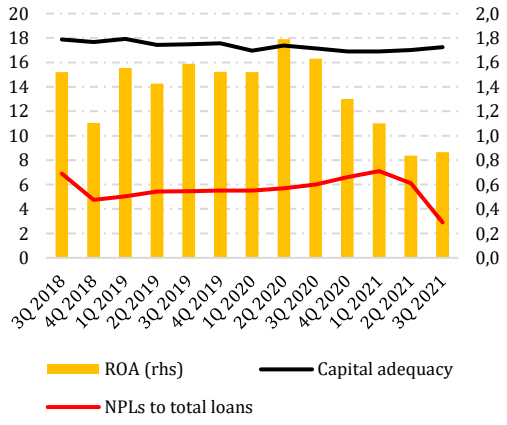
Source: RAEX-Europe calculations based on data from the CBA, IMF and EBD

Graph 5: Financial dollarization, % of total



Source: RAEX-Europe calculations based on data from the CBA

Graph 6: Financial soundness indicators, %



Source: RAEX-Europe calculations based on data from the CBA

a result of the pandemic: imports decreased by more than 15p.p. from 54,6% to 39,5% of GDP, whereas exports shrank by more than 10p.p. from 41,2% to 30,7%. In 2021 both indicators remained at the same level: 39% of GDP for exports and 31,1% of GDP for imports, however exports start accelerating faster than the imports. Foreign exchange reserves have been relatively stable throughout the second half of 2020 and increased from 2,6 to 3,0 bn USD between December 2020 and November 2021. The AMD was strengthening in 2021 and reached its pre-pandemic level of about 480 AMD/USD (see graph 7).

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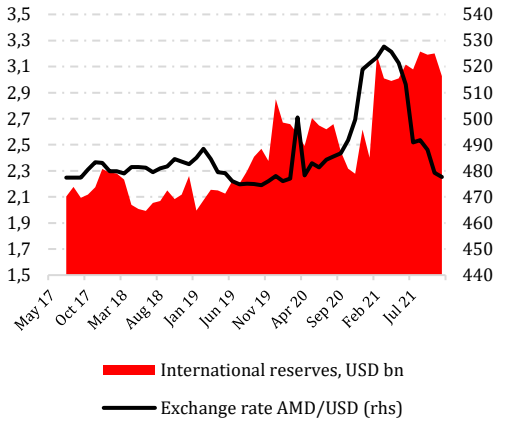
Graph 7: International reserves and exchange rate



Source: RAEX-Europe calculations based on data from the WB, IMF and CBA

Stress factors:

- Financial dollarization remains high; loans and deposits in FX were equivalent to 44,5% and 42,6% of total loans and deposits respectively as of October 2021 (weak stress-factor);
- The escalation of the conflict with Azerbaijan for the Nagorno-Karabakh and the probability of its further development are another downside risks affecting the rating.

The following developments could lead to an upgrade:

- Faster and stronger than expected recovery of the global economy, as well as the main trade partners, including Russia, which can lead to an improvement of the external position of Armenia and a faster recovery from the current crisis;
- Substantial decrease of the public debt and deficit metrics on a recovery phase of the economic cycle;
- 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:

- Continued lock-down measures in the country and longer period of turbulence in the global economy, including the second wave of COVID-19 pandemic, which would lead to a further deterioration of the external position, as well as a deeper contraction of local economy;
- Higher than expected increase of the government debt and deficit metrics due to the need of additional financing for the government expenses, and underperforming of tax and external revenues;
- Substantial deterioration of the stance of the banking system with sharp growth of NPLs levels, a drop of profitability and capitalization metrics, combined with a lack of liquidity in the system.

ESG Disclosure:

Inherent factors

- Quality of fiscal policy; quality of monetary policy; natural resources; natural and climatic threats; environmental threats; level of corruption, CPI; Government Effectiveness Index; quality of the

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business environment; position in Doing Business Ranking; level of investment in human capital, adjusted for inequality; Rule of Law Index; transparency of government policymaking Index; level of information transparency of the government; Political Stability and Absence of Violence/Terrorism Index; natural disasters, constant exposure to difficult natural conditions.

Drivers of change factors

- None.

Next scheduled rating publication: 8 July 2022. The full sovereign rating calendar can be found at Sovereign Rating Calendar 2022.

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RATING HISTORY:

Date	Review reason	SGC		Outlook	
		National currency	Foreign currency	National currency	Foreign currency
09.07.2021	Scheduled revision of both types of ratings for the country	B+	B+	Stable	Stable
08.01.2021	Scheduled revision of both types of ratings for the country	BB-	BB-	Negative	Negative
10.07.2020	Scheduled revision of both types of ratings for the country	BB-	BB-	Stable	Stable
10.01.2020	Scheduled revision of both types of ratings for the country	BB-	BB-	Positive	Positive
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

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Minute's summary

The rating committee for Armenia was held on 7 January 2022. 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 August 2020). 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: IMF, World Bank, Central Bank of Armenia, Ministry of finance of Armenia.

ESG Disclosure

We consider Environmental, Social, and Governance (ESG) risks and opportunities in the creditworthiness analysis of our Sovereign entities. The disclosure document can be found on the Agency's website in the section: ESG factors in RAEX-Europe's Credit Ratings

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.

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