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## Main Economic Indicators of Armenia

Macro indicators	2012	2013	2014
Gross pub. debt, bill AMD	1556	1729	1901
Nominal GDP, bill AMD	4001	4273	4526
Real GDP growth, %	7,1	3,5	3,2*
Gross gov. debt/GDP,%	38,9	40,5	42,0
Deficit (surplus)/GDP,%	-1,5	-1,6	-2,0
Inflation rate,%	3,2	5,6	4,6
Curr. Account balance/GDP,%	0,0	-24,6	-22,5

## Development indicators

	2014
Inequality adj. HDI	0,65
GDP per capita (Thou. of USD)	7,37

## Default indicator

	2014
10Y Gov Bond Yield, %	16,1%

Sources: RAEX (Europe) calculations based on data from IMF, Ministry of Finance of Armenia, Central Bank of Armenia, UN. \*IMF Projection

## Introduction

Armenia's dependence on external loans and foreign remittances remains the main risk for the economy, while stable monetary and fiscal policies help to mitigate the major challenges. The country has moderate level of government debt. However the debt has steadily risen since 2010, of which 84% is denominated in foreign currency. Spillover of the economic downturn in Russia has led to a 50% fall in remittances and a 17% depreciation of the AMD. Tensions with Azerbaijan over Nagorno-Karabakh remain a key political risk and socio-economic protests in Yerevan have not eased since June 2015.

**Debt remains manageable with upward risks.** Government debt ended 2014 at AMD 1 901bn – equivalent to 42% of GDP and 161% of budget revenues. These ratios have increased steadily over the past six years but remain moderate. Debt growth is mainly the result of the government response to external factors and constantly negative trade balance. The 2008-2009 global crisis had a strong impact on Armenia causing sharp fall of capital inflows, which ultimately affected construction (the key growth driver for a decade) and forced the government to step in. Thanks to loans granted from international financial institutions (IFIs), Armenian authorities stabilized the country at the expense of increasing government debt.

FX denominated debt accounts for about 84% of total debt and was the main driver of total debt increase during 2015. Devaluation of AMD in Q4 2013 and at the beginning of 2015, as well as new USD 500m Eurobonds issued in March 2015, resulted in government debt increase by about 9% during the 8 months of 2015 (see graph 1 and 2).

**Monetary and fiscal policies remain sound.** Armenia's monetary policy is oriented at targeting inflation to 4% within the range of 1,5p.p. The Central Bank of Armenia (CBA) has succeeded at meeting the target during the past four years. However, annualized inflation rate reported in the 1H 2015 reached 5,5% fueled by lagged effect of AMD devaluation in January 2015. If the upward trend in prices continues in 2H 2015, inflation rate is likely to exceed the CBA's target by the end of 2015.

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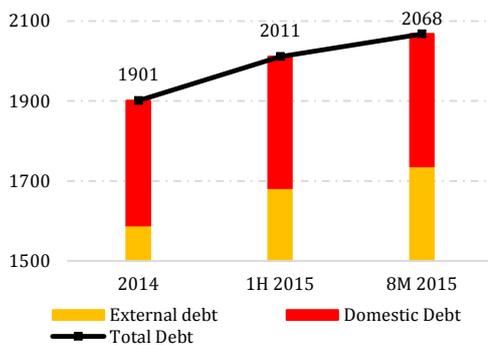
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**Graph 1: USD vs AMD**



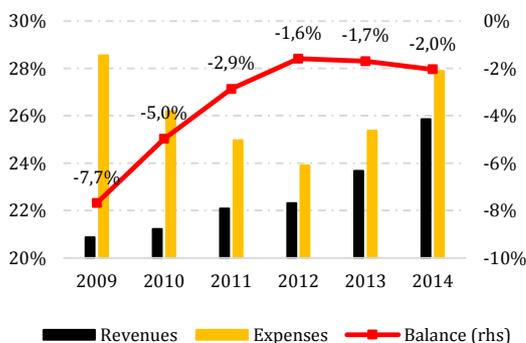
Source: RAEX (Europe) calculations based on data from CBA

**Graph 2: Government debt (bill AMD)**



Source: RAEX (Europe) calculations based on data from Armenian Ministry of Finance

**Graph 3: Fiscal balance of Armenia (as % of GDP)**



Source: RAEX (Europe) calculations based on data from IMF, Armenian Ministry of Finance

Exchange rate policy continues to be guided by a floating exchange rate with occasional interventions to mitigate shocks and, where possible, to build buffers. Since the sharp devaluation of the AMD in January 2015, the exchange rate demonstrated a flat long-term trend with low volatility. Additionally, FX reserves increased 26% from USD 1,4bn in January to USD 1,7bn in July 2015. Overall, this evidences the commitment of the authorities to stick to the “de-jure” exchange policy.

Progress has been achieved in terms of fiscal policy as well. The Armenian government was able to reduce budget deficit to 2% of GDP in 2014 from 7,7% of GDP in 2009 (see graph 3). The improvement was the result of cautious and more efficient government spending combined with an increase in budget revenues. The Armenian government reported a deficit of AMD 52bn in 1H 2015, diverting significantly from the AMD 29bn surplus reported in 1H 2014. Therefore, Armenia is highly likely to report larger deficit in 2015 compared to the last four years.

**Dollarization still high.** Armenian authorities have enforced a number of measures to reduce dollarization since June 2014. As mentioned in our previous research report<sup>1</sup>, the measures include three categories; macroeconomic policies, prudential regulations and forced de-dollarization. So far, there has been little progress in accomplishing the goals with deposit and loan dollarization remaining flat at around 63% and 66% respectively as of June 2015.

**Regional slowdown deteriorated Armenia’s external position.** Armenia is highly dependent on Russia both economically and politically and has suffered from the Russian economic crisis. The country benefits from Russia in terms of trade (through exports of local goods and imports of oil and gas), as well as in terms of remittances. Armenia has relatively high dependence on labor remittances at about 19% of the GDP in 2014, while about 75% remittances originated in Russia in June 2015. Net remittances from Russia amounted to USD 0,6bn in 1H 2015 falling 46% compared to 1H 2014. Sharp reduction of remittances also damaged the balance of payments by widening the current account deficit in 1Q 2015 (see graph 4).

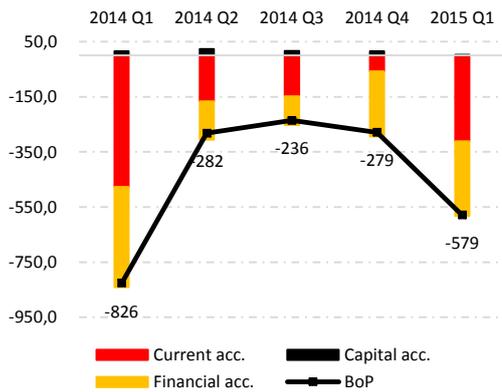
Debt denominated in foreign currency, which accounted for USD 3,4bn USD and represented around 85% of gross government debt in July 2015, is a key external risk for the country. CBA’s FX reserves at 50% of external debt and three months of imports as of July 2015 partly cushion the risks. However, potential further devaluation pressures would

<sup>1</sup> Research report on Armenia from 27th March, 2015 ([http://raexpert.eu/reports/Research\\_report\\_Armenia\\_27.03.2015.pdf](http://raexpert.eu/reports/Research_report_Armenia_27.03.2015.pdf))

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**Graph 4: Balance of payments (Mill USD)**



Source: RAEX (Europe) calculations based on data from CBA

reduce FX reserves and increase foreign denominated debt as percentage of GDP.

**Internal and regional tensions remain in place.** The Nagorno-Karabakh conflict between Armenia and Azerbaijan remains in place and tensions have recently escalated. Earlier this month, the US department of state released evidences that Armenian and Azerbaijani forces have used heavy weapons along the border and a number of civilian casualties and damages were reported. Additionally, Turkey's foreign minister reinforced his country's support to Azerbaijan.

Internally, Armenia is also facing socio-economic distress. A number of street riots have taken place in the capital after the state regulatory commission decided to increase electricity tariffs following the request of a major electricity company.

## Conclusion

The overall creditworthiness of Armenia is supported by moderate levels of government debt as well as sound monetary and fiscal policy. However, debt load and fiscal balance are likely to deteriorate by the end of 2015. Armenia's high dependence on Russia has led to deterioration of its external position and higher foreign currency risks as the spillover effects of the Russian crisis. Nagorno-Karabakh conflict has escalated latterly and internal unrest led to socio-economic instability.

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