

## **Rating-Agentur Expert RA GmbH assigned 'B+' sovereign government and 'B' credit climate ratings to Armenia**

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

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

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

#### **Positive factors:**

- The structure of Armenia's debt is satisfactory. Short-term debt to GDP is as low as 1,2% and it is covered by FX reserves by 14x. Even though 85,6% of total debt was denominated in foreign currency by end-2015, 84,8% of its creditors are international organizations providing soft loans;
- Real GDP growth, albeit declining, has been positive and steady over the past six years. Even with the decline in metal prices and the spillover effects from neighboring countries the economy grew at a 3% rate in 2015;
- Effective monetary policy which managed to contain external shocks in late-2014. Going forward, the Central Bank is planning to continue a loose monetary policy while at the same time paying attention to potential external spill-overs.

#### **Restricting factors:**

- Gross government debt to GDP (48,7%) is at acceptable levels. However, it is higher than its regional non-oil dependent peers<sup>1</sup>;
- FX reserves to gross government debt stood at 34,9% in 2015. Since most of the debt is external, this could be a source of risk for the country. However, a high share of it is concessional;
- The 2015 fiscal balance is projected to present a deficit of 4,0% of GDP, the widest deficit since 2011. It is also the highest amongst its regional non-oil dependent peers;
- The country's GDP per capita is acceptable at USD 8,4 th and stands above its peers;
- Inflation rate has been volatile over the past six years and was slightly negative in 2015 at -0,1%;
- The banking sector showed mixed results in 2015. While assets and private credit dropped due to lower consumption and government spending, the banking system remains well capitalized (average CAR of the banking system was 14,28% in 2015) and profitable (ROA was 0,53% in 2015);
- The government has missed fiscal policy targets. In 2014, both revenues and expenditures fell short of expectations due to weak economic activity and capital underspending. In 2015, revenues continued to be slow and the government increased budget lending;

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

- Acceptable level of institutional development in the country. There are good conditions in the country for business, nonetheless corruption remains a drag for economic growth.

Negative factors:

- Gross government debt to GDP and to budget revenues have been trending upwards for the past six years and presented a substantial increase from 2014 to 2015 (7p.p. and 36p.p. respectively) due to the slowdown of the economy causing lower revenues;
- The yield of 7,93% as compared to the original 7,15% coupon on the 10Y government bond indicates the high cost of financing for the government and the risk aversion of investors towards Armenia's debt;
- Unemployment was around 18,2% by June 2015 and, even though it has remained steady, it has been above 16% for the last six years;
- NPLs in the financial system have risen at worrisome levels in the last four years. In 2012 the percentage of NPLs to total loans was as low as 3,6%, at the end of 2015 it stood at 9,1%, where most of them were denominated in FX;
- Underdeveloped stock and bond markets. There are only 10 companies and 13 bonds listed on NASDAQ Armenia. The stock market capitalization equaled 2,0% of GDP as of December 2015;
- During 2013-2015 the level of national savings declined by 1,3p.p. reflecting lower investment and government funding potential in the economy;
- Armenia's economic competitiveness is low as measured by a foreign trade deficit of 16,7% in 2015 and the country's position in the global competitiveness ranking of the World Economic Forum (85<sup>th</sup> out of 144 countries).

Stress factors:

- High levels of financial dollarization in the economy. In 2015, loans and deposits in FX were equivalent to 65,7% and 69,6% of total loans and deposits respectively;
- Conflict with Azerbaijan for the Nagorno-Karabakh remains unresolved. Additionally, spill-overs from regional peers were reflected in the 2015 macroeconomic figures and could potentially harm the Armenian growth prospects further.

#### ADDITIONAL FACTORS THAT INFLUENCED CCE RATINGS:

Negative factors:

- High real interest rate at 16,1% in 2015.

Positive factors:

- Spread between the interest rate on loans and the interest rate on deposits was acceptable at 186b.p. in 2015;
- Debt load of the private sector is at moderate levels (94,6% of GDP in 2015).

#### SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Stable and sustainable decline in the gross government debt to GDP and to budget revenues ratios;
- Reduction of the external exposure shown by a more balanced current account.

The following developments could lead to a downgrade:

- Continuous increase of the gross government debt to GDP ratio;
- Deterioration of regional economic conditions (especially in Russia) which would cause spillover effects and trigger internal imbalances;

- Increase of NPLs in the financial system caused by further loan dollarization combined with exchange rate depreciation.

"Armenia's ratings were negatively influenced by the upward and accelerating trend of gross government debt, high levels of financial dollarization and the exposure of the economy to external imbalances. However, factors such as the favorable structure of the public debt regarding maturity and creditors, stable real GDP growth and the effective response of monetary policy tools to absorb external shocks, contributed positively to the country's creditworthiness." – Clarified Hector Alvarez, Expert of Rating-Agentur Expert RA GmbH

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

Reviewer: Gustavo Angel, Expert of Rating-Agentur Expert RA GmbH

Research report on Armenia is available at:

[http://raexpert.eu/reports/Research\\_report\\_Armenia\\_04.03.2016.pdf](http://raexpert.eu/reports/Research_report_Armenia_04.03.2016.pdf)

Next scheduled rating publication: 5 August 2016. The full sovereign rating calendar can be found at <http://raexpert.eu/sovereign.php#conf-tab-5>.

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## Minute's summary

The rating committee for Armenia was held on 2 March 2016. 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 2015) can be found under the following link: <http://raexpert.eu/files/methodology/Methodology-Short-Sovereign.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.

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## 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.

Despite similar methodologies, credit ratings of Armenia from RAEX (Moscow) (both SGC and CCE) may be different from those assigned by Rating-Agentur Expert RA GmbH due to:

- Possible differences in expert assessments of individual factors;
- Some differences in methodologies (methodologies are similar but not identical);
- Differences in the date/period of assessment for individual factors.

## 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

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This Report 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.