Rating-Agentur Expert RA GmbH confirmed at 'B+' the sovereign government and at 'B' the credit climate ratings of Armenia

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

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

MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

Positive factors:

- The banking sector continued to strengthen. As of May 2017, it presented a capital adequacy ratio of 20%, NPLs at 7% (showing a consistent reduction over the last 15 months) and consistently positive ROA of 1%. Moreover, the recovery in credit to the economy has been maintained; in May 2017 loans grew at a 7% y-o-y rate in absolute terms;

- Armenia's debt structure is still satisfactory and has been consistent for the past years. As of May 2017, short-term debt was as low as 4,2% of total debt and foreign currency denominated debt remained almost unchanged since our last review at 80,9% of total debt and it is mostly concessional. In addition, the share of floating interest rate debt decreased to 12,4% of overall debt;

- The real economy grew at a moderate 0,2% in 2016 driven by economic struggles in the CIS region but we expect it to perform better going forward. In 1Q 2017 it grew by 6,5%, although this level is not sustainable, it is a good sign of higher consumption fueled by higher remittances, fiscal stimulus and lower local currency lending rates;

- The Central Bank of Armenia (CBA) cut the refinancing rate by an additional 0,25% in February 2017 down to 6% given the CBA's anticipation of low prices. We expect further accommodation due to low inflation expectations which would propel further credit growth and inflation levels towards the CBA's target of 4% in the mid-term perspective;

- Armenia has a strong investment potential as showed by net FDI inflows to GDP of 3,2% in 2016.

Restricting factors:

- International reserves, despite having slightly decreased in 1Q 2017, they remain solid at USD 2 bn covering short-term debt by 9x and showing an improvement as a percentage of gross government debt at 40%;

- As a result of lower than expected revenues and higher expenditures, the budget presented a deficit of 5,3% of GDP in 2016, the widest deficit since 2009 (7,7%). However, we have already seen signs of increased revenues, mainly tax collections stemming from the new tax code and better tax administration in 2017;

- GDP per capita in PPP terms remains acceptable at USD 8,6 th in 2016 as compared to the average of its regional non-oil dependent (RNOD) peers[1];

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[1] Non-oil dependent peers include Georgia, Kyrgyzstan and Tajikistan.

- Despite two years in a row of deflation (-0,1% in 2015 and -1,1% in 2016), the CPI has started to show a positive trend in 2017 given a recovery in domestic demand. As of May 2017 the y-o-y growth in the CPI index was 1,6%;

- The fiscal policy effectiveness has already shown signs of improvement in 2017. Despite revenues and expenditures being off-target in 2016, the new tax reform introduced in 2017 will help to reduce the debt burden and narrow the deficit;

- Acceptable level of institutional development in the country. There are good conditions in the country for business, with a moderate rule of law index and acceptable government transparency. Nonetheless, corruption remains a drag for economic growth.

Negative factors:

- Revised figures show that government debt to GDP rose to 51,8% of GDP in 2016, around a 9p.p. increase from a year before, and to 242% of budget revenues. Overall public debt was up to 55,1% of GDP. However, after the implementation of a softer fiscal policy, we expect debt figures to stabilize;

- The yield on the USD denominated 10Y government bond has decreased to 5,6% as of July 2017;

- Unemployment remained high and stable at around 18,1% as of end-2016;

- The ratio of NPLs to total loans continued its downward trend and stood at 7,2% as of May 2017 as a result of a general enlargement of the banks' balance sheets;

- The underdevelopment of the stock and bond markets remains a negative factor. As of mid-2017, market capitalization was below 3% of GDP, the volume of outstanding bonds around 1% of GDP and trading is still highly concentrated;

- Low competitiveness of the economy. The country's position in the global competitiveness ranking of the World Economic Forum was 79th out of 138 countries and the economy relies heavily on imports.

Stress factors:

- Financial dollarization, despite easing in 2017, remains high; loans and deposits in FX were equivalent to 64,1% and 58,7% of total loans and deposits respectively as of May 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 370b.p. as of December 2016;

- The external debt load of the private sector is moderate at 94,5% of GDP by end-2016.

Negative factors:

- High real interest rate estimated at 16% in 2016.

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Continued and sustainable consolidation of the fiscal balance combined with lower and more stable levels of government debt;

- Sustained reduction in the dependence on external developments combined with a steep decrease in levels of dollarization.

The following development could lead to a downgrade:

- Unsuccessful consolidation process which would result in constantly widening fiscal deficits as well as the increase of government debt metrics.

"Armenia's ratings remain unchanged supported by improving metrics in the banking sector, positive government debt structure, a favorable real GDP growth perspective and improvement in the management of monetary policy.

However, government and public debt levels have steeply increased and, although we expect the fiscal deficit to narrow going forward, it widened further in 2016. Moreover, still high levels of dollarization as well as NPLs, coupled with considerably high exposure to external factors remain a drag for the country's creditworthiness". – 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_28.07.2017.pdf

Next scheduled rating publication: TBD in December 2017.

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RATING HISTORY:

Date	Review reason	SGC		CCE	
		National currency	**Foreign currency**	**National currency**	**Foreign currency**
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 26 July 2017. 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. 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.

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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.

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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.