

Responsible Expert:

Vladimir Gorchakov
Associate Director

For further information contact:

Rating-Agentur Expert RA GmbH
Walter-Kolb-Strasse 9-11,
60594 Frankfurt am Main, Germany
+49 (69) 3085-45-00, ext. 1211
E-mail: gorchakov@raexpert.eu
www.raexpert.eu

RAEX-Europe confirmed at 'BB-' the credit ratings of Armenia. The rating outlook changed from stable to negative.

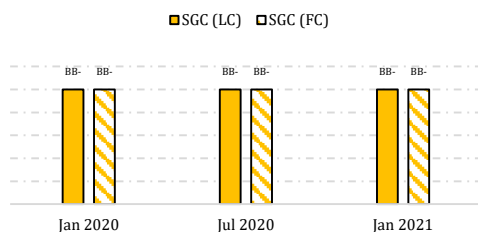
RAEX-Europe confirmed the sovereign government credit rating (SGC) of Armenia at 'BB-' (Sufficient level of creditworthiness of the government) in national currency and at 'BB-' (Sufficient level of creditworthiness of the government) in foreign currency. The rating outlook changed from stable to negative, which means that in the mid-term perspective there is a high probability of downgrading the rating score.

Ratings

Sovereign Government Credit (LC)	BB-
Sovereign Government Credit (FC)	BB-
Outlook (LC)	Negative
Outlook (FC)	Negative

* These ratings are unsolicited

Ratings dynamics



Main Economic Indicators of Armenia

Macro indicators	2018	2019	2020*
Gross gov. debt, AMD bn	3351	3512	4071
Nominal GDP, AMD bn	6017	6569	6140
Real GDP growth, %	5,2	7,6	-7,3
Gross gov. debt/GDP, %	55,7	53,5	66,3
Deficit (surplus)/GDP, %	-1,8	-1,0	-7,0
Inflation rate, %	1,8	0,7	1,5
Current Account Balance/GDP, %	-6,9	-7,2	-6,0
External debt, USD bn	-	-	6,0
Development indicators	2020*		
Inequality adj. HDI	0,70**		
GDP per capita, USD th	13,8		
Default indicator	8.01.2021		
9Y Gov Bond Yield, %	3,9***		

Source: RAEX-Europe calculations based on data from the IMF, WB, UN, Armenia Ministry of Finance, CBA.

* Forecast **Figure from 2019 *** Maturity in 2029

Summary

The change of the rating outlook for Armenia from stable to negative reflects a higher than expected increase in the budget deficit and in debt levels by the end of 2020, together with the anticipated contraction of the economy due to the COVID-19 outbreak, as well as worsened forecasts for 2021. Moreover, the high unemployment rate, the still latent rise of a further escalation of the military conflict in the Nagorno-Karabakh region and the deteriorated external position, further hamper the creditworthiness of the sovereign.

However, we anticipate the Central Bank of Armenia (CBA) to continue to maintain an adequate expansionary monetary policy. In addition, the inflation rate remains low and has risen only slightly closer to the end of the year whereas the banking system demonstrates a stable stance.

The contraction of the Armenian economy due to the COVID-19 pandemic is higher than expected. As of 3Q 2020, the real GDP plummeted by 6,6% y-o-y and we estimate the overall contraction of the economy to have been around 7,3% by the end of 2020. The sharp contraction is mainly due to a fall in consumer demand, drop of remittances inflows and a significant slowdown of business activity in such industries as tourism, transportation, retail trade and entertainment. Additionally, the monthly indicator of economic activity in October 2020 demonstrated a decline of 8,1% as compared to October 2019. On a positive note, this reading is lower than the May 2020 figure of 12,8% and reflects the easing of the government lockdown measures.

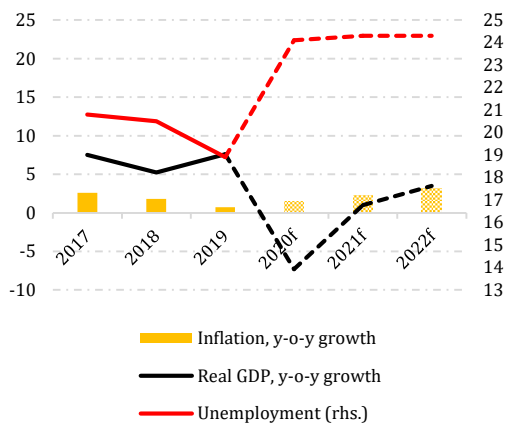
In September 2020, the Armenian government reopened the airspace, lifted the state of emergency, and imposed a quarantine regime (prohibition of large gatherings, fines for not wearing a mask in public) until 11 January 2021. As of October 2020, the fiscal response to the COVID-19 outbreak

Disclaimer

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 Research Reports.

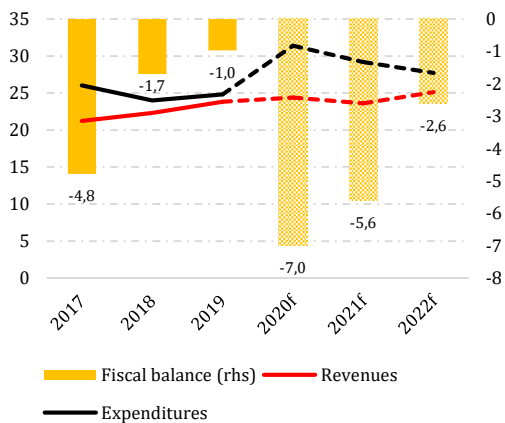
This Report represents the opinion of Rating-Agentur Expert RA GmbH and is not a recommendation to buy, hold or sell any securities or assets, or to make investment decisions.

Graph 1: Macroeconomic indicators, %

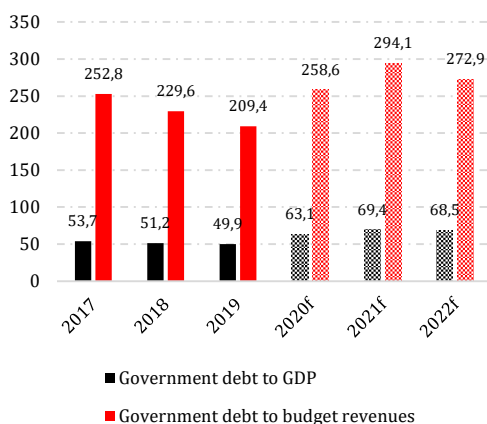


Source: RAEX-Europe calculations based on data from the IMF

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

included 24 support packages aimed at subsidizing loans for affected businesses and SMEs, direct money transfers to firms and grants to vulnerable individuals. The overall amount of aid funds allocated as of the end of October 2020, together with bank supports, equals AMD 192,3 bn (USD 367 m) and may reach AMD 230 bn (2,3% of GDP) for 2020. Indirect support in the form of tax deductions adds another 1,4% of GDP.

However, these measures have not been enough to halt the pandemic-related shock on the economy and the negative impact on the unemployment rate, which is expected to have risen to 24,1% in 2020. We expect this metric to remain relatively high until at least 2022. In addition, the economic competitiveness and institutional development indicators in Armenia remain subdued.

Another downside risk affecting the rating is the probability of further escalation of the military conflict in the Nagorno-Karabakh region and its negative effect on the Armenian economy. The most violent armed conflict between Armenia and Azerbaijan since 1994 broke out in September 2020 (death toll of more than 2 500 Armenian people, according to the authorities), which coincided with the peak of the second wave of the pandemic causing a double negative effect on the sovereign. The conflict deescalated only after three failed attempts by signing a trilateral Armenia-Azerbaijan-Russia ceasefire agreement on 10 November 2020.

Taking into account all the above-mentioned factors, we expect the real GDP output to turn positive not earlier than by the end of 2021 (in the range between 0,5% and 1,5%) and start approaching its pre-crisis level not earlier than in 2022 (see graph 1).

Sharp increase in the fiscal deficit and debt load by the end of 2020.

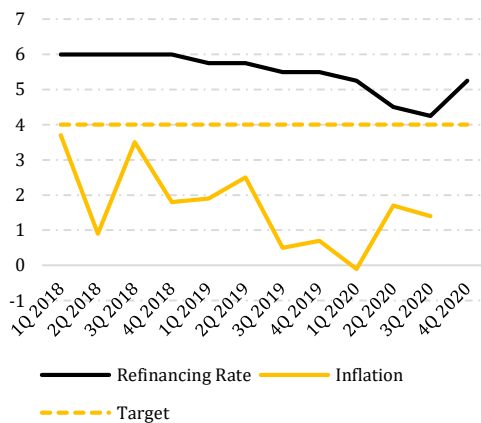
The implementation of the fiscal stimulus in 2020 as a response to the COVID-19 outbreak, as well as additional security spending led to a significant increase in government expenditures, as these rose by 6,6 p.p. y-o-y as of the end of 2020, from 24,8% to 31,4% of GDP. Moreover, in the first 9M 2020, the deficit amounted to AMD 155 bn whereas during the same period of the previous year it posted a surplus of around AMD 95 bn. Taking into account the strong negative trend in GDP dynamics, the fiscal deficit is expected to widen to 7% of GDP this year and then to decrease slightly down to 5,6% of GDP in 2021 (see graph 2).

Under these conditions the levels of both public and publically guaranteed debt and central government debt are expected to increase drastically by 12,8 p.p. (to 66,3% of GDP) and 13,2 p.p. (to 63,1% of GDP), respectively. We expect government debt to grow up to 259% of budget revenues in 2020 and approach its peak of 294% in 2021 (see graph 3).

Disclaimer

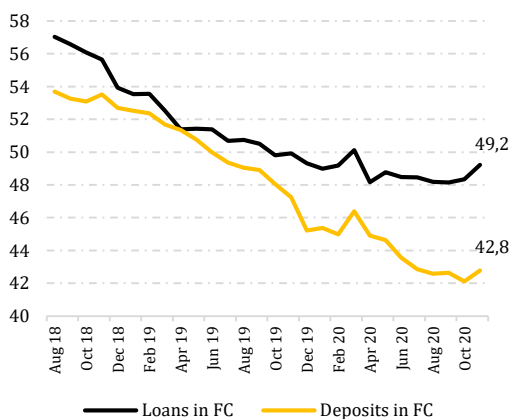
The Agency disclaims all liability in connection with any consequences, interpretations, conclusions, recommendations and other actions directly or indirectly related to the conclusions and opinions contained in the Agency's Research Reports. This Report represents the opinion of Rating-Agentur Expert RA GmbH and is not a recommendation to buy, hold or sell any securities or assets, or to make investment decisions.

Graph 4: Target vs inflation rate, %



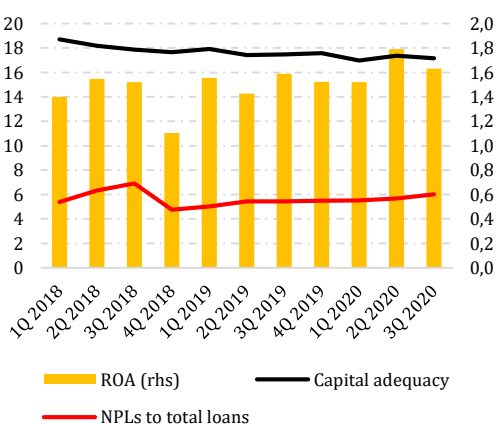
Source: RAEX-Europe calculations based on data from the CBA and IMF

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

We consider these dynamics, combined with the uncertainty of the further developments around COVID-19 outbreak, a strong factor restricting the credit rating. Nonetheless, the quality of the fiscal policy is estimated as adequate and transparent. The implementation of the long-term fiscal consolidation program in the future and gradual recovery from the crisis would positively affect our assessment.

The CBA will continue to maintain an expansionary monetary policy. The inflation rate in Armenia is low but is has slightly risen closer to the end of the year. According to the forecast, the CPI increased by around 1,5% as of the end of 2020, 0,8 p.p. higher than by the end of 2019. The metric is expected to keep growing in the next quarters. Nevertheless, partially because of the weaker consumer demand, the inflationary environment is running below the CBA target of 4% that remained unchanged.

Due to the acceleration of inflation expectations coupled with the depreciation of AMD and the increase in the country’s risk premium, the CBA raised the refinancing rate in the 4Q 2020 by 1p.p. (see graph 4). By doing so, the CBA still plans to keep the expansionary monetary policy stance while being ready to stabilize the inflation near the target in the medium term. We assess the quality of the monetary policy as positive; however, the level of financial dollarization in Armenia remains elevated: as of November 2020, FX deposits constituted 42,8% of total deposits and FX loans – 49,2% of total loans (see graph 5).

The banking sector may show signs of weakening in the future. The financial soundness indicators of the banking sector have remained generally stable throughout the year. As of the end of 3Q 2020, ROA was 1,63%, slightly above the analogous figure of 2019 (1,59%). NPLs to total loans ratio demonstrated a minor increase to 6,0%, whereas a capital adequacy ratio declined by about 0,5p.p. from the beginning of 2020 to the end of 3Q 2020 to 17% (see graph 6).

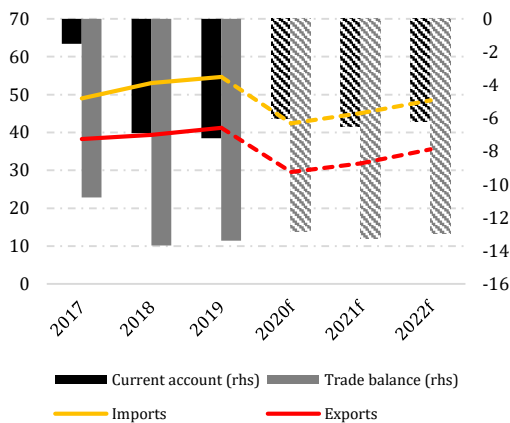
Due to the stable demand for mortgages and demand from construction sector, credit to the economy expanded by 12% in October y-o-y. Capital buffers of the banks showed a slight decrease since December 2019. Despite currently not demonstrating any signs of deterioration, we anticipate the banking sector to weaken in the future since all effects of the pandemic as well as of the military conflict on it will be visible with a delay. Moreover, concentration of the banking system on the three largest banks (Ameriabank, Armbusinessbank and Ardshinbank) remains high and exceeds 42% of total assets.

External position worsened during the year. A significant drop in the economic activity and consumer demand caused by pandemic in 2020 led to a sharp contraction of both imports and exports. The decrease of import as % of GDP is expected to be higher (around 12,2 p.p.) than decrease of

Disclaimer

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 Research Reports. 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.

Graph 7: External sector indicators, % of GDP

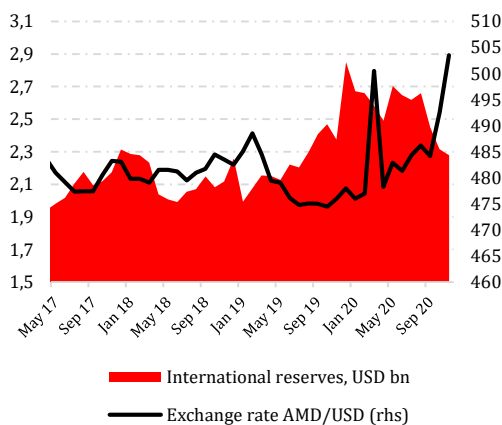


Source: RAEX-Europe calculations based on data from the WB, IMF and CBA

export (around 11,6 p.p.). At the same time, Armenia experienced weakened FDI, remittances and tourism receipts that is why the current account deficit is forecast to narrow down by 1,2 p.p. We expect the foreign trade indicators to slowly recover starting from 2021 and to approach pre-pandemic levels in 2022 (see graph 7).

In 2020, the foreign exchange reserves are expected to decline to USD 2,28 bn from USD 2,85 bn a year earlier which is equal to 5,2 month of imports. Moreover, in November 2020 the AMD depreciated by more than 5% against USD (y-o-y) (see graph 8). This factor coupled with a high reliance on the weakening remittances and FDI, restricts our rating assessment.

Graph 8: 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 49,2% and 42,8% of total loans and deposits respectively as of November 2020 (weak stress-factor);
- The escalation of the conflict with Azerbaijan for the Nagorno-Karabakh this year 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.

Disclaimer

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 Research Reports. 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.

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 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: 09.07.2021. The full sovereign rating calendar can be found at [Sovereign Rating Calendar 2021](#)

For further information contact:

Responsible expert:

Vladimir Gorchakov,
Associate Director of RAEX-Europe
+49 (69) 3085-45-00, ext. 1211
gorchakov@raexpert.eu

Reviewer:

Mikhail Kaptsov,
Rating Analyst of RAEX-Europe
+49 (69) 3085-45-00, 1216
kaptsov@raexpert.eu

Rating-Agentur Expert RA GmbH (RAEX-Europe)

Walter-Kolb-Strasse 9-11,
60594 Frankfurt am Main, Germany
+49 (69) 3085-45-00
E-mail: info@raexpert.eu
www.raexpert.eu

Disclaimer

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 Research Reports.

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.

RATING HISTORY:

Date	Review reason	SGC		Outlook	
		National currency	Foreign currency	National currency	Foreign currency
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

Disclaimer

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 Research Reports.

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.

Minute's summary

The rating committee for Armenia was held on 08.01.2020. 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 \(from April 2019\)](#). 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.

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.

Disclaimer

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 Research Reports.

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.