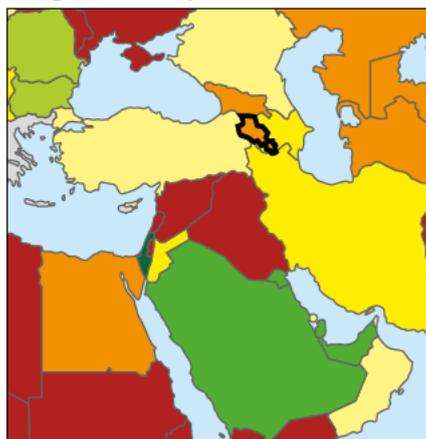




The country risk categories range from 0 to 7. The lower the number, the better the credit rating of the country.



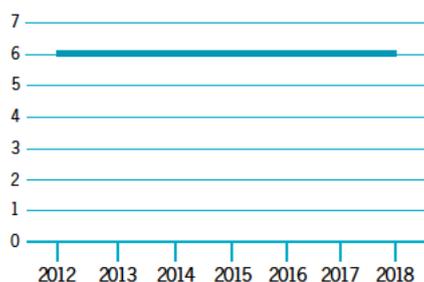
#### CONTACT

Country analyst: Martin Ingvarsson  
Tel. +46 (0) 8 788 00 56  
e-mail: martin.ingvarsson@ekn.se

#### BASIC FACTS

Population	3.0 million (2016)
GDP, nominal	USD 10.5 bn (2016)
BNP/capita	USD 3 500 (2016)

#### COUNTRY CLASSIFICATION HISTORY



Source: EKN

## Continued large fluctuations for the Caucasian Tiger

From the middle of the 1990s and up until 2008, Armenia's economy grew at a rapid pace, which caused the World Bank to nickname the country the "Caucasian Tiger". However, declining remittances from the USA and Russia in connection with the global financial crisis in 2008 put an abrupt end to the high growth. Since then, the economy has grown by an average of 3.5 per cent per year, and in 2017, the growth is expected to stop at just under three per cent. The small economy is dependent on natural resources and trade and is highly sensitive to external disturbance, which leads to large fluctuations in the economy where constant current account deficits, significant external debt and a high debt service ratio give cause for concern. The low-intensity conflict with Azerbaijan regarding the Nagorno-Karabakh enclave continues to be costly for the country. Weak growth prospects in Russia put an addition damper on the Armenian economy, which is highly dependent on Russia in terms of trade, remittances, direct investment and aid.

EKN places Armenia in country risk category 6 of 7. Normal risk assessment is applied for sovereign risks, bank risks and corporate risks. EKN has long experience of payment risks in Armenia, and the payment experience has been very good.

#### THE COUNTRY'S STRENGTHS AND WEAKNESSES

##### STRENGTHS

- + Relatively high political stability
- + Significant reserves of metals and minerals lead to large export revenues.
- + Reassuring level of international reserves.

##### WEAKNESSES

- Low-intensity conflict with Azerbaijan about the enclave Nagorno-Karabakh.
- Prolonged current account deficit along with a very high external debt and debt service ratio.
- A small economy that is dependent on natural resources and trade entails large fluctuations in the current account, currency, international reserves and inflation.

## SWEDISH EXPORTS TO ARMENIA, MSEK

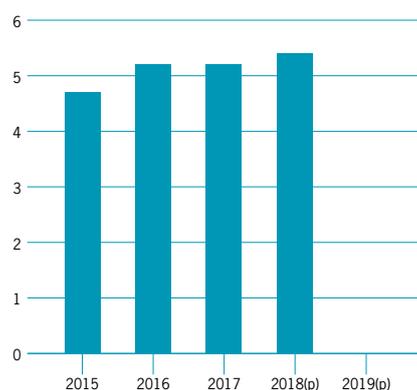
	MSEK
2016	67
2015	100
2014	181
2013	95
2012	159

Source: SCB

## EKN'S EXPOSURE

	MSEK
Guarantees	458
Offers	74

## INTERNATIONAL RESERVES (MONTHLY IMPORT REQUIREMENTS)



Source: IMF 2017

The international reserves are at a reassuring level.

## EKN:S POLICY

EKN has placed Armenia in country risk category 6 of 7 since 2006. Classification is carried out in collaboration with other OECD countries. EKN applies normal risk assessment for pure sovereign risks, bank risks and corporate risks. In the case of other public purchasers, a letter of credit or bank or sovereign guarantee is required.

## EKN'S COMMITMENT AND EXPERIENCE

EKN's outstanding guarantees in Armenia amount to SEK 532 million after a significant increase in guarantees during 2016 and 2017. The outstanding guarantees consist mainly of transactions within the mining, power and transport industries. The number of guaranteed transactions is low. Three transactions were completed in 2016 and four were completed in 2017. Payment experience is very good – no claims adjustment has been effectuated in the last decade and there are currently no registered delays.

## WHAT MIGHT CAUSE A CHANGE IN THE COVER POLICY?

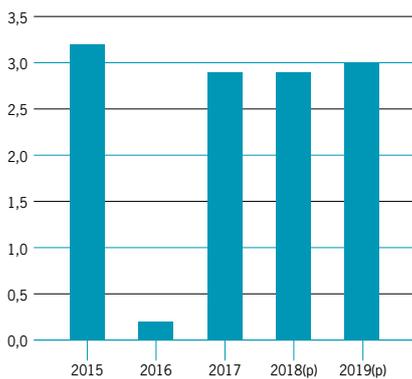
### EASING OF RESTRICTIONS, IN THE EVENT OF:

- A resolution of the conflict regarding Nagorno-Karabakh.
- Significantly reduced external debt and debt service ratio.

### THE TIGHTENING OF RESTRICTIONS, IN THE EVENT OF:

- A significant and prolonged reduction in exports, aid and remittances as well as a depletion of the international reserves, which jeopardises the country's ability to pay.
- Increased political instability, which for example threatens the important influx of direct investments.

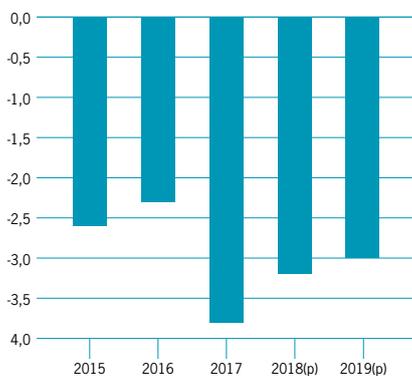
## GDP GROWTH (% PER ANNUM)



Source: IMF 2017

Growth has returned.

## CURRENT ACCOUNT (% OF GDP)



Source: IMF 2017

Armenia is struggling with a prolonged current account deficit.

## COUNTRY ANALYSIS

### BACKGROUND

Armenia's independence from the Soviet Union was initiated in 1991 by a four-year war against its neighbour Azerbaijan. The reason for the conflict was Nagorno-Karabakh, which formally belongs to Azerbaijan but which is populated by ethnic Armenians and has been occupied by Armenian troops ever since the war. Since 1994, there is a poorly adhered to armistice; in some years, fighting along the border has claimed up to one hundred casualties. Despite this, the armistice was an economic turning point for Armenia, whose GDP grew continuously up until 2008. Fewer remittances from the USA and Russia in connection with the global financial crisis in 2008 put an abrupt end to the high growth rate. In 2009, GDP dropped by 14 per cent, and the Armenian dram lost nearly 25 per cent of its value. Since then, the economy has grown an average of 3.5 per cent per annum and the currency has been gradually weakened.

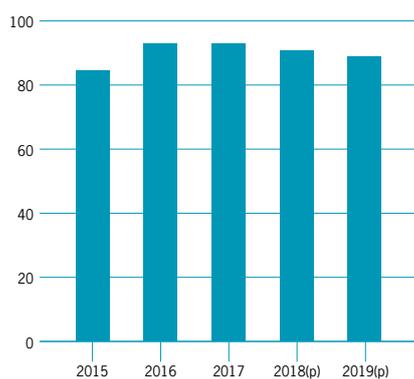
As a result of the conflict regarding Nagorno-Karabakh, Azerbaijan and Turkey have set up an economic blockade of Armenia, meaning that the country's only trade routes go through Georgia and Iran. Due to labour emigration, Armenia's population has been declining for several decades. As a result, the Armenian diaspora is estimated to be nearly four times as large as the country's population. Russia is the country's closest ally, which was emphasised when Armenia chose to join the Russian-led Eurasian Economic Union (EEU) instead of a closer collaboration with the EU in 2015. Russia has a military base in the country that provides protection in the event of a renewed conflict with the significantly wealthier Azerbaijan. Domestic policy is characterised by nationalism, weak political parties, low election turnout and recurring electoral fraud, but also by relative political stability.

### RECENT DEVELOPMENTS

Falling export prices of copper and reduced remittances from Russia led to zero growth for Armenia in 2015-2016. Growth has now once again gathered momentum, and is expected to be 2.9 per cent in 2017. The deflation of previous years has been turned into an inflation of 1.7 per cent in 2017 - significantly lower than the Central Bank's goal of 4 per cent. The Republican Party, which is represented by President Serzj Sargsyan, won the parliamentary elections of January 2017 with 49 per cent of the vote. This confirmed the Republican Party's role as the dominant political player in the country. The election results allow Sargsyan to be named Prime Minister and thereby stay in power in Armenia after the presidential election being held in 2018, at which point the presidential office becomes solely ceremonial. This entails a risk of the country heading further towards an authoritarian direction, but it will likely remain relatively politically stable.

The proportion of non-performing loans in the Armenian banking sector has increased steadily over the last decade as the economy has deteriorated. In 2015, the trend was turned around, and the proportion of non-performing loans has dropped by around three

## EXTERNAL DEBT (% OF GDP)



Source: IMF 2017

The external debt is high, given Armenia's income level.

percentage points to just under seven per cent in 2017. This is still high, but with an average capital adequacy of a little over 20 per cent in 2017 along with increased provisions, it does entail a stabilisation. The major domestic banks have a significantly better quality of assets than average. The improvement of the banking sector is the result of stricter regulatory requirements from the Central Bank, which came into force on 1 January 2017. The most urgent weakness of the banking sector is that approximately 60 per cent of deposits are made in dollars, which, when combined with a historically volatile dram, constitutes a significant currency risk for the banks. Armenia uses a floating exchange rate that suits the small, trade-dependent economy well, but which can lead to large exchange rate fluctuations.

### THE LONG-TERM TREND

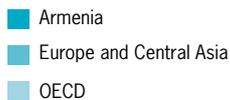
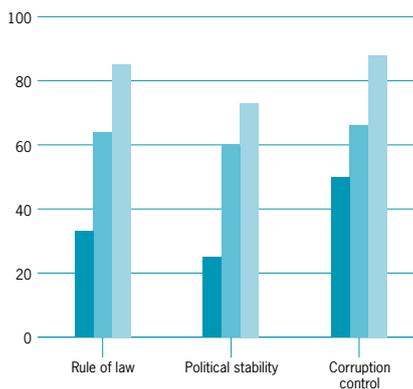
The Nagorno-Karabakh conflict will remain costly for Armenia in the long term. The low-intensity conflict with Azerbaijan entails significantly limited access to trade routes, increased military expenditure and significant costs associated with financing the regime in Nagorno-Karabakh. Armenia therefore has much to gain from a peace treaty in regard to the disputed region; an immediate resolution is unlikely however. Russia has recently sold weapons systems on both sides of the conflict, which has upset Armenia and hardly indicates a de-escalation of the conflict.

When it comes to growth, Armenia will benefit in the short term from the recovery of the Russian economy. However, the weak long-term growth prospects in Russia entail unfavourable external conditions for Armenia, which hampers growth in the long term. In the first decade of the 2000s, growth was driven primarily by a construction boom that was mainly financed through remittances and direct investments originating in a strong Russian economy. Armenia's period of rapid growth therefore more or less coincided with that of Russia.

As a result of aggressive borrowing, the Armenian government debt has risen from 15 to 55 per cent of GDP in the last decade and is now nearing a vulnerable level. The currency exposure constitutes the greatest vulnerability in terms of debt. As much as 87 per cent of the loans are in foreign currencies, primarily USD and EUR, which could lead to payment difficulties in case of a significant drop in the Armenian dram in relation to these currencies. The probability of default is somewhat reduced by the fact that the debt is exclusively medium to long-term, which entails a lower refinancing risk. An increased tax yield, a broadening of the tax base and more effective tax collection will be required to turn around the budget deficit of approximately three per cent of GDP. Since 2010, Armenia has completed two full-scale IMF programmes, the latest of which ended in June 2017. According to the IMF prognosis, the budget deficit and government debt will be reduced in 2018 and 2019, but the public finances will remain vulnerable.

Armenia's external debt remains very high given the country's income level. In 2017, the external debt corresponded to a little over 90 per cent of GDP, which, when combined with a very high debt service

## BUSINESS ENVIRONMENT



Ranking from 0 (worst) to 100 (best)

Source: World Bank

ratio, constitutes a significant payment risk. The country furthermore struggles with a prolonged current account deficit, which is currently around three per cent of GDP. Copper exports and remittances, along with aid, are very important to the current account, while a substantial flow of foreign direct investment and loans are used to cover the current account deficit. The fundamental reason for the deficit is a non-competitive economy, and there are no indications that it will be possible to turn it into a surplus in the near future. This means that the economy will remain highly sensitive to changes in external factors. At present however, there are sufficient reserves, corresponding to five months' imports, to cover possible current account deficits and to stabilise the floating exchange rate if need be.

## BUSINESS ENVIRONMENT

Armenia is in place 47 out of 190 in the World Bank's Doing Business Index, which is in the middle for the countries of the Caucasus region. The neighbouring country Georgia is ranked in ninth place, while Azerbaijan is in place 57. When it comes to investor protection and insolvency procedures, Armenia is ranked especially low, while its position for contract compliance is slightly better. Among the challenges are monopoly/oligarchy structures in terms of import and sale of goods, which leads to a lack of competition on the domestic market. Large parts of the economy are dominated by business leaders who have very good connections within the government. The corruption within the business sector, legal system and government administration is still an issue. Armenia is ranked in place 113/176 in Transparency International's Corruption Perception Index, which is significantly worse than Georgia, but slightly better than Azerbaijan. The legal system is feeble, which, when combined with widespread corruption, can lead to arbitrary and unpredictable justice. Furthermore, there is a cumbersome bureaucracy. Government agencies are sometimes used to get to political opponents and companies.

When it comes to currency transfers, the regulation is liberal and the country has ratified the IMF's Article VIII on free currency convertibility. Armenians and foreign nationals alike are able to transfer currency more or less freely. Considering the large and persistent current account deficits, the large external debt and the high debt service ratio, there is a certain risk of problems in the balance of payments, which may entail increased currency regulation. When making export transactions, the transfer risk shall therefore be taken into consideration, despite the liberal regulations at present.