

Affected by low commodity prices and Russia crisis

General Information



GDP	USD10.6bn (World ranking 133, World Bank 2015)
Population	3.0mn (World ranking 136, World Bank 2015)
Form of state	Republic
Head of state	President Serzh SARGSIAN (since April 2008)
Next elections	2017 legislative; 2018 presidential

Strengths

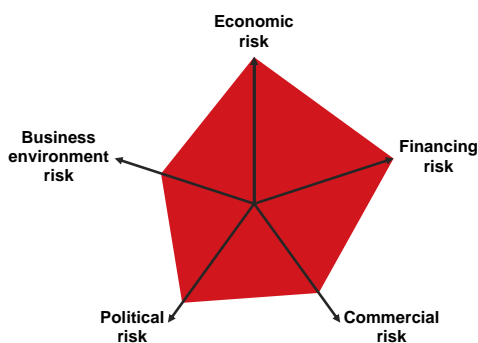
- Moderate inflation
- Gradually but continuously improving business environment

Weaknesses

- Backward economic structure, with production and exports narrowly based on commodities, foodstuff and simple products
- Vulnerability to the business cycle of Russia which is a the major trading partner and an important source of remittances inflows
- Deteriorating fiscal position
- Large current account deficits since 2007
- High external debt
- Low foreign exchange reserves (2.2 months import cover)
- Exchange rate vulnerability

Country Rating

D4



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports	Rank	Imports
Russian Federation	20% 1	24% Russian Federation
China	11% 2	7% China
Germany	10% 3	6% Turkey
Georgia	9% 4	6% Iran (Islamic Republic of)
Canada	6% 5	5% Germany

By product (% of total)

Exports	Rank	Imports
Metalliferous ores and metal scrap	22% 1	10% Gas, natural and manufactured
Beverages	12% 2	7% Petroleum and petroleum products
Non-ferrous metals	12% 3	6% Non metallic mineral manufactures
Non metallic mineral manufactures	9% 4	5% Road vehicles
Iron and steel	7% 5	3% Gold, non-monetary (excl. ores)

Source: Unctad (2014)

Economic Overview

Unfavorable economic structure

The structure of the Armenian economy is unfavorable. In 2014, agriculture accounted for about 22% of GDP (up from a low of 18% in 2008), services for 48%, construction for 11%, mining and utilities for 8%, and manufacturing for just 11% (see Figure 2).

Industrial production and exports are narrowly based on commodities, foodstuff and simple products, which makes the economy highly vulnerable to shifts in global prices for these goods. In 2014, commodities (mostly metals) accounted for 74% of total Armenian merchandise exports.

In terms of markets, Russia is the key trade partner, accounting for 20% of Armenian exports and 24% of imports, adding further vulnerability to the Russian business cycle.

Moreover, Russia is an important source of remittances for Armenia. Remittances from Russia stood at USD1.6bn in 2013 (before the Russian crisis) accounting for 14% of Armenian GDP. However, they have dropped to USD0.7bn or 6% of GDP in 2015 (see also Figure 4).

Subdued economic growth

After double-digit real GDP growth rates in 2002-2007 (annual average +13.4%) thanks to the commodity price boom, falling commodity prices combined with the end of a construction boom and sharply reduced external demand in the wake of the global economic crisis caused growth to slow rapidly and to shift to GDP contraction of -14.2% in 2009. Following a short-lived recovery with growth reaching +7.1% in 2012, growth has faltered again since 2013 as a result of the renewed fall in global commodity prices and the crisis in Russia (see Figure 3).

In full-year 2015 the economy expanded by +3%, followed by +4.5% y/y in Q1 2016 and +1.5% y/y in Q2 2016 (volatility partly due to base effects). We forecast full-year growth of +2.2% in 2016 and +2.5% in 2017. In the next few years, annual growth is likely to remain subdued (around +3%) as global commodity prices as well as the Russian economy are expected to remain under pressure. This is too low for a frontier market to catch up substantially.

Twin deficit to continue

The annual fiscal deficit widened to -4.9% in 2015 and is forecast to come in at around -4% of GDP in 2016-2017. Public debt — 87% of which is foreign exchange (FX) debt — has more than tripled in relation to GDP from just 14% in 2007 to 49% in 2015 and will rise further in 2016-2017.

The current account deficit narrowed from -7.3% of GDP in 2014 to a more adequate -3.2% in 2015 as import growth slowed more markedly than export growth, in part thanks to lower oil and gas prices (Armenia is a net energy importer). However, we expect the current account to widen again to around -4% to -5% of GDP in 2016-2017.

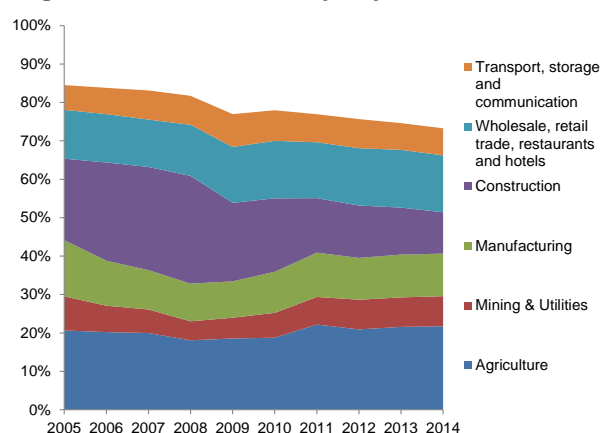
External debt stood at USD8.9bn in 2015, equivalent to a hefty 84% of GDP, a rapid increase from just 31% of GDP in 2008.

Figure 1: Key economic forecasts

	2014	2015	2016f	2017f
GDP growth (% change)	3.5	3.0	2.2	2.5
Inflation (% end-year)	4.6	-0.1	1.0	4.0
Fiscal balance (% of GDP)	-1.9	-4.9	-4.1	-3.6
Public debt (% of GDP)	43.5	48.7	52.5	54.0
Current account (% of GDP)	-7.3	-3.2	-4.0	-5.0
External debt (% of GDP)	71.	84.3	86.5	86.5

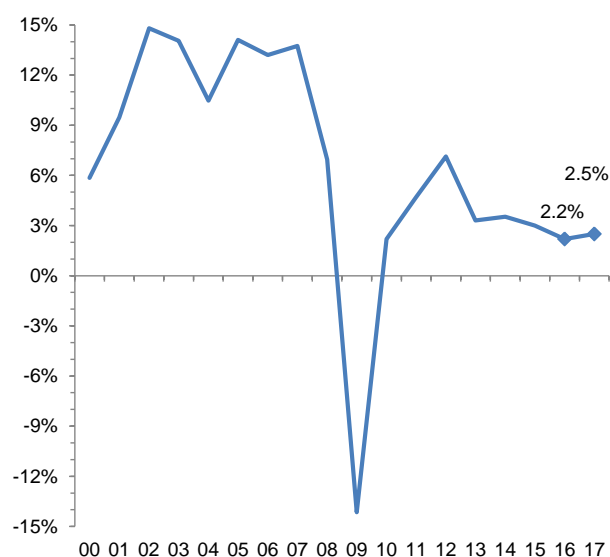
Sources: IMF, ADB, National statistics, IHS, Euler Hermes

Figure 2: GDP distribution by major sectors 2005-2014



Sources: UN, Euler Hermes

Figure 3: Annual real GDP growth (%)



Sources: IMF, Euler Hermes forecasts

Increased vulnerabilities and IMF support

Armenia's official FX reserves came under pressure in 2014 as a result of weakening exports and remittances (see Figure 4), falling to USD1.5bn at end-2014 from USD2.3bn a year earlier. This forced the central bank at the end of 2014 to stop supporting the AMD, which then depreciated by about -16% against the USD.

In order to tackle the fiscal and external vulnerabilities (especially the large twin deficit on the fiscal and current account) Armenia requested successfully for IMF support and agreed in March 2014 on a 38-month IMF program, providing funding of about USD120mn. The third review of the arrangement in July 2016 was broadly positive, although some slippage in reaching fiscal deficit targets was noted.

Meanwhile, the IMF arrangement has helped to stabilize FX reserves (they stood at USD1.6bn in June 2016) and the exchange rate. The latter, while still showing moderate volatility since the start of 2015, stood at 475 AMD per USD at the time of writing, the same as at end-2014.

Summarizing, macroeconomic fundamentals are relatively weak and the data indicate considerable imbalances. Risks to financing flows, external liquidity and the exchange rate remain elevated and the IMF arrangement appears crucial to mitigate economic strains.

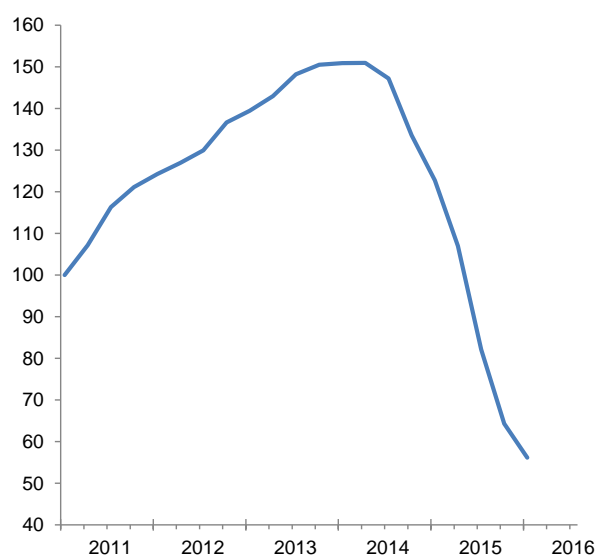
Business environment

The business environment has improved over the past decade. The World Bank's *Doing Business 2016* survey assigns Armenia a good rank of 35 out of 189 economies. The country scores particularly well in the sub-components *Starting a business*, *Trading across borders* and *Enforcing contracts*. *Resolving insolvencies* in Armenia is ranked 71st, still a bit more difficult though also above the global average.

The Heritage Foundation *2016 Index of Economic Freedom* ranks Armenia 54th out of 186 economies.

However, the World Bank Institute's *Worldwide Governance Indicators 2015* survey indicates considerable weaknesses with regard to *regulatory quality* (ranked 84 out of 206) and, in particular, the *rule of law* (rank 118) and *control of corruption* (rank 125). The latter is in line with Transparency International Corruption Perception Index 2015 which puts Armenia at rank 95 out of 168 economies.

Figure 4: Remittances from Russia
(4 qtrs moving average, Q1 2011 = 100)



Sources: Central Bank of Russia, Euler Hermes

Figure 5: Key business environment indicators/rankings

WB Doing business 2016 survey (covering 189 economies)	
Overall ranking	35
Starting a business	5
Protecting investors	49
Trading across borders	29
Enforcing contracts	28
Resolving insolvencies	71
WB Worldwide Governance Indicators 2015 (covering 206 economies)	
Regulatory quality	84
Rule of law	118
Control of corruption	125
Heritage Foundation 2016 Index of Economic Freedom (covering 186 economies)	
Overall ranking	54
Transparency International Corruption Perception Index (covering 168 economies)	
Overall ranking	95

Sources: World Bank, Heritage Foundation, Transparency International

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