
Fitch Upgrades Armenia To 'BB', Outlook Stable

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Fitch Ratings agency has upgraded Armenia's long-term foreign and local Issuer Default ratings (IDRs) to 'BB' from 'BB-' (BB minus). The Outlooks have been changed from Positive to Stable. The agency has also upgraded the Country Ceiling to 'BB+' from 'BB' and affirmed the Short-term IDR at 'B', says the Fitch report on Armenia.

Fitch experts say that the upgrade of Armenia's sovereign ratings reflects the economy's rapid growth, rising incomes and strong policy framework, which the agency cited as potential triggers when it placed the ratings on Positive Outlooks in May 2007. The Armenian economy grew 13.8% in 2007, extending a five-year rolling average of 13% annual growth. This buoyed average incomes to around the 'BB' median of USD 3,000 in 2007, easing a previous rating weakness.

According to Fitch, Armenia scores relatively favourably on the World Bank's Doing Business survey, where the country ranks 39th out of 178 economies, well above the 'BB' median of 98th place.

The budget deficit has run at or below 2% of GDP since 2003, contributing to a drop in general government debt to 65% of fiscal revenues by 2007 from 139% in 2004, helping to make Armenia's public finances a clear rating strength, the Fitch experts say. The central bank has allowed the dram to appreciate, driven by remittance incomes and increasingly by strong capital inflows, helping to contain inflationary pressure. Average annual inflation in 2007 of 4.4% was below the 'BB' median of 7.9%.

According to Fitch, Armenia faces some risk of overheating, although pressures are moderate relative to 'BB' peers.

Annual inflation was 9.9% in May 2008, boosted by rising food prices (54% of the basket). Armenia's central bank cites the strong seasonal component to inflation, and 275 bps of policy rate hikes since June 2007 (to 7.25%), in support of its view that inflation will fall back to around 6% by end-year.

Credit growth of 79% in 2007 is concerning, although Fitch bank analysts note improvements in system quality, while the banks' small size remains the key weakness. Total credit to the private sector was just 14% of GDP at end-2007. Strong bank credit expansion contributed to the widening of the CAD from 1.8% in 2006 to 6.2% in 2007, although strong capital inflows drove an improving external liquidity position. According to Fitch, the violent crackdown on post-election protests in March 2008 has made political risk more salient in the credit profile.

However, tensions appear to have eased and the government has promised some structural reforms to help address social grievances, while political risk in Armenia is not out of line for the 'BB' range.

"Sustained growth and disciplined macroeconomic policies, and concrete action on the new government's reform agenda, could exert more upward pressure on Armenia's ratings in the long term. A failure to contain overheating pressures, problems in the banking system, or signs of a breakdown of political stability could be negative for the ratings," said Andrew Colquhoun, Director in Fitch's Sovereigns Group. N.V.
