Armenia’s prime minister Nikol Pashinyan tells Global Markets how his government’s agenda to reform the economy and eradicate corruption will lead to both stronger exports and the creation of technology ‘unicorns’

pursue opportunities to expand our footprint in global trade.

Focusing on exports across industries is one of the main value drivers in our strategy. Our strategic engagement with both the Eurasia Economic Union (EEU) and the Comprehensive and Enhanced Partnership Agreement (CEPA) with the EU is a solid foundation for achieving this goal.

We have made a strong start towards meeting our export target of around 50% of GDP over the long term.

Some 1.65m international tourists visited Armenia in 2018, and the figures for the first half of 2019 are 12% higher. The high-tech sector is also booming, growing 20%-30% per annum. We already have several start-up companies (such as PicsArt) that have successfully attracted US venture capital and are approaching several hundred million dollar valuations.

Finally, by implementing our long-term transformation strategy and building our cutting-edge innovation ecosystem, we hope to host many homegrown unicorns with some of them reaching $10bn in valuation.

What measures are you taking to ensure the Armenian economy is resilient? Indeed, the global economy is currently facing massive uncertainty and Armenia as a small open economy is exposed to external shocks. Our main actions to ensure the resilience in the long-term are our wide-ranging structural reforms. These measures are intended to increase the potential of the economy.

In the short term, preserving our macroeconomic stability is our first line of defence. Public debt is sustainable, which allows us to build buffers for countercyclical fiscal policy in case of an adverse shock. On the monetary and financial stability side, the Central Bank of Armenia has advanced policy frameworks, which have been tested many times. Results speak for themselves — inflation has been under control and banks have been resilient despite massive regional volatility.

What is Armenia’s five-year economic plan progressing? What are the main goals and how will you achieve them?

Our government’s five-year programme will transform Armenia into a modern, high-tech and well-governed democratic society. It will be free from corruption, with well-established institutions ensuring our nation’s security and the protection of human and property rights.

On the economy, the programme is built on three principles: zero tolerance to corruption; improving revenue mobilisation through ensuring fairness in the tax system; and structural measures to foster inclusive growth through achieving a business-friendly environment and healthy competition in the private sector.

In this context, enhancing the government’s spending capacity and its efficiency, especially in human development, is a key success factor.

Our programme also includes a new economic growth strategy. We are moving from a model driven by domestic demand to one focused on exports and investment.

We are only at the beginning of the journey, but some results are already apparent. Our economic growth rates are above the average for the region and for the world. Tax revenues have also increased by more than 25% in the first half of this year, showing strengthened trust in the government.

We are developing a long-term country transformation strategy called Vision of Armenia for 2050. This will kick-start wide ranging public and professional consultations and set strategic goals and actions for the next 10 years. It also aims to build consensus among all Armenians around the world.

One of the aims of the economic plan is to increase exports from 20% to 43%-45% of GDP by 2024. How will you achieve this?

One of the key lessons learned since Armenia gained independence in 1990 is that expanding our export potential is a crucial goal. We must
From revolution to reform: Armenia sets sights on next economic level

By Lewis McLellan

A political revolution can often throw a small and developing economy like Armenia into disarray, but after the Velvet Revolution of May 2018, Armenia and its new regime have enjoyed GDP growth of 5.2%, in spite of a period of difficult political transition. The nation’s partnership with international financing institutions like the IMF and the World Bank has helped smooth over the bumpy period and is now shepherding the country through a challenging programme of institutional reforms.

Among the biggest challenges facing the new regime was Armenia’s history of endemic corruption. Former prime minister Tigran Sargsyan said in 2008 that corruption was Armenia’s number one problem obstructing reforms. Armenia still ranks 105th in Transparency International’s Corruption Perceptions Index, although it has steadily crept up the rankings from 113th in 2016.

Previous efforts at tackling the problem have had little success. An anti-corruption council was established in 2004 but was widely regarded to have achieved little of value. In 2015, a second attempt was made, and the anti-corruption council was relaunched. If anything, the results were even worse. The council was quickly beset by accusations of lavish spending, and an unwillingness to pursue investigations into senior politicians robbed the initiative of credibility.

“Previous governments failed to tackle the problem effectively, largely because they were corrupt themselves,” says Tigran Jrbashyan, head of management advisory services at Ameria CJSC, one of Armenia’s top consultancy and advisory companies. “It’s different this time. The new government is quite radical on fighting corruption within the public sector.”

Part of this is achieved through reforms to the judicial system, making the judiciary more independent, but the enforcement aspect is perhaps more important. “The new government has taken the fight against corruption to a completely new level,” says Jrbashyan. “Now they are quite radical on fighting corruption and shadow economy. There’s a clear message to public officials that things have to be done above board. However, fight against corruption should be accompanied with building effective institutions.”

New prime minister Nikol Pashinyan announced in September that there would be two new bodies set up to tackle corruption, and that they are moving towards establishing an independent judiciary. Armenia has also set up a register of beneficial ownership that will provide public information on the real owners of businesses operating in Armenia. The bill has been signed and the register should be fully operational by December 2020.

The focus on corruption should help to improve investors’ confidence in doing business in Armenia.

“Transparency, rule of law and consistency should create a new level of trust, both in Armenia and abroad. FDI should improve.”

—Tigran Jrbashyan, head of management advisory services, Ameria CJSC

Despite the political upheaval following its 2018 political revolution, Armenia has launched an aggressive and wide-ranging series of reforms that, if carried through successfully, should propel the economy to a new level.
**ECONOMIC OVERVIEW**

**SCENES FROM YEREVAN**

Hrazdan Stadium, downtown bitcoin advertising, a gas pipeline near the Armenia-Iranian border, Zvartnots international airport, the Rossia Mall shopping centre, and the Yerevan Metro rapid transit system

"From a macro stability point of view, Armenia has been very impressive," says Jrbashyan. "After the global financial crunch, growth has been remarkably stable, and we do expect further positive developments in this regards. Armenia has proved to be outstanding in the region with an average inflation of 3%-4% for the last 10 years, only 1%-2% fluctuation of exchange rate over the last five years and much better diversified economy, where the largest sector of economy has less than 14% share."

The government's new tax code, which it will implement between 2020 and 2023, will lessen the tax burden for smaller businesses and entrepreneurs in an effort to create a better environment for business.

But despite cutting and simplifying taxes, government tax receipts climbed hugely this year and are expected to continue rising. "Armenia is pursuing an e-governance concept that would give a leap to transparency and reporting, as well as enable many online services both by the public and private sectors," says Jrbashyan.

Christian Fang, senior analyst for Armenia at Moody’s, agrees. "Expanding digitisation to include invoicing as well as revenue collection has really helped cut down on tax avoidance. Over the next year or so, the filing of income taxes will become automated, which should improve things even more."

But beyond the government’s attempt to reform itself, it is working on structural changes to the Armenian economy. Fang says: “These reforms, if effectively implemented, will increase Armenia’s economic competitiveness and its attractiveness as a business destination.”

Armenia is working hard on developing various sectors of its economy. It has never been a manufacturing powerhouse, although the manufacturing sector output increased by 10% in 2018, but the jewel of Armenia’s economy and the sector that will likely drive the bulk of its economic growth in years to come is technology.

Armenia has become a hub for software development, industrial computing and general information technology services.

**RESILIENCE AGAINST EXTERNAL SHOCKS**

Armenia has experience in riding out periods of domestic and regional turmoil, but with the world facing a slowdown in growth, Armenia will have to adapt to survive. Where many economies around the world will suffer from the slowdown in economic growth and the spillover of reduced demand thanks to the trade war between the US and China, Armenia will only be indirectly exposed to the conflict.

"Armenia has a pretty limited exposure to US and China trade tensions," says Fang. “Its main trading partners are the EU, Switzerland and Russia, not the US or China."

But should the decline in global growth result in a fall in commodity prices, it is likely that Armenia would suffer as a result. Mining, particularly of copper, is still an important part of the Armenian economy. However, as the importance of the technology sector grows, Armenia’s reliance of mineral production will fall. The World Bank has been pursuing a programme of trade promotion in Armenia, seeking to address the country’s reliance on low value-added commodity products.

“The technology sector of its economy is growing strongly, and we expect it to prove resilient in the face of slowing growth,” says Fang. “Armenia services a wide region as a provider of technology solutions, and they’ll likely be needed even in times of slow growth.”

**CHALLENGES FACING ARMENIA**

Most agree that if Armenia successfully accomplishes its programme of reforms, it will reap the rewards — a stable, diverse economy with dynamic growth. However, that it is successful in its reforms is not a foregone conclusion.

“The government is currently working on the transformation strategy of the country. We are proud to have developed innovation-led industrial strategy, yet implementation of all those great ideas is still a big challenge. It will require detailed and consistent implementation,” says Jrbashyan.

The government was elected with a 70% majority in December 2018 and appears to still enjoy much of the goodwill that carried it to victory. That goodwill will go a long way towards facilitating reform.

But that goodwill will not last forever. Unless the government is able to produce results in line with the public’s expectations, it could begin to evaporate quickly.

“Apart from quality of decision making, there is a huge time pressure and I expect that more public sector operations should be outsourced to the private sector to enable swift and efficient implementation of good intentions of the government,” says Jrbashyan.

Some of Armenia’s structural challenges are less amenable to improvement through reform. It is a landlocked nation, and two of its four borders are closed. Poor diplomatic relations with Turkey and Azerbaijan mean that those countries are barred as routes for trade. Its borders with Georgia and Iran are open, but the economic sanctions on Iran make it a difficult option for trade opportunities. There is little that can be done to address this, but Armenia’s membership of the Eurasian Economic Union provides a valuable outlet for trade.

Although Armenia’s GDP is growing at an impressive rate, and projected to continue to do so, its current account deficit and trade balance are both substantial. The World Bank projects that these deficits will fall, thanks to structural reforms calculated to boost exports and tourism.

Armenia’s new government, although it was born out of a revolution, has proved an ambitious but credible body. Its reform programme, though daunting, has the advantage of public support and the backing and confidence of the international investment community.
Next Level of Transformation is the Switch to Digital Banking

GlobalMarkets: Mr. Hanesyan, what is behind the growth of the Armenian banking sector in the last year?

Artak Hanesyan, Ameriabank: One of the reasons I would like to highlight is the growth of Armenian economy over the last two years. After the Velvet Revolution, Armenia undertook political and economic reforms and a huge fight against corruption.

This has greatly improved Armenia’s image internationally and helped to generate trust in our country, its economy and its real estate.

Banks have also played a significant role in economic growth by financing the private sector. Armenia’s assets to GDP ratio is 83%, which is approaching that of Eastern European countries, demonstrating the increasingly important role the banks play in the Armenian economy.

The growth rate of the banking sector is impressive. Loans alone grew by 36% in 2018. We are pleased to note that the growth is represented in both retail and business, as well as the mortgage sector where demand is currently higher than supply.

The volume of deposits in Armenian banks increased by 12.7% during the year. The market is becoming more active by the day, and even during the vacation period, the number of operations was comparable with the highest season of the previous year.

What we observe now is the synergy of banking and the economy: growth of lending stimulates the economy and economic growth in turn stimulates the demand for loans and other banking products.

The Armenian banking system has faced two global financial recessions in the last 10 years, as well as the Velvet Revolution. It came through all of them without any serious consequences or bankruptcies. Our financial system is stable and our banks are sustainable, highly transparent and enjoy the trust of their clients.

How is Ameriabank able to remain the leader in the Armenian banking sector year after year amid such tough competition?

We have always made a point of putting long-term projections at the core of all our strategies. We strove to keep pace with global trends even where local market was still centered on traditional models. Innovation is and has always been our signature move.

Moreover, we develop Ameriabank’s products based on detailed analysis of our clients’ needs. That’s why they meet our clients’ expectations to the highest possible degree. We offer a wide palette of distance banking services, actively promoting online lending. We do everything to deliver the best service to our clients, protect their operations and save their time. This is what makes it possible to be the leader – good customer experience, up-to-date methods and professional staff.

Moody’s has recently raised Ameriabank’s rating to Ba3. What does this mean for you?

The new rating was affirmed after Moody’s reviewed and raised Armenia’s sovereign rating from B1 with positive outlook to Ba3 with stable outlook earlier this year. Since the credit rating of a company is constrained by the sovereign credit rating of the country, Ameriabank has the highest possible rating for an Armenian company, which is the same as the Armenia’s sovereign rating.

The upgrade of Ameriabank’s long-term local currency deposit rating from B1 to Ba3 was driven by the upgrade of its Baseline Credit Assessments (BCAs) reflecting a combination of the Armenian banking system’s improved macro profile and the bank’s consistently sound financial metrics such as asset quality, strong capital position, high ROA and ROE, sufficient liquidity and diversified funding base.

Ameriabank’s long-term foreign currency deposit rating was upgraded from B2 to B1 and the long-term counterparty risk from Ba3 to B2. These ratings are very important for attracting equity market investments and international funds.

The market is always changing, from technology to consumer attitudes. How has Ameriabank changed, and what will be next?

10 years ago nobody could have imagined how impressive Ameriabank’s transformation would be during those years. From a small bank with $45 million in assets and $8 million in equity Ameriabank has grown into the dominant leader of the Armenian banking system. Our asset base is 36 times larger than it was 10 years ago, while our loan portfolio is 130 times larger.

We have been the leader in terms of assets and loans for some time now; we are the 11th largest taxpayer in the country, far ahead of all other Armenian banks. Since 2008 we have raised more than $1 billion from IFIs – a strong indication of our partners’ trust. We are also number one in investment banking with a 30% share of corporate bond issuance.

We have grown from a petty bank to become the leading financial institution in Armenia by financial ratios, service quality and global-level innovation. We did not grow with the market; we surpassed it.

The main change over these 10 years is technological breakthroughs. Instead of remaining a purely financial company, we decided to venture into technology, actively promoting digital solutions and distance banking.

Due to robust corporate governance systems in line with best international practices and balanced HR policy we have been able to bring together a brilliant team of like-minded professionals. The success of our business rests on people and technology.

As for further transformation: I am confident that technology is and will remain the key to success in banking. For Armenia, with its small domestic market, digital transformation in banking will be especially important as the foundation of development for years to come.
Armenia’s banking sector — the region’s strong man

Armenia’s restrictions on lending are starting to pay off, as its banks are able to lend effectively to the country’s burgeoning private sector and so help drive economic growth.

By Lewis McLellan

Regulation of Armenia’s banks is among the toughest in the Commonwealth of Independent States region, and Central and Eastern Europe, and it’s only getting tougher. The central bank is set to introduce Basel III, requiring the nation’s banks to maintain the capital buffers the regulation mandates.

While the 2014 economic slowdown hit Armenia as it did everyone else in the region — credit quality has still not yet recovered according to the IMF — the response in Armenia was more muted than elsewhere.

“Overall, the Armenian banking sector has been extremely stable over the last 20 years and is rather overcapitalised,” says Artashes Shaboyan, chief researcher at Ameria CJSC, one of Armenia’s top consultancy and advisory companies. “Most of the banks apply best practice corporate governance and high level of transparency in reporting per IFRS standards.”

With 17% total capital to risk weighted assets and 15% as common equity tier one, Armenia is well ahead of the capital requirements imposed by most regulators. Even with the planned phase-in of the Basel III capital requirements, and the IMF’s counter-cyclical buffer, the average Armenian bank is holding more than enough capital.

Banks have had to struggle against regulation to make risky loans and preserve profitability. However, the restraint has stood Armenia in good stead, setting it up with a stable financial system.

“The Central Bank of Armenia was swift in implementing international regulatory standards in the early 2000s, and up until now they are in many cases even ahead of Western countries with applying Basel and other relevant standards,” says Shaboyan.

That has led Armenia to hold a smaller proportion of non-performing loans than most of its peers in Eastern Europe. Christian Fang, senior analyst for Armenia at Moody’s says: “NPLs rose over 2015 and 2016 on the back of the large economic shock that hit the region in 2014, but only to around 10% or so. Many of the other countries in the Eurasia region had much higher levels of impaired assets.”

Now, with the economy enjoying growth of more than 5%, and banks holding generous capital buffers, credit has been growing robustly in Armenia over the past few years — a period in which banking systems with less proactive supervisory policies have contracted, according to Fang.

“Investment accounted for a significant share of lending in 2018,” he says. “Such investment in productive capital will contribute to future growth.”

“There’s growth in demand for loans, thanks to the growing economy, and growth in financial liquidity among customers,” he adds. “I expect credit to expand quite dramatically over the next few years.”

Of course, there remains room for improvement in any banking system. Despite strong capitalisation, around 50% of deposits in Armenian banks are in foreign currencies. The high dollarisation of the Armenian economy is a structural challenge for the banking system.

With growth in the global economy slowing, many will opt for the safe haven trade and keep their funds in dollars. Should the dollar strengthen against the Armenian dram, Armenia’s liabilities will increase dangerously.

The Armenian central bank has taken steps to mitigate these risks, imposing higher risk weights on dollar assets, for which it received the IMF’s commendation. The IMF has also suggested more measures to address the risk of Armenia’s FX exposure: a stressed debt service to income ratio limit and a requirement for banks to maintain foreign currency reserves against foreign currency liabilities.

DIGITALISATION TO DRIVE CONSOLIDATION

The Armenian banking sector is undergoing changes from within, as well as reacting to impositions from regulators.

Armenia’s banks are pursuing an aggressive digitalisation strategy, updating their processes both internally and externally. The moves should lower costs of running business and increase sales, according to Armenian analysts.

But the drive to digitalise is not just going to make Armenian banks more efficient and competitive internationally; it will change the make-up of the industry.

“Over the next couple of years, I expect to see another round of consolidations in the Armenian banking system,” says Tigran Jbrashyan, head of management advisory services at Armenia CJSC. “I would be surprised to see small and low efficiency banks that have not adopted a digital transformation strategy survive in Armenia past the next few years.”

Although the IMF will always have suggestions for improvements to Armenia’s banking regulation, the country’s central bank deserves praise for managing a stable and secure banking system, which will help power Armenia’s growing economy.
Expanding horizons in mining