

Armenia: Joint Bank-Fund Debt Sustainability Analysis¹

Armenia is considered to be at a low risk of debt distress with all debt indicators well below the relevant country-specific debt-burden thresholds, including when subjected to stress tests (see Table 1 below).

The baseline DSA has been developed on a cautious set of assumptions, including: i) real GDP growth of 5 percent per year over the period 2008–12, and 4 percent thereafter; ii) inflation of 3 percent throughout the projection period; iii) an overall fiscal deficit of 2.9 percent of GDP through the PRSP horizon of 2015, and 2.3 percent of GDP thereafter (implying a debt-stabilizing primary balance); iv) a steady increase in the share of both exports and imports as a proportion of GDP, leading to a gradual improvement in the current account balance over the projection period; and v) a shift away from highly concessional forms of external financing.

Under the baseline scenario:

- the fiscal position remains sustainable (see Table 1a and Figure 1). In particular, the net present value of domestic and external public debt increases from 23 percent of GDP in 2005 to 31 percent in 2025. Note that this result is based on the conservative assumption that the deficit is financed with increasingly expensive borrowing.² The net present value of debt to revenue, and the debt service to revenue ratio remain relatively stable throughout the projection period, and;
- the external debt outlook is benign (see Table 2a and Figure 2).³ In particular, the net present value of external debt falls steadily from around 15 percent of GDP in 2005 to just over 8 percent by 2025, the net present value of debt-to-exports falls from just over 60 percent to around 25 percent over the same period, and the debt service-to-exports ratio decline from just under 6 percent in 2005 to around 2 percent by the end of the projection period.

¹ This DSA was undertaken jointly by Fund and Bank staff, in consultation with the government of the Republic of Armenia, in August and September 2005. The DSA has been prepared in line with the interim guidance on the preparation of joint Fund-World Bank DSAs for low-income countries. Fund and Bank staff have collaborated previously on debt sustainability issues, including in the context of the report on “Poverty Reduction, Growth and Debt Sustainability in Low-Income CIS Countries”, 5 February 2002, (SM/02/34).

² This assumption also implies that as interest expenditure rises, the primary balance improves steadily.

³ To ensure data consistency, the external DSA covers only public and publicly guaranteed debt. The authorities are currently considering ways to enhance the coverage and reporting of external private debt statistics. According to current data, private external debt totaled USD 704 million at end-2004.

| Table 1. Armenia's External Debt Burden Indicators | | | |
|---|---------------------|-------------------------|-------------|
| | Threshold 1/ | Armenia's Ratios | |
| | | 2005 | 2025 |
| <i>NPV of debt in percent of:</i> | | | |
| Exports | 200 | 60 | 25 |
| GDP | 50 | 15 | 8 |
| <i>Debt service in percent of:</i> | | | |
| Exports | 25 | 6 | 2 |

1/ Threshold values are based on the guidelines for low-income country DSAs, in which Armenia is considered to be a strong performer.

The framework for low-income country DSAs incorporates alternative scenarios and bound tests aimed at identifying the sensitivities of the baseline projection to a range of potential shocks (see Tables 2b and 3b below). Based on these it can be seen that Armenia's debt outlook is particularly sensitive to i) a lasting shock to the growth outlook, and ii) a slowdown in export growth. Nevertheless, even in these scenarios, Armenia's debt outlook is likely to remain manageable. Staff also considered the possible impact on debt sustainability of a 'significant' fiscal event, such as assumption by the government of pension liabilities. Assuming such an event were to occur in 2010 and cost around 10 percent of GDP, the net present value of public debt to GDP ratio in 2025 would remain manageable at about 40 percent. While the historical scenario (which can be considered as a "no-reform" scenario) also projects debt ratios below the threshold indicators, the ratios generally continue on an upward trend through the projection period. **This finding underlines the importance of continuing the process of structural reform, and preserving macroeconomic stability in order to safeguard the debt outlook.** This is a key lesson from the DSA.

The authorities welcomed the finding that Armenia is at a low risk of debt distress. Sound debt management continues to be a priority for the government. Since 2001 the Ministry of Finance and Economy has produced an Annual Report on Public Debt of the Republic of Armenia, covering both domestic and external debt. This publication reports on the evolution of debt aggregates and the government's debt management strategy. Looking ahead, the authorities are considering the possibility of contracting commercial external debt cautiously, seeking, where possible to learn lessons from other countries in the region. As noted above, they are also considering ways to strengthen the coverage and reporting of external private debt.