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INFORMATION DISCLOSURE

This Review includes a detailed description of the current internal and external macroeconomic setting and an agreed set of forecasts that takes into account the interrelationships between the economies of the EDB operating region and the external sector.

The forecasts of the main macroeconomic indicators were prepared by the EDB jointly with the EEC using an integrated system of models based on a multi-country structural dynamic macroeconomic general equilibrium model. More detailed information about the structure of the integrated system of models, its main components, and its use for analysis of the macroeconomic situation and forecasting is contained in a joint EDB and EEC report entitled “Forecasting System for the Eurasian Economic Union”.

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LIST OF ABBREVIATIONS

CBRA – Central Bank of the Republic of Armenia
EAEU – Eurasian Economic Union
EDB – Eurasian Development Bank
EEC – Eurasian Economic Commission
FDI – Foreign Direct Investment
GDP – Gross Domestic Product
IBL – Interbank Loans Market
pp – percentage point
RA – Republic of Armenia
RF – Russian Federation
USA – United States of America
% – per cent
% YoY – Year-on-Year growth rate
Armenia’s economic growth accelerated in the first half of 2019 as household consumer activity and the mining industries recovered. The EDB projects Armenia’s GDP to grow by 6.5% over 2019, more than in 2018 (5.2%), driven among other reasons by the preceding year’s low base in the mining industry. In 2020 and 2021, economic growth will trend towards its potential rate that we estimate at about 5%. It may increase as the government implements its business climate improvement initiatives.

For most of the first half of 2019, inflation kept below the CBRA target range (4+/−1.5%). Food price trends were a source of volatility. Core inflation sanitized from the influence of the unstable prices in the food market decreased as the dram strengthened against the main trade partner countries’ currencies.

The EDB predicts inflation to stay weak in the second half of 2019, with 1% consumer price growth over the year. In the medium term, inflation growth will be driven by domestic demand increasing as both wages and lending grow. By the end of 2021, inflation will approach the middle of the CBRA target range.

The Central Bank of the Republic of Armenia reduced its refinancing rate by 0.25 pp, to 5.75% p.a., in January 2019, as the price growth rate was low. According to the EDB’s base case projection, the Central Bank will begin raising its interest rate in 2021 as inflation gradually accelerates.

In the first half of 2019 the State budget posted a surplus for the first time since 2014, at AMD 121.9 billion (4.5% of GDP). Public finance improved mainly on account of a better tax collection rate. The switch to a budget surplus had a beneficial effect on Armenia’s public debt data.

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1 Another 0.25 pp decrease, to 5.5%, occurred in September 2019.
STATE OF THE ECONOMY

Economic Activity

GDP Growth Accelerates

Armenia’s economic growth accelerated in 2019. According to our calculations, real GDP grew by 6.8% YoY in the first half of 2019 (vs. 5.2% in 2018). The main factors behind the improvement in economic data included households’ expanding consumption and the recovery in mining (after a 14% decline in 2018).

Activity in Most Sectors Increases

Most of the main sectors of the economy showed positive trends in the first half of this year. Industry, construction, trade and the service sector contributed positively to GDP growth. Agriculture was an exception, with its trends still affected by the weather.

Figure 1. Economic Activity

Source: Statistical Committee of the RA, calculations by the authors

Consumer Demand Grows Rapidly

Household consumption expanded considerably in the first half of 2019, by 14.1% YoY in January to June 2019 after 4.8% in 2018. The private consumption recovery was driven by an increase in lending and both public and private sector wages.
According to the Statistical Committee of Armenia, industrial output increased by 6.9% YoY in the first half of 2019 after 4.3% in 2018. The sector’s activity accelerated as mining increased (+6.8% YoY in January 2019 after -14.0% YoY in 2018, when some major mining companies suspended their works). Strong trends also continued in the manufacturing industry, whose output grew by 8.7% YoY in the first half of 2019 (vs. +10.0% over 2018).

Agricultural output fell by 7.4% YoY in the first half of 2019 (after a 7.6% fall over 2018). The sector’s negative growth this year results from a high comparison base in the first half of 2018 (as the 2018 agricultural decline was exclusively on account of the second semester’s trends).

Gross savings were a detractor from GDP growth in the first half of this year, as they declined by 18.9% and 21.1% YoY in the 1st and 2nd quarters, respectively. Investment in fixed capital was quite volatile in January to June, with 10.2% YoY growth in the 1st quarter followed by a 0.5% YoY decrease in the 2nd quarter.

**Gross Savings Fall as Inventory Stocks Decrease**

**Industrial Growth Acceleration Driven by Mining**

**Agricultural Output Declines**
The external sector’s contribution to Armenia’s economic growth reversed direction in the first half of 2019. After a 5.1% YoY fall in exports in the 1st quarter, real growth in sales of Armenian goods abroad increased by 8.8% YoY in the 2nd quarter to exceed the import expansion rate (+4.9% YoY).

**Net Export trends Improve in 2Q2019**

*Source: Statistical Committee of the RA*

**Figure 3. Production Activity (period’s growth rate year-on-year)**

**Figure 4. Physical Volumes of Foreign Operations (period’s growth rate year-on-year)**

*Source: Statistical Committee of the RA*
The Labor Market

Wages Growth with Rising Demand for Labor

Wages growth accelerated to 5.6% YoY, well above inflation, in the first half of 2019 (we estimate real average wages growth in the first semester at 3.6% YoY). The increase in remuneration resulted from the expansion of economic activity that raised demand for labor. In May 2019, the job seekers to vacancies ratio\(^2\) reached its minimum over 2011–2019.

![Figure 5. Labor Market Indicators](image)

**Source:** Statistical Committee of the RA

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Inflation

**Inflation Kept Below CBRA Target**

For most of the first half of 2019, inflation stayed below the CBRA target range (4+/-1.5%). The sources of volatility included food prices, whose growth temporarily drove up inflation in the spring of 2019. Core inflation\(^3\) slowed down from 1.8% YoY in December 2018 to 0.8% YoY in June 2019, mainly because the Armenian dram strengthened versus the main trade partner countries’ currencies.

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\(^2\) Calculated by the Statistical Committee of the RA.

\(^3\) Core inflation is sanitized from the influence of unstable food prices and thus describes the average annual price trends in the economy.
Food prices grew by 4.6% YoY in June 2019 after 1.6% YoY in December 2018. The acceleration of inflation in this segment mainly resulted from the appreciation of vegetables (+19.1% YoY) due to their low harvest in 2018, whose effect on the price level continued into the first half of 2019.

Non-food goods appreciated by 1.9% YoY in June 2019 (vs. +3.2% YoY in December 2018). Their trends were driven by the stabilization of petrol and diesel fuel prices and by the strengthening of the Armenian dram.

Service prices grew by 0.1% YoY in June 2019 (vs. 0.8% YoY in December 2018). The growth of utility charges and some transport tariffs was low. In particular, passenger fares decreased by 3.5% YoY.
The External Sector

The current account of the balance of payments recorded a deficit of USD 549.8 million in the first half of 2019 (vs. USD 501.2 million in the same period last year) as the foreign trade balance remained negative (USD 770.1 million). The increase of the current account deficit was largely caused by a worsening balance of the country’s incomes in the form of wages and salaries, investment income and grants to USD 261.9 million, down from USD 304.9 million a year before. Such trends may be explained by a slowdown of economic activity in Russia. Against this backdrop, net remittance inflow also decreased somewhat, to USD 218.4 million in the first half of 2019 from USD 223.5 million a year before.

Negative Balance of Trade in Goods Stabilizes

The negative balance of foreign trade in goods was USD 831.2 million in the first half of 2019, virtually the same as in the same period last year (USD 832.7 million). Food exports increased while imports decreased due to growing domestic production of foodstuffs. Imports of machines and equipment declined amid unstable domestic investment demand. The first half of this year saw an increase in imports of mineral products resulting from growing demand amid fast economic growth and, possibly, from repair works at the Armenian Nuclear Power Plant.
EAEU countries now account for a greater share of Armenia's foreign trade. Exports to EAEU countries grew by 5.7% YoY in January to June 2019 to reach USD 322 million (27.4% of all exports to foreign countries). Imports to Armenia from EAEU countries also increased, by 5.7% YoY, to USD 722.4 million (31.1% of all Armenian imports). The structure of goods exports to EAEU countries in the first half of 2019 featured a growing share of food products and agricultural raw materials, while imports from EAEU countries featured a growing share of mineral products.

Source: Statistical Committee of the RA, calculations by the authors

Source: EEC, calculations by the authors
The Fiscal Sector

State Budget in Surplus

In the first half of 2019 the State budget posted a surplus of AMD 121.9 billion (4.5% of GDP). This is the first time that a positive State budget balance has been recorded in Armenia since 2014. The improvement of public finance mainly resulted from the growth in tax and duty revenues (to 26.2% of GDP in the first half of 2019 from 23.1% of GDP a year before). Public income increased after measures were taken to increase the tax collection rate. On the other hand, public spending as a percentage of GDP decreased to 23.4% in January to June 2019 from 24.6% in the same period last year.

Public Debt to GDP Ratio Decreases

The switch to a surplus budget had a beneficial effect on Armenian public debt, which decreased to 52.8% of GDP as of end of June 2019 (vs. 55.6% of GDP at the beginning of 2019). The share of domestic debt in the State’s liabilities grew to 21.3% in the first half of 2019 from 20.0% at the end of 2018, which will make the economy more resilient to external shocks.

Sovereign Rating Improves

Moody’s raised Armenia’s sovereign rating from B1 to Ba3. The rating’s outlook was changed from Positive to Stable. The improvement in the rating resulted from the rising number of factors behind Armenia’s economic growth, recognition of the national authorities’ experience in macroeconomic stabilization, and from the strengthening of public finances compared to 2014–2017.
The Central Bank of the Republic of Armenia reduced its refinancing rate by 0.25 pp, to 5.75% p.a., in January 2019. The main reasons were a low price growth rate in the country and the need to additionally stimulate the economy in order to return inflation to its target range (4+/-1.5%). On 10 September 2019, the rate was reduced by another 0.25 pp, to 5.5%.

The interbank market rates decreased somewhat as the refinancing rate was reduced in January 2019, and remained stable until its further reduction in September. The temporary acceleration of inflation in the spring of 2019 and the increase of demand for loans, as economic growth accelerated, may have had an effect on bank deposit and loan interest rate trends in the first half of 2019. Those factors, in particular, prevented bank loan rates from decreasing in tandem with the CBRA refinancing rate in 2019.
Bank lending growth slowed down to 13.0% YoY in June 2019 from 17.2% YoY in December 2018, which mainly results from trends in loans in foreign currencies (a decrease by 2.0% YoY in June 2019). In turn, the volume of borrowings in drams continued to expand (40.4% YoY growth in June 2019 after 35.4% YoY in December 2018), which was primarily driven by an increase in consumer and mortgage lending.

The decrease of the degree of dollarization continued into the first half of 2019. The share of loans in foreign currency decreased to 52.0% in June 2019, from 54.8% in December 2018, and the share of residents’ foreign currency deposits declined to 50.0% from 52.7% over the same period.

In the first half of the year, the Armenian dram strengthened against the major currencies. In June 2019, the dram appreciated by 0.9% YoY versus the U.S. dollar, by 4.2% YoY versus the euro, and by 2.9% YoY versus the Russian ruble. The real effective dram exchange rate grew by 4.2% YoY as it strengthened nominally versus the trade partner countries’ currencies and as inflation in Armenia stayed low compared to most neighboring countries.
**Figure 15. Real Effective Dram Exchange Rate**

*(period’s growth rate, year-on-year, + = dram strengthening)*

*Source: CBRA, calculations by the authors*
ECONOMIC OUTLOOK

Background

External Demand Constrained Economic activity in the countries that are Armenia’s main trade partners slowed down in the first half of the year. Growth slowdown in the Eurozone is largely resulting from the negative effect of world trade tensions on net exports and investment. In Russia, GDP growth slowed down in the first half of 2019 as the world economy decelerated and fiscal policy was tightened, with the VAT rate raised and public investment spending reduced temporarily.

Stimulative Monetary Policy Worldwide The projection’s base scenario assumes that global trade tensions persist at their level prevailing in September 2019, with no additional protectionist measures anticipated (besides those announced). In this situation, the increasingly uncertain outlook for the global economy will keep hindering investment activity in the Eurozone countries in the medium term. Throughout the projection horizon, monetary conditions will remain stimulative, which will manifest itself in a slow recovery of the Eurozone countries’ aggregated GDP growth rate in 2020–2021.

In Russia, the implementation of the national projects is expected to accelerate in the second half of this year, which will lead to a gradual increase of economic activity. The economy will be additionally supported by the easing of monetary policy after the Bank of Russia reduced its key rate in June to September. We project this to result in some 2% annual economic growth in Russia in 2020–2021.

Weak Inflationary Pressure from Abroad The external sector’s inflationary pressure on the Armenian economy is expected to be low. The projection’s base scenario assumes a gradual decrease of oil prices relative to their average level of 2019 as world demand growth slows down. Russian inflation is assumed to temporarily slow down below its target level by the end of the current year and to gradually recover to 4% in 2020–2021. Low and inertial expectations will continue to hinder growth in the Eurozone, so we project inflation below the ECB target (close to but lower than 2%) in 2019–2021.
Our projection assumes Armenia’s fiscal policy assigns greater priority to supporting economic growth. This will not undermine fiscal and debt sustainability, for better fiscal performance will increase public revenue. The RA Central Bank’s monetary policy will continue to pursue the objective of keeping inflation within its 4+/−1.5% target range.

Table 1. Projected Main Foreign Economic Indicators

<table>
<thead>
<tr>
<th>Year</th>
<th>Average annual copper price (USD per tonne)</th>
<th>Average annual Urals oil price (USD per barrel)</th>
<th>Food price index, 2010=100</th>
<th>Russia’s real GDP growth rate, %</th>
<th>Eurozone’s real GDP growth rate, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019</td>
<td>5,972</td>
<td>63.6</td>
<td>86.7</td>
<td>1.1</td>
<td>1.3</td>
</tr>
<tr>
<td>2020</td>
<td>5,789</td>
<td>60.7</td>
<td>87.3</td>
<td>1.8</td>
<td>1.3</td>
</tr>
<tr>
<td>2021</td>
<td>5,842</td>
<td>58.9</td>
<td>87.6</td>
<td>2.0</td>
<td>1.5</td>
</tr>
</tbody>
</table>

Source: calculations by the authors, EEC

Economic Activity

GDP Growth to Accelerate in 2019

6.5% GDP growth over 2019 is projected, driven by consumer demand expansion as wages and the bank lending growth rate increase, as well as by factors on the supply side, namely an agricultural and mining output recovery.

Figure 16. Real GDP (period’s growth rate year-on-year)

Note: seasonally adjusted data.

Source: calculations by the authors, EEC

* Here and elsewhere the fan chart ranges correspond to the 10%, 50% and 75% confidence intervals.
In 2020, GDP growth will be lower than in 2019 as the effect of the comparison base, resulting from the low harvest and ore mining output drop in 2018, is exhausted. Nevertheless, the economy will continue to grow at a fairly high rate of some 5% per year. This will be facilitated by the implementation of the State’s investment climate improvement initiatives and by the increase of public spending envisaged by the draft budget for 2020.

Figure 17. Output Gap

Source: calculations by the authors, EEC

5% Potential Growth

In the medium term, Armenia’s economic growth is expected to be close to its potential level that we estimate at some 5%. Economic growth will be driven by labor productivity and investment demand. In addition to Armenia’s traditional areas of investment (mining and metallurgy, the agro-industrial sector, and construction), a growing share of investment may go to relatively small sectors, e.g. the textile and apparel industry. Structural reforms implemented by the Government may serve to increase the economy’s potential growth in the long run.

Inflation

Inflation will stay below the CBRA target range in the second half of 2019 and will be 1.2% over the whole year. By the end of 2021, inflation will approach the middle of the CBRA target range (4+-1.5%), driven by increasing domestic demand as both wages and lending grow.
In our projection, we expect a round of rate rises to begin in 2021 as inflation gradually accelerates. In the medium term we expect stimulative monetary policy to continue overall.

The dram to U.S. dollar exchange rate is expected to be stable in the medium term. A balanced balance of payments and an increasing inflow of foreign investment will keep the national currency stable.
Main Macroeconomic Indicators of the Republic of Armenia

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>GDP in constant prices (% growth YoY)</td>
<td>0.2</td>
<td>7.5</td>
<td>5.2</td>
<td>6.5</td>
<td>4.8</td>
<td>5.6</td>
</tr>
<tr>
<td>Consumer price index (% growth in December to previous year’s December)</td>
<td>-1.1</td>
<td>2.6</td>
<td>1.8</td>
<td>1.2</td>
<td>2.7</td>
<td>3.9</td>
</tr>
<tr>
<td>1 Day Interbank Loans in National Currency (the year’s average % per annum)</td>
<td>7.6</td>
<td>5.9</td>
<td>6.1</td>
<td>6.0</td>
<td>6.0</td>
<td>6.7</td>
</tr>
<tr>
<td>Nominal Armenian Dram to U. S. Dollar Exchange Rate, (AMD per USD)</td>
<td>480</td>
<td>483</td>
<td>483</td>
<td>480</td>
<td>478</td>
<td>484</td>
</tr>
</tbody>
</table>

Source: calculations by the authors, EEC
Your comments and suggestions concerning this review are welcome at: pressa@eabr.org