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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

CA – Current Account

CBRA – Central Bank of the Republic of Armenia

EAEU – Eurasian Economic Union

EDB – Eurasian Development Bank

EEC – Eurasian Economic Commission

GDP – Gross Domestic Product

IBL – Interbank Loans Market

pp – percentage point

RA – Republic of Armenia

RF – Russian Federation

U.S. or USA – United States of America

% – per cent

% YoY – Year-on-Year growth rate
Armenia’s economic growth accelerated to 7.6% in 2019 (after 5.2% in 2018). The main factors behind the better economic performance are household consumption expansion and recovery in mining. The EDB projects the country’s GDP to grow by 5.6% in 2020. The GDP slowdown compared with last year is particularly attributed to the exhaustion of the low base effect in the metal ore mining sector. Economic growth will be supported by positive trends in the manufacturing and construction sectors as well as by recovering agricultural output. In the short term, business activity is exposed to weakening risks stemming from a decline in both demand and supply caused by the adverse effects of the coronavirus spread.

For 2021–2022, we project the economy to expand at a rate close to its potential estimated around 5%. It may accelerate as the State implements its business climate improvement initiatives.

Inflation was 0.7% YoY in December 2019, which is below the Central Bank’s target range of 4±1.5%. The factors behind price deceleration included the dram’s strengthening against the currencies of the main trade partner countries, a weak price situation abroad, the structure of consumption, and commodity market pricing.

The EDB predicts the consumer price index to grow by 0.2% in 2020 amid weak consumer demand and slow economic growth in Armenia’s main trade partner countries. Price growth will be contained in particular due to increased competition in commodity markets. In the medium term, inflation will approach its Central Bank target as aggregate demand increases, boosted by accommodative monetary and fiscal policy measures.

The Central Bank of the Republic of Armenia reduced its refinancing rate by 0.25 pp twice in 2019 (to 5.5% p.a.) as the price growth rate was low. According to the EDB’s baseline projection, the CBRA will start raising its policy rate in 2021 as inflation gradually picks up.

The state budget deficit decreased to 63.9 billion drams (1.0% of GDP) in 2019, down from 105.4 billion (1.7% of GDP) the year before. The better performance in public finances was achieved through improved tax collection. Narrowing deficit had a favorable effect on Armenia’s public debt, which decreased by 2.2 pp over the year, to 53.6% of GDP as of the end of 2019.
STATE OF THE ECONOMY

**Economic Activity**

**GDP Growth Accelerates**

Armenia’s economic growth accelerated to 7.6% in 2019 (vs. 5.2% in 2018). The main factors behind the improvement of economic trends included household consumption expansion and the recovery in mining sector (after a 14.2% decline in 2018).

**Activity in Most Sectors Increases**

Most of the main sectors of the economy showed a positive performance. Manufacturing, construction, trade and the service sector contributed positively to GDP growth. Agriculture was an exception, with its performance still affected by the unfavorable weather conditions.

**Consumer Demand Grows Rapidly**

Consumer demand was the main driver of economic growth. Household consumption expanded by 12.8% after 4.8% in 2018, mainly fueled by intense lending to individuals and wage increases in both the public and private sectors. Imports and trade in motor vehicles showed a strong performance against this backdrop.

**Investment Activity Grows**

Despite the high volatility throughout the year investment in fixed capital increased by 4.3%, more than in the previous period (4.2% in 2018). This improvement was obtained through quicker allocation of Government’s capital expenditures funding in the second half of the year.

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**Figure 1. Economic Activity**

Source: Statistical Committee of the RA

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**Output gap**

<table>
<thead>
<tr>
<th></th>
<th>I</th>
<th>II</th>
<th>III</th>
<th>IV</th>
<th>I</th>
<th>II</th>
<th>III</th>
<th>IV</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP growth, YoY</td>
<td>12</td>
<td>6</td>
<td>0</td>
<td>-6</td>
<td>-12</td>
<td>-6</td>
<td>0</td>
<td>6</td>
</tr>
</tbody>
</table>

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**GDP growth, YoY**

<table>
<thead>
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<th></th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
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<tr>
<td>Output gap</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GDP growth, YoY</td>
<td>12</td>
<td>6</td>
<td>0</td>
<td>-6</td>
</tr>
</tbody>
</table>

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**Source:** Statistical Committee of the RA
Net Export Performance Improves in 2019

Foreign trade's negative impact on economic growth was less marked in 2019. Physical exports of goods and services increased by 10.3% over the year, outrunning the import expansion (+9.1%). The increase in exports resulted from resumed works at mining enterprises.
Figure 4. Physical Volumes of Foreign Operations (period’s growth rate year-on-year)

Source: Statistical Committee of the RA

The Labor Market

Wages Grow as Demand for Labor Increases

Wages growth accelerated to 5.8% YoY, well above inflation, in 2019 according to preliminary data from the RA Statistical Committee (we estimate real average wages growth at 4.3%). The increase in remuneration resulted from the expansion of economic activity, which increased demand for labor. In December 2019, the ratio of job seekers per vacancy\(^1\) was 25% lower than in the same period of the previous year.

Figure 5. Labor market indicators (period’s growth rate year-on-year)

Source: Statistical Committee of the RA

\(^1\) Calculated by the RA Statistical Committee.
Inflation

Inflation Stays Low

Inflation was 0.7% YoY in December, below the CBRA target range (4±1.5%). The weak inflation resulted not only from external factors but also from domestic economic structural factors, namely a shift in household demand from soft goods to durables and an improved competitive situation in goods markets.

Figure 6. Inflation trends
(the last month in a quarter vs. the last month of the same quarter a year before)

The causes of volatile inflation included food price trends. Core inflation\(^2\) slowed down from 1.8% YoY in December 2018 to 0.1% YoY in December 2019, mainly as the Armenian dram strengthened versus the main trade partner countries’ currencies.

Food Prices Go Down in 2019

Food prices decreased by 0.3% YoY in December 2019 after 1.6% YoY growth in December 2018. The fall of prices in this segment resulted in particular from a slower decline of agricultural output in 2019 and the strengthening dram.

Non-Food Inflation Slows Down

Non-food goods appreciated by 1.4% YoY in December (vs. +3.2% YoY in December 2018). In addition to the above factors, their trend was influenced by the stabilization of petrol prices. Service prices grew by 1.1% YoY in the last month of 2019 (after 0.8% YoY in December 2018). Moderate appreciation was observed in most main categories of services.

\(^2\) Core inflation is adjusted to remove the influence of unstable food prices and thus describes the medium-term price trends in the economy.
Figure 7. Trends of inflation components (the last month in a quarter vs. the last month of the same quarter a year before)

Source: Statistical Committee of the RA, CBRA

The External Sector

Balance of Payments Current Account Deficit Narrows

The current account of the balance of payments recorded a deficit of USD 727.5 million in January to September 2019, less than in the same period of the previous year (USD 764.9 million). The smaller CA deficit resulted from the decrease in the negative balance of trade in goods to USD 1,203.0 million (after USD 1,249.9 million in January to September 2018). The increase of the primary income balance to USD 516.3 million from USD 477.9 million the year before also facilitated the CA's improvement. Increased economic activity in the RF in the second half of 2019 led to an increased net inflow of remittances to USD 383.4 million in the first nine months (vs. USD 377.9 million the year before).

Figure 8. Balance of payments of the RA

Source: CBRA

Trade Balance Improves

The negative balance of foreign trade in goods expanded at a slower rate in 2019 than in the previous year. That was due to accelerated growth of
exports in monetary terms and imports slowing (against past periods’ high base). The increase in exports resulted from the recovery of ore mining and production of metals. Exports of precious stones and metals grew, as did food exports, the latter development resulting from expanded domestic production of foodstuffs. Imports of machines and equipment declined amid unstable investment demand. Imports of mineral products increased last year.

**Figure 9. Contributions of Commodity Groups to Goods Export and Import Growth (January to December 2019 vs. January to December 2018)**

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

**Trade in Goods with EAEU Countries Grows**

EAEU countries now play a greater part in Armenia’s foreign trade. Exports to Union countries grew by 10.5% in 2019, to reach USD 760.9 million (28.8% of all exports). Imports to Armenia from EAEU countries also increased, by 17.6%, to USD 1,531.4 million (27.8% of all Armenian imports). The structure of Armenian goods exports to EAEU countries in 2019 featured a higher share of food products and agricultural raw materials, while imports from EAEU countries featured a growing share of mineral products.

**Figure 10. Goods exports and Imports**

Source: EEC, calculations by the authors
The Fiscal Sector

State Budget Posts
Smaller Deficit

The state budget deficit decreased to 63.9 billion drams (1.0% of GDP) in 2019, from 105.4 billion drams (1.7% of GDP) the year before. The improvement in public finances mainly resulted from the growth of tax and duty revenues (to 22.3% of GDP in 2019, from 20.9% of GDP the year before), assisted by measures taken to improve tax collection. Expenditures as a percentage of GDP increased by a small margin last year, to 24.8%, from 24.1% of GDP in 2018.

Figure 11.
The State Budget
(the period’s cumulative balance)

Public Debt to GDP Ratio Decreases

Thanks to the reduced budget deficit, Armenia’s public debt decreased to 53.6% of GDP by the end of 2019 (55.8% of GDP as of the end of 2018). The share of the state’s domestic liabilities stabilized at 20.9% in 2019 (vs. 20.0% by the end of 2018), which may eventually make the economy more resilient to external shocks.

Sovereign Rating Improves

In the second half of 2019, international agencies upgraded Armenia’s sovereign ratings. Moody’s raised its rating from B1 to Ba3 with a positive outlook instead of stable. The rating improved on account of more factors now underlying the country’s economic growth, recognition of the authorities’ experience in maintaining macroeconomic stability, and the strengthened public finances compared with 2014–2017. Fitch Ratings also raised Armenia’s long-term issuer default rating to BB– from B+ with a stable outlook. It reflects Armenia’s positive foreign trade performance, decreased public debt to GDP ratio and improved structural parameters of the economy.
In 2019, the RA Central Bank conducted an accommodative monetary policy amid low inflation, focusing on a gradual return of the consumer price index to the target range of 4±1.5%. On two occasions during the year, in the 1st and 3rd quarters, the regulator reduced its refinancing rate by 0.25 pp, to reach 5.5%.

The interbank market rates decreased, following the refinancing rate. Towards the end of the year, the value of short-term assets decreased in almost all the segments of the financial market, including Government bonds. The interest rates on bank loans remained stable notwithstanding the refinancing rate reductions. This may have resulted from an increase in demand for borrowed funds amid accelerated economic growth or expectations of a recovery in inflation.
High Lending Growth Rate

Bank lending to residents grew by 18.0% YoY in 2019 after accelerating from 16.6% YoY in 2018. The increased volume of mortgage loans issued was a factor behind its acceleration.

Reduction in Forex Share of Loans and Deposits

The use of foreign currency in the economy continued to decrease in 2019. In December the share of lending to real sector residents in foreign currency fell to 49.5%, from 54.1% the previous year’s December, while the share of residents’ foreign currency deposits in the same period decreased to 44.6%, from 51.8%.  

Figure 14. Dram Nominal Exchange Rate (period year-on-year, += dram weakening)

Source: CBRA, calculations by the authors

Figure 15. Real Effective Exchange Rate (period’s growth rate year-on-year, += dram strengthening)

Source: CBRA, calculations by the authors

3 According to December 2019 data in the CBRA statistical bulletin.
ECONOMIC OUTLOOK

Background

Economic growth in the countries that are Armenia’s main trade partners slowed down in 2019. Russia’s GDP increased by 1.3% that year, after 2.5% the year before. Economic growth in the first half of the year was constrained by the increased fiscal load and weak external demand. In the second semester, Russian output began showing signs of recovery, supported by the easing of tax and budgetary policy and bank lending conditions.

The Eurozone’s aggregate GDP growth declined to 1.2%, from 1.9% in 2018; the U.S. economy grew by 2.3% after 2.9%, and China’s grew by 6.1% after 6.6%. The slowing global trade and worsening economic sentiment amid mounting trade protectionism constrained production and investment activities and were only partially offset by stimulative domestic policies.

The external setting remained highly uncertain early this year. On the one hand, the Phase 1 trade agreement entered into by the USA and China reduced the risk of global recession. On the other hand, the spread of the coronavirus may offset the positive effect of emerging progress in the settlement of their trade conflict. The EDB’s base case projection is for the epidemic to gradually stabilize this year but that it will still depress economic activity worldwide.

Russian GDP is projected to grow by 1.3% in 2020, like the year before. Domestic demand will be supported by the implementation of the national projects passing into their main stage and by household income stimulation measures. Russian non-energy producers may derive additional competitive advantages from a weakening ruble. On the other hand, the said factors’ positive contribution to economic growth may be offset by the adverse consequences of the spread of coronavirus and falling oil prices, resulting from the weakening of external demand for Russian exports, worsening economic sentiment and the disruption of production chains. In 2021 and

Moderate External Demand in Medium Term

2022, Russia’s annual economic growth will accelerate to 1.9% as the world economy and commodity markets stabilize and domestic structural reforms are implemented.

We estimate China’s economic growth to slow down to 5.0% in 2020. The key factor will be the coronavirus epidemic’s effects on consumer and manufacturing activities. The shock is supposed to be temporary and the Chinese economy should begin recovering this year, supported by monetary and fiscal stimuli. It should be noted that the assessment of the current situation’s impact on business activity is far from certain.

Economic growth in the Eurozone is projected to slow down in 2020. Late 2019 and early 2020 data point to continued weakness of the German industrial sector, and the consequences of the spread of coronavirus will have an additional negative effect. The Eurozone’s economy will stay supported by its soft monetary policy; in conjunction with a recovery of global trade, projected for the medium term, this will serve to accelerate the zone’s GDP growth.

The weaker fiscal impetus will slow U.S. economic growth in the medium term and cause it to stabilize at its near-potential level. The worsening global economic situation and the problems faced by Boeing Corporation may be additional constraints in 2020. We estimate U.S. monetary policy to retain its stimulative nature throughout the projection period.

Lower Oil Prices in 2020

The uncertain global outlook put pressure on commodity prices in 2019, with most of them depreciating. The fall of energy prices accelerated early this year because of the negative effect of the spread of coronavirus on energy consumption predicted by international organizations, as well due to the unexpected outcome of negotiations in the OPEC+ Ministerial Committee, which failed to reach consensus to extend the oil production reduction agreement. We expect a weak price situation in the world energy market to prevail in the coming months. In the medium term, the weakening of the coronavirus epidemic’s negative effects and recovery of demand for hydrocarbons will support oil prices.

External Inflation Background Weak

Inflation in Russia slowed down to 3.0% YoY in 2019, which is below the Central Bank’s target of 4%. This was facilitated by a strengthening ruble.

5 In December 2019 Boeing Corporation announced the suspension of production of its 737 MAX airliners. According to the company’s latest statements, it expects to resume production in mid-2020. For more information see Boeing Statement Regarding 737 MAX Production and Boeing Statement on 737 MAX Return to Service.
moderate consumer activity and increasing supply of food. The EDB projects the said factors’ impact to gradually weaken in the current year as household demand strengthens and the Russian currency’s exchange rate decreases. The resultant 2020 inflation is estimated at 3.8%, while in 2021–2022 inflation is projected to be close to the target set by the Bank of Russia.

Consumer price index growth in the Eurozone and USA is projected to be lower than the ECB and FRS targets throughout the time horizon, amid moderate economic activity, decreasing energy prices and low inflationary expectations. Inflation in China is expected to slow down gradually after accelerating in 2019 as the meat price shock effect peters out.

The EDB projection assumes the fiscal policy of the Republic of Armenia to stay focused on supporting economic growth. That will not reduce its tax, budget and debt sustainability as tax collection improves and helps raise the budget’s revenues. The RA Central Bank’s monetary policy will continue pursuing the objective of keeping inflation within its 4±1.5% target range in the medium term.

### Table 1. Forecast Key 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>Euro Zone real GDP growth rate, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>2020</td>
<td>5641</td>
<td>44.1</td>
<td>88.8</td>
<td>1.3</td>
<td>0.7</td>
</tr>
<tr>
<td>2021</td>
<td>5694</td>
<td>49.8</td>
<td>87.0</td>
<td>1.9</td>
<td>1.3</td>
</tr>
<tr>
<td>2022</td>
<td>5715</td>
<td>52.8</td>
<td>87.8</td>
<td>1.9</td>
<td>1.4</td>
</tr>
</tbody>
</table>

Source: calculations by the authors, EEC

### Economic Activity

#### GDP to Grow by 5.6% in 2020

GDP is projected to grow by 5.6% in 2020. The indicator’s decrease from last year’s level is mainly attributable to slower consumer demand and to the exhaustion of the low base effect in the ore mining sector. Weakening external demand will also slow down Armenia’s exports. Economic activity will be supported by a recovery of agricultural output and by increasing volumes of construction as mortgage lending is stepped up. We expect tax and budgetary policy to exert a stimulative effect on domestic demand, which will be an additional driver of economic growth in conjunction with the conducted monetary policy.
Figure 16. Real GDP (period’s growth rate year-on-year)

Note: seasonally adjusted series
Source: calculations by the authors, EEC

There are short-term risks of economic activity weakening due to the consequences of the coronavirus spread. First of all, the restriction of cross-border freight traffic (with Iran and China) may disrupt supplies of intermediate goods. The state of emergency declared in the country\(^7\) is also likely to reduce business activity. Manufacturing, trade and service sectors such as culture, recreation and entertainment, the hotel business and public catering are the most vulnerable in this situation. Uncertainty may also have a negative effect on investment sentiment in the country.

Figure 17. Output Gap

Source: calculations by the authors, EEC

5% Potential Growth  In the medium term, GDP growth is expected to be close to its potential, which we estimate at around 5%. Economic activity will be driven by trends in

\(^6\) Here and elsewhere, the fan chart ranges correspond to the 10%, 50% and 75% confidence intervals.

\(^7\) Under the state of emergency declared, it is prohibited to hold public events with more than 20 participants between 16 March and 14 April. For more information see https://arka.am/ru/news/society/v_armenii_zapreshchayutsya_massovye_meropriyatiya_v_usloviyakh_chp_vvedennogo_na_fone_koronavirusa/
labor productivity and investment demand. In addition to Armenia’s traditional areas of investment (mining and metallurgy, the agro-industrial sector, and construction), more investment may go to relatively smaller sectors, e.g. the textile and apparel industry. Long-term growth of the economy will be driven by the improving business and investment environment in the country as the Government implements its structural reforms.

**Inflation**

**Inflation to be Weak in 2020**

In 2020, inflation will remain low as the price situation is weak and economic growth slow in Armenia’s main trade partner countries. Price growth will be contained, in particular, by increasing competition in goods markets. The fall in oil prices and slowing growth of food prices in international markets will serve to additionally restrict inflation in the country.

Under the influence of stimulative monetary and fiscal policy measures, inflation will return to the CBRA target range (4±1.5%).

In the short term there are disinflationary risks resulting from the probability of domestic and external demand falling lower than anticipated in the EDB’s base case projection due to the adverse consequences of the coronavirus spread.

**Figure 18. Inflation (period, year-on-year)**

![Inflation Chart](image)

*Source: calculations by the authors, EEC*

**Monetary Conditions**

**Rates to Increase as Inflation Accelerates**

Due to weak inflation, we expect monetary policy to remain accommodative in the medium term. The EDB expects a round of refinancing rate rises to start in 2021 as inflation gradually approaches its target level.
Dram Exchange Rate to Stabilize

The dram to U.S. dollar exchange rate is expected to be stable in the medium term. A neutral balance of payments and an increasing inflow of foreign investment will keep the national currency stable.
### Table 2. Key Macroeconomic Indicators of the Republic of Armenia

<table>
<thead>
<tr>
<th>Indicator</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020F</th>
<th>2021F</th>
<th>2022F</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>GDP in constant prices</strong> (% growth YoY)</td>
<td>7.5</td>
<td>5.2</td>
<td>7.6</td>
<td>5.6</td>
<td>4.6</td>
<td>5.2</td>
</tr>
<tr>
<td><strong>Consumer Price Index</strong> (% growth in December to previous year’s December)</td>
<td>2.6</td>
<td>1.8</td>
<td>0.7</td>
<td>0.2</td>
<td>2.5</td>
<td>3.1</td>
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<td><strong>1 Day Interbank Loans in National Currency</strong> (% per annum. the year’s average)</td>
<td>5.9</td>
<td>6.1</td>
<td>5.8</td>
<td>5.4</td>
<td>5.9</td>
<td>6.7</td>
</tr>
<tr>
<td><strong>Armenian Dram to U. S. Dollar Exchange Rate</strong> (AMD per USD)</td>
<td>483</td>
<td>483</td>
<td>480</td>
<td>482</td>
<td>478</td>
<td>481</td>
</tr>
</tbody>
</table>

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