



ARMENIA

Highlights

- **Economic growth has regained momentum.** GDP growth accelerated to an estimated 5.9 per cent year-on-year in the first half of 2017, supported by strong export performance and a recovery in money transfers which followed three years of contraction.
- **Fiscal consolidation is under way.** The higher-than-planned budget deficit in 2016 led to budget consolidation required by the fiscal rule, and the deficit is planned to fall to under 3 per cent of GDP in 2017. At the same time, tax revenue over-performance in the first half of 2017 has created space for additional capital spending.
- **Banking sector capital buffers have improved.** Higher minimum capital requirements for the banking sector became effective in January 2017. This led to the injection of additional capital into the banking system and to a reduction in the number of banks.

Key priorities for 2018

- **Policies should be aimed at creating more fiscal space for tackling social and infrastructural challenges.** Further reforms in tax and customs administration should focus on mobilisation of revenues in a fair and equitable manner, and the fiscal rule needs to be updated to allow counter-cyclical response to exogenous economic shocks.
- **A new framework for public-private partnerships (PPPs) needs to be developed and adopted.** A framework of universal PPP legislation would help in attracting a greater number of PPP projects and managing contingent liabilities that might arise from such projects. A robust PPP framework would require, among other things, sound planning and project selection, strong budgeting, accounting and reporting practices and adequate fiscal risk analysis on a project level.
- **The operational environment in the banking sector requires further improvement.** In the wake of the recent successful recapitalisation, the banking system's ability to raise overall profitability and generate higher returns on equity has been limited. Supervision should remain vigilant to avoid a deterioration in underwriting standards.

Main macroeconomic indicators %

	2013	2014	2015	2016	2017 proj.
GDP growth	3.3	3.6	3.2	0.2	3.5
Inflation (average)	5.8	3.0	3.7	-1.4	1.9
Government balance/GDP	-1.6	-1.9	-4.8	-5.6	-3.3
Current account balance/GDP	-7.3	-7.6	-2.6	-2.3	-3.6
Net FDI/GDP [neg. sign = inflows]	-2.9	-3.3	-1.5	-2.6	-3.6
External debt/GDP	78.5	73.6	84.5	94.1	n.a.
Gross reserves/GDP	20.2	12.8	16.8	20.8	n.a.
Credit to private sector/GDP	39.5	45.3	42.0	48.0	n.a.

Macroeconomic performance

Growth came almost to a standstill in 2016 but rebounded strongly in the first half of 2017.

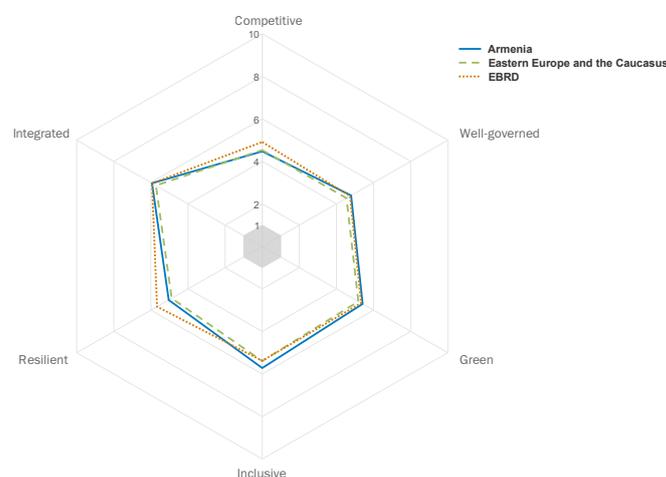
GDP growth slowed from 3.2 per cent in 2015 to 0.2 per cent in 2016, the lowest rate since 2009. This was driven by a decline in two major sectors of the economy: construction and agriculture. Construction output shrank by 10.8 per cent in real terms and agriculture contracted by 5.8 per cent in real terms. The decline in household consumption and capital investment was offset by a 19.1 per cent increase in the volume of exports. GDP expanded by 6.5 per cent year-on-year in the first quarter of 2017 and by a further 5.5 per cent year-on-year in the second quarter. In 2016, negative inflation of 1.4 per cent reflected weak domestic demand and low import prices. In reaction to slowing growth, deflation and a stabilising exchange rate, the Central Bank of Armenia (CBA) gradually lowered the refinancing rate from 10.5 per cent in August 2015 to 6.0 per cent in February 2017. An upturn in remittances in the first half of 2017 provided a stimulus to household consumption. As a result, consumer price inflation slowly increased to 0.6 per cent year-on-year in the first nine months of 2017.

External adjustment helped to maintain a stable exchange rate. The current account deficit shrank from 7.6 per cent of GDP in 2014 to 2.3 per cent in 2016 on the back of import compression and strong exports receipts driven by the recovery in copper prices and the diversification of Armenia's exports to new markets. Favourable net foreign exchange inflows have contributed to the stability of the dram-US dollar exchange rate from the beginning of 2015. Money transfers to Armenia increased by 17.5 per cent year-on-year in the first eight months of 2017 following a contraction of close to 30 per cent in 2015-16. Gross international reserves recovered from US\$ 1.26 billion in February 2015 to US\$ 2.1 billion in September 2017, providing five months of import coverage.

Fiscal consolidation aims to rein in public debt. In 2016, the budget deficit widened to 5.6 per cent of GDP, beyond the initially planned 3.5 per cent. The public debt-to-GDP ratio increased to approximately 57.0 per cent at the end of 2016, triggering the deficit adjustment required by the fiscal rule. To satisfy this requirement, the authorities plan to reduce the budget deficit to around 3.0 per cent of GDP in 2017, mainly through lower capital spending, although more recently tax revenue over-performance has created room for additional spending on infrastructure. Budget revenues increased by 6.3 per cent year-on-year in the first nine months of 2017.

The growth outlook is supported by the ongoing regional recovery. Economic recovery in the main trading partners is expected to have positive spillovers into Armenia's economy, which is projected to grow by 3.5 per cent in 2017 and 3.5 per cent in 2018, but the economy remains exposed to several risks, including volatility in the commodity markets.

Assessment of transition qualities (1-10)



Major structural reform developments

Armenia has successfully completed the IMF programme. The completion of the final review in June 2017 enabled the release of a US\$ 22 million tranche, bringing the total disbursement under the programme to approximately US\$ 112 million. The IMF assessed the programme performance as satisfactory. During the programme, the authorities enacted a financial recovery plan for the energy sector, adopted a new tax code in October 2016 and initiated improvements to the fiscal framework. Some efforts were made to develop legislative changes aimed at promoting domestic competition, improving bankruptcy procedures, and developing capital markets.

The fiscal framework is undergoing improvements. The authorities took steps to optimise planning of investment projects funded by international donor organisations. Prioritisation of these projects was carried out to ensure that loan absorption dynamics are consistent with the deficit and public debt reduction targets. The authorities initiated a revision of the fiscal rule to take into account implementation characteristics of donor-financed projects, mitigate the pro-cyclical bias and allow for more flexibility in periods of external shocks. The revised rule is expected to be submitted to the parliament by the end of 2017.

Recapitalisation of the banks was completed in an orderly fashion. The banking sector's capital buffers improved following the increase in minimum capital requirements (up from approximately US\$ 10 million to US\$ 60 million) which came into force in January 2017. New capital requirements led to consolidation in the banking sector, with the number of banks dropping from 21 to 17 in 2016. Progress has been made in developing a legal framework for capital markets. In October 2016, the parliament adopted laws on implementation of International Swaps and Derivatives Association (ISDA) Master Agreements, which will support the development of derivatives and hedging markets.

Measures to improve the business environment and attract investors continued. Efforts have been under way to streamline tax and customs administration, including via organisational changes. The time required for exporters to receive tax refunds has been shortened. In January 2017, the Center for Strategic Initiatives (CSI) was established to help attract foreign investments, promote PPPs, communicate key reforms and serve as a platform for cooperation between the private sector and the government. The board of trustees of the CSI involves high-level representatives of private and public sectors. Armenia ranks 47th out of 190 economies in the World Bank's *Doing Business 2018* report. Lower scores in dealing with construction permits, getting electricity, paying taxes and resolving insolvency contrast to higher scores in other areas.

The authorities have introduced a Government Reform Programme for 2017-22. Adopted in June 2017, the programme contains a list of reforms in the areas of public governance and legal system, foreign policy and defence, economic progress and social issues. Planned reforms are accompanied by implementation timelines.

Negotiations on the Comprehensive and Enhanced Partnership Agreement (CEPA) with the European Union (EU) have advanced. The negotiations were finalised on 26 February 2017, and the text of the agreement was signed off in March 2017. The CEPA will create a framework for closer political and economic cooperation between Armenia and the European Union.