



ARMENIA

Highlights

- **Armenia's "Velvet Revolution" resulted in a peaceful transition of power.** The new government of Armenia took early steps to deliver on its declared commitment of fighting corruption, alleviating tax evasion, reducing the shadow economy and tackling monopolisation.
- **Strong GDP growth has been largely unaffected by political developments.** Following a growth stagnation in 2016, economic growth rebounded to 7.5 per cent in 2017 and then to 8.3 per cent in the first half of 2018.
- **The fiscal framework has been refined to strike a better balance between stimulation of growth and public debt reduction.** The new fiscal rule has been introduced with the aim of providing more flexibility for growth-enhancing capital expenditure while keeping current spending in check.

Key priorities for 2019

- **Fostering transparency and demonopolisation are top priorities.** The anti-corruption drive should be pursued vigorously, tax and customs reforms need to focus on transparency, fairness and compliance, while informal barriers to entrepreneurship should be dismantled.
- **More fiscal space is necessary to finance critical public infrastructure upgrades.** To put the public debt-to-GDP ratio on a downward sloping trajectory, Armenia needs to implement the new fiscal rule and boost the tax revenue intake.
- **Armenia needs to develop and implement a comprehensive programme of vertical reforms.** Initial steps taken by the authorities to combat corruption and economic crimes are welcome and should be followed up by sector-specific economic reform plans and prompt execution.

Main macroeconomic indicators %

	2014	2015	2016	2017	2018 proj.
GDP growth	3.6	3.2	0.2	7.5	5.5
Inflation (average)	3.0	3.7	-1.4	1.0	3.0
Government balance/GDP	-1.9	-4.8	-5.5	-4.8	-2.7
Current account balance/GDP	-7.6	-2.6	-2.3	-2.4	-3.8
Net FDI/GDP [neg. sign = inflows]	-3.3	-1.5	-2.6	-2.0	-2.5
External debt/GDP	73.6	84.5	94.4	91.2	n.a.
Gross reserves/GDP	12.8	16.8	20.9	20.1	n.a.
Credit to private sector/GDP	48.8	45.6	52.2	52.9	n.a.

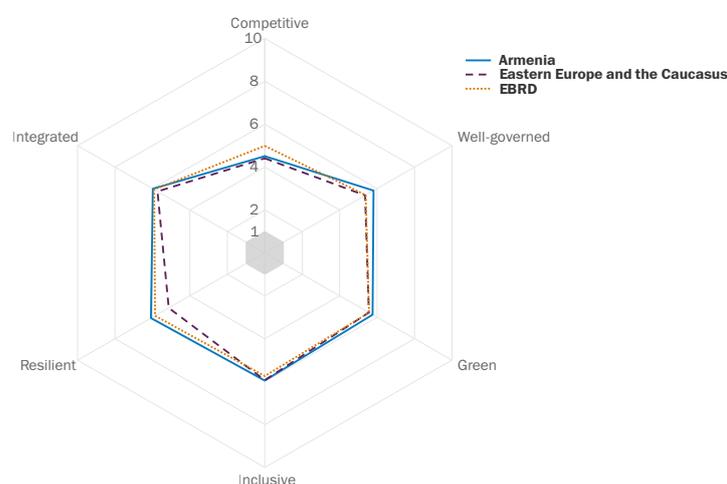
Macroeconomic performance

Armenia's economy is growing at a robust pace despite political uncertainty. GDP growth rebounded from a near-standstill in 2016 to 7.5 per cent in 2017, driven by a combination of strong demand from major trading partners and a recovery in internal consumption and investment. The volume of exports from Armenia increased by approximately 40.8 per cent in 2016-17 in cumulative terms, with the European Union (EU) and Russia accounting for approximately 28 and 24 per cent of goods, respectively, exported from Armenia in 2017. Following two consecutive years of decline, household consumption increased by 8.8 per cent in 2017, supported by a recovery in remittances. In 2017 capital investment recorded growth of 7.7 per cent after eight years of decline (with the exception of 2015 when it grew by 2.5 per cent). From a sectoral perspective, GDP growth in 2017 was broad-based, although agricultural output declined for the second consecutive year. The economic impact of political turmoil and the peaceful revolution was limited in the first half of 2018. GDP growth is estimated at 8.3 per cent year-on-year in this period. Capital investment and exports expanded by 14.7 per cent and 9.7 per cent, respectively, in the first half of 2018.

The macroeconomic environment remains generally sound. The current account deficit-to-GDP ratio averaged approximately 2.4 per cent in 2015-17. This is significantly lower than the 9.8 per cent averaged in the period 2010-14. Money transfers to Armenia increased by approximately 14.6 per cent in 2017 and by 4.9 per cent year-on-year in the first eight months of 2018. The dram remained stable against the US dollar in the first nine months of 2018. Gross international reserves stood at US\$ 2.1 billion in September 2018, providing approximately four months of imports coverage. Inflation is gradually picking up although, at 2.6 per cent in the first nine months of 2018, it remains below the central bank's target of 4.0 per cent. Monetary policy remains relatively loose with the central bank's policy rate at the lowest level since the beginning of 2010. The budget deficit widened to 5.5 per cent of GDP in 2016 before declining to 4.8 per cent of GDP in 2017 (including a large one-off military loan of approximately 1.5 per cent of GDP). The public debt-to-GDP ratio increased to approximately 59 per cent in 2017. To put it on a declining path, the Armenian authorities have attempted fiscal consolidation with a plan to bring down the budget deficit to around 3 per cent of GDP in 2018.

The economy is set to maintain strong growth momentum. Real GDP is forecast to grow by 5.5 per cent in 2018 and by 5.0 per cent in 2019. The near-term economic outlook is shaped by a relatively benign external environment and the expected positive growth effects of ongoing governance reforms. At the same time, downside risks come from the exposure of the economy to fluctuations in commodity prices, both directly through copper exports, and indirectly through the impact on major economic partners.

Assessment of transition qualities (1-10)



Major structural reform developments

The new government is tackling deep-seated governance problems. The government has pledged to root out corruption, decrease the size of the shadow economy, boost tax revenues (at 22.9 per cent of GDP, one of the lowest ratios in the region) and tackle monopolies. A series of high-profile corruption and tax evasion inquiries as well as arrests have been made against former public officials and politically connected business representatives. A number of customs brokerage firms have been prosecuted for tax evasion and fraud as part of the efforts to tackle informal monopolies on imports and customs corruption. According to the authorities, more than US\$ 42 million of unpaid taxes was recovered from 73 companies by mid-July, which is approximately 1.6 per cent of tax revenue in 2017.

The authorities have adopted a new fiscal rule. The new rule, effective from January 2018, is designed to curb current spending while leaving more flexibility for the implementation of growth-enhancing investment projects in case public debt levels exceed the preset threshold. Under the new rule, if the government debt-to-GDP ratio exceeds 40 per cent, the government will be allowed to run a fiscal deficit exclusively for financing of capital expenditures. If the ratio rises above 50 per cent, the government will be further required to cap current spending and develop a medium-term plan to lower the debt burden. In addition, if public debt surpasses 60 per cent of GDP the government will need to link current expenditures to tax revenues and submit a remedial action plan to the parliament. Escape clauses were introduced for extreme cases (such as natural disasters, wars or economic shocks). New budget allocation rules that incentivise competitive procurement through the new e-procurement system will foster spending efficiency.

A mandatory funded pension system has come into effect for all workers. The new system is in place for private sector workers from July 2018, having become compulsory for public sector employees in 2014. Implementation for private sector workers had been kept optional until July 2018 due to a strong public outcry when first introduced. At this initial stage, employee contributions into an individual savings account will amount to 2.5 per cent of their salary and will be matched by a 7.5 per cent contribution from the state. Retirement savings are to be placed into one of two approved asset management providers and invested into both local and foreign financial assets.

Armenia has completed its inaugural renewable energy auction. The winner of the international tender for construction of a solar plant in Armenia was announced in March 2018 and the agreement signed in July 2018. This is the first instance of attracting private sector participation in renewable energy development through a competitive international auction in eastern Europe and the Caucasus (EEC). Once installed and operational, the solar power plant will contribute towards the diversification of Armenia's energy sources.

A Comprehensive and Enhanced Partnership Agreement (CEPA) with the European Union has been provisionally applied from 1 June 2018. The Armenian parliament had previously ratified the CEPA in April 2018. Priority areas of cooperation include: strengthening institutions and good governance; economic development and market opportunities; connectivity, energy efficiency, environment and climate action; and mobility and people-to-people contacts.