



ARMENIA

Highlights

- **Strong GDP growth has continued despite a slowdown in exports.** The economy grew by 5.2 per cent in 2018 and by an estimated 6.8 per cent year-on-year in the first half of 2019. The export-oriented mining sector, however, underperformed in 2018.
- **The new government is targeting higher and inclusive growth.** A new precautionary programme from the International Monetary Fund (IMF) is supporting the authorities' reform efforts.
- **The authorities have adopted a package of tax reforms.** Measures include flattening the personal income tax system, cutting corporate taxes and simplifying taxation for small businesses. Social security contributions, excise taxes and licence fees have been increased to offset the fall in budget revenues.

Key priorities for 2020

- **Efforts to tackle corruption, strengthen competition, foster transparency and ensure a level playing field need to continue.** Reforms need to be institutionalised in a way that does not negatively affect regular operations of the private sector.
- **Initial success in enhancing tax compliance opens space for further reforms.** Strengthening the tax administration and further increasing the fairness and transparency of the tax framework would facilitate the private sector's ability to drive future growth.
- **Addressing infrastructure bottlenecks needs to remain among the top priorities.** Building public administration capacity and advancing the regulatory and operational framework for public-private partnerships would improve the execution of existing and new growth-enhancing infrastructure projects.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	3.2	0.2	7.5	5.2	6.0
Inflation (average)	3.7	-1.4	1.0	2.5	1.7
Government balance/GDP	-4.8	-5.6	-4.8	-1.8	-1.4
Current account balance/GDP	-2.7	-2.1	-3.0	-9.4	-7.4
Net FDI/GDP [neg. sign = inflows]	-1.5	-2.5	-1.9	-2.0	-2.2
External debt/GDP	84.5	94.4	91.3	87.8	n.a.
Gross reserves/GDP	16.8	20.9	20.0	18.1	n.a.
Credit to private sector/GDP	45.6	52.2	53.0	57.2	n.a.

Macroeconomic performance

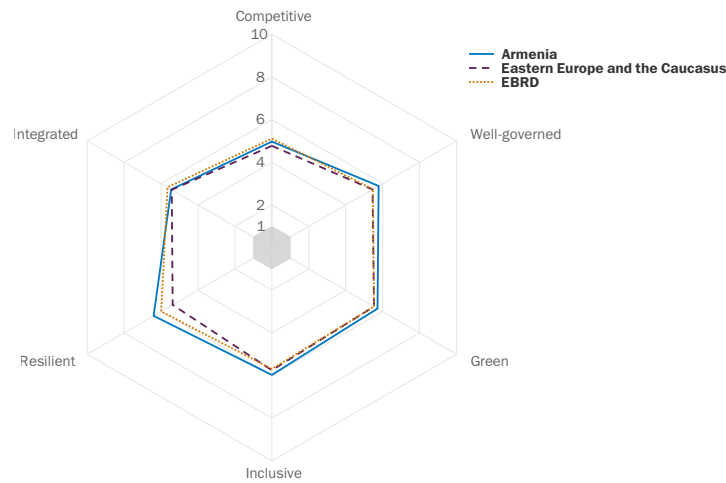
The economy maintained robust growth despite a slowdown in exports. In the first half of 2018, the economy expanded by a strong 8.7 per cent year-on-year. However, a contraction in the agriculture sector, traditionally the largest sector of the economy, and the mining and quarrying sectors, the strongest contributors to export growth, led to a growth slowdown in the second half of the year. With GDP growth at 3.0 per cent year-on-year in the second half of the year, Armenia's economy grew to 5.2 per cent overall in 2018. Gross fixed capital formation, household consumption and exports grew in real terms, albeit at lower rates than a year earlier. From a production perspective, the arts, entertainment and recreation sectors were the main contributor to growth, expanding by 31.5 per cent in real terms. This sector has been growing rapidly in recent years; its output doubled since 2015 in current prices and has increased nearly six fold since 2012. GDP growth increased to an estimated 6.8 per cent year-on-year in the first half of 2019, supported by strengthened household consumption that is benefiting from credit growth and a stronger inflow of money transfers.

In light of slower export growth, healthy domestic demand led to the widening of the current account deficit. Weighed down by underperformance in the mining sector, the growth of export receipts decelerated to 9.0 per cent in 2018 from 23.2 per cent a year earlier. At the same time, imports increased by 16.1 per cent in nominal US dollar terms. This led to a widening of the trade deficit by more than three times compared with the previous year and moved the current account deficit to a nearly double-digit level (as a per cent of GDP). The current account deficit levelled off in the first half of 2019. Nevertheless, the Armenian dram remains stable, financed largely by the inflow of foreign currency and deposits to the banking sector in the same period. Inflation declined from 2.5 per cent in 2018 to 1.6 per cent in the first nine months of 2019 (0.5 per cent in September) affected by the contractionary fiscal policy and stable exchange rate. This prompted the Central Bank of Armenia (CBA) to lower its refinancing rate two consecutive times from 6.0 per cent in January 2019 to 5.5 per cent in September 2019, bringing the policy rate to its lowest level since the beginning of 2010. International reserves are at adequate levels, covering approximately four months of imports.

Fiscal balances have improved. After reaching nearly 60.0 per cent of GDP, the public debt to GDP ratio decreased by approximately three percentage points in 2018 compared with a year before and stood at 55.7 per cent at the end of 2018. This reflected favourable macroeconomic developments, including strong GDP growth and fiscal consolidation. The lower-than-planned fiscal deficit in 2018 at 1.6 per cent of GDP was underpinned by strong tax administration efforts and government underspending on the back of delays in both current and foreign-financed capital expenditure. In the first six months of 2019, the fiscal balance was in surplus, at 1.9 per cent of forecasted GDP.

Economic growth is expected to stay robust. Real GDP is forecast to grow by 6.0 per cent in 2019 and by 5.0 per cent in 2020. However, the economy remains vulnerable to external shocks in the form of a global and regional slowdown in growth, volatility in the commodity markets and the conflict over Nagorno-Karabakh. Unleashing the economy's growth potential requires consistent implementation of comprehensive economic reforms and the attraction of efficiency-enhancing foreign investments.

Assessment of transition qualities (1-10)



Major structural reform developments

The authorities have introduced a new five-year programme for 2019-23. The programme was adopted by the new government in February 2019, one month after it took office. The overall aim is to promote competitive and inclusive economic growth. It focuses on combating corruption and enhancing public governance, creating conditions for positive economic activity, developing human capital, ensuring social protection and expanding access to infrastructure.

A new precautionary Stand-By Arrangement (SBA) with the IMF has been signed. The three-year SBA was approved in May 2019 for the total amount of US\$ 248.2 million. In the absence of external shocks, the authorities intend to treat the programme as precautionary. The arrangement aims to support the government’s reform efforts towards strengthening economic fundamentals and policy frameworks as well as implementing the structural reforms needed to generate broad-based economic growth.

A new tax reform has been introduced. The reform, adopted in June 2019, aims to boost medium-term economic activity and to increase tax compliance. Among other measures, the corporate income tax was reduced by two percentage points to 18.0 per cent and the tax on dividends for non-resident organisations halved to 5.0 per cent. Two alternative tax systems for small businesses – on self-employed and on family-entrepreneurship – were replaced by a single micro entrepreneurship system. Micro entrepreneurs, defined as entities with an annual sales turnover lower than AMD 24 million (US\$ 50,500), will be subject to an income tax of only AMD 5,000 (US\$ 10) per employee per month. The fall in revenues from these measures will be offset partly by higher excise taxes, the removal of selected tax exemptions, and by increased gambling and financial-sector licence fees. The authorities are also developing measures that will address any potential distributional effects from the tax amendments that might affect those from a lower-income background.

The Ministry of High-Tech Industry has granted tax privileges to tech start-ups. Amendments to the law on State Support for the Information Technologies Sector, voted in April 2019 and effective since May 2019, include a zero per cent profit tax and 10 per cent income tax to tech start-ups. Companies eligible for the preferential tax treatment need to have fewer than 30 employees and should not have been established as a result of the reorganisation of another company. The authorities are hoping these measures will help draw the Armenian diaspora back to the country. While still small in size, Armenia’s information and communications technology sector has been developing rapidly in recent years. From 2012-18, the number of companies and employees in the sector approximately doubled, while their turnover and exports nearly tripled.

The central bank has set additional capital buffers in the banking sector. In force since April 2019, the regulator set three buffers exceeding the current capital adequacy requirement compliant with the Basel III regulation: a capital conservation buffer, a counter-cyclical capital buffer and a systemic risk buffer. Full implementation of the buffers over the course of the next few years will strengthen the financial sector's resistance to economic shocks and help increase the efficiency of macroprudential policies.

Government restructuring was completed in 2019. In an effort to enhance efficiency, several ministries were merged. The overall number of ministries was reduced from 17 to 12.

