



## ARMENIA

### Highlights

- **Strong economic growth and macroeconomic stability have been challenged by the shock of the Covid-19 pandemic.** GDP growth of 7.6 per cent in 2019 was followed by a slowdown to 3.7 per cent year-on-year in the first quarter of 2020 and to a 13.7 per cent year-on-year decline in the second quarter.
- **A crisis response package has been supported by external financing.** To cope with rising financing needs the authorities drew on the existing International Monetary Fund (IMF) programme and augmented the financial assistance envelope.
- **The authorities took steps to tackle longstanding governance and business environment deficiencies.** Measures adopted in the past year are helping to institutionalise the fight against corruption, address labour market shortcomings and advance business environment reforms.

### Key priorities for 2021

- **The government should continue steps towards a new growth model.** The Covid-19 pandemic has shown the limitations and weaknesses of a growth model based on consumption driven by remittances. Good domestic policies, drawing on the support of the diaspora, could be helpful in exploiting new opportunities in the post-pandemic world.
- **Reforms in the key areas of governance and competition need to continue.** The institutional fight against corruption, a better rule of law and a good business environment are key components in building an economy more resilient to external shocks.
- **Fiscal prudence should be continued with a clear focus on needs and priorities.** Once the Covid-19 crisis subsides and the flare-up in Nagorno-Karabakh calms, the fiscal prudence characteristic of the last year can help to reduce the elevated public debt level. However, that should not be at the cost of much-needed infrastructure investments.

#### Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth <sup>1</sup>	0.2	7.5	5.2	7.6	-5.0
Inflation (average)	-1.4	1.0	2.5	1.4	0.9
Government balance/GDP	-5.6	-4.8	-1.8	-1.0	-5.8
Current account balance/GDP	-1.0	-1.5	-6.9	-7.2	-8.8
Net FDI/GDP [neg. sign = inflows]	-2.5	-1.9	-2.0	-2.9	n.a.
External debt/GDP	94.4	91.3	87.6	90.3	n.a.
Gross reserves/GDP	20.9	20.1	18.1	20.8	n.a.
Credit to private sector/GDP	52.2	53.0	57.1	62.3	n.a.

<sup>1</sup>The GDP forecast for 2020 was determined prior to the flare-up of the conflict over Nagorno-Karabakh.

## Covid-19: macroeconomic implications

**Covid-19 containment measures are weighing on the economy in 2020.** GDP growth of 3.9 per cent year-on-year in the first quarter of 2020, following 7.6 per cent growth in 2019, turned to a 13.7 per cent year-on-year decline in the second quarter as household consumption contracted by nearly 20 per cent, investments by nearly 30 per cent and trade by approximately 35 per cent year-on-year in real terms. Household consumption, the largest growth driver in Armenia, was affected by a severe drop in money transfers from abroad (close to 24 per cent year-on-year in the second quarter) and containment measures being put in place. The state of emergency, introduced in March 2020 and extended for five consecutive months until the first half of September, was replaced by a nationwide quarantine that will be in force until 11 January 2021. Measures of social containment and low mobility affect Armenia's tourism sector, which is largely dependent on visits from the diaspora. The decrease in remittances nearly levelled off in June to July and increased in August, driven by a strong increase in transfers from the United States of America, which were balanced against the continued shrinking of remittances from Russia. High-frequency indicators of economic activity point to a 6.6 per cent year-on-year decline in economic output in the period January to September 2020.

**Despite the crisis, macroeconomic stability was preserved in the first three quarters of 2020.** In the first six months of 2020, a contraction of goods and services imports balanced out the decline in export revenues, helping to contain currency pressures and supporting exchange rate stability following a short period of depreciation at the onset of the pandemic. International reserves assets, propped up by external financing, stood at US\$ 2.4 billion in September 2020, covering 4.3 months of imports. In the absence of significant inflationary pressure, the refinancing rate was decreased four consecutive times in 2020, reaching 4.25 per cent in September.

**The authorities' crisis response was supported by external financing.** The initially announced package of measures to support the economy and the population amounted to 2.2 per cent of GDP. To satisfy rising financing needs the authorities asked for augmentation of the IMF programme, which, together with the authorities' intention to draw on the purchase rights accumulated under the Stand-By Arrangement, made around US\$ 280 million available to the authorities. Because of Covid-19 disruption, the IMF projects government debt to exceed 60 per cent of GDP by the end of 2020. However, with the authorities' commitments to the medium-term fiscal goal of debt sustainability, it is expected that the ratio will gradually decline over the medium term.

**The sharp decline of economic output in 2020 is likely to be followed by a gradual recovery.** The Armenian economy is expected to shrink by 5.0 per cent in 2020, followed by growth of 4.0 per cent in 2021, but with considerable uncertainty depending on the future path of the pandemic. The flare-up of the conflict over Nagorno-Karabakh adds to the uncertainty and its impact on the economic performance of Armenia depends on the duration and human and material costs.

## Policy response to Covid-19

**Immediate relief measures adopted by the authorities aim to preserve jobs and protect the most vulnerable.** Between the onset of the pandemic in March 2020 and August 2020, the authorities implemented 24 different measures amounting to 2 per cent of GDP (US\$ 300 million) to support the economy. Measures include subsidised loans of two- or three- year terms to the most affected sectors and businesses, in particular in tourism and agriculture, grants to the private sector and direct wage subsidies to micro, small and medium-sized enterprises (MSMEs), under the condition that they keep their employees. The authorities also strengthened their social assistance programme with additional lump sum transfers to socially vulnerable groups. Enabled by low inflationary pressures, the central bank lowered the monetary policy rate to ensure liquidity in the banking sector and made limited interventions in the foreign exchange market to avoid excessive dram volatility. The regulator recommended banks to consider voluntary loan restructuring and limited payment holiday periods.

### Assessment of transition qualities (1-10)



### Structural reform developments

**The authorities advanced their efforts to institutionalise the fight against corruption.** An anti-corruption strategy for 2019-23, approved in October 2019, outlines the new institutional framework and proposes concrete actions. The strategy envisages setting up an Anti-corruption Committee, an independent entity in charge of detection and investigation of corruption offences, in 2021. Also in October 2019, the government approved the 2019-23 Strategy for Judicial and Legal Reforms aiming at enhancing the effectiveness of courts, the prosecutor's office and investigative bodies as they play a key role in the anti-corruption fight.

**New labour market policies have been adopted.** These include an employment strategy and an increase in the minimum wage. The employment strategy aims to address persistent labour market shortcomings. Armenia is facing skills mismatches despite rising educational attainment levels, and the private sector often has difficulty in finding skilled workers although the unemployment level is high. Adopted in December 2019, the employment strategy "Work, Armenia" proposes a set of active labour market policies in order to address labour market shortcomings and create sustainable and inclusive employment. At the same time, the government approved an increase in the minimum wage by 23 per cent to the equivalent of US\$ 142 per month, effective from January 2020.

**The authorities have adopted a new strategy for the development of capital markets.** Implementation of the capital market development programme, adopted by the authorities in July 2020, would help better utilise domestic savings while increasing transparency in the corporate sector and enhancing the monetary transmission. The programme analyses the current state of the capital market in Armenia and proposes an action plan to strengthen the foundations, expand the market and achieve longer-term goals.

**Improvements in the business environment have been made.** At the end of 2019, the authorities created an Investment Support Office within the Ministry of Economy to promote domestic and foreign investments. The office acts as a one-stop-shop for investors, providing information on investment opportunities and the business environment, and supporting investors in accessing public services and in communicating with the state authorities. The government approved a set of measures for 2020-23 to address drawbacks in the business environment as identified in the World Bank *Doing Business 2020* report, while the strategy for the development of SMEs for 2020-24 and the associated action plan for 2020-22 aim to create a more favourable environment for smaller companies. Lastly, to strengthen state-owned enterprise (SOE) reporting requirements, audit and publication of financial reports of SOEs fulfilling certain criteria were made mandatory from January 2020.