

The effects of the war in Ukraine on Armenia

The invasion of Ukraine triggered severe Western sanctions against Russia. These sanctions not only lower the economic growth prospects for Russia but will also negatively affect the Armenian economy. The most important implications for Armenia are an expected decrease in exports to Russia and a reduction of remittances received from Russia. In particular, exports of agricultural and food products will be adversely affected, while remittances from Russia are expected to decline by 50%.

Contrary, a positive effect on tourism revenues is expected since many high-skilled Russians come to (temporarily) live in Armenia. Despite that, overall tax revenues are likely to decline due to the weakened economy. This will further widen the budget deficit.

Lastly, as gas import prices from Russia are fixed and Armenia buys Russian oil, which is traded at a significant discount, Armenia will not face higher energy prices in 2022. However, Armenia will still have to deal with higher global wheat prices.

Introduction

The sanctions against Russia in response to the invasion of Ukraine will not only significantly weaken the Russian economy, but will also greatly affect other countries in the region. In 2022, Russia's real GDP is expected to shrink by 10%, while inflation is forecast to reach 20%. This newsletter gives an overview of the different channels via which Russia's economic weakness is expected to affect the Armenian economy.

Drop in exports

Firstly, and most importantly, exports to Russia will be adversely affected. A total of 29% (or USD 800 m) of Armenian goods exports go to Russia. Even though – unlike e.g. for Moldova – there are no major disruptions in logistics between Russia and Armenia, the purchasing power of the Russian economy will be significantly weakened. This income effect is likely to reduce demand for Armenian export products from Russia.

Armenian exports of goods to Russia



Sources: WITS, own estimates

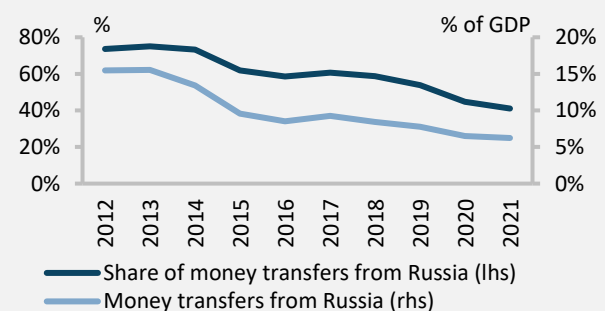
Agricultural and food products are most exposed since they account for 61% of goods exports to Russia. We estimate the largest negative effect for brandy with a total expected loss of USD 47 m. Trout, tomatoes and apparel will also be significantly affected with an expected loss of around USD 16 m each. The total drop in exports is estimated to amount to USD 279 m. This would correspond to 2% of GDP.

Armenian companies exporting diamonds or precious stones could aim to reorientate their exports to other markets to decrease their losses. Moreover, EU firms selling cognac, brandy or non-knitted apparel have left the Russian market. Therefore, Armenian exporters of these products could aim to replace the EU firms' products. Taking a possible reorientation and substitution into account, total losses of exports would account for USD 244 m, 1.8% of GDP.

Decrease in remittances

Secondly, the Armenian economy will be adversely affected by decreasing remittances from Russia. Remittances play a key role for Armenia: in 2021, they accounted for USD 1.6 bn or 11.6% of GDP. With 41% of total remittances, Russia remains the main source. In 2021, Russian remittances accounted for 6.2% of GDP.

Personal remittances inflows from Russia*



Sources: Central Bank of Armenia, IMF, own calculations, *based on money transfer data

For 2022, we estimate that remittances from Russia will decrease by 50%. Whereas the effect on GDP is moderated by the high import share in the Armenian economy, the effect on individual households will be severe. Overall, we expected the remittances shock to lead to a reduction of GDP by 1.3%.

Tourism to Armenia is likely to increase

On a positive note, the overall tourism inflow from Russia to Armenia is likely to increase. While the income shock in Russia will lower the propensity to spend money on tourism, there is likely to be a substitution effect: some Russians who would have spent their vacation in popular tourist destinations (e.g. in Western Europe) will be looking for other destination due to sanctions (e.g. payment systems, flight connections). Moreover, there is currently an influx of many high-skilled Russians who come to (temporarily) live in Armenia due to the difficult economic and political situation in Russia.

We expect the positive effects to outweigh the negative effect of the income shock and thus the overall impact on Armenian tourism revenues to be positive.

Wheat prices increase, but energy prices unchanged

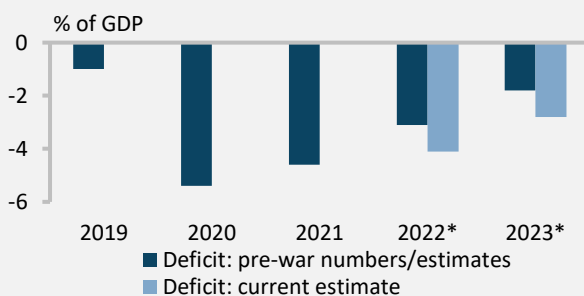
The war in Ukraine will lead to a significant decrease in Ukrainian wheat exports this year. Therefore, Armenia will face higher global wheat prices. This could account for EUR 25 m additional expenditures and a balance of payment shock of 0.2% of GDP.

Armenia’s dependency on Russia regarding its energy supply is high: Russia accounts for 85% of the Armenian gas imports and 73% of the Armenian oil imports. However, gas prices are regulated via a long-term contract with Gazprom and a swap agreement with Iran. Moreover, Russian oil is sold at a discount these days and its price has thus not increased much lately. Thus, Armenia’s energy prices will remain practically unchanged.

Budget deficit likely to widen

The originally planned budget deficit of 3.1% of GDP is no longer realistic. The weakened economic activity will result in lower tax revenues. Moreover, in case the migration to Armenia extends to less affluent (ethnic) Armenians, considerable additional social security expenditures should be expected. Together with decreased tax revenues, this puts the budget deficit at risk to be significantly widened.

Central government budget deficit



Sources: Ministry of Finance, IMF, *forecasts

Conclusion

Russia’s economic weakness affects Armenia primarily via fewer remittances and less demand for Armenian products. A possible role of donors in financing additional expenditures, e.g. increased social security spending, should be considered. Only for tourism, a slight positive effect is expected.

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This newsletter is based on the Policy Briefing: [Economic implications on Armenia of the war in Ukraine and sanctions against Russia](#)

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