

Economic implications on Armenia of the war in Ukraine and the sanctions against Russia

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Summary

- **ARM economy** strongly affected by war in UKR and sanctions against RUS
 - Significant drop in **exports** in 2022 expected: USD 244 m or 1.8% of GDP
 - Strongest decline: **brandy** (USD 47 m) and further agro-food products (trout, tomatoes, peaches and cheese)
 - **Remittances** from RUS likely to drop by 2.8% of GDP; strong shock
 - Effect on **tourism** might be positive, due to influx of high-skilled Russians
 - Neither **energy** security nor prices affected; ARM purchases Russian oil, which currently trades at a discount; gas contract with Gazprom covers full year
 - Consequently, no negative effect of energy prices on **inflation**; despite this, need for maintaining tight monetary policy to anchor expectations
 - **Budget deficit** likely to increase due to weaker economic outlook; possible sizeable emigration of (ethnic) Armenians from RUS later this year would post a major challenge to fiscal policy; possible role for donors
- **Strong economic shock on ARM, mainly due to lower remittances and exports**

Outline

1. Introduction
2. Economic outlook in Russia in 2022
3. Implications for exports to Russia
4. Implications of higher wheat import prices
5. Implications for energy imports from Russia
6. Implications for Russian tourism
7. Implications for remittances from Russia
8. Macroeconomic implications

1. Introduction

The war in UKR and sanctions against RUS affect ARM economy in many ways

- The RUS economy is severely weakened
- As a result, ARM exports to RUS, but also remittances from RUS will suffer
- Tourism from RUS might also be affected
- Furthermore, sanctions against RUS could influence energy prices for ARM
- Also higher food prices could create challenges

Aim of the briefing

- Analysis of key economic implications of war in UKR & sanctions against RUS
- Recommendations on policy reaction to this shock

2. Economic outlook in Russia in 2022

Selected economic indicators

Indicators	2022
Real GDP growth, %	-10%
Nominal USD GDP growth, %	-34%
Inflation, % eop	20%
Exchange rate, RUB/USD	120

Sources: Goldman Sachs, CBR, own assumptions/calculations

Historic GDP declines



Source: Rosstat, own calculations

Severe economic and financial damage

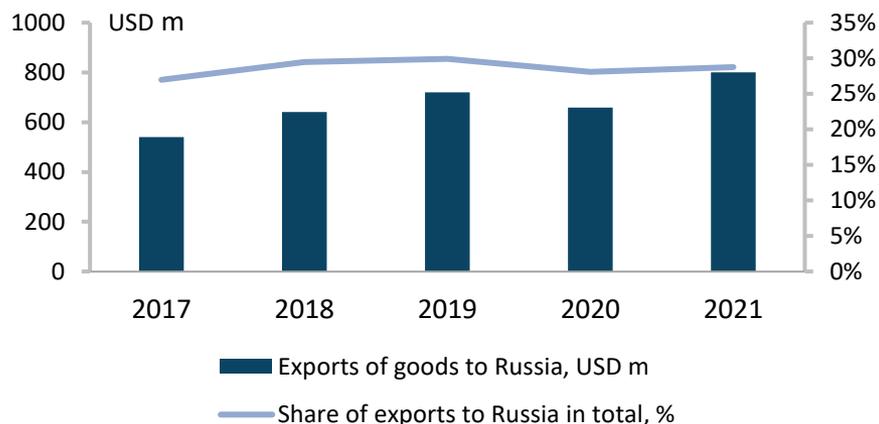
- The war has led to a wave of sanctions on RUS by Western countries
 - Significant impediments to trade (including logistics) as well as to foreign investments
 - RUS reacted by tightening financial conditions, e.g. emergency CBR rate hike to 20% p.a.
 - Material risk that RUS defaults, ratings only slightly above 'Default' status

Still high uncertainty

- As war continues, new sanctions may follow & target the crucial energy sector
- **RUS real GDP likely to decline by 10% in 2022, which is unprecedented in modern history**

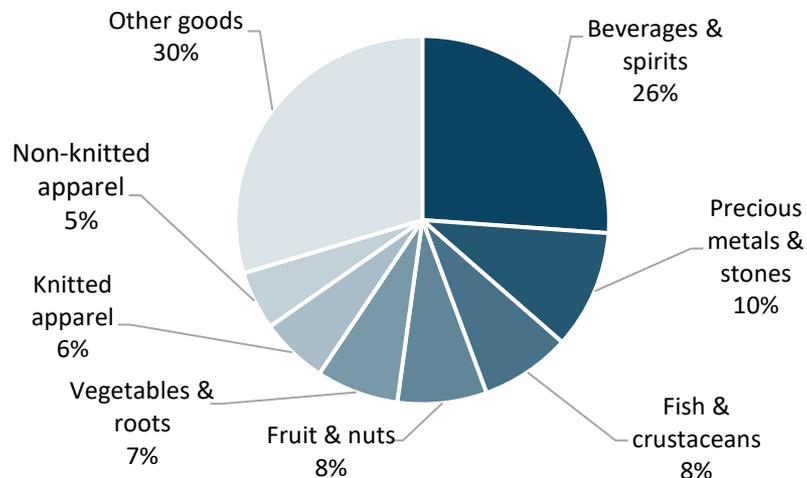
3. Implications for exports to Russia

ARM exports of goods to RUS



Source: WITS, own estimates

Structure of ARM exports to RUS, 2021



Source: WITS, own estimates

ARM exports of goods to RUS, 2021:

- USD 800 m, 29% of total goods exports
- Share in GDP: 5.9%

➤ Significant role of RUS market

Export structure by products, 2021:

- Agriculture & food: 61%
- Apparel & footwear: 12%
- Stones & glasses: 11%

➤ Exports of agro-food is most exposed

Outlook for 2022

- Decline in exports but no full disruption

Estimation of impact on exports

		ARM exp to RUS, USD m, 2021	Exp loss to RUS, USD m, 2022*	Total exp loss, USD m, 2022*
1	Spirits obtained by distilling grape	172	-47	-47
2	Diamonds, whether or not worked	66	-46	-13
3	Trout, fresh or chilled	52	-16	-16
4	Apparel, knitted	47	-16	-16
5	Tomatoes, fresh or chilled	44	-15	-15
6	Apparel, non-knitted	41	0	0
7	Apricots, cherries, peaches	18	-11	-11
8	Precious stones, other than diamonds	16	-6	-4
9	Cigarettes	14	0	0
10	Cheese and curd	14	-2	-2
	Other products*	317	-120	-120
	Total	800	-279	-244

Source: WITS, own estimates; * benchmark response for RUS imports from ARM (excl. top-10 products), 2015 vs 2013: 1.12

- ARM drop in exports to RUS estimated at **USD 279 m or 2.0% of GDP in 2022**
- Due to reorientation, total losses of exports are smaller: **USD 244 m or 1.8% of GDP**

Policy recommendations on exports

Spirits obtained by distilling grape

- RUS can no longer import FRA cognac & ESP brandy
- Therefore, ARM could replace FRA cognac & ESP brandy, which is not shipped to RUS anymore

Diamonds

- Exports could be reoriented to Switzerland (CHE)

Non-knitted apparel

- EU firms offering non-knitted apparel left RUS market
- ARM could aim to replace these products, which are no longer available on the RUS market

Precious stones

- Some potential for reorientation toward the EU & USA

4. Implications of higher wheat import prices

Wheat price shock

	Wheat
Net quantity imported p.a.	268 thsd t
Import price before war*	255 EUR/t
Expected import price**	349 EUR/t
Price differential	94 EUR/t
Additional cost p.a.	EUR 25 m
Additional cost p.a., % GDP	0.2 %

Sources: Comtrade, World Bank, Marketwatch, own calc.; *avg. 2021 for wheat;

**avg. 2022 future prices for wheat

Wheat

- UKR is a major wheat producer; exports this year will go down significantly due to war
 - Implication: much higher global wheat prices
 - Assuming prices remain high, ARM will face additional expenditures of EUR 25 m or 0.2 % of GDP in 2022
- **Balance of payments shock of 0.2% of GDP due to higher wheat prices**

5. Implications for energy imports from Russia

ARM energy supply and imports (2019)

	Share in TES*	Gross import share	RUS share in imports	RUS share in TES*
Natural gas	61%	100%	85%	52%
Oil and oil products	12%	100%	73%	8%
Solid fossil fuels	0%	99%	79%	0%
Nuclear	18%	-	-	-
Renewables	9%	-	-	-

Sources: IEA, The Observatory for Economic Complexity, own calculations, *total energy supply

ARM gas transmission network



Source: Adapted from ENTSOG

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Gas

- Most important energy source
- 85% of imports from RUS, but low risk of disruption of supply
- Furthermore: no price increase in 2022; prices regulated via long-term contract with Gazprom & swap agreement with Iran

Oil

- 73% of imports from RUS; but no major risk for disruption
- No significant price increase, given that RUS oil is sold at a discount
- **No significant effect on energy security and prices**

6. Implications for tourism revenues from Russia

RUS invasion of UKR will affect ARM tourism revenues in 2022 in three main ways:

1. Price & income effect → negative

- RUS GDP will strongly decline in 2022 (esp. in USD terms)
- The resulting income shock will lower propensity to spend money on tourism

2. Substitution effect → positive

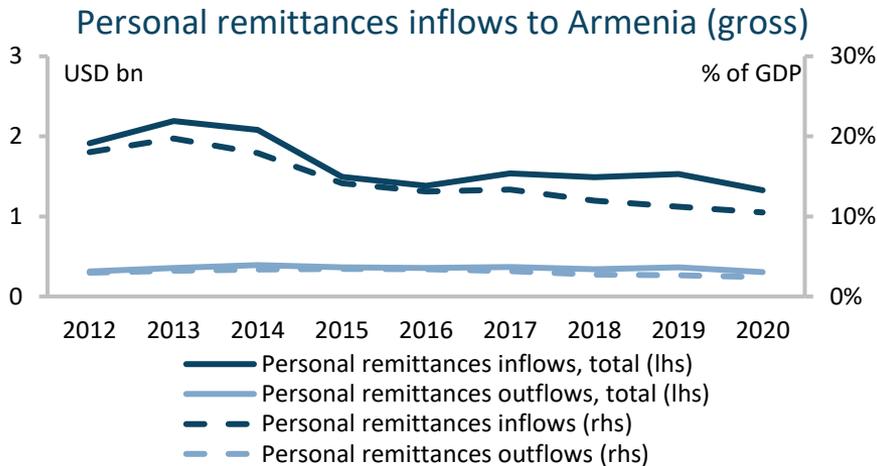
- Without the war, many RUS would have spent their vacation in popular tourist destinations (e.g. in Western Europe)
- However, due to the war, RUS tourists face obstacles when visiting countries which introduced sanctions (e.g. payment systems, flight connections etc.)
- As a result, some RUS will spend their vacation in RUS. However, others look for substitute destinations (such as ARM)

3. Influx effect → positive

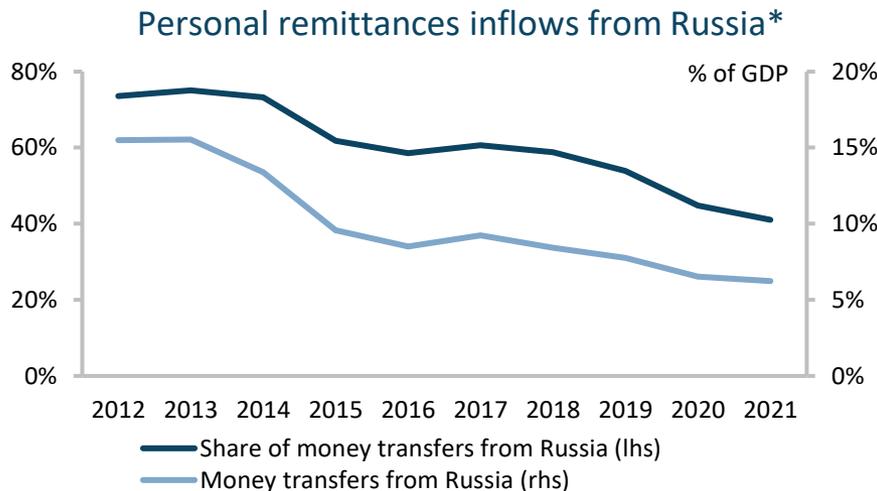
- The war has caused a significant influx of (high-skilled) Russians into ARM, whose expenditures will (temporarily) increase tourism revenues
- Effect is difficult to estimate due to high uncertainty of underlying factors (number of people, avg. expenditure, length of stay, etc.)

➤ **Forecast not feasible, but net effect is likely to be positive**

7. Implications for remittances from Russia



Sources: Central Bank of Armenia, IMF, own calculations; Note: personal remittances = personal transfers + compensation of employees



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

- Remittances play a key role for the economy of ARM
 - USD 1.3 bn (10.5% of GDP) in 2020
 - Not a component of GDP, but support economic demand
- Share of RUS has decreased, but RUS remains main source
 - 2013: 75% of inflows
 - 2020: 41% of inflows
- Remittances from RUS, 2021
 - USD 865.6 m or 6.2% of GDP

➤ **Important role of remittances from RUS for the ARM economy**

Expected shock and economic effects

	Reduction in remittances from RUS		Effect on GDP		Effect on consumption		Effect on investment	
	USD m	% of GDP	USD m	% of GDP	USD m	% of GDP	USD m	% of GDP
Expected shock	-436.7	-2.8%	-206.4	-1.3%	-315.5	-2.0%	-49.5	-0.3%
Maximum exposure	-864.4	-5.5%	-439.4	-2.8%	-679.0	-4.3%	-98.0	-0.6%

Source: own calculations; note: economic effects calculated as a short-term demand shock caused by declining remittances, methodology analogous to GET MDA, PP/03/2014

- Economic sanctions will decrease remittances from RUS by ca. 50%
- Effect on GDP is moderated by high import share in ARM economy
- Effects are likely most severe for individual households
- **Sizeable economic effects:** -2.8% of GDP in remittance income, -1.3% of GDP effect on growth
- **Possible policy responses:** targeted social assistance for affected individuals, retraining and relocation assistance for returning labour migrants

8. Macroeconomic implications

RUS invasion of UKR has potentially various macroeconomic implications beyond the already discussed transmission channels, to which policy makers must react:

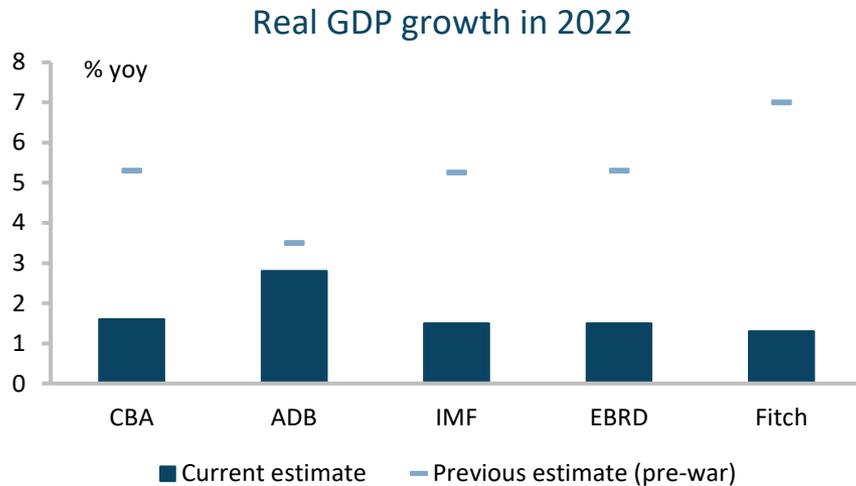
Monetary policy must address inflationary pressures

- Inflation might accelerate due to higher commodity prices
- Depreciation pressures could deepen as currency inflows from remittances are affected

Fiscal policy will be negatively affected

- Lower revenues due to weaker economic outlook
- Increased number of migrants from RUS might pose an additional challenge
- Tighter external financing conditions could create problems

Economic growth



Source: respective institutions

Regional comparison of real GDP forecasts for 2022

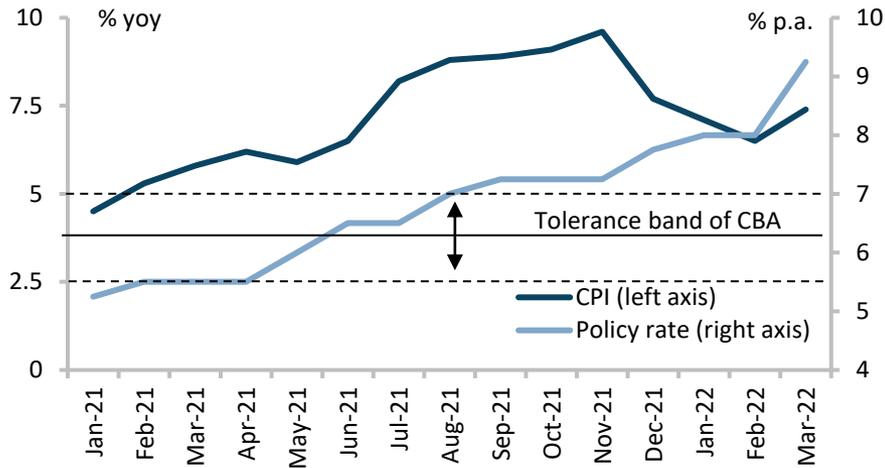
	Current forecast (% yoy)	Change in forecast (pp)
Armenia	1.6	-3.7*
Georgia	3.5	-1.5
Azerbaijan	3.7	1.2
Russia	-10.0	-12.0
Germany	2.1	-1.9
EU-27	2.8	-0.7

Sources: CBA, ADB, Goldman Sachs, IfW Kiel; *excl. GDP reduction due to supply issues in copper industry

- GDP forecast 2022 by Central Bank of Armenia before the war: 5.6% yoy
 - Due to expected decline of exports and remittances, forecast has been reviewed
 - New forecast by CBA: 1.6%
 - However, supply constraints in copper industry contributed 0.3 pp to forecast reduction
 - Thus: war-induced reduction in GDP forecast amounts to 3.7%
 - Potential upsides through high-skilled migration and relocation of firms from RUS
- **Strong effect of war in UKR on GDP**

Monetary and exchange rate policy

Inflation and policy rate



Source: CBA

Inflation

- 2021: high inflation driven by food prices (36% of CPI basket)
- 2022: further increase of food prices due to war in UKR
- But: ARM somewhat isolated from higher energy prices due to war
- Thus: limited effect of war on inflation
- CBA hiked its policy rate by 125bp since start of the war to anchor expectations

Exchange rate



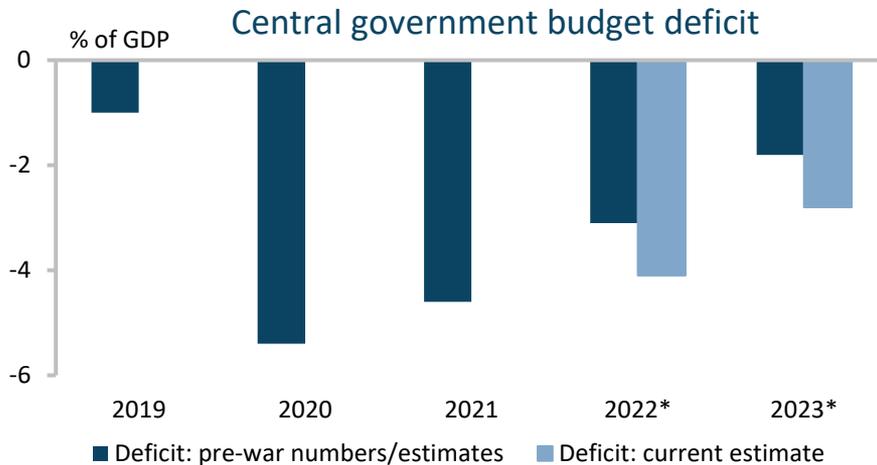
Source: Armstat

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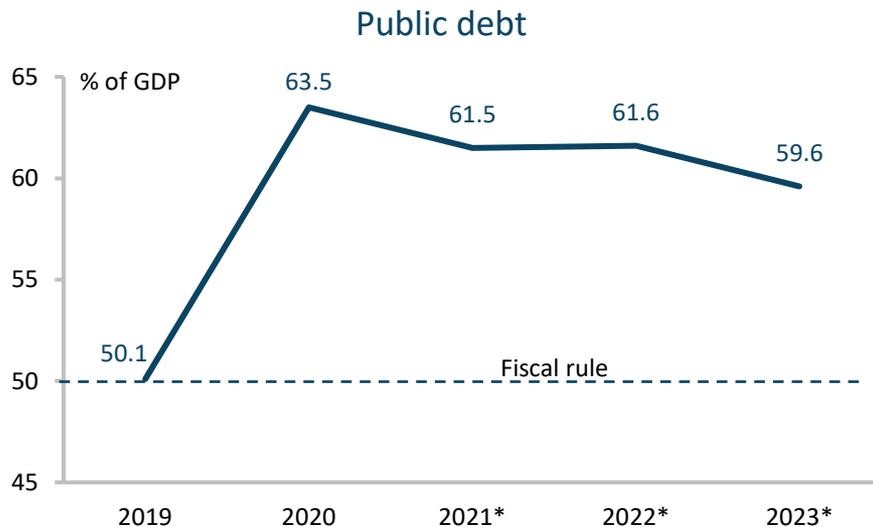
Exchange rate

- Depreciation after start of war in UKR
 - But exchange rate stable; below Jan-21
- **Limited effect of war on inflation**
- **CBA needs to maintain tight monetary policy to anchor expectations**

Fiscal policy



Source: Ministry of Finance, *forecast



Source: IMF, *estimation/forecast, note: central government's public and publicly-guaranteed debt, estimates before start of war in UKR

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Budget deficit

- Original plan: 3.1% of GDP
- But: plan not realistic anymore
- Lower revenues due to weaker economy
- Probably also considerable expenditures to deal with migration of (ethnic) Armenians from RUS later this year

Public debt

- Eurobond spread increased strongly, but maturity in 2031; no immediate concern
- Renewed staff-level agreement and cooperation with IMF important

➤ **Possible role of donors in financing additional expenditure due to migration from RUS later this year**

About the German Economic Team



Financed by the Federal Ministry for Economic Affairs and Climate Action, the German Economic Team (GET) advises the governments of Ukraine, Belarus*, Moldova, Kosovo, Armenia, Georgia and Uzbekistan on economic policy matters. Berlin Economics has been commissioned with the implementation of the consultancy.

**Advisory activities in Belarus are currently suspended.*

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