

NO 09 | DEC 2022

**POLICY BRIEFING**  
**ARMENIA**

# **Dram appreciation: should government support exporters?**

by Dmitry Chervyakov and Dr Ricardo Giucci

# Contents

1. Introduction
2. Background: dram appreciation
3. Dram appreciation: need for government support?
4. Support instruments
5. Conclusions

# 1. Introduction

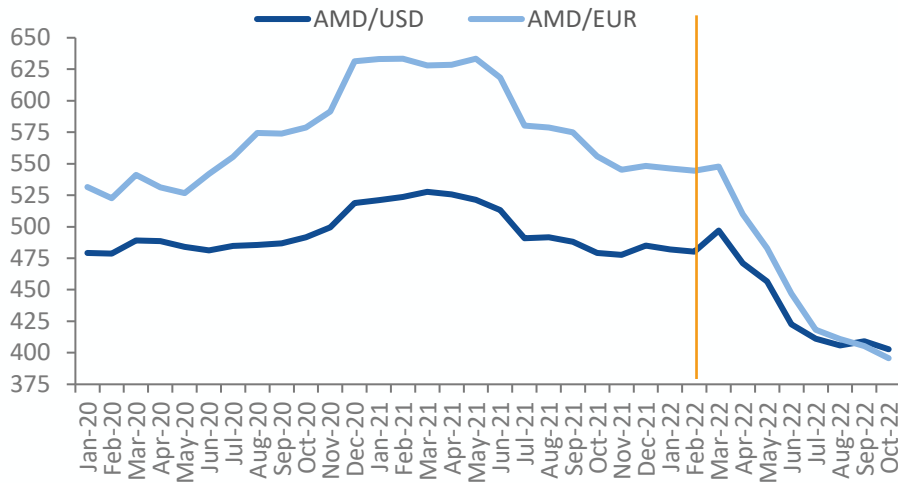
- » Armenian dram experienced a strong and rapid appreciation against the US dollar and Euro in recent months
- » So far: macroeconomic implications of the appreciation remain limited; no negative effect on GDP and even a positive effect on inflation
  - Index of economic activity signals GDP growth of 14.5% (10M2022)
  - Inflation is still at an elevated level (Nov-22: 8.8%), but declined over recent months
- » But: some export-oriented sectors are negatively affected by the loss of competitiveness due to the (real effective) appreciation of the dram
- » Moreover: there already is a strong call for government support, especially from the IT sector

## In this Policy Briefing

- » Should the government support exporters in light of strong dram appreciation?
- » If so, what instruments should be used?
- » Remark: this is a follow-up on the analysis [„Economic implications of the recent appreciation of the Armenian dram“](#) (PB 08 2022)

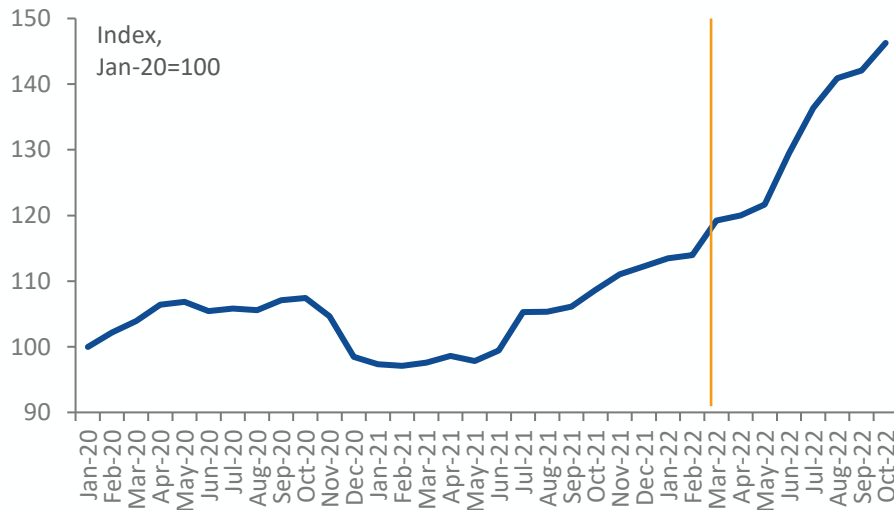
## 2. Background: magnitude of appreciation

Exchange rate vs USD and EUR



Source: Central Bank of Armenia

Real effective exchange rate (REER)



Source: Central Bank of Armenia

- » Over the recent months: strong and rapid dram appreciation vs USD
  - End Oct-22: 18.3% since 23.02.2022
- » Similarly, strong appreciation vs EUR
  - End Oct-22: 27.4% since 23.02.2022
- » Also: real effective appreciation of dram
  - Oct-22 vs Feb-22: 21.0%
  - Loss in competitiveness for some export-oriented sectors
- » However: exporters to Russia are not negatively affected
  - End Oct-22: depreciation against RUB of 6.3% since 23.02.2022
  - Armenian exports to Russia grew by 152% yoy (10M2022)
- Strong appreciation vs USD and EUR over a relatively short period of time
- Loss of competitiveness for exporters to the EU and US; exporters to RUS are not negatively affected

### 3. Dram appreciation: need for government support?

- » From a macroeconomic perspective, the current dram appreciation does not pose any major risks for economic growth or monetary stability
- » As outlined in previous GET research (PB 08 2022), **the development of the financial market should be the top priority for the medium and long term:**
  - **Good opportunity to develop hedging instruments.** As the FX forward market was usually asymmetric (only importers wanted to hedge), banks were not able to offer low-cost hedging instruments
  - **A functional FX forward market is important to prepare for future FX volatility,** as uncertainty towards economic developments in Russia remains high
  - This would also reduce the pressure on the CBA to monitor the exchange rate and thus allow it to maintain the focus on inflation targeting
  - The private sector needs to learn how to live with dram appreciation. For this, **improving financial literacy and promoting hedging instruments is important**
- » **In the short term:** exporters with a high geographic share of exports to EU/US market or service exporters with the main share of their income in EUR/USD (e.g. IT sector) might have troubles → **government support reasonable**
- Thus: what type of instruments could be used to support affected exporters?

## 4. Support instruments: loans vs grants

- » There are no best practice approaches on how governments have supported exporters in the specific case of a strong appreciation of the local currency
- » However, a number of support instruments exist that aim to provide companies with liquidity in the short term
- » During the COVID-19 pandemic (but also other crises), most governments supported businesses by providing grants or subsidised loans
- » **In the case of Armenia, we strongly advocate for loans rather than grants:**
  - (1) Exporters have a financial burden in case of dram appreciation, but additional profits during depreciation. If grants are used to support the business during appreciation, companies should pay in case of depreciation to **avoid “socialising losses and privatising profits”**
  - (2) **Grants usually entail bandwagon effects:** everyone wants a piece of the pie, even if they don't need it. This leads to a wasteful allocation of scarce tax resources
  - (3) Loans are usually only claimed only by companies that really need the money – a **very good filter to avoid misuse**
- There is a good amount of international experience with liquidity loans (e.g. KfW support programmes), which can and should be built upon

## 4. Support instruments: main characteristics

- » The support instrument should ideally follow the TTT criteria (timely, targeted, and temporary). The main questions to consider:

### What type of instrument?

- » Loans and not grants due to reasons outlined before
- » Ideally, an already existing loan instrument (e.g. an instrument that was already used during the pandemic) → **timely support**
- » The interest rate can be subsidised, with a term that leaves enough time for the exporter (e.g. with a grace period for repayment) to overcome the short-term liquidity issue

### Who should be eligible?

- » Exporters who have a high geographic share of exports to the EU/US or service exporters who receive most of their income in USD/EUR (e.g. IT sector)
- » A company needs to credibly show (e.g. through financial statements) that they are in financial distress due to the dram appreciation
- » Strict but clear selection criteria are needed → **targeted support**

### Who will administer the support?

- » Directly by the government (e.g. through Enterprise Armenia): the fastest way to offer support, but highest risks in case of non-repayment → **more timely**
- » Through the banking sector: banks could take on 10%-20% of the risk. As firm's banks usually know their client's financial situation quite well, this would help to filter out hopeless/over-indebted companies → **more targeted**

### Timeframe

- » It should be made clear, that the support programme is **only temporary**
- » Moreover: it should be a one-off measure in order to not contradict the medium/long-term goal to get the companies used to hedging

## 5. Conclusions

- » The Armenian economy was hit by an external shock that caused a strong appreciation of the dram in a relatively short period of time
- » Due to the rapid onset of the shock, **some export-oriented sectors may face short-term liquidity problems**, as income and costs diverge negatively in the short term due to the appreciation
- » The government could **assist affected exporters in the short term by providing liquidity through loans** with special conditions
  - The support should be structured to be timely, targeted and temporary
  - There already is a vast international (but also domestic) experience in providing liquidity loans; no need to create entirely new instruments
- » From a medium- and long-term perspective, however, it is **important to develop a competitive FX forward market**; should be the top priority
  - As FX volatility is likely to remain high, the private sector needs to...
    - a) ... have access to a variety of hedging instruments at a competitive price
    - b) ... and have enough financial literacy to understand the importance of hedging instruments / how to use them



# 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.*

## CONTACT

Dmitry Chervyakov, Project Manager Armenia  
[chervyakov@berlin-economics.com](mailto:chervyakov@berlin-economics.com)

## German Economic Team

c/o BE Berlin Economics GmbH  
Schillerstraße 59 | 10627 Berlin  
Tel: +49 30 / 20 61 34 64 0  
info@german-economic-team.com  
www.german-economic-team.com

Our publications are available under  
<https://www.german-economic-team.com/>

Implemented by

