

ECONOMIC MONITOR

ARMENIA

Overview

- » 2023: real GDP growth projected at 5.5% by the IMF; positive effect related to influx of migrants from RUS begin to fade out
- » 2024: slight slowdown to 5.0%; real GDP growth converges towards its potential
- » Inflation decreased significantly and is expected to be as low as 0.4% at the end of 2023; monetary policy continues to be tight
- » Armenian dram was stable against the US dollar (7M2023: slight appreciation by 2%), while it strengthened significantly against the weak Russian ruble (29% appreciation)
- » Higher budget deficit (2.9% of GDP) and public debt (49.9% of GDP) in 2023; but fiscal position remains stable
- » 7M2023: goods exports increased by 62%, while imports grew by 63%; trade dynamics continue to be dominated by re-export business

Special issues

- » **Green hydrogen.** Production of green hydrogen in ARM could be cost-competitive, but absence of export infrastructure and domestic use cases weakens the case for production
- » **Economic exposure to Russia.** ARM exposure to RUS is traditionally high, but did not further increase in the course of 2022

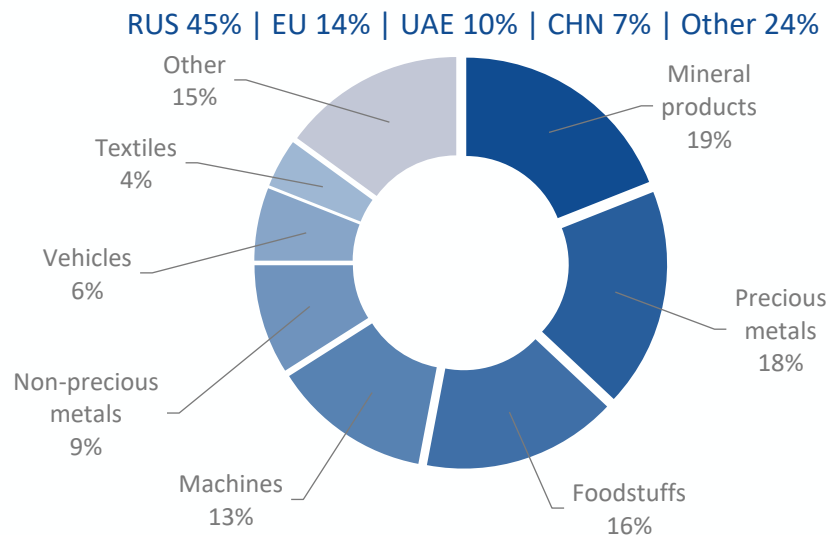
Basic indicators

	Armenia	Azerbaijan	Georgia	Ukraine	Russia
GDP, USD bn	19.5	69.9	24.6	151.5	2,215.3
GDP/capita, USD	6,583	6,826	6,671	4,346	15,443
Population, m	3.0	10.2	3.7	34.8	143.4

Sources: IMF, Note: data for 2022

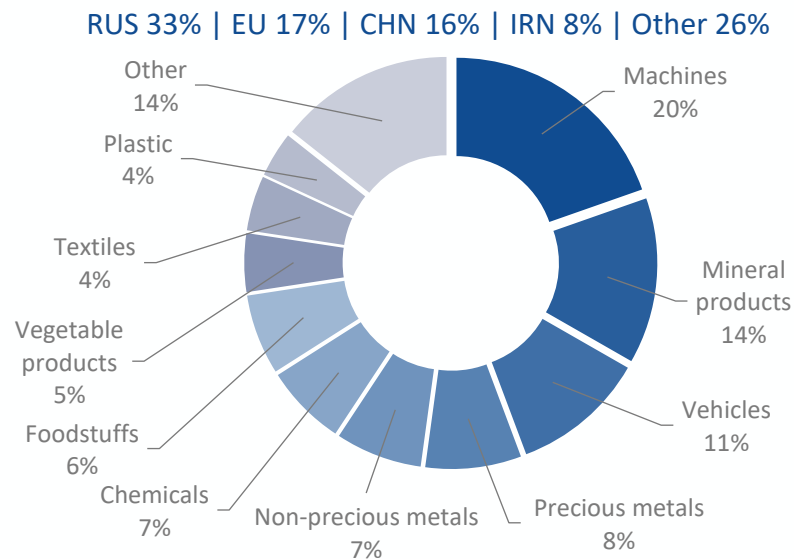
Trade structure

Exports



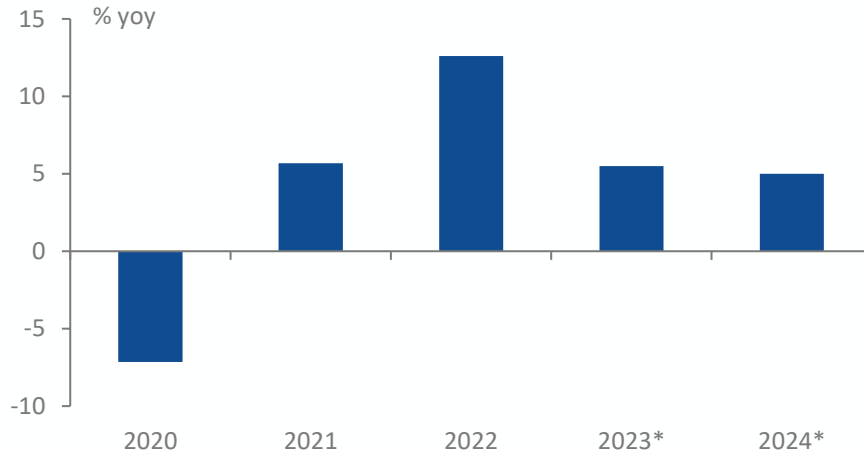
Source: Armstat, data for 2022, Note: merchandise trade

Imports



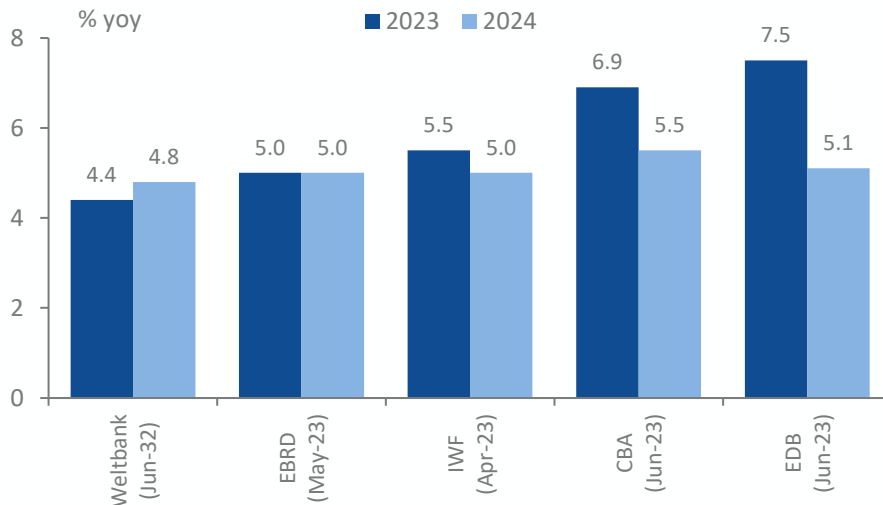
Economic growth

Real GDP growth



Source: IMF, *estimate/forecast

Comparison of real GDP forecasts for Armenia



Source: respective institutions

2023

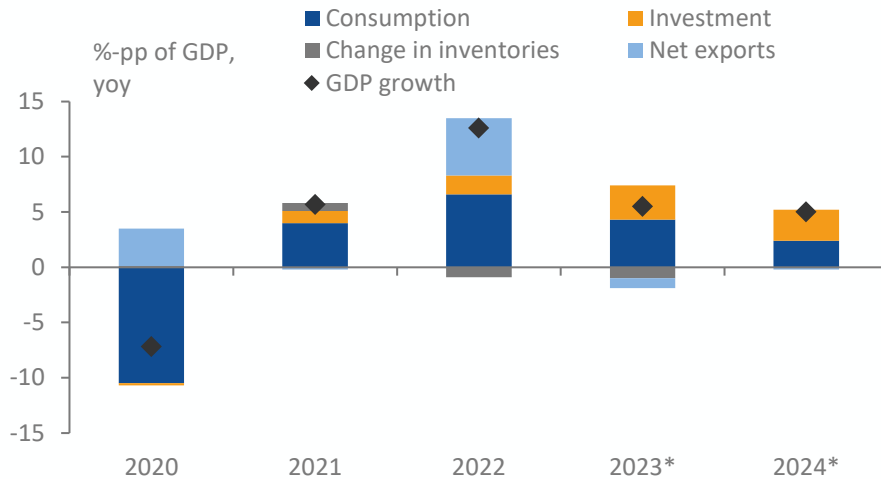
- » Growth remained strong during the first half of the year (H1 2023: 11.4% yoy)
 - Positive impact of migration inflows from RUS persists
- » However: real GDP growth is expected to decelerate over H2 2023
 - Positive shocks of 2022 gradually fade out
- » IMF forecasts 5.5% growth in 2023
 - Other projections range between 4.4% (WB) and 7.5% (EDB)

2024

- » Growth continues to slow down
 - Real GDP forecasted at 5.0% by IMF
 - Other projections: 4.8%-5.5%
- » Situation in RUS and regional dynamics remain the main uncertainty factors
 - Negative shocks due to a reversal of capital and migration flows possible
- Growth momentum weakens as positive shocks gradually fade out

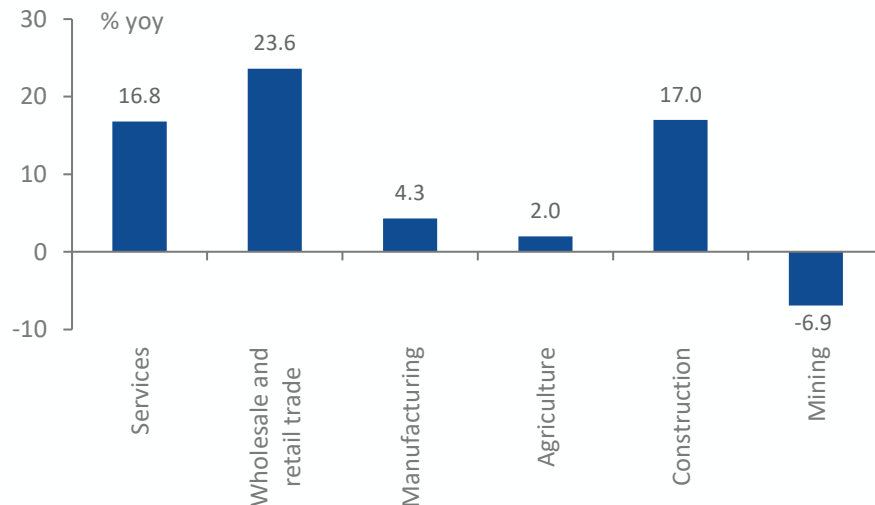
GDP: demand and supply

Contribution to real GDP growth



Source: IMF, *estimate/forecast

Sectoral dynamics (6M2023)



Source: Armstat; Note: sorted from left to right by share in GDP in 2022 in descending order

Demand-side dynamics

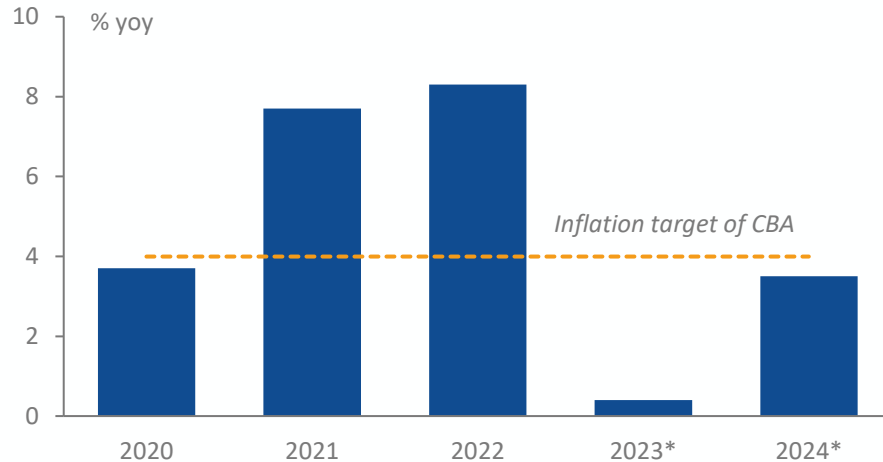
- » 2023: consumption remains the main growth driver; (public) investment is expected to pick up
- » 2024: positive contribution by consumption and investment

Supply-side dynamics (6M2023)

- » Positive migration shock continues to boost growth in related sectors
 - Services: +16.8% yoy
 - Trade: +23.6% yoy
- » Strong performance of construction sector (6M2023: +17.0% yoy)
 - Planned phasing out of tax refund programme and migrant inflow boost short-term activity
- » Comparably weak growth in manufacturing and agriculture
- » Problems in the mining sector persist
 - Operation of mines affected by RUS sanctions and regional conflict
- Consumption remains the main growth driver, boosting trade and services

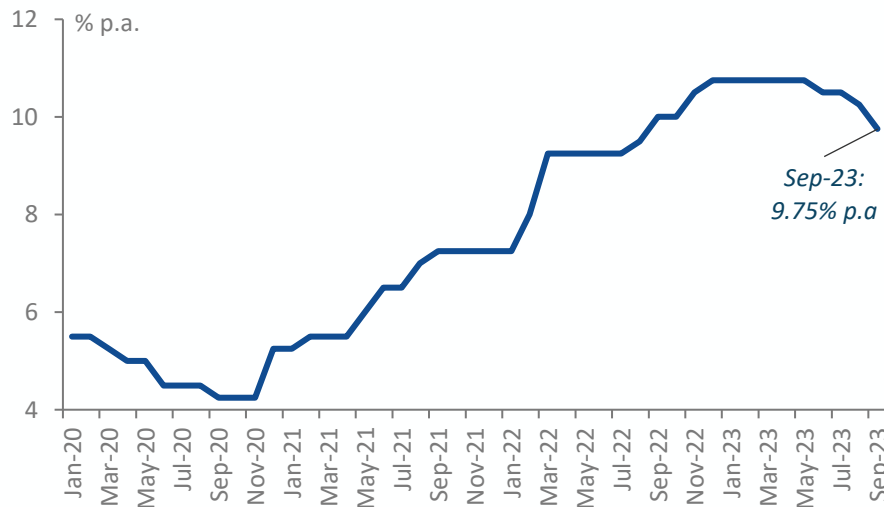
Inflation and monetary policy

Inflation rate



Source: CBA; *estimate/forecast; Note: end of period

Policy rate of CBA



Source: CBA; Note: eop

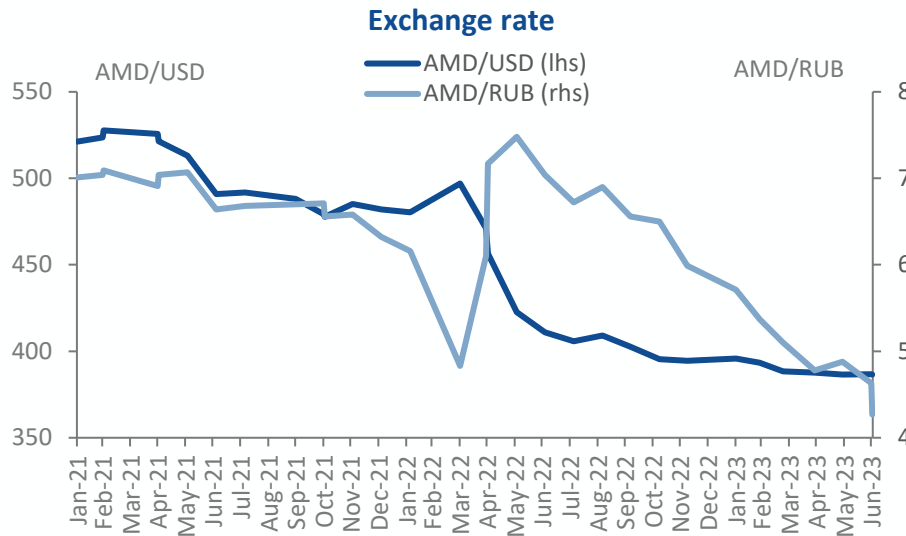
Inflation

- » Jul-23: -0.1% yoy; second month with negative inflation rate in a row
 - Strong reduction throughout H1 2023
 - Base effects and strong dram contribute to decreasing food prices
- » 2023: 0.4% expected at the end of the year; below inflation target of 4%
- » 2024: 3.5%; rebound towards CBA target

Monetary policy

- » Tight monetary policy stance helped to ease the inflationary environment
 - Policy rate remained at 10.75% p.a. for most of H1 2023
- » Easing of policy stance as inflation declined
 - Sep-23: 9.75% p.a.
 - However: CBA is likely to maintain a contractionary policy stance to stabilize demand and inflation expectations
- » Monetary policy likely to remain tight in 2023 despite decreasing inflation

Exchange rate and currency reserves



Source: CBA, period average



Source: CBA, end of period

Exchange rate

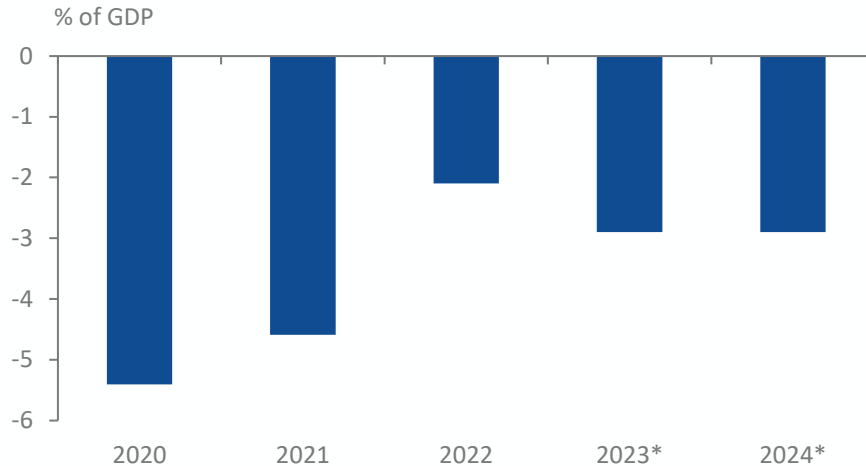
- » Exchange rate vis-à-vis the US dollar remained stable in 2023
 - Only slight appreciation of 2% until Jul-23
 - Helps to reduce imported food inflation
- » In parallel: significant appreciation of the dram against the Russian ruble
 - 2023: strong appreciation of 29% until Jul-23 as ruble significantly weakened
 - Could negatively impact tourism

International currency reserves

- » 2023: after a drop at the start of the year, FX reserves gradually increased again
 - Jul-23: USD 4.1 bn; World bank budget loan disbursement of USD 100 m
 - Import cover of 4.3 months
- » Stabilisation of the dram against the US dollar at the high level of 2022
- » Accumulation of international reserves

Public finances

Budget balance



Source: Ministry of Finance of Armenia, *estimate/forecast

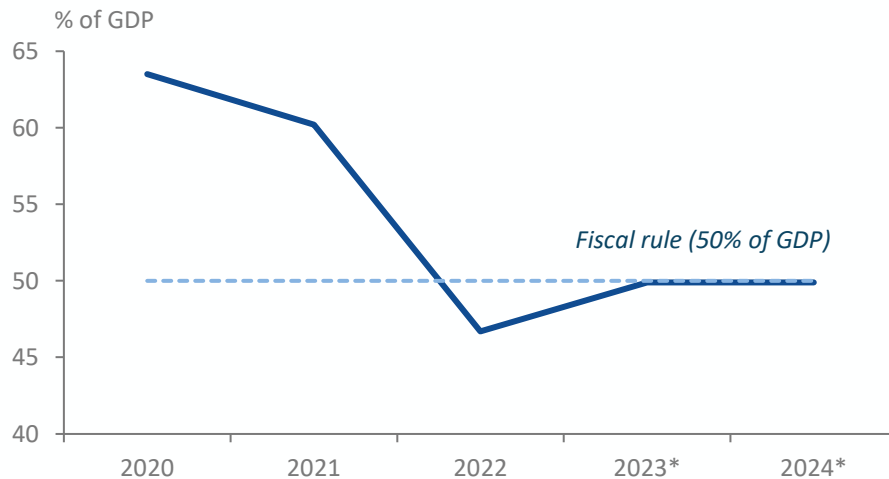
Budget balance

- » 2023: increase of deficit to 2.9% of GDP
 - Higher capital spending and infrastructure development budgeted
 - However: under-execution of investment plan so far; budget surplus in H1 2023
- » 2024: -2.9% of GDP; similar level planned

Public debt (central government)

- » 2023: 49.9% of GDP expected at the end of the year
 - Slight increase of public debt planned, but still within the fiscal rule threshold
 - Could turn out slightly lower depending on budget execution
- » 2024: -49.9% of GDP; debt planned to remain just below fiscal rule of 50% of GDP
 - Risks: growth and exchange rate stability
- Fiscal position is likely to remain stable in 2023/2024

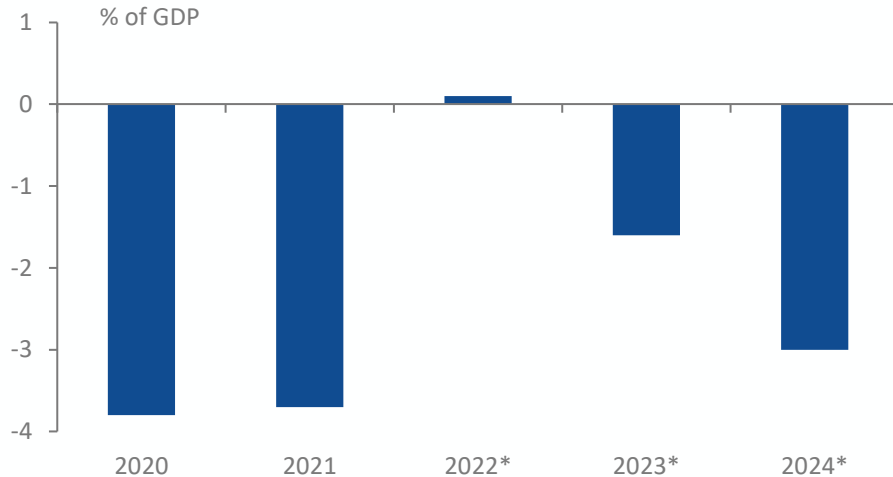
Public debt (central government)



Source: Ministry of Finance of Armenia, *estimate/forecast

Current account and FDI

Current account

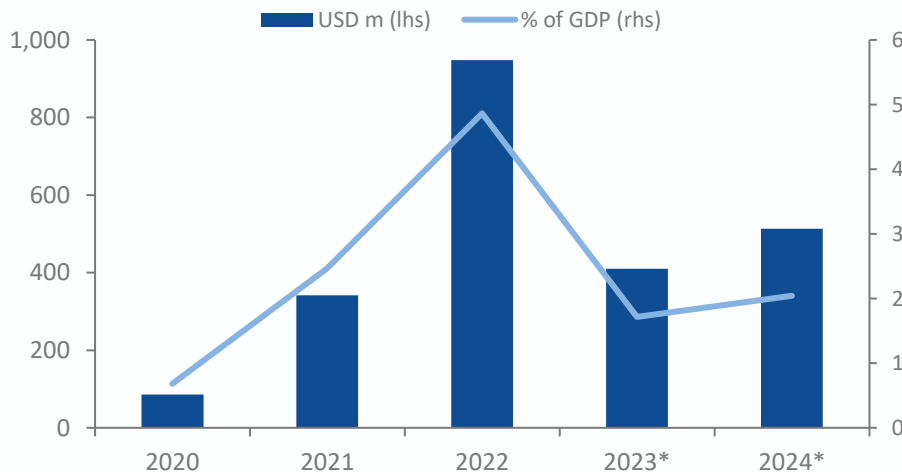


Source: CBA, IMF, *estimate/forecast

Current account

- » 2023: -1.6% of GDP expected; return to deficit after a surplus in previous year
 - Service exports to remain strong
 - Normalisation of personal transfers after peak inflows in 2022
 - Significant increase of imports against the background of a strong dram
- » 2024: -3.0% of GDP; return to past levels

Net foreign direct investment



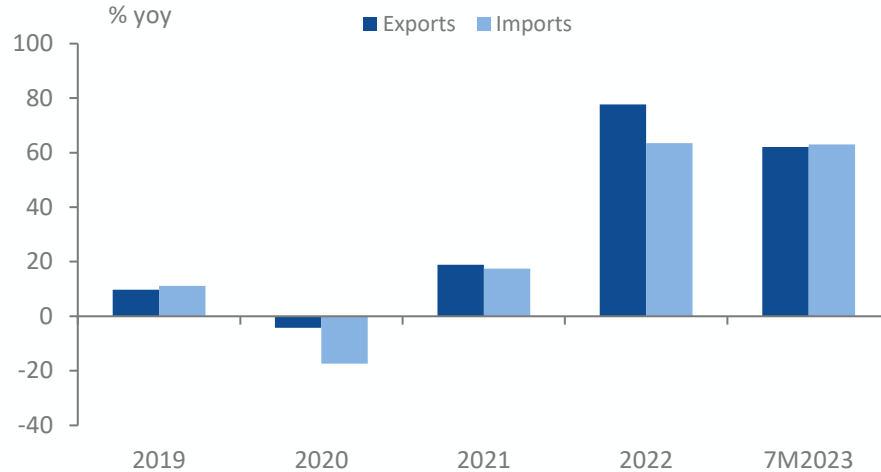
Source: IMF, *estimate/forecast

FDI

- » 2023: 1.7% of GDP expected
 - Normalisation of flows as external factors fade out
- » 2024: 2.0% of GDP; slight increase
- External position to normalise over the course of 2023/2024

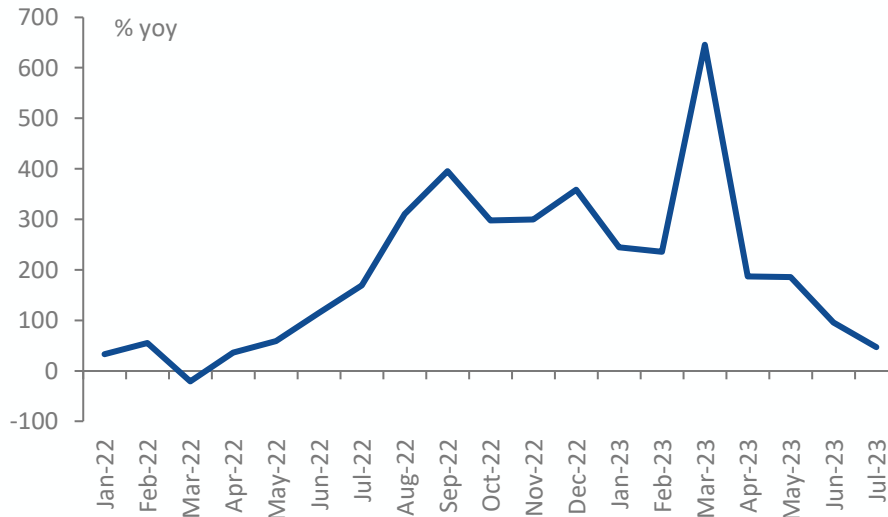
Trade in goods

Foreign trade in goods



Source: Armstat

ARM exports to RUS



Source: Armstat

Exports

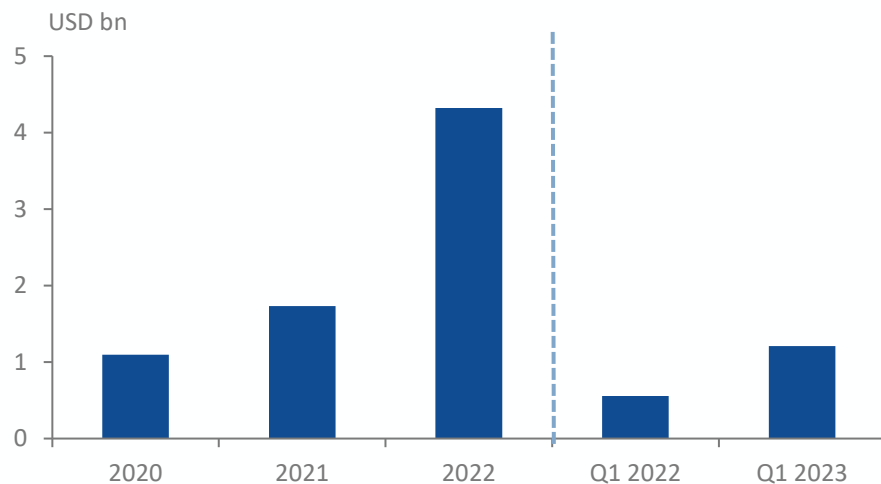
- » 7M2023: +62.1% yoy; strong growth driven by re-exports
 - Vehicles : + USD 384 m; +929% yoy
 - Machinery: + USD 558 m; +427% yoy
- » Exports to RUS remained most pronounced (7M2023: 160.5%), but growth rate slowed down significantly in 2023
- » However: share of RUS grew again as exports to EU declined
 - 2021: 27%; 2022: 45%; 7M2023: 53%

Imports

- » 7M2023: +63.0% yoy; mainly driven by imports connected to re-export business
 - Vehicles: + USD 905 m; +287% yoy
 - Machinery: + USD 749 m; +427% yoy
 - Imports mainly from EU, USA, Georgia and Arabic countries
- » Furthermore: strong dram supports imports
- » External trade dynamics continue to be dominated by re-export business

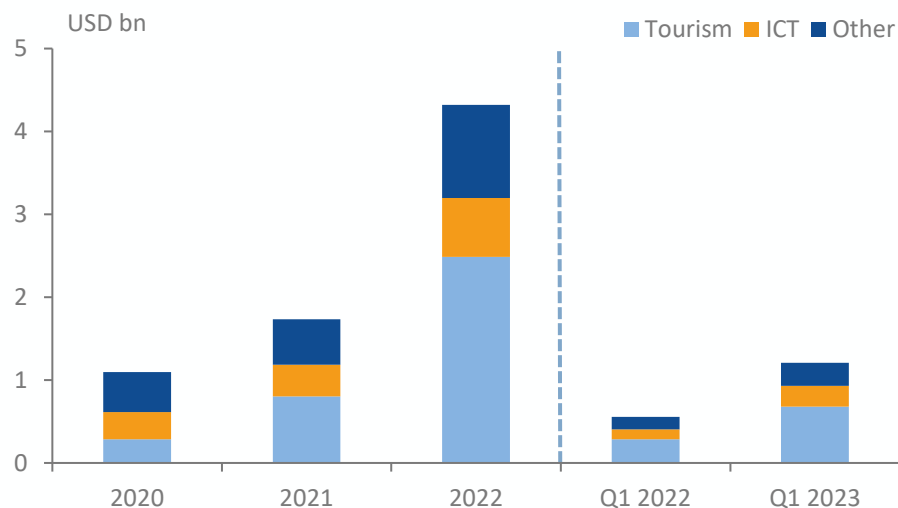
Trade in services: exports

Exports of services



Source: CBA

Exports dynamics by service category



Source: CBA

Exports of services

- » Q1 2023: +116.9% yoy; strong dynamic of 2022 continues
- » Service exports continue to profit from the influx of export-oriented migrants in the ICT sector, as well as tourists from RUS
- » However: base effects are also at play
 - Main impact of influx of migrants became visible only after Q1 2022
 - Growth rate likely to slow down

Tourism

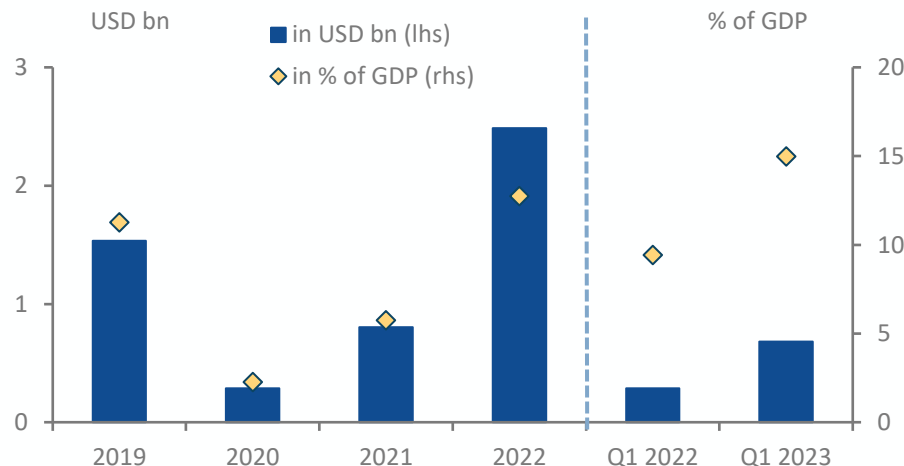
- » Q1 2023: +136.6% yoy
- » Main driver of service exports

ICT sector

- » Q1 2023: +108.2% yoy; growth rate even picked up compared to 85.8% in 2022
- » Overall opportunity to further develop the Armenian IT sector
- Strong dynamic continues, but slowdown over the rest of the year likely

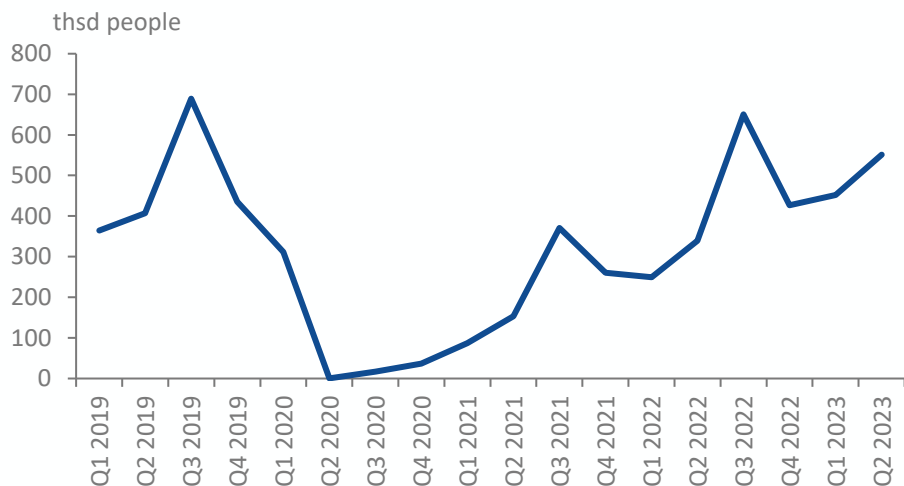
Trade in services: tourism

Tourism-related revenues



Source: CBA

Inbound tourists



Source: Armstat

Economic importance of tourism

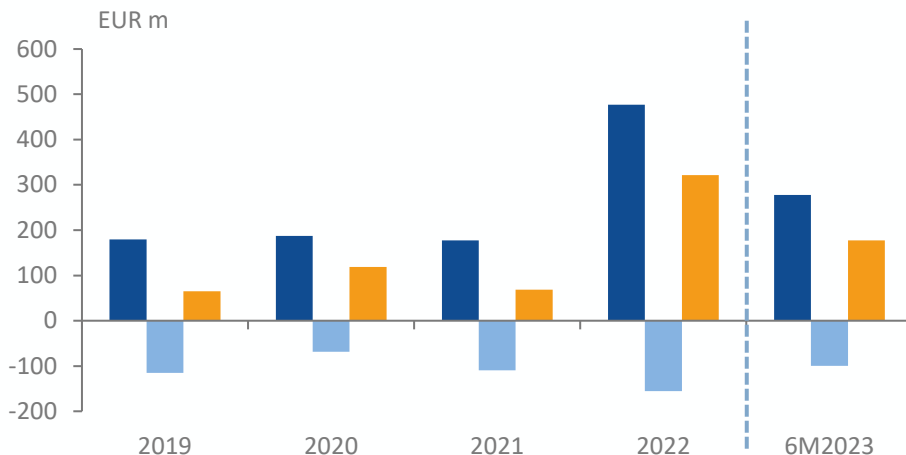
- » Tourism is a key source of income for the Armenian economy
- » 2020/2021: sharp drop during the pandemic
- » 2022: tourism-related revenues amounted to USD 2.5 bn (12.8% of GDP)
 - Influx of tourists from RUS significantly contributed to growth

2023

- » Q1 2023: revenues of USD 0.7 bn or 15.0% of GDP; continuation of strong 2022 trend
- » Number of inbound tourists also grew significantly (H1 2023: +70% yoy)
 - H1 2022: 589,000 tourists
 - H1 2023: 1,003,000 tourists
 - However: statistics might be distorted by the relocation of people from RUS
- » Further development will depend on economic and political situation in RUS
- **Tourism-related revenues remain strong, but further development is uncertain**

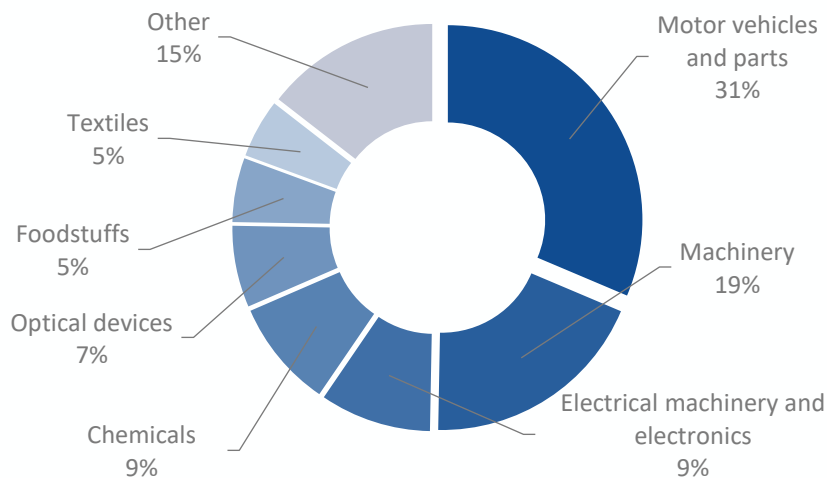
Bilateral trade between Armenia and Germany

German trade with Armenia



Source: Destatis

German Exports to Armenia



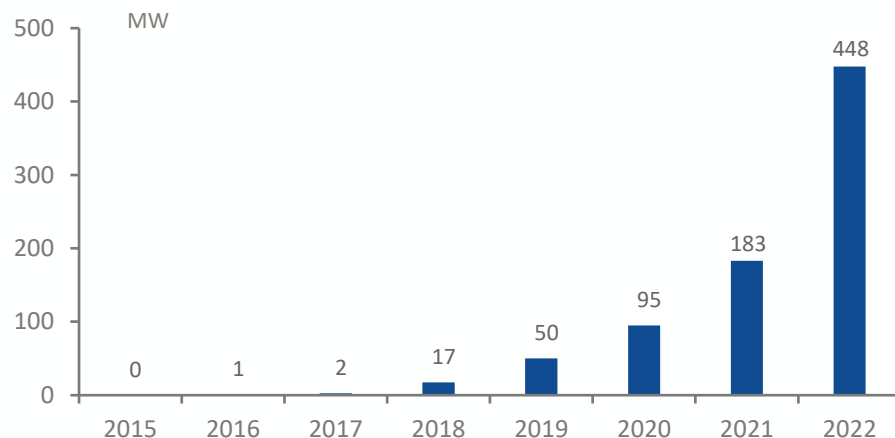
Source: Destatis; data for 6M2023

6M2023

- » German exports: EUR 277 m; +97% yoy
- » German imports: EUR 100 m; +30% yoy
- » Trade balance: EUR 178 m: +178% yoy
- » Structure of exports changed significantly in 2022 due to ARM re-export business and remained similar in 6M2023
- » Strong growth trends for some goods suspected to be re-exports continued during the first half of 2023
 - Vehicles and parts: +197% yoy
 - Optical equipment: +166% yoy
 - Machinery: +90% yoy
- » However: overall dynamic has slowed down; likely to further deaccelerate in H2 2023
- Bilateral trade between Germany and Armenia continues to grow
- But: growth is likely mainly caused by re-export business

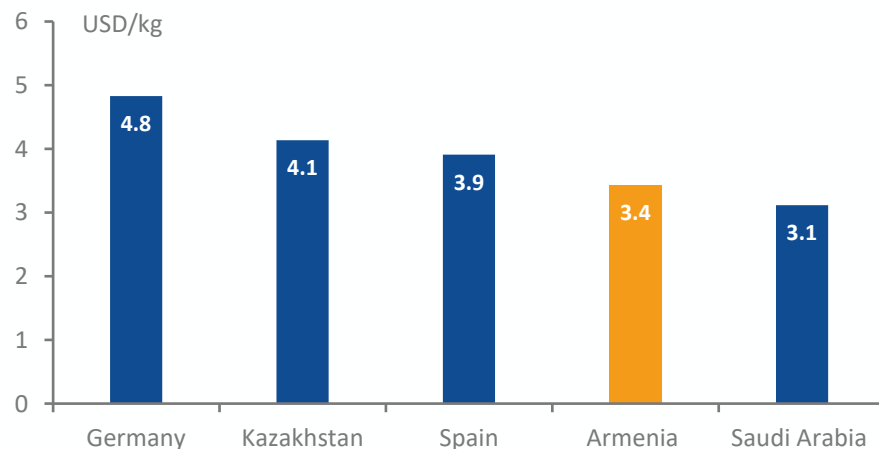
Potential of green hydrogen in Armenia

Installed solar PV capacity in Armenia



Sources: IRENA, IEA

Cross-country comparison of levelized production cost



Source: GET calculations; Note: assuming a preferential interest rate of 2%

Background

- » ARM possesses significant renewable energy potential, especially in solar PV (scale-up of capacity to 1,000 MW envisioned by 2030)
- » Green hydrogen production could be one of the options to utilise this potential

Assessment of green hydrogen potential

- » GET calculated levelized cost of green hydrogen production in ARM at 3.4 USD/kg, making it internationally competitive
- » However: no clear domestic use cases for green hydrogen exist in ARM as of today
 - Future applications could be copper smelting, ammonia-based fertiliser production and transportation
- » Moreover: exports (e.g. to EU) are unlikely in the medium term due to high CAPEX requirements for new infrastructure
- Limited perspective in the medium term despite competitive production costs
- Broader regional hydrogen export project would lower costs

Economic exposure to Russia (1/2)

Development of Armenian goods exports to Russia

	RUS share (%)		Change (pp)
	2021	2022	
Exports to RUS	27	45	+18
Re-exports	*	*	*
Traditional goods	23*	26*	+3
<i>Beverages</i>	72	80	+8
<i>Apparel and clothing accessories</i>	47	46	-1
<i>Precious, semi-precious stones</i>	24	21	-3
<i>Fish and crustaceans</i>	99.5	99.2	-0.3
<i>Fruits and nuts</i>	97	89	-8

Sources: UN Comtrade, Armstat, own calculations; * own estimate assuming no other significant re-exports of ARM aside from RUS

Overview of selected Armenian imports from Russia

	RUS share (%)		Change (pp)
	2021	2022	
Total RUS imports	34	30	-4
<i>Natural gas</i>	85	88	+3
<i>Oil products</i>	72	72	-0.4
<i>Gold</i>	79	89	+10
<i>Diamonds</i>	15	46	+31
<i>Wheat, corn and wheat flour</i>	99	98	-0.6
<i>Iron, steel and products thereof</i>	28	32	+4
<i>Sunflower oil and margarine</i>	90	92	+2
<i>Nuclear fuels</i>	100	100	+0
<i>Other imports</i>	19	15	-4

Sources: UN Comtrade, own calculations

Background

- » ARM economic exposure to Russia – its main trading partner – has traditionally been high
- » Key question: has economic exposure to RUS increased in 2022?
- » Exposure: structural dependence that cannot be changed in the short-term

Goods exports: slight increase of exposure

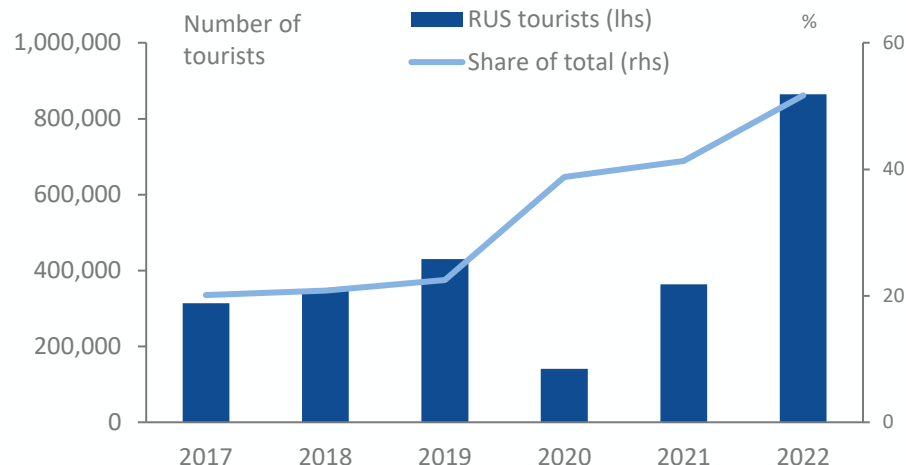
- » Share of RUS in total exports increased significantly (2022: 45%; +18 pp)
- » However: surge of re-exports main reason for this shift; does not constitute exposure
- » But: increase in exposure for some traditional goods such as beverages

Goods imports: high exposure, but no increase

- » Strong increase in imports, but share of RUS market decreased slightly (2022: 30%; -4 pp)
- » Some sectoral exposure increased; value addition for gold and diamonds expanded

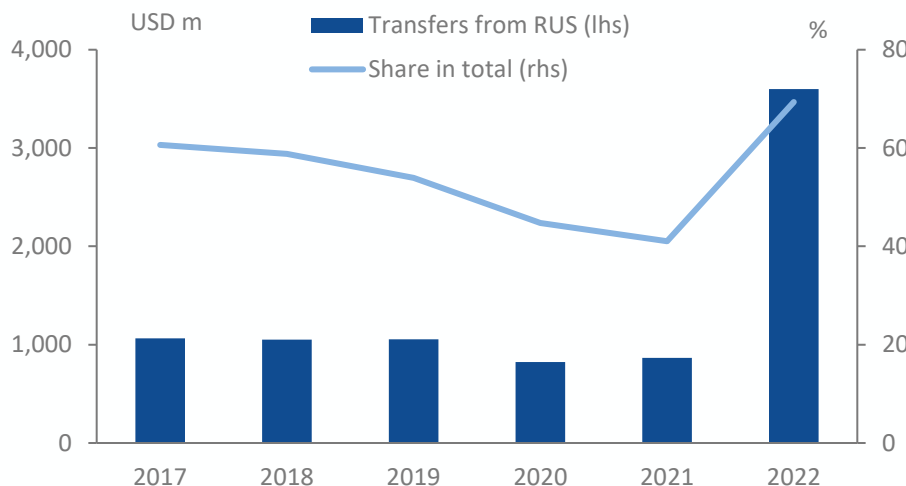
Economic exposure to Russia (2/2)

Number of Russian tourists in Armenia



Source: Armstat, own calculations; Note: According to WTO methodology, tourists are considered residents only if they stay in the country for more than one year

Money transfers from RUS to ARM



Source: CBA; Note: inflows

Tourism: migration as a special factor

- » Tourism is traditionally an important source of revenues (11% of GDP pre-COVID)
- » RUS tourists have a significant share, which increased throughout 2020-2022
- » However: numbers might be somewhat distorted by influx of 55,000 people from RUS

Other factors

- » **Remittances**: no increase; hike in money transfers from RUS related to migration
- » **FDI**: no evidence for increased exposure, but hard to determine sectoral importance
- » **Banking sector**: already low exposure further decreased as VTB market share halved
- » **Public debt**: no increase of outstanding debt (exposure) to RUS; share decreased
- » **Market sentiment**: analysts do not perceive higher risk; no increased exposure
- » Overall, ARM exposure to RUS remains high, but did not increase in 2022

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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