NEWSLETTER
ARMENIA

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Economic slowdown continues as positive shocks fade out

The Armenian economy remains in good shape with growth of 8.7% in 2023, still profiting from the high influx of Russian migrants in 2022. However, the effect is slowly fading out with GDP growth gradually declining. For 2024, real GDP growth is forecast at 5.0% by the IMF. Inflation weakened significantly, with a rebound towards the inflation target of 4.0% expected in 2024. The exchange rate against the US dollar remained mostly stable. Regarding foreign trade, Armenia's re-export business keeps on being a main driver. While the strong re-exports of cars to Russia significantly declined at the end of 2023, there are now substantial imports of gold and diamonds from Russia, which are in turn being re-exported to the United Arab Emirates. Following the escalation of the Nagorno-Karabakh conflict in September 2023, Armenia now faces the challenge to integrate more than 100,000 refugees, which is also reflected in an increase of the budget deficit. However, this could also become a growth driver in 2024. A major risk, on the other hand, is a potential worsening of economic relations to Russia.

Economic situation gradually returns to normal level

The Armenian economy grew by 8.7% in 2023, marking the second consecutive year with a very significant economic activity. With the dram remaining strong, GDP per capita in US dollar grew by 74% since 2021. However, the positive migration shock is gradually fading out. Nevertheless, there was no major reversal of the trend, as most Russians that came to Armenia are still staying there. For 2024, the IMF predicts a GDP growth of 5% reflecting a further fade out of the migration shock and the absence of new growth drivers.

Real GDP growth
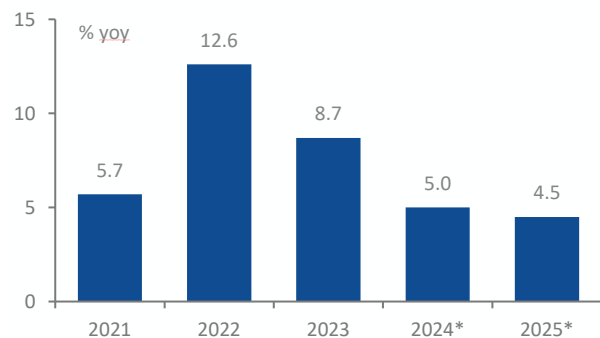
Source: Armstat, IMF, *forecast

Moreover, the Armenian economy faces significant uncertainties regarding the integration of 100,000 refugees from Nagorno-Karabakh and a potential worsening

of the economic relations with Russia. At the sectoral level, the fade out of the migration shock is also noticeable. Financial sector activity shrank by 8% yoy and is thus slowly returning to its pre-shock level. However, the momentum in the ICT sector as well as trade and construction, which have benefited from the shock, remains strong. In contrast, the manufacturing and agricultural sector performed weakly.

Sectoral dynamics
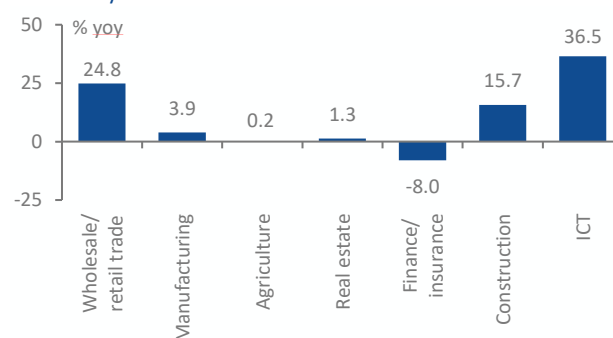
Source: Armstat; data for 2023
Note: sorted from left to right by share in GDP in descending order

Inflationary pressure eased significantly

Inflation has rapidly declined throughout 2023 and stood at -0.6% at the end of the year, facilitated by a strong Armenian dram and decreasing prices for imported food and fuel. The decreasing inflationary pressure allowed the Central Bank to cut the policy rate since May 2023 for a total of 200 basis points (Jan-24: 8.75% p.a.). For 2024, a gradual rebound of inflation to 3.1% is expected with a further easing of the monetary policy stance.

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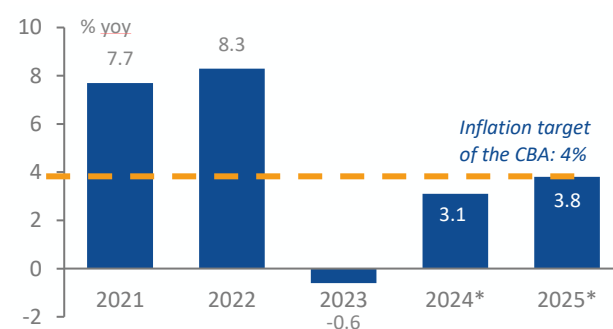
Source: CBA, *estimate/forecast; Note: end of period

### Armenian dram remained strong

Throughout 2023 the exchange rate of the Armenian dram against the US dollar remained mostly stable. There was only a slight depreciation in October 2023 (4.3% mom) caused by the escalation of the Nagorno-Karabakh conflict. However, the dram remained stable since then at a level which is still significantly above the level of early 2022.

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The strong dram enabled the Central Bank to build-up its international currency reserves. However, since September 2023 there is a declining trend, which is linked to sizable external debt repayments. In particular, USD 187 m of the Eurobond 2025 were bought back. In January 2024 reserves stood at USD 3.6 bn. Import coverage decreased to 3.6 months and is now only slightly above the international standard of 3 months.

Financial situation deteriorates slightly

In terms of budget balance, the deficit increased to 3.1% of GDP in 2023. This was majorly caused by unforeseen expenditures due to the inflow of about 100,000 refugees from Nagorno-Karabakh which account for about 3.3% of the Armenian population. To provide adequate social assistance, the government set up several refugee support mechanisms and plans to allocate funds of around 1.5% of the GDP in 2024. Consequently, the deficit is expected to increase to 4.6% of GDP in 2024.

Development of the budget balance
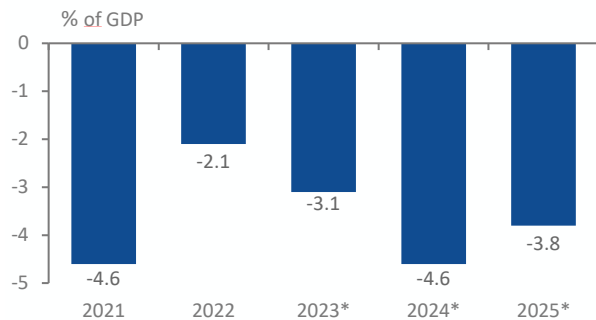
Source: MoF, IMF, *estimate/forecast

Public debt slightly increased to 48.1% of GDP in 2023. This was mainly driven by the partial assumption of Nagorno-Karabakh debt (ca. USD 550 m). For 2024, a further increase to 49.3% of GDP is expected.

Re-exports remain important driver for foreign trade

Armenian exports of goods grew by 55% yoy in 2023 and imports by 40% with the main traded goods being machinery and vehicles. Re-exports to Russia remained an important driving force behind the strong growth. However, new sanctions make the re-export business to Russia more difficult, causing it to slow down. While Russia remains the most important export destination for Armenia, its share of total exports decreased by 4 percentage points to 41% in 2023. At the same time, imports from Russia grew strongly since September 2023. This is primarily due to a new re-export scheme emerging, which involves imports of gold and diamonds from Russia and their re-export to the United Arab Emirates.

Development of trade with Russia
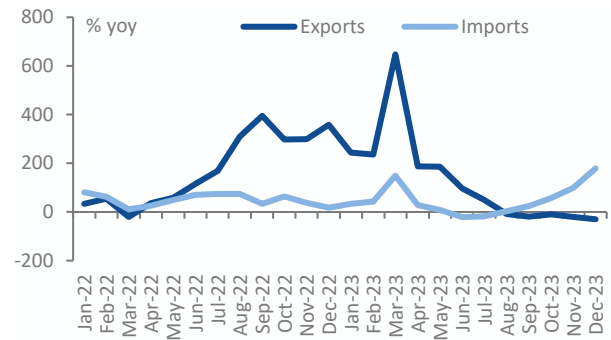
Source: Armstat

Summary and outlook

The positive migration and external demand shock still had a significant impact in 2023 but its effect is gradually fading out. With no new growth drivers in sight, the economy is bound to cool down in 2024. Additionally, integrating the 100,000 displaced persons from Nagorno-Karabakh is currently a challenge for Armenia, which is clearly reflected in the deterioration of the fiscal situation. On the other hand, if done correctly, this could also be a potential driver of growth for the upcoming years. Another uncertainty factor is a potential worsening of the economic relation to Russia, which still is Armenia's most important economic partner. Should this be the case, major problems in the agricultural and energy sector are to be expected, where Armenia's economic exposure vis-à-vis Russia is the highest.

This newsletter is partly based on the _11th issue of the Economic Monitor Armenia_.

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