

Overview

- Economic growth at ca. 7.0% in 2019, significantly higher than expected
- Main driver was private consumption, on the back of robust retail lending
- Investment activity declined in 2019, with negative implications on mid-term growth
- GDP is forecast to grow by 4.9% in 2020
- **Strong economic growth, but weak investment is an issue**
- Low budget deficit at 1.5% of GDP in 2019
- Reasons: high revenues, but also under-execution of capital expenditures
- **Fiscal stability positive, but low public investment is an issue**
- Inflation in 2019 at 0.7%; low inflation key ingredient of macroeconomic stability
- Wide current account deficit at ca. 8.0% of GDP in 2019, partly due to special factor
- Weak FDI inflows (0.7% of GDP) in 9M2019, too little for financing current account deficit
- **FDI attraction remains a key issue**

Special topics

- **Export potential of the agro-food sector.** Opportunities for various goods
- **Increase of minimum wage by 24%.** Economic implications
- **Effectiveness of free economic zones.** Recommendations for reform
- **Armenia, the EU and the Eurasian Economic Union.** Implications for free trade with EU

Basic indicators

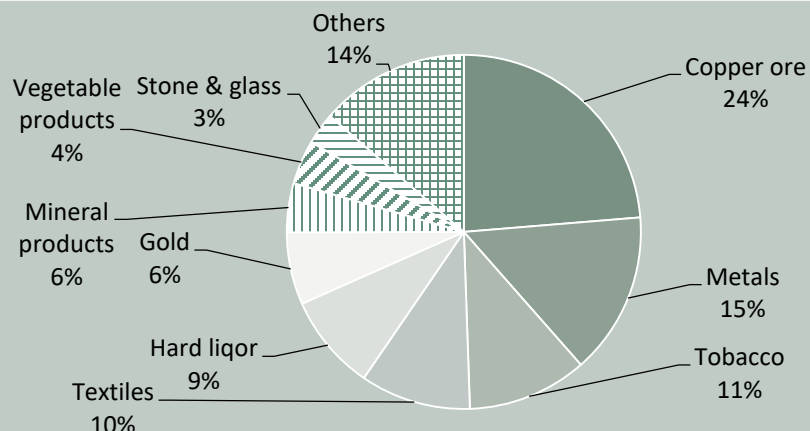
	Armenia	Azerbaijan	Georgia	Belarus	Ukraine	Russia
GDP, USD bn	13.4	47.2	16.1	63.1	150.4	1637.9
GDP/capita, USD	4,528	4,689	4,380	6,659	3,592	11,163
Population, m	3.0	10.1	3.7	9.5	41.9	146.7

Source: IMF, Belstat, own calculations; Forecast 2019

Trade structure

Exports

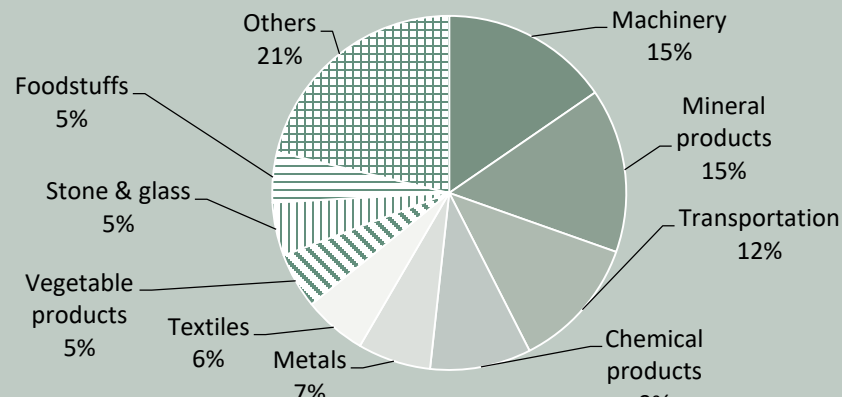
Russia 27% | EU 23% | Switzerland 17% | Others 33%



Source: Armstat 10M2019; Note: Trade in goods

Imports

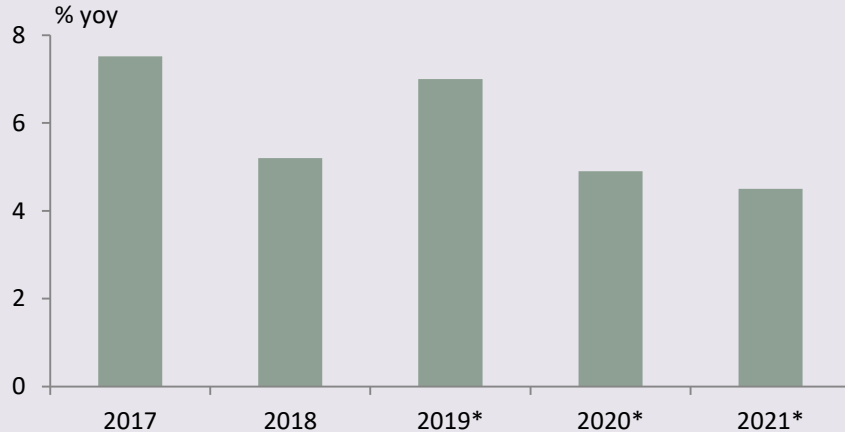
Russia 27% | EU 21% | China 14% | Others 38%



Source: Armstat 10M2019; Note: Trade in goods

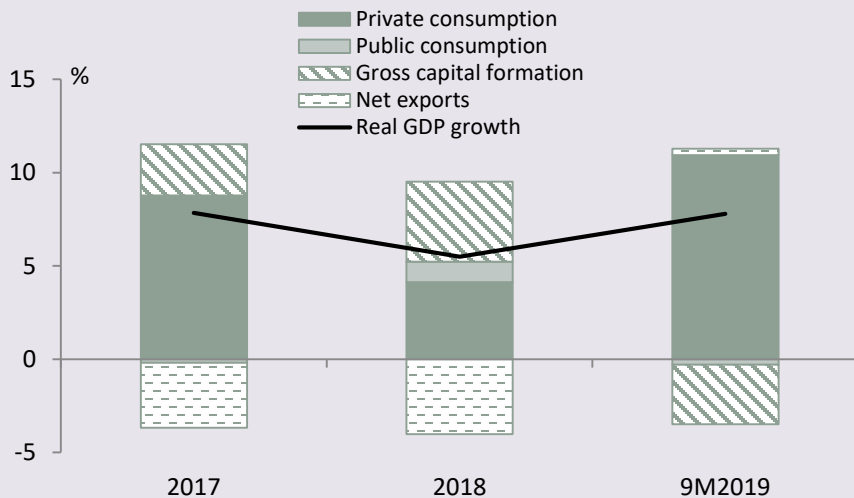
Economic growth

Real GDP growth



Source: IMF; *forecast

Contribution to economic growth by expenditure



Source: Armstat

Economic growth

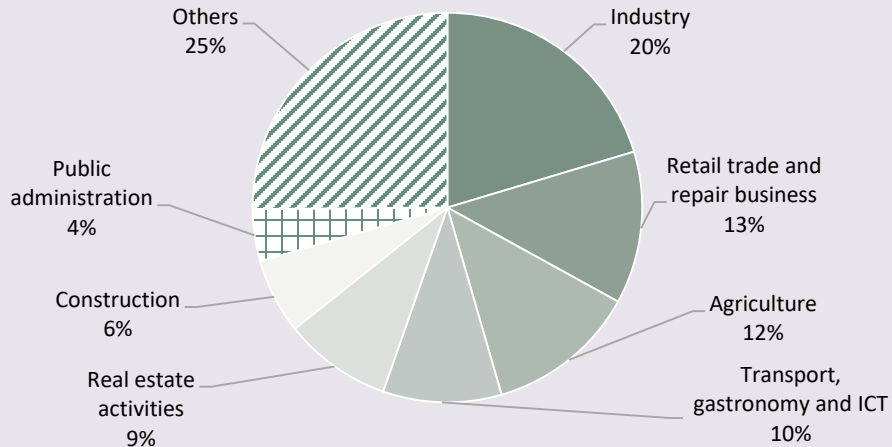
- 2019: GDP rose by 7.0%; high level
- 2020: growth forecast at 4.9%, i.e. considerably lower than in 2019

Contributors to growth

- Private consumption grew by 11.0%; key determinant of high growth
 - Investment declined in 9M2019, raising questions about mid-term growth
 - Reasons:
 - Under-execution of capital expenditure (40% of plan)
 - Low private investment
- **High growth in 2019, but weak investment performance**
- **Resumption of public and private investments is a key issue**

Sectoral perspective

Composition of economy



Source: Armstat, 9M2019

Sectoral dynamics



Source: Armstat

Agriculture

- Continuation of long-term contraction process
- Structural problems in agriculture

Mining

- 2018: copper mine Teghut and foundry temporarily closed; negative impact on growth
- 2019: Teghut re-started operations, thus contributing to GDP growth

Manufacturing

- Positive contribution to GDP

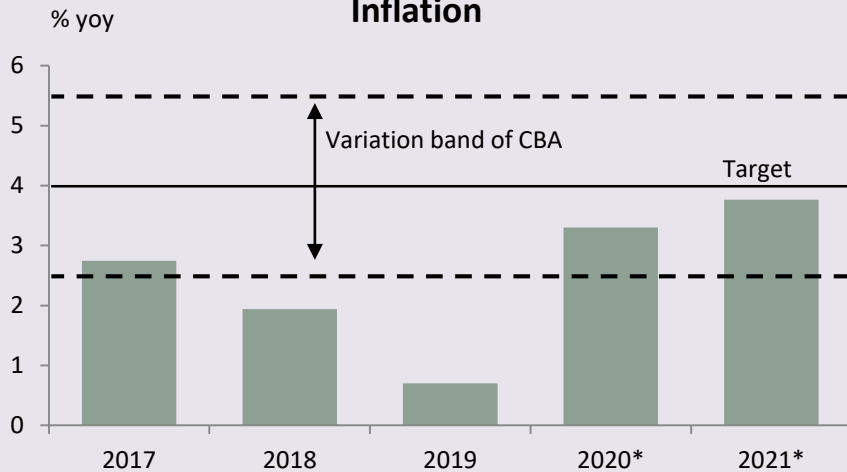
Services

- Contributor to GDP growth, mirroring strong private consumption

➤ **Growth driven by mining, manufacturing and services**

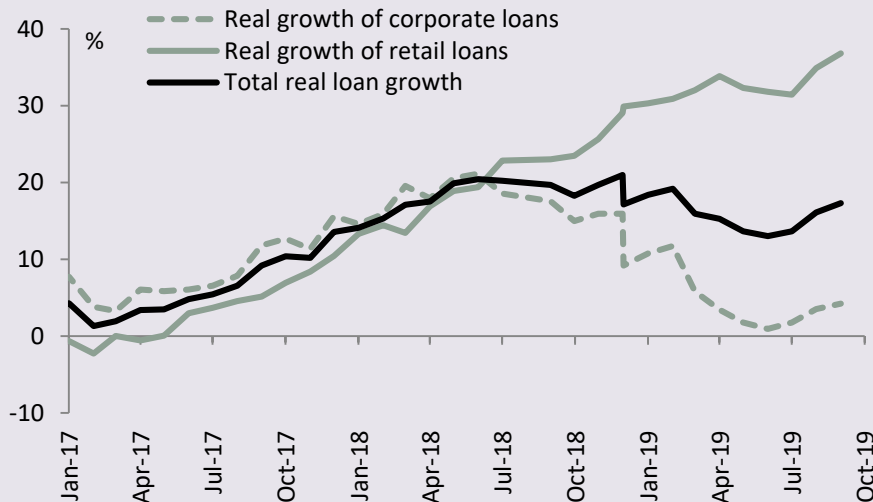
Inflation and banking sector

Inflation



Source: IMF; *forecast; note: end of period (consumer prices)

Corporates vs retail loan growth



Source: CBA, own calculations

Monetary policy

- Medium-term target of CBA is 4.0%, with a variation band of +/-1.5%
- Despite high economic growth, inflation rate in Dec 19 at only 0.7%, i.e. below variation band
- Despite this, overall success of CBA in keeping inflation under control

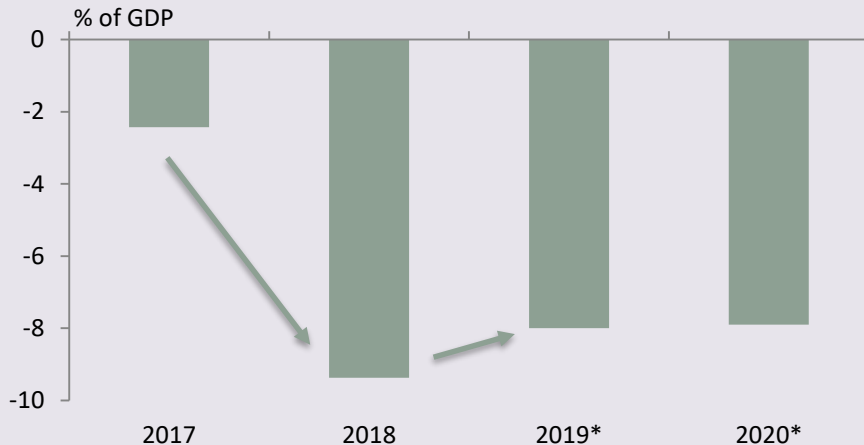
Banking sector

- Stable sector, with most banks being subsidiaries of foreign banks
- Sep 19: strong increase of retail lending by over 35% yoy; need to monitor further dynamic
- Moderate performance of corporate loans, in line with weak investment

➤ **Low inflation and stable banking sector**

Current account and FDI

Current account



Source: IMF; *Forecast

Net FDI flows



Source: Armstat, CBA; percentages denote net FDI flows as % of GDP

Current account deficit (CAD)

- 2018: jump of CAD to 9.4% of GDP
- 2019: only slight reduction to 8.0%

Key reason for high CAD

- When Armenia joined the Eurasian Economic Union, it negotiated to keep low import tariffs for cars till end 2019
- Effect: strong imports and re-exports of used cars in 2018/2019, with only imports being properly recorded

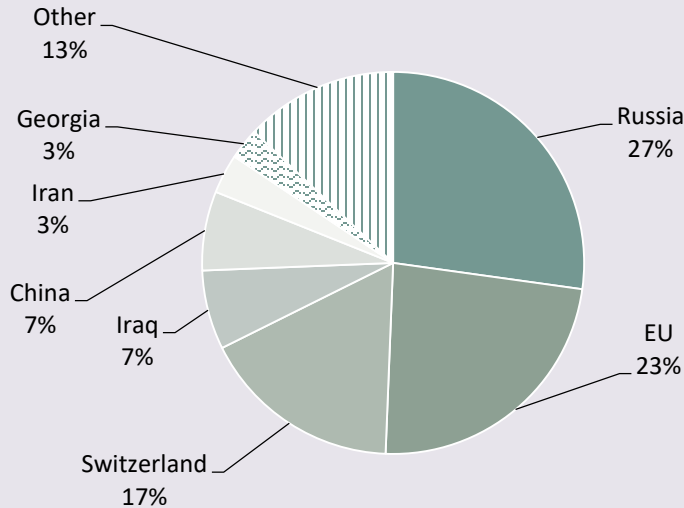
➤ **Excluding cars, CAD “only” ca. 6% of GDP; manageable**

Capital account

- Very low FDI, inflows below 1% of GDP in 9M2019
- **FDI attraction is a key issue**

Trade in goods

Export by countries



Source: Armstat, 10M2019; Note: trade in goods

Exports of mining products and metals

	USD m	% of total exports
Copper ores	508.2	23.7%
Other mineral products	96.4	4.5%
Metals	221.0	10.3%
Gold	188.9	8.8%
Sum	1,014.6	47.3%

Source: Armstat, 10M2019; Note: trade in goods

Regional structure of trade

- Russia and EU are main export destinations, with a share of 27% and 23% each in total exports
- Large share of Switzerland (17%) due to exports of gold and copper

➤ Regional trade rather limited

Reasons

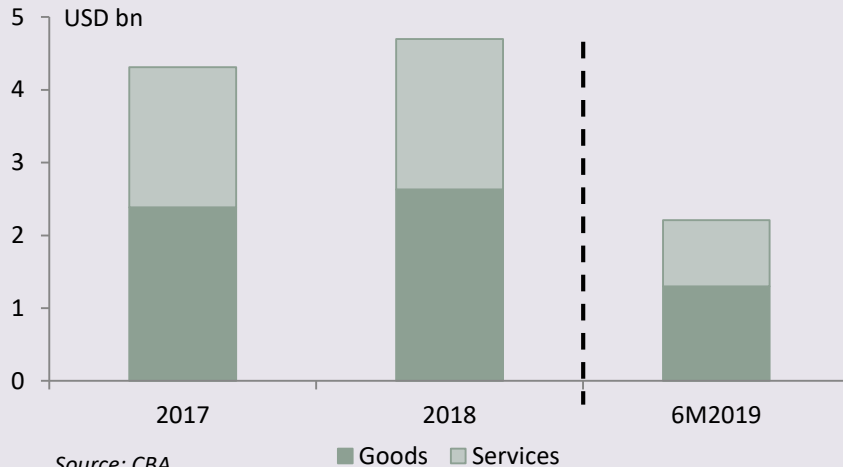
- No trade with Azerbaijan and limited (indirect) trade with Turkey
- But also: concentrated commodity composition of exports; mining and metals 47% of total exports

➤ Diversification of commodity composition of exports is an issue

➤ Possible: export promotion of agro-food (see special slide)

Trade in services

Export of goods and services



Exports of services

- Traditionally strong services' exports
- 2018: services accounted to 44% of exports of goods & services
- Rather high in international perspective

Reasons

- Limited regional trade
- Landlocked country with relatively high transportation cost for goods
- Tourism: strong link to large diaspora
- IT: strong link to FDI in IT sector

Export performance in 6M2019

- Tourism: USD 532 m; +9.4%
- IT: USD 126 m; +4.4%
- Transport: USD 120 m; -1.3%
- Construction: USD 63 m; -19.6%

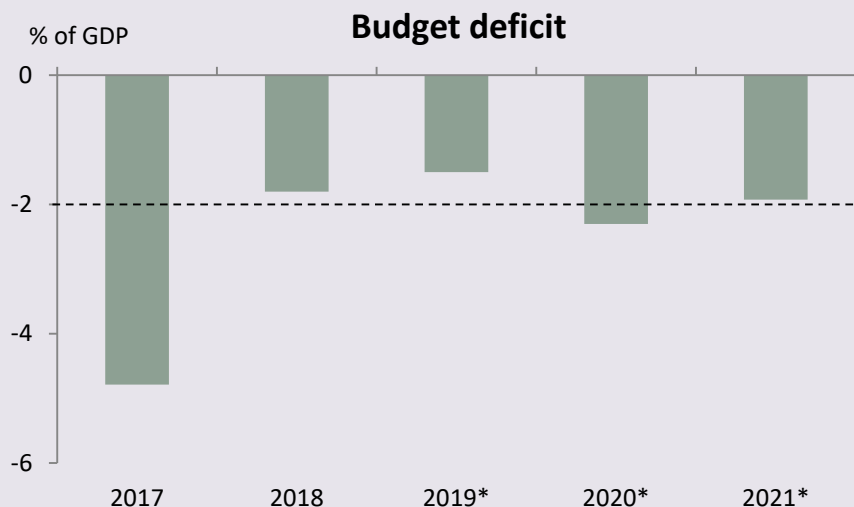
➤ Mixed performance of services' exports

Importance of exports of services: international comparison

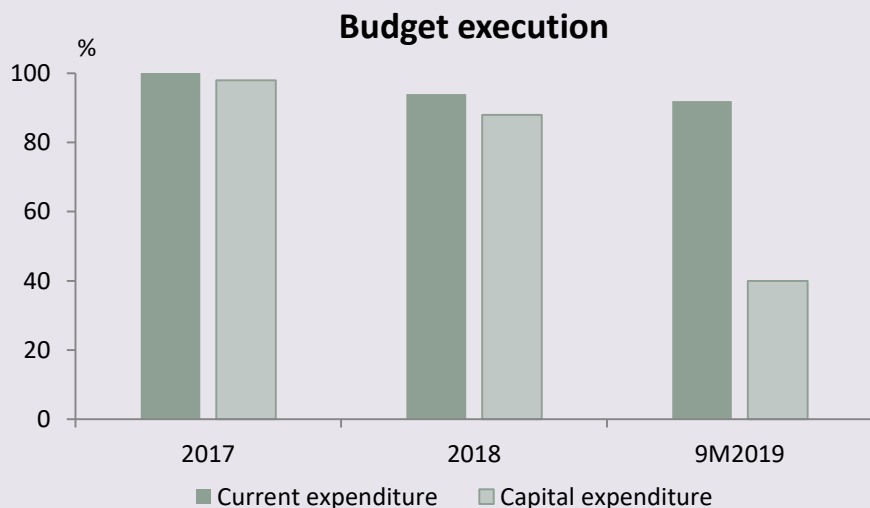
	Share of services in exports of goods & services
Georgia	51%
Armenia	44%
USA	33%
Ukraine	27%
Germany	23%
Azerbaijan	18%
Russia	13%

Source: central banks of respective countries, 2018

Public finances



Source: IMF, *forecast; Note: GFSM 1998-Definition



Source: IMF

2019

- Budget deficit estimated at 1.5% of GDP
- Low deficit partly due to higher revenues
- But also due to significant under-execution of capital expenditure; only 40% of plan in 9M2019
- This is particularly the case for foreign financed capital expenditure; only 26% of plan in 9M2019

➤ **Need to increase capital expenditure**

➤ **Key issue also for international financial cooperation**

Mid-term outlook: fiscal consolidation

- Medium term reduction of deficit to $\approx 2\%$
- How? Growth-friendly fiscal consolidation

Revenue and expenditure plans

Budget 2020 onwards: revenue side

Tax	Until 2019	2020 onwards
Personal income tax	progressive 23-36%	flat 2020: 23% 2021: 22% 2022: 21% 2023: 20%
Corporate income tax	20%	18%
Excise tax	e.g. on alcohol & tobacco	increases by 2021: factor 1.03 2022: factor 1.06 2023: factor 1.09
VAT		reform of VAT exemption

Source: Parliament.am

Revenue side from 2020 onwards

- Lower personal income tax rate
- Lower corporate income tax
- Very high threshold for VAT participation
- Practically no taxation of microbusiness

Expenditures side

- Increase of pensions by 10% in 2020
- Increase of minimum wage by 24% in 2020 leads to higher public expenditure

Key question

- Compatible with fiscal consolidation?

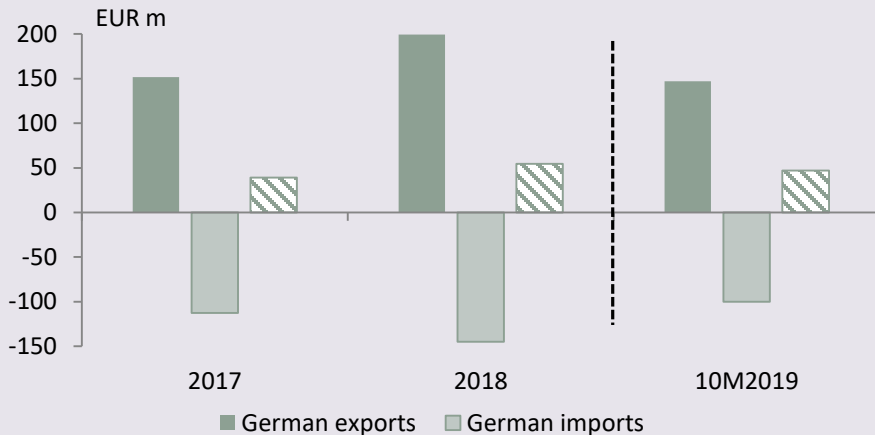
Government approach

- Higher taxes for alcohol, tobacco, etc. as part of a general shift from direct to indirect taxes
- Strengthening tax administration
- Stronger property taxation

➤ Ambitious plans in the fiscal sphere

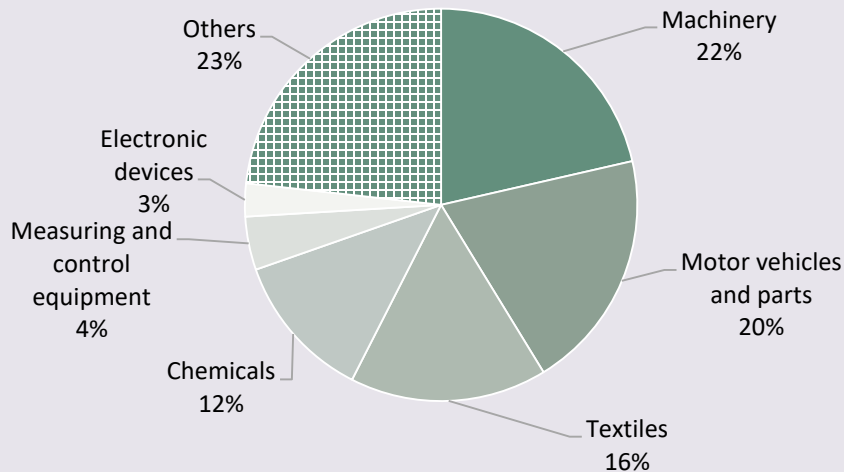
Bilateral trade between Germany and Armenia

German trade with Armenia



Source: German Federal Statistics Office; Note: trade in goods

German exports to Armenia



Source: German Federal Statistics Office, 10M2019

Turnover

- 2018: EUR 344 m, increase by 30%
- Germany is Armenia's most important trading partner in the EU
- 10M2019: decrease by 14%

German exports

- 2018: significant increase by 31%
- Main reason: higher exports of cars (mainly used cars)
- 10M2019: decrease by 11% yoy (according to DEU statistics), mainly due to drop in specialized machinery exports
- Link to weak investment activity in ARM

German imports

- 2018: sizeable rise by 28%
- Main reason: increase in metals imports
- 10M2019: decrease by 18%

Strong performance of bilateral trade in 2018; weaker data for 10M2019

Export potential of the agro-food sector

Rank	HS 2012 Product Description	Exports 2018, USD m
1	Spirits obtained by distilling grape wine or grape marc	199.5
2	Fruit, prepared or preserved: grapes, plums, figs	5.3
3	Nuts and other seeds, incl. mixtures, prepared or preserved	1.9
4	Tomatoes, fresh or chilled	13.4
5	Fresh cut roses and buds	8.8
6	Whiskies	2.2
7	Vegetables, uncooked or cooked by steaming or by boiling in water, frozen	0.1
8	Fresh apples	1.5
9	Ethyl alcohol of an alcoholic strength of < 80% vol, not denatured	3.3
10	Jams, jellies, marmalades	2.1

Source: own estimates

ARM exports of agro-food

- 2018: USD 0.7 bn, 28% of total exports
- Key partners: Russia (50%), Iraq (22%), Syria (8%), UAE (5%), Georgia (3%)

Market access

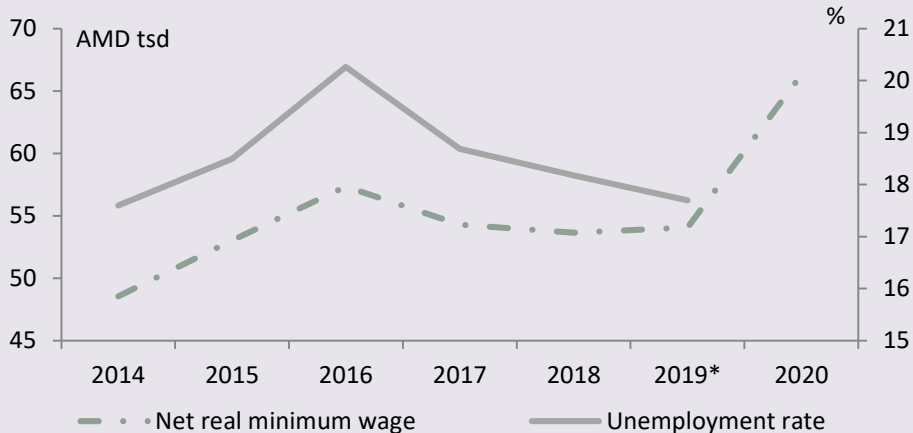
- Membership in the EAEU since 2015
- FTAs: CIS FTA 2011, Georgia, Turkmenistan, Vietnam
- Preferential access: GSP+ (EU), GSP (Canada, Japan, Norway, Switzerland, Turkey, USA)

ARM export potential in agro-food

- Key categories in top-20 products: alcohol beverages, prepared fruits and nuts, fresh vegetables, fruits and berries
- Most potent destinations: Russia, Belarus, EU, China and Israel

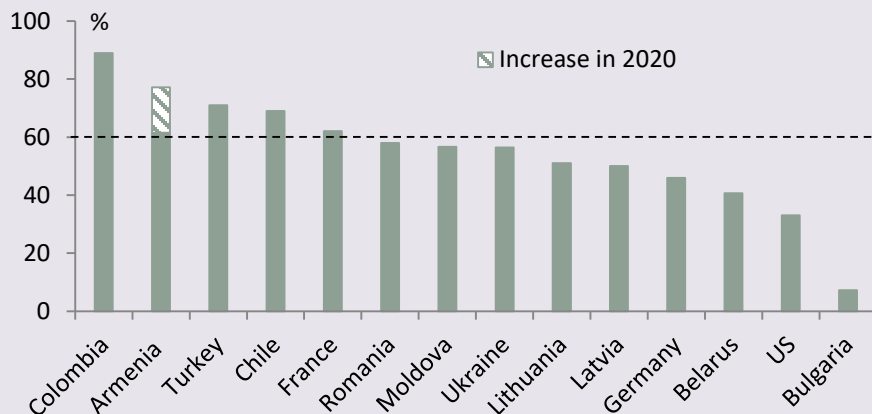
Minimum wage

Real minimum wage and unemployment rate



Source: IMF, Trading Economics; *estimation

Minimum wage/median wage ratio in selected countries



Source: OECD, Eurostat, ILO, national statistics, own calculation

Jan 20

- Monthly minimum net wage increased from AMD 55,000 to 68,000 (ca. USD 143)
- Sudden increase by ca. 24%

Implications

- High minimum wage, when compared to the minimum/median wage ratio
- Ratio of minimum to median wage at 77%; clearly above recommended 60%

Economic implications

- To some extent: lower wage payments in “envelopes”; de-shadowing of economy
- However: strong rise might put pressure on SME, especially outside Yerevan
- Possible outcome: higher unemployment and/or increase of shadow activities

➤ **Impact of higher min wage to be watched**

➤ **Possible positive relationship between unemployment and real min. wage**

Reform of free economic zones

Free economic zones in Armenia



Source: own display

Background

- Five FEZ founded in Armenia since 2013
- With one exception (FEZ Meghri), all FEZ in Armenia run by private companies

Challenges

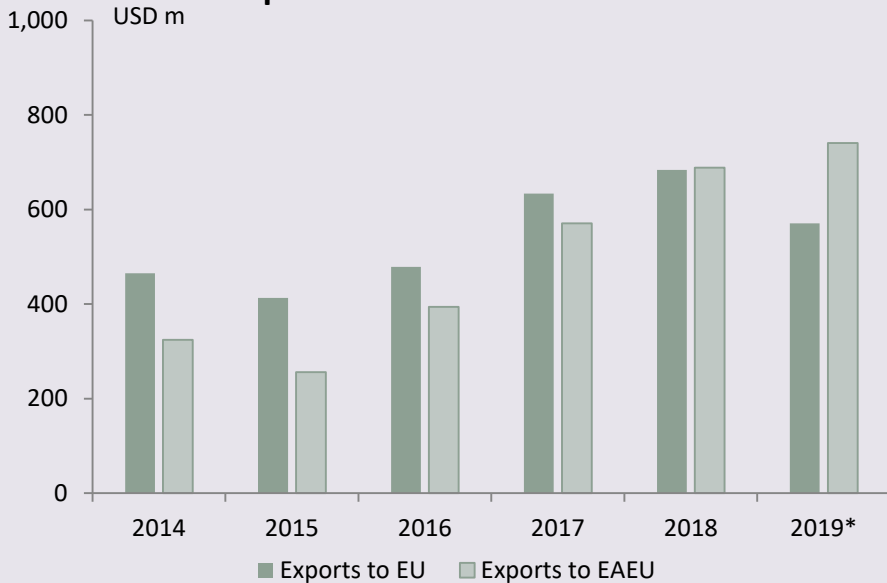
- So far, only few investors attracted or jobs created
- Main incentives: tax and customs exemptions

Recommendations for reform of FEZ

- Create strategic framework and focus
- Develop a value proposition based on a target-group oriented infrastructure and services
- Refine institutional framework
- Intensify promotion of zones

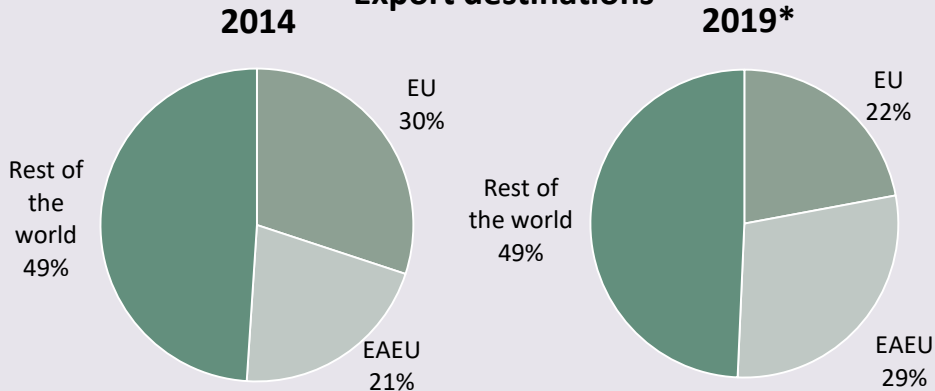
Armenia, the EU and the Eurasian Economic Union

Exports of Armenia to EU vs EAEU



Source: Armstat; *estimation

Export destinations



Source: Armstat; *estimation; Note: trade in goods

Jan 15: ARM joins the EAEU

Implications for trade with EU

- So far still good access of ARM to EU market, given the GSP+ preferences unilaterally provided by the EU
- Condition for providing GSP+ preferences: country is classified as having an income level below “upper middle income” by the World Bank
- Armenia will most likely reach an upper middle income level this year (“graduate”)
- Thus: ARM will almost certainly lose GSP+ preferences starting from 2022

➤ **Membership in EAEU precludes a free trade with the EU; negative implication of EAEU membership**

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