

Overview

- GDP to decline by 7.6% in 2020; twin shocks: COVID-19 and military confrontation
- Slow recovery expected; GDP to stagnate in 2021, uncertainty stems from political instability
- Investment likely to remain subdued in 2021, consumption may recover
- Budget deficit estimate: 5.4% of GDP in 2020; public debt to rise to 69% of GDP in 2021
- Current account deficit estimated at 6.0% in 2020; lower than 2019
- Strong decline in exports (esp. tourism) counteracted by even larger import contraction
- At the same time: FDI declined by almost half in 2020, expected to recover only slowly
- Augmentation of IMF stand-by arrangement and disbursement of approx. USD 232 m key for financing the budget deficit in 2020
- Rather stable exchange rate in 1H-2020, depreciation of Dram amid high uncertainty in Q3
- After multiple reductions in 2020, hikes in policy rate in Dec-20/Jan-21 due to increased inflation

Special topics

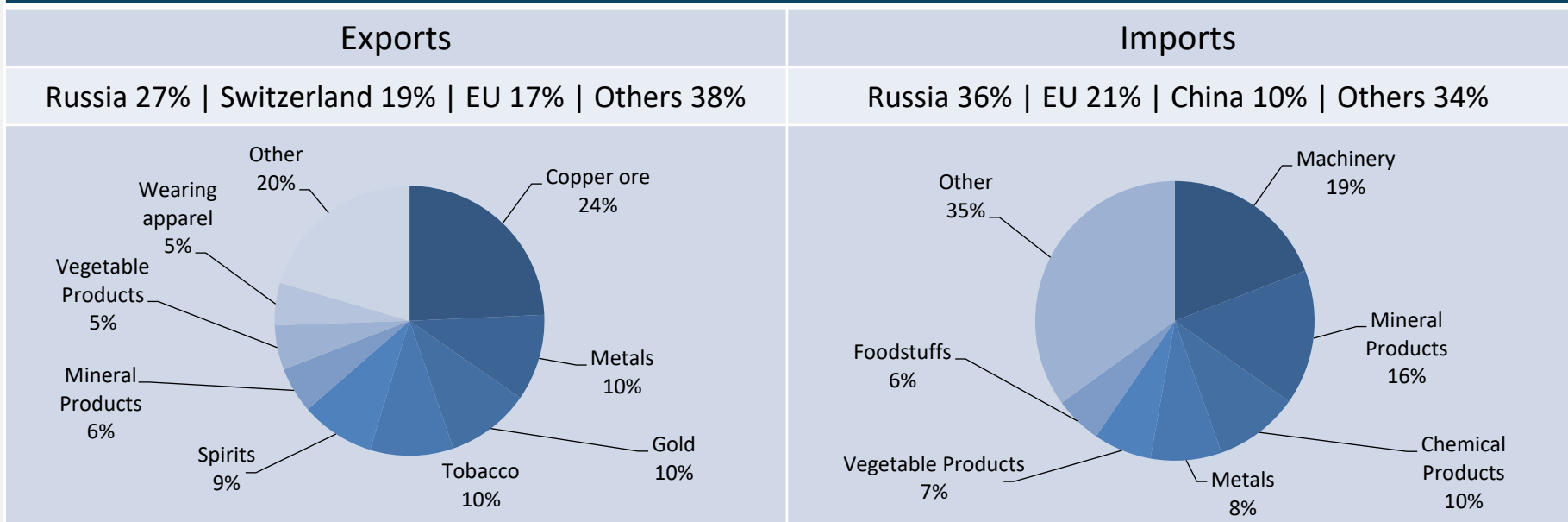
- **Trade with the EU.** Negative impact of the GSP+ graduation on textile exports
- **Regional trade.** Ban on Turkish imports
- **COVID-19.** Latest data and measures of the government
- **Business climate.** Proposals in cooperation with German and European business

Basis indicators

	Armenia	Azerbaijan	Georgia	Belarus	Ukraine	Russia
GDP, USD bn	12.7	42.6	16.2	60.3	154.7	1,464.1
GDP/capita, USD	4,264	4,219	4,358	6,379	3,717	9,973
Population, m	3.0	10.1	3.7	9.4	41.6	146.8

Sources: National statistical offices, IMF; 2020 estimates

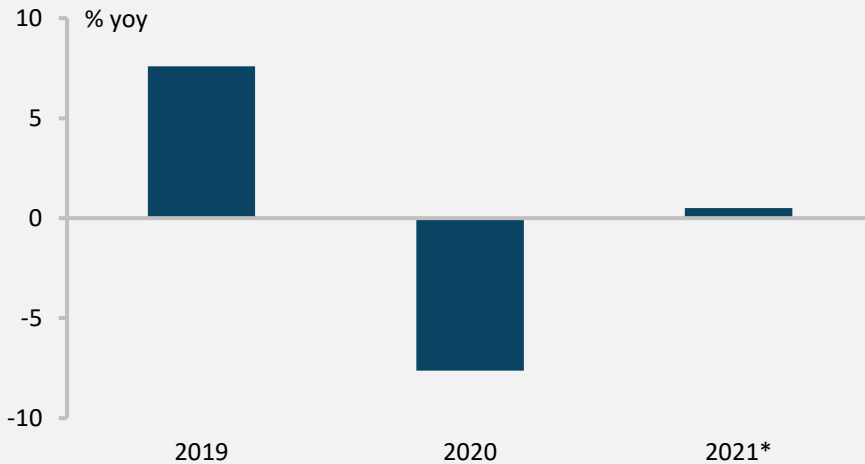
Trade structure



Source: Armstat; 2020; Note: trade in goods

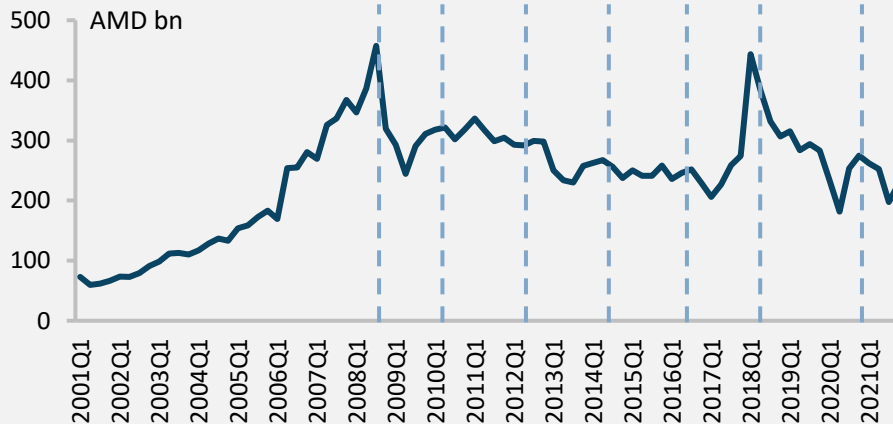
Economic growth: domestic forecast

Real GDP growth



Source: IMF/Armstat; *GET forecast

Reactions of investment to conflict flare-ups



Source: Armstat, GET calculation, note: real investment seasonally adjusted

2020

- Twin shocks of COVID and military conflict
- 2020: GDP contraction of 7.6%

2021

- 2021: up to 0.5% GDP growth expected
- Downside risk: political instability in the aftermath of the conflict
- Historically, conflict flare-ups have had a negative effect on investment, waning over two to four quarters
- GET output forecast accounts for the effect of the 2020 conflict by modelling this trend

➤ **Medium-term forecast: output growth depressed due to low investment, slow recovery**

Economic growth: regional comparison

Change in GDP forecasts for 2020

	GDP forecast (% yoy)		Change (pp)
	early 2020	latest	
Armenia	5.5	-7.6	-13.1
Azerbaijan	2.1	-4.0	-6.1
Georgia	4.3	-5.0	-9.3
Turkey	3.0	-5.0	-8.0
Iran	2.1	-5.0	-7.1
Russia	1.9	-4.1	-6.0
Germany	1.1	-5.0	-6.1

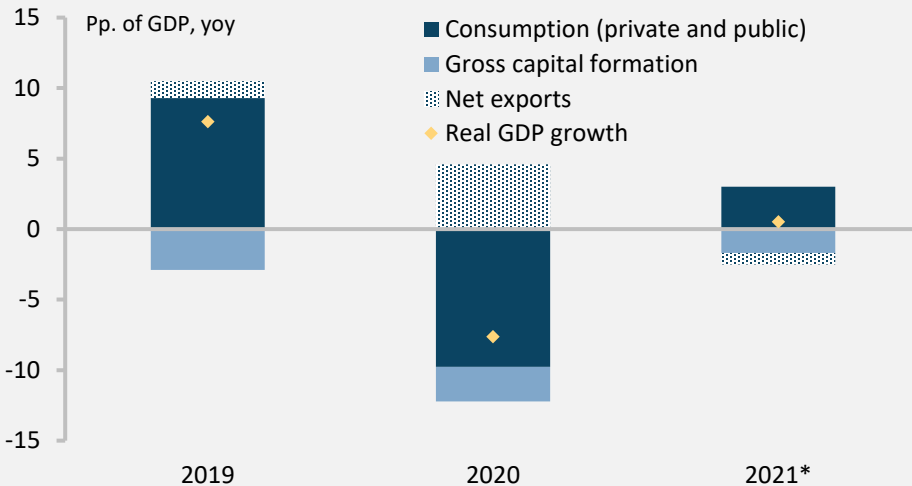
Source: IMF, World Bank, national statistics offices

Regional perspective

- ARM: worsening of economic situation throughout 2020 very large (-13.1pp)
- Main reason: twin shocks, as opposed to single shock (COVID) in most countries

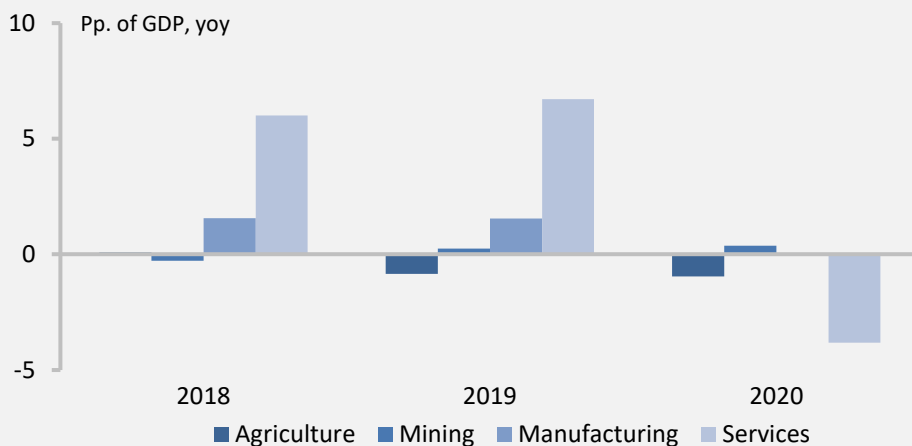
GDP dynamics: demand and supply side

Contribution to GDP growth by expenditure



Source: Armstat, GET; *GET forecast

Contribution to GDP growth by production



Source: Armstat, note: nominal GDP growth

GDP: demand side

- 2020: Strong decline of consumption and investment
- Sizeable drop in exports (esp. tourism) counteracted by even large import contraction
- 2021: consumption rebound possible, but investment likely to remain subdued

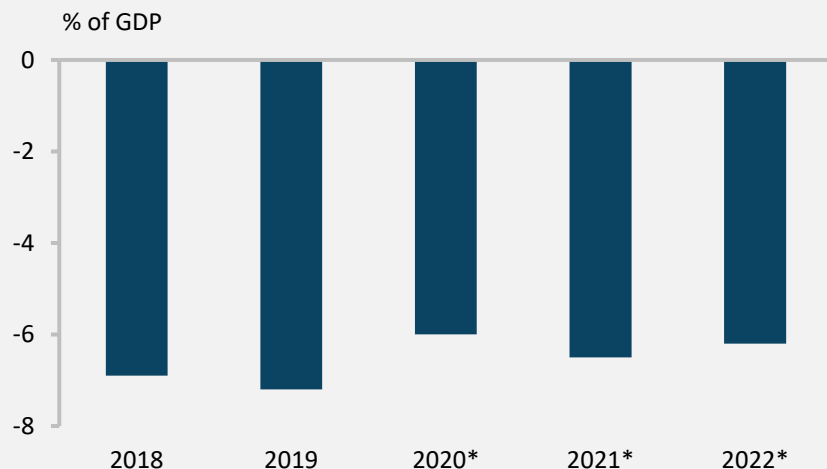
GDP: supply side in 2020

- Strong impact of COVID on services, esp. retail trade
- Weak performance of agriculture, where structural problems persist
- Strong performance in mining (13% yoy)

➤ **Main drivers of recession: consumption/investment and services**

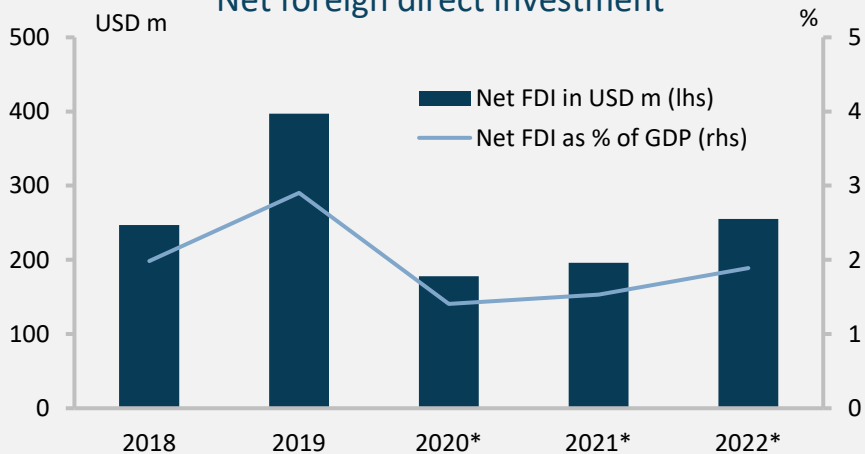
Current account

Current account balance



Source: IMF; *forecast/estimate

Net foreign direct investment



Source: IMF, Armstat; *forecast/estimate

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Impact of COVID on current account

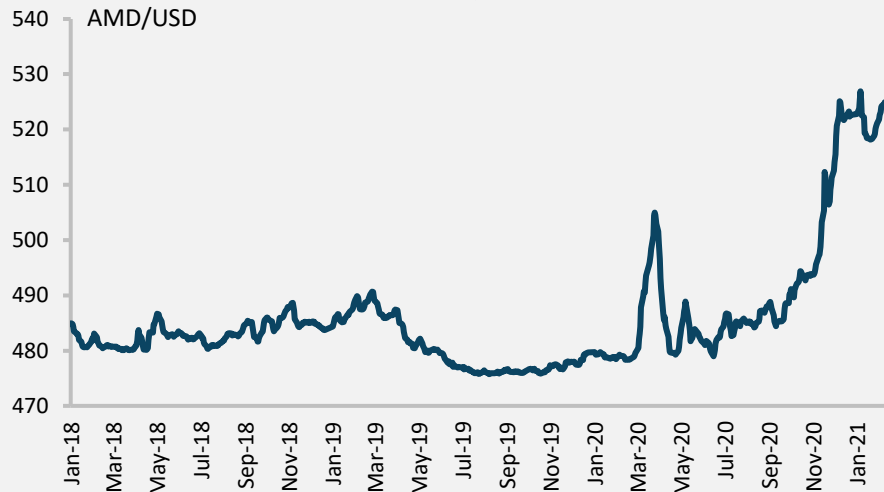
- Exports of goods and services (g&s) estimated to drop by 33.5% in 2020
 - Estimated large import (g&s) contraction by 28.1%; in absolute terms much larger than export drop
- **Current account deficit is estimated to have narrowed to 6.0% of GDP in 2020**

Financing of current account deficit

- Lower private capital inflows
 - Estimated FDI flows down by more than half (1.4% of GDP in 2020), slow recovery expected
- **Key role of IMF program in assuring external stability**

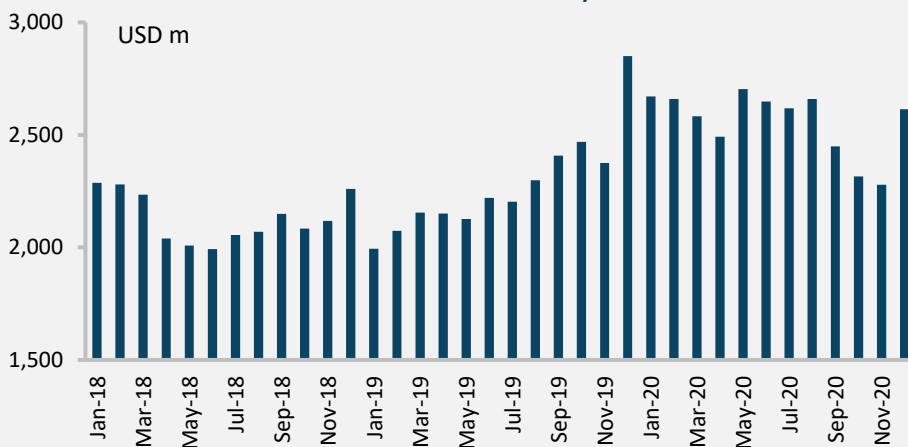
Exchange rate

Exchange rate



Source: Central Bank of Armenia (CBA)

International currency reserves



Source: CBA

1H2020: volatility due to COVID

- Exchange rate fluctuations in Mar/Apr
- But: CBA managed to reduce volatility

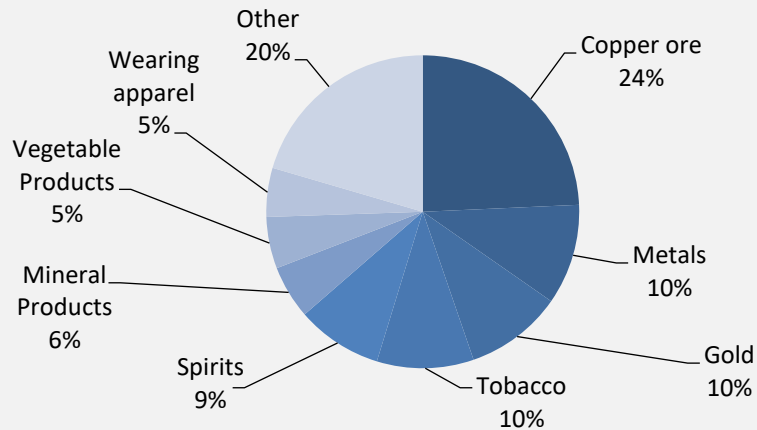
➤ **No long lasting impact of COVID on exchange rate**

Since Sep 2020: depreciation due to conflict

- Dram depreciated by 6.5% against the USD in Q4
- CBA intervened at the FX market; net selling of approx. USD 110 m
- After a drop in Sep-Nov, FX reserves recovered in Dec 2020
- FX reserves at an adequate level, covering more than 5 months of imports
- **Sizeable impact of conflict on exchange rate and FX reserves**
- **But: FX reserves at adequate level**

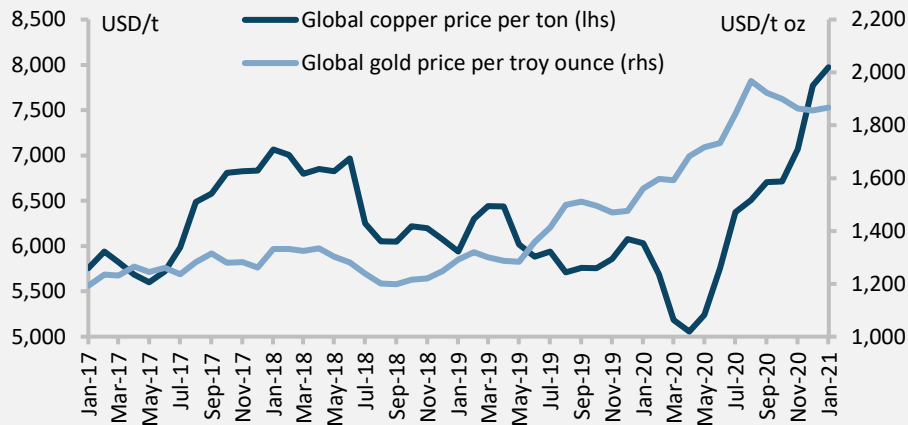
Trade in goods

Exports by goods



Source: Armstat, 2020

Global price of copper and gold



Source: IMF

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Export of goods

- Exports hardly affected
- Only 4% decline in 2020
- Reason: increase in global prices of two most important export items of Armenia, copper and gold

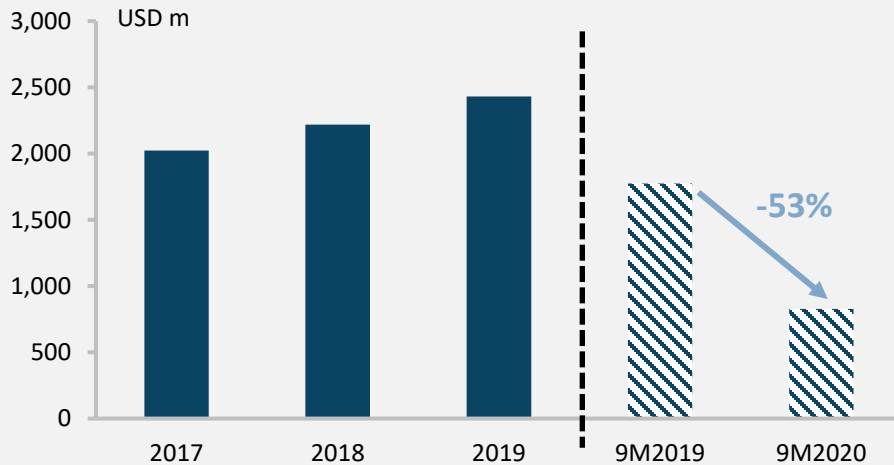
Import of goods

- Much stronger impact on imports
- Decline of 37% in 2020
- Especially passenger cars: decline of USD 495 m (88%)
- But mainly due to base effect: high imports and re-exports of passenger cars to members of EAEU in 2019

➤ **Limited impact of COVID on exports of goods**

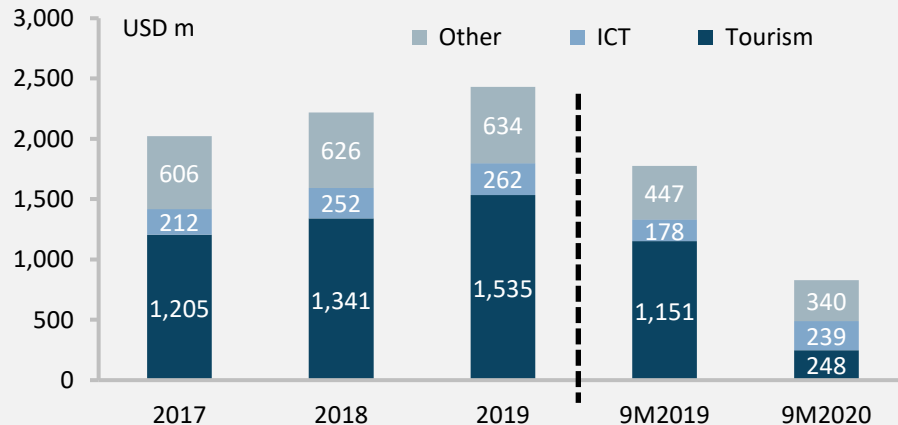
Trade in services

Exports of services



Source: CBA

Service exports by category



Source: CBA; Tourism: tourism-related services in travel and passenger transport; ICT: Telecommunications, computer, and information services

Importance of trade in services

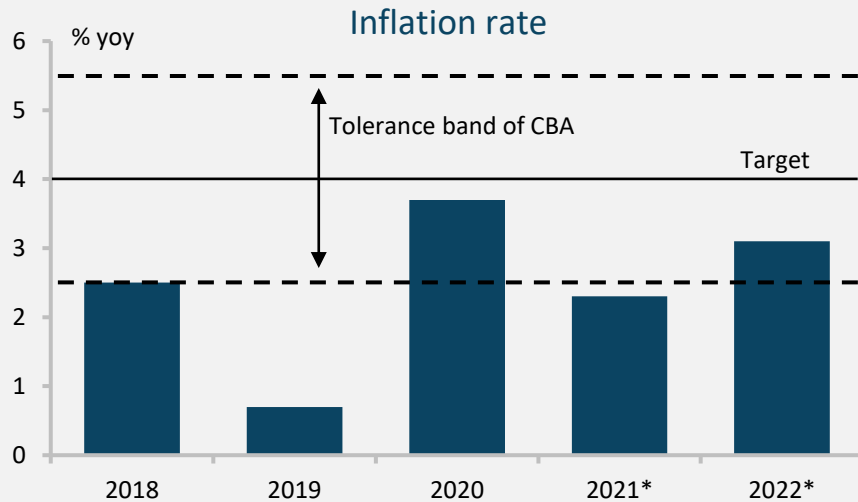
- Exports of services traditionally very strong in ARM
- 2019: 43% of total exports
- Main items: tourism and ICT sector

Impact of COVID

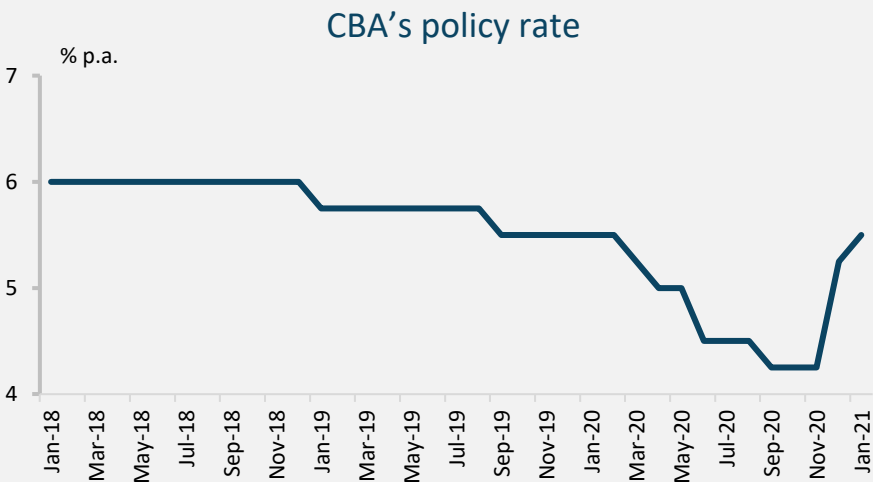
- Tourism: massive negative impact due to travel restrictions: -78% in 9M2020
- ICT: exports up by 35% in 9M2020; i.e. it benefitted from COVID crisis

- **Positive perspectives for ICT sector**
- **Tourism much more vulnerable; overdependence should be avoided**

Inflation and monetary policy



Source: CBA; * IMF forecast; Note: consumer prices, end of period



Source: Central Bank of Armenia

Inflation

- 2020, eop: inflation increased to 3.7%
- Main reason: pass through effect of Dram depreciation on food products
- 2021: inflation expected to be 2.3%
- Thus: inflation rate in line with medium term target of CBA (4.0% +/- 1.5% tolerance band)

➤ Inflation within the CBA's tolerance band

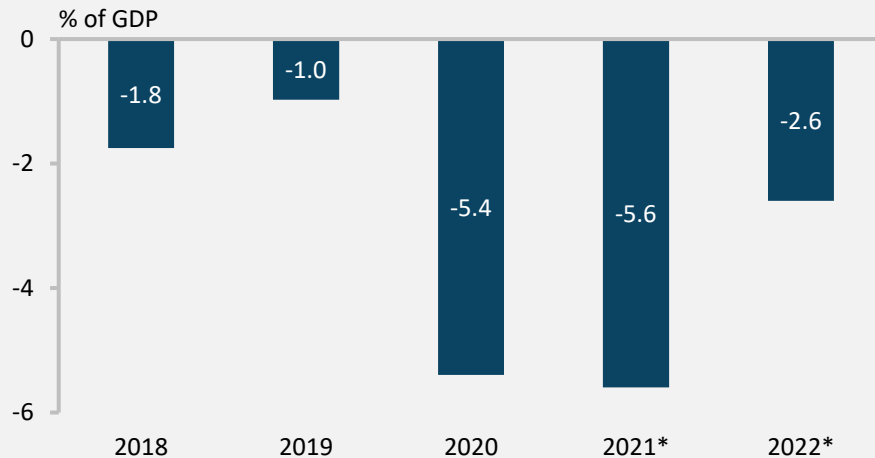
Policy rate

- On the back of low inflation in 9M2020, CBA was able to reduce its policy rate to support the economy
- However, in Dec 20, policy rate was increased to 5.25%, and to 5.5% in Jan 21
- Reason: sizeable increase in inflation and inflation expectations

➤ Hike in policy rate to reduce inflationary pressure

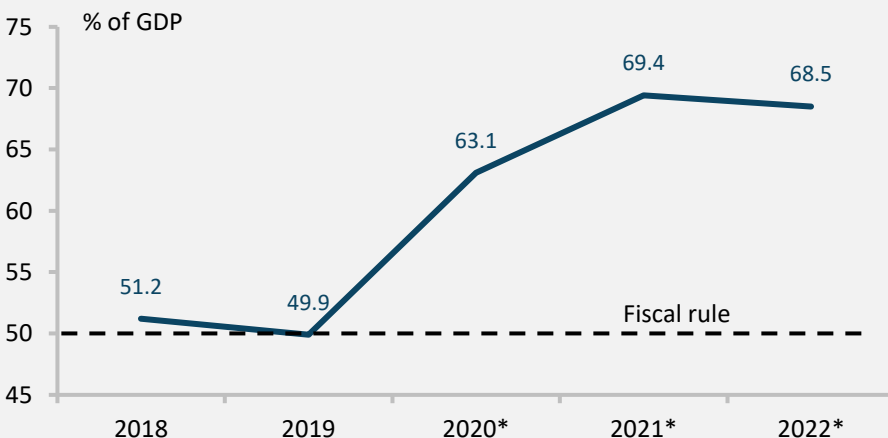
Public finance in 2020

Budget deficit



Source: Armstat, IMF, *forecast

Public debt (central government)



Source: IMF, *forecast/estimate, note: central government's public and publicly-guaranteed debt

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Budget deficit in 2020

- Original pre-COVID plan: 2.3% of GDP
- Actual: 5.4% of GDP

Revenues and expenditures (in AMD)

- Revenues: -3.0% yoy
- Expenditure: +16.3% yoy, particularly due to higher social transfers and COVID-related spending
- Cost of COVID measures: ca. USD 400 m

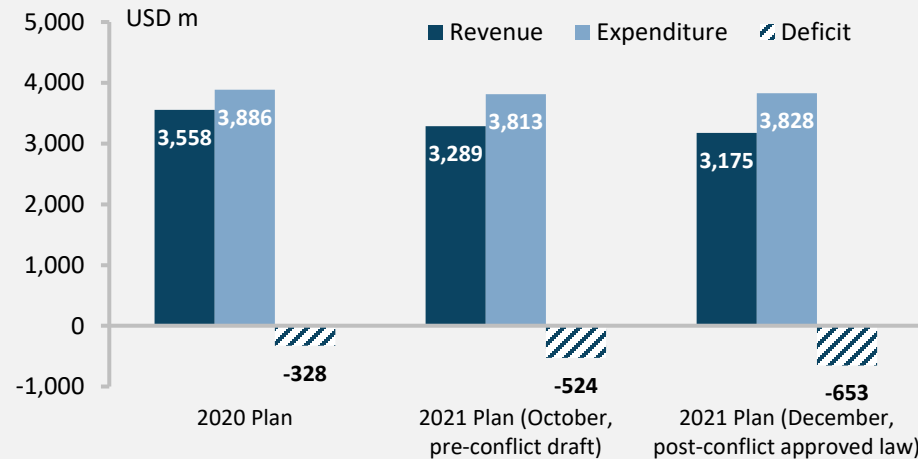
Public debt (central government)

- Large increase from 49.9% in 2019 to 63.1% in 2020
- Technically violates the fiscal rule, but exception due to military conflict

➤ **Key role of IMF programme augmentation in financing additional deficit in 2020**

Public finance in 2021

Planned budget of central government



Source: Ministry of Finance, note: USD values calculated with annual avg FX rate for 2020, FX rate from 31.12.2020 for 2021

Financing the budget deficit 2021

Budget deficit 2021	approx. USD 650 m
Domestic sources	approx. USD 270 m
External sources	approx. USD 380 m

Source: IMF, Ministry of Finance, USD values based on FX rate from 31.12.2020

Revised budget for 2021

- Oct-2020: draft budget 2021 was passed
 - Dec-2020, i.e. after military conflict: revision of budget 2021
 - Lower revenues
 - Practically no change in expenditures
 - Slight increase of deficit by USD 130 m
- **Fiscal costs of post-conflict measures not properly reflected**

Outlook

- Revision of budget to be expected
 - Expenditure to rise, revenue likely to be lower than expected due to suppressed growth
 - External financing is available: 10-year Eurobond of USD 750 m issued in Jan-21
 - Ambitious tax reform planned to boost budget revenue
- **Fiscal situation and debt sustainability to be monitored, even if not immediately critical**

Trade with EU – Implications of GSP+ graduation on textile exports

Exposure of companies exporting to the EU

Level of exposure to EU market (exports to EU as % of production)	No. of firms	Employees working on EU exports
Strong exposure (95-100%)	3	3,276
Medium exposure (20-50%)	4	211
Low exposure (0-10%)	2	n/a

Source: GET calculations based on interviews

Background

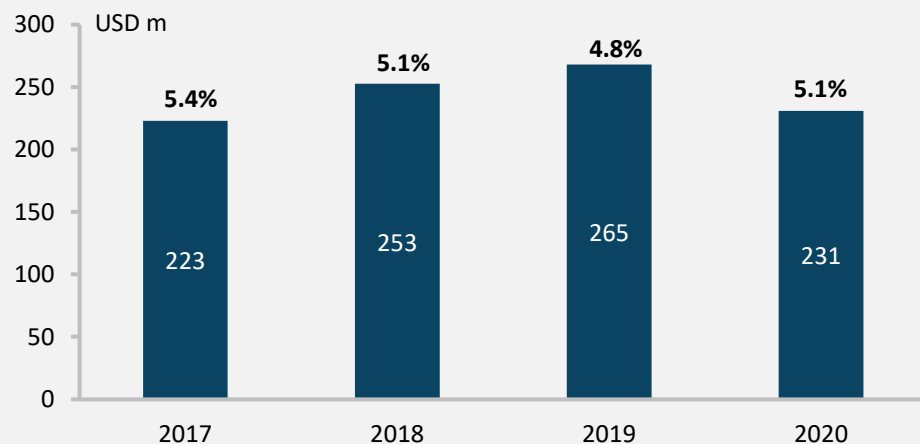
- Armenia will “graduate” from GSP+ and thus lose duty-free access to EU in Jan-2022
- GET study found that exports of apparel may be substantially affected by higher tariffs

Implications on the textile sector

- GET conducted interviews with companies exporting textile & apparel products to EU
- Result: 3,300 jobs depend on exports to EU
- 90% women, most without higher education
- Jobs are located throughout Armenia
- **Economic and social impact not be underestimated**
- **Possible support by gov / int. donors: consulting to affected companies to increase productivity and lower cost**

Regional trade – Ban on Turkish imports

Armenian imports of Turkish goods



Source: Armstat, note: percentages show share of total imports

Structure of Armenian imports of Turkish goods

Product group	ARM imports, USD m	Volume affected by ban, USD m
Textiles, wearing apparel and footwear	76.5	49.4
Machinery, equipment and vehicles	46.3	46.3
Products of chemical industry	45.2	37.7
Mineral products	25.1	24.5
Food and agricultural products	22.1	21.8
Metals and metal products	21.6	20.4
Leather and fur products	15.0	14.1
Other	13.0	13.0
TOTAL	264.8	227.0

Source: GET calculation, Eurasian Commission, Ministry of Economy, note: based on 2019 data

Background

- Trade between ARM and TUR is limited due to closed borders
- Trade is possible only via Georgia
- Turkish products make up approx. 5% of Armenia's imports
- Main items: textiles, machinery, chemicals, mineral products and fruits

Ban on imports

- In the context of the military conflict, ARM banned the import of a wide range of TUR goods from Jan 2021, initially for six months

Effect of ban

- Imports from TUR to go down by ca. USD 200 m per year, according to ARM Ministry of Economy
- Major re-sourcing of imports unlikely, if ban upheld for only 6 months

Business Climate – Proposals in cooperation with DEU/EU business

High-impact reforms

1. Strengthening the anti-monopoly authority
2. Reforming the Labour Code

„Quick win“ proposals

1. Abolishing the requirement to maintain “cash books”
2. Accepting invoices for customs clearance
3. Recognising training costs as operating costs

Source: *Improving the Business Climate – Boosting Private Investment: Proposals from German and European business in Armenia, PS/03/2020*

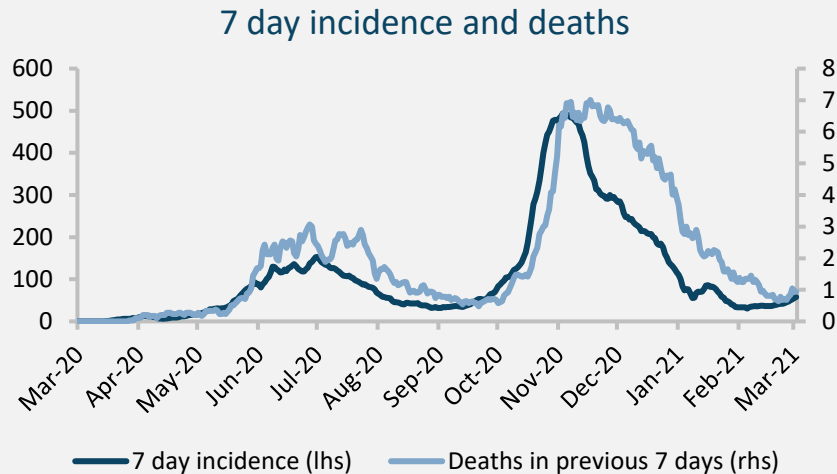
Background

- Joint study of GET and DEU/EU business associations in ARM with reform proposals
- Goal: improve investment climate by solving practical problems of businesses

Methodological approach

- Bottom up approach: proposals from companies analysed & edited by GET experts
 - Total of 13 proposals in 3 categories: regulation, taxation and foreign trade
 - Focus on solutions to practical problems, complementary to work on high-impact reforms
- **Realistic reform proposals to improve the business climate in Armenia**

COVID-19: overview of cases



Source: Johns Hopkins University. Figures per 100,000 people

	7 day incidence	Deaths in previous 7 days
Armenia	60	1.0
Azerbaijan	16	0.2
Iran	68	0.7
Turkey	5	0.2
Georgia	60	1.9
Russia	16	0.3
Germany	68	2.5
European Union	81	2.0

Sources: Johns Hopkins University, Worldometer. Figures per 100,000 people. Data as of 3 March 2021

Domestic perspective

- After a delayed start, Q2 saw cases increasing exponentially
- Over the summer, cases stabilised
- Second wave in Q4 with peak in early November
- Cases have dropped significantly since then, but hump in Jan-21 and recent rise could signal third wave

International perspective

- Very high number of cases and deaths in relation to population size
- 7 day incidence has dropped significantly since peak in Nov-20, but relatively high in comparison

COVID-19: containment measures and lifting

Selection of containment measures in spring 2020

Freedom of movement

- Border closure
- Public transport
- Curfew
- Travel restrictions in major cities
- Use of private cars

Education

- Closure of pre-schools and kindergardens
- Closure of schools and universities
- Remote learning

Business

- Cancellation of events
- Closure of shopping malls, restaurants and hotels
- Suspension of delivery services
- Halting of construction
- Closure of retail shops
- Closure of repair shops

Lifted containment measures

- Significant restrictions had been in place in the spring of 2020
- Most were lifted in May, some later
- State of emergency due to COVID expired on 12 Sep 2020

Rules currently in place

- Quarantine regime until 11 Jul 2021, i.e. testing upon entry into the country, 14-day self-isolation
- Personal protective equipment (masks) mandatory in public spaces
- Social distancing rules to be observed in gatherings

Source: Government of Armenia

COVID-19: support by the government

Selection of government support measures

Population / Vulnerable groups

- Support for affected families / pregnant women
- Enhanced support for unemployed or temporarily part-time employed people
- Support for workers/self-employed in affected industries (esp. hospitality/tourism)
- Support to low-income households for energy bills
- Tuition fee reduction for high-performing students

Business

- Interest rate subsidies for specific business loans
- Grants as a share of salaries (job support)
- Interest rate subsidies/co-financing for agriculture
- Grants for successful high-tech entrepreneurs

Specific measures for SMEs and start-ups

- Loans for SMEs in affected industries (esp. tourism, transportation, healthcare, construction)
- Blended support for new business ventures
- Targeted support for micro-enterprises

Government support measures

- 24 support packages approved
- Overall amount of AMD 192.3 bn (approx. USD 400 m)

Main items of support

- Lump-sum transfers to vulnerable groups of the population
- Interest rate subsidies and grants as short-term support for business
- Additional specific measures for SMEs and start-ups
- Targeted support for particularly affected sectors and as well as promising industries

COVID-19: international support

International assistance by IFIs/donors

Organisation	Amount of support
IMF	approx. USD 175 m (augmentation of 3-year stand-by arrangement)
EU Commission	EUR 92 m (medical equipment and training, SMEs, social assistance)
ADB	USD 20 m (emergency loan: COVID-19 Working Capital Support project)
U.S. / USAID	USD 6.6 m (emergency assistance, health, businesses, social, NGOs)
World Bank	USD 3 m (medical equipment)
EBRD	USD 167 m (mainly in loans for banks for SME finance; energy, transport)
ISAR Germany	Technical medical support (doctors, specialists and equipment)
World Food Programme	44,000 food rations for vulnerable groups affected by the pandemic

Sources: respective institutions; Note: selection of new measures; differentiation of COVID-specific from other support not always possible

- IMF conducted the third review of Armenia's performance under its stand-by arrangement (SBA) in November
 - Result: Armenian authorities can draw approx. USD 37 m
 - Total SBA: approx. USD 443 m (augmented in May-20), so far disbursed: approx. USD 332 m
- EU has so far disbursed EUR 59.6 m (out of EUR 92 m pledged) for healthcare and anti-crisis measures for vulnerable groups and businesses

About the German Economic Team



Financed by the Federal Ministry for Economic Affairs and Energy, the German Economic Team (GET) advises the governments of Moldova, Georgia, Ukraine, Belarus and Uzbekistan on economic policy matters. Furthermore, GET covers specific topics in other countries, such as Armenia. Berlin Economics has been commissioned with the implementation of the consultancy.

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