

ARMENIA

Recent developments

Table 1 **2015**

Population, million	3.0
GDP, current US\$ billion	10.6
GDP per capita, current US\$	3501
Poverty rate (\$2.5/day 2005PPP terms) ^a	26.3
Poverty rate (\$5/day 2005PPP terms) ^a	75.9
Gini Coefficient ^a	31.5
Life Expectancy at birth, years ^b	74.4

Sources: World Bank WDI and Macro Poverty Outlook.

Notes:

(a) Most recent value (2014)

(b) Most recent WDI value (2013)

As external conditions deteriorated, Armenia's economic activity slowed in 2015, but performed better than initially expected. The fiscal deficit widened sharply, driven by the weak revenue collection, compounded by the introduction of a fiscal stimulus. The economy is expected to recover modestly over the medium term as global economic conditions improve gradually. However, growth prospects are shadowed by the slow progress on structural reform agenda, hindering job creation and poverty reduction.

Growth slowed slightly to 3 percent in 2015 from 3.5 percent in 2014, despite the spillover from Russia and the fall in the prices of base metals, Armenia's main export commodities. Output expansion was driven by a good agriculture harvest, the opening of a new copper mine, and a fiscal stimulus. Growth of services and manufacturing suffered due to the softening demand driven by the sharp fall in remittances.

The fiscal position deteriorated significantly, reflecting slowing economic activity in tax-generating sectors and the fiscal stimulus, comprising tax relief and increased spending on infrastructure investment, social protection, public sector wages, and subsidized lending. Following the decision to raise electricity tariffs in June, the government, under intense public pressures, agreed to temporarily compensate households and SMEs for the tariff increase (0.1 percent of GDP). The resulting fiscal deficit, estimated at 4.9 percent of GDP (compared with 2 percent in 2014), was financed mainly by external borrowing, including Eurobonds and budget support from the World Bank, leading to a build-up of government debt to about 50 percent of GDP at end-2015.

Inflation has been declining since mid-2015, with the dissipation of the pass-through effect of the dram's depreciation in late 2014. As domestic demand weakened further, inflation declined to -0.2 percent (y/y) in December 2015, allowing the

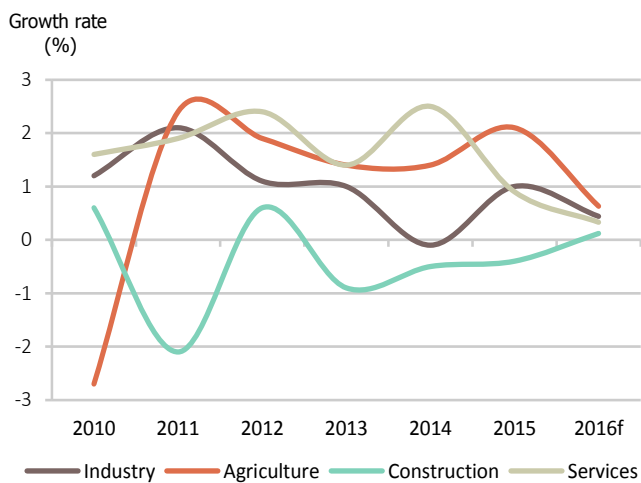
Central Bank to cut policy rates in steps. However, monetary conditions remained tight with negative credit growth.

The current account deficit narrowed to an estimated 3.2 percent of GDP in 2015 from 7.3 percent in 2014, due to the significant reduction in the trade deficit, which more than compensated for the 36 percent fall in remittances (in US dollar terms). The improved trade balance was the result of the exchange rate adjustment and a sharp import contraction, reflecting soft domestic demand and low international energy and food prices. Exports performed better than expected, as declining exports to Russia were largely offset by rising exports to China and the Middle East. On the back of improved external accounts, pressures on the dram eased; the Central Bank reduced forex intervention sharply in the second half of the year, leading to an increase in official reserves to US\$1.8 billion at end-2015 from US\$1.4 billion in January 2015.

Vulnerabilities in the banking sector intensified, and the share of nonperforming loans increased from 3.7 percent in early 2015 to more than 9 percent in late 2015. In the context of high dollarization, currency mismatches on banks' balance sheets pose risks to the sector's stability and profitability, prompting the Central Bank to raise the minimum capital requirement during the year.

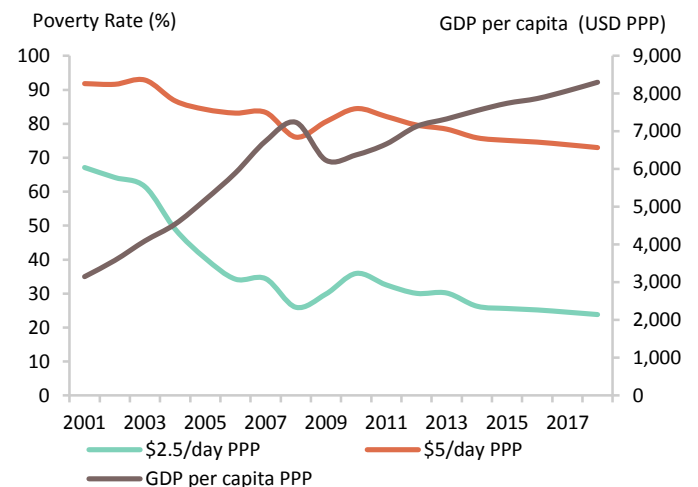
Falling remittances and weak domestic labor market conditions slowed progress on poverty reduction. The poverty rate (measured at US\$2.5/day) fell from 26.3 percent in 2014 to an estimated 25.6 percent in 2015. Lower remittance inflows have translated into welfare losses for all

FIGURE 1 Armenia / GDP growth by sector, 2010-2016



Sources: Armenia Statistical Service.

FIGURE 2 Armenia / Actual and estimated poverty rates and GDP per capita (PPP)



Sources: World Bank (see notes to Table 2).

households. Despite strong agricultural growth, the domestic labor market deteriorated due to limited job creation in other sectors compounded by the large-scale return of migrant workers from Russia. The unemployment rate rose from 17.5 percent in Q3 2014 to 18.2 percent in Q3 2015.

Outlook

Growth is projected to slow to 1.9 percent in 2016, on the back of continued weaknesses in the external conditions and fiscal tightening. With the recovery of the global economy, including metal prices, Armenia's growth is expected to pick up over the medium term, but only moderately to about 3 percent a year, hampered by structural weaknesses.

The budget deficit is projected to remain wide in 2016, at 3.9 percent of GDP, despite fiscal tightening through a combination of revenue raising measures and moderate expenditure cuts. The fiscal position is expected to improve over

time, as the stimulus measures are phased out and an economic recovery boosts revenue collection.

Poverty reduction and income growth across all levels of the welfare distribution are likely to stagnate during 2017-18. Even under an optimistic scenario—the agricultural sector continues to perform well and remittance inflows recover—without substantial improvements in the business environment and the domestic labor market the poverty rate is projected to fall only gradually to 23.8 percent in 2018. The elimination of temporary electricity subsidies, scheduled in August 2016, would negatively affect poor households, whose expenditure of electricity amounts to more than 5 percent of total consumption.

Risks and challenges

Armenia's economic outlook is subject to considerable downside risks. Sustaining growth in a difficult external environment with limited fiscal space is a serious policy challenge. Further deterioration of the

external environment, including a worsening recession in Russia the slow recovery of base metal prices, represent significant risks to Armenia's prospects for economic growth and job creation. Furthermore, recent reshuffling in the government personnel and political developments slated for 2017-18 (Parliamentary and Presidential elections) could delay the implementation of structural reforms necessary to improve the business environment, thereby hindering productivity growth over the medium term.

As public debt continues to rise, the government has to consolidate fiscal position, while protecting critical expenditures in areas such as social assistance and public investment. Persistently low capital outlays, which bore the brunt of expenditure compression in recent years, and low execution rates of public investment could limit Armenia's medium-term growth. Armenia's fiscal sustainability could be also threatened by the deteriorating financial performance of the energy sector.

TABLE 2 Armenia / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

	2013	2014	2015 e	2016 f	2017 f	2018 f
Real GDP growth, at constant market prices	3.3	3.5	3.0	1.9	2.8	2.9
Private Consumption	0.9	0.5	-4.1	1.3	2.2	2.6
Government Consumption	7.0	6.7	-4.8	-6.3	4.6	4.3
Gross Fixed Capital Investment	-7.0	-2.4	0.5	0.8	1.6	1.4
Exports, Goods and Services	8.6	6.4	-1.0	3.2	4.3	5.2
Imports, Goods and Services	-2.1	-1.0	-17.3	1.2	2.3	3.6
Real GDP growth, at constant factor prices	3.2	3.7	4.0	1.8	2.8	3.0
Agriculture	7.6	7.8	11.4	3.2	3.6	3.8
Industry	0.5	-2.2	2.6	1.9	3.3	4.1
Services	2.4	5.9	-0.9	0.3	1.4	1.1
Inflation (Consumer Price Index)	5.8	3.0	3.7	3.5	4.0	4.0
Current Account Balance (% of GDP)	-7.6	-7.3	-3.2	-3.3	-3.5	-4.0
Financial and Capital Account (% of GDP)	10.3	7.9	3.8	4.0	4.1	4.7
Net Foreign Direct Investment (% of GDP)	3.2	3.3	3.2	3.8	4.2	4.7
Fiscal Balance (% of GDP)	-1.6	-2.0	-4.9	-3.9	-2.4	-1.3
Debt (% of GDP)	40.9	43.7	49.3	52.2	51.5	50.4
Primary Balance (% of GDP)	-0.6	-0.7	-3.2	-2.0	-0.5	0.2
Poverty rate (\$2.5/day PPP terms)^{a,b,c}	30.2	26.3	25.6	25.2	24.5	23.8
Poverty rate (\$5/day PPP terms)^{a,b,c}	78.4	75.9	75.1	74.6	73.8	73.0

Sources: World Bank. Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.

Notes: e = estimate, f = forecast.

(a) Calculations based on ECAPOV harmonization, using 2011-ILCS and 2014-ILCS.

(b) Projection using point-to-point elasticity (2011-2014) with pass-through = 0.7 based on GDP per capita constant PPP.

(c) Actual data: 2013, 2014. Projections are from 2015 to 2018.