- *Economic dynamism remains strong, with growth driven by services and recovery of mining.*
- *Inflation remains subdued, with limited impact of the 50 bp reduction of the policy rate earlier in 2019.*
- *The Budget balance turned to deficit as a result of high capital spending in December.*
- *Despite good export performance, the trade deficit widened.*

In December, growth of the Economic Activity Index (EAI) peaked at 10.7 percent year-on-year (yoy). Services continued to post the highest growth rates, with particularly strong performance by transport (with a 25 percent yoy growth in freight transported). This brought the cumulative annual EAI growth in 2019 to 7.8 percent, the highest since the global financial crisis. In 2019, the growth rate of industrial output doubled compared with 2018, and reached 9 percent yoy, mainly due to recovery of mining operations at the Teghut mine were re-started. Manufacturing grew at a healthy rate of 7.6 percent, though lower than 10 percent growth registered in 2018. Construction output increased by 4.5 percent in 2019, same as a year earlier. Agricultural output continued to contract in 2019, though at a slower pace than in 2018 (by about 4 percent in 2019, vs. 7 percent decline in 2018).[1] Fishery was the only sub-sector in agriculture which grew.

Inflation remained low in December 2019 (0.7 percent, yoy) and slowed further in January 2020. The main contributors to inflation in December were the 4.6 percent increase in prices of alcoholic beverages and tobacco products and the 2.3 percent increase in transport costs. The average annual inflation rate in 2019 stood at 1.4 percent (down from 2.5 percent in 2018), one percentage point of which was due to food and beverages price increase. More recent data shows almost no price change in January with 0.2 percent yoy inflation. Despite the inflation rate being well below the CBA inflation target band (4 +/-1.5 percent), the CBA in its January 24th Board meeting decided to leave the policy rate unchanged at 5.5 percent, noting that the expected expansionary fiscal stance in the period ahead could stimulate inflation.

Imports in December recorded a 52 percent yoy growth, versus a 13 percent growth in exports. About one fourth of the import increase was due to unusually high import of vehicles in December, in advance of the increase in customs duties as of January 2020.[2] In 2019, 189 thousand vehicles were imported, compared to 64 thousand in 2018. Imports of minerals and chemical products also grew rapidly in December, by 10 and 20 percent yoy, respectively. The 2019 cumulative trade data show that with stronger growth of imports (10.8 percent) than exports (9.4 percent), the trade deficit deteriorated by more than US$300 million. The structure of exports shows further concentration in the three main groups of commodities: i) minerals (28 percent share in total export), ii) stones and metals (26 percent), iii) food products (24 percent).

Other current account inflows performed well. Arrivals of international tourist was up by 14.7 percent in 2019 to reach 1.9 million tourists. Furthermore, transfers from abroad increased strongly, also probably due to unregistered re-exports.

After mild depreciation of the nominal exchange rate in December, the Armenian dram strengthened in January 2020. The nominal AMD/USD exchange rate depreciated by 0.4 percent in December, but then appreciated in January. To smooth the fluctuations the CBA intervened and purchased more than US$20 million from the market. International reserves increased to US$2.8 billion, the highest level ever.

Strong capital expenditures in December turned the AMD 40 billion budget surplus in November to an AMD 71 billion deficit at the end of the year. Still, the deficit is lower than the annual budget deficit plan of AMD 98 billion. This was due to 5 percent extra net tax collection (after AMD 42 billion refund of old tax liabilities to businesses), and 15 percent under-execution of capital spending, while current spending was executed as planned. The increase in capital spending in December was also due to a large military equipment purchase. Government debt at end-2019 was below 50 percent of projected GDP.

Credit and deposits grew by 17 and 21 percent yoy, respectively, in 2019, resulting in a slight improvement in the loan-to-deposit ratio to 1.02 percent. With a faster-growing dram-denominated loan portfolio, credit dollarization declined to 51 percent at end-2019 from 56 percent in 2018. The banking sector remained stable in 2019, with robust capital adequacy, improving profitability and manageable non-performing loans.

[1] The registered decline in agriculture output could also reflect statistics and measurement issues, given growing exports of agricultural goods and limited pressure on agricultural products prices in the market.

[2] A significant number of the vehicles are exported to other Eurasian Economic Union member, though not necessarily reflected as exports.

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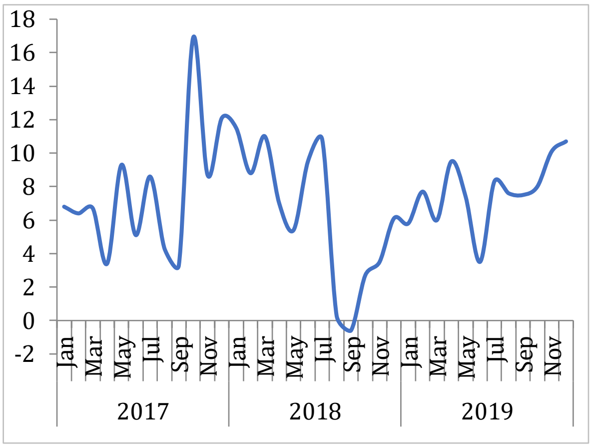
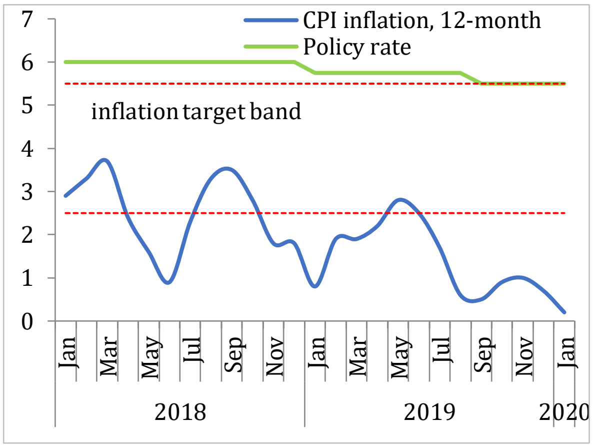
Figure 1. Economic growth overperformed expectations
(yoy change, in %)



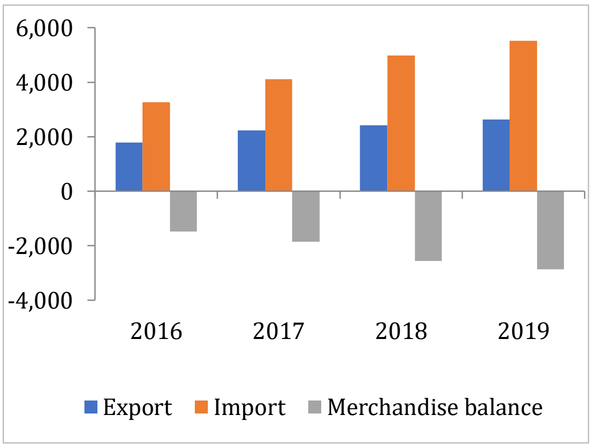
Source: Statistical Committee of RA

Figure 2. Inflation diverging further from the CBA target band
(in %)



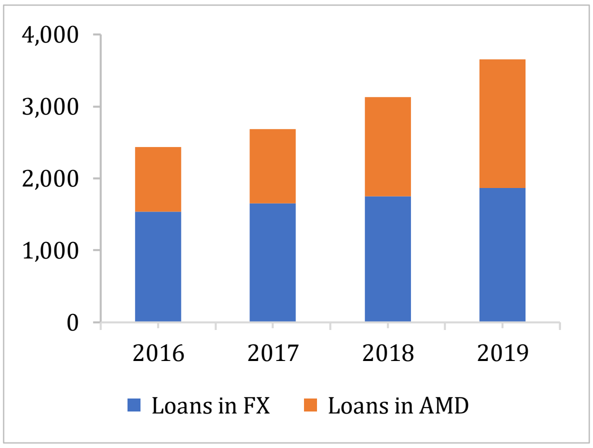
Source: Statistical Committee of RA

Figure 3: With imports growing faster, the trade deficit widened
(in USD million)



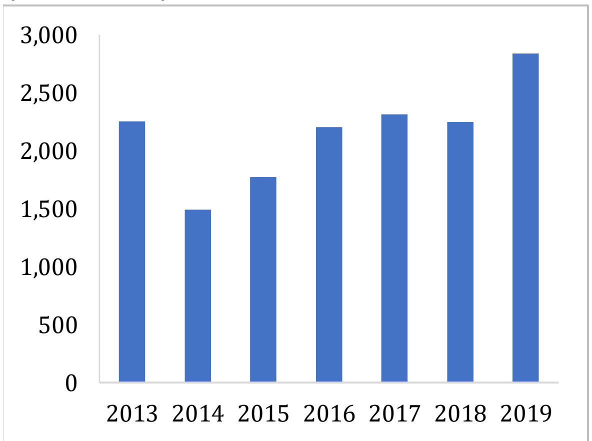
Source: Statistical Committee of RA

Figure 4. Credit dollarization reduced due to higher dram-denominated lending
(in AMD million)



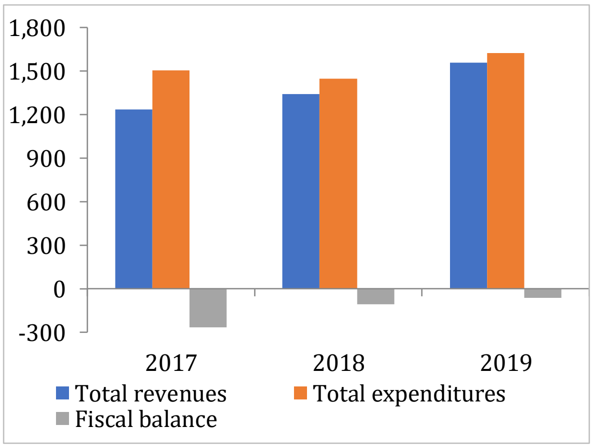
Source: CBA

Figure 5. International reserves reached their highest level on record.
(in USD million)



Source: CBA

Figure 6: The Budget turned to deficit in December
(in AMD billion)



Source: MOF

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