

ARMENIA

Recent developments

Table 1 **2018**

Population, million	3.0
GDP, current US\$ billion	12.4
GDP per capita, current US\$	4095
International poverty rate (\$ 19) ^a	14
Lower middle-income poverty rate (\$3.2) ^a	12.3
Upper middle-income poverty rate (\$5.5) ^a	50.0
Gini index ^a	33.6
School enrollment, primary (% gross) ^b	94.3
Life expectancy at birth, years ^b	74.6

Source: WDI, Macro Poverty Outlook, and official data.

Notes:

(a) Most recent value (2017), 2011 PPPs.

(b) Most recent WDI value (2016).

Armenia's economy slowed in late-2018 but still grew by 5.2 percent for the year, reflecting higher private investment and consumption. Two years of pro-poor growth lowered the poverty rate (\$3.2/day at 2011PPP) to 12.3 percent in 2017, its lowest level since the 2008–09 crisis. GDP growth is expected to moderate slightly in 2019 and accelerate in the medium term, subject to reforms. An increasingly uncertain external environment and the ability to push through reforms are significant challenges.

After growing by 7.5 percent in 2017 and 8.3 percent in the first half of 2018, real GDP moderated in the rest of 2018 reflecting weakening exports and remittances, lower-than-planned public capital spending, and slowing investment. Still, the economy expanded at a robust 5.2 percent rate for the year due to higher private consumption and a strong build-up of inventories.

On the supply side, services were once again the main driver of growth, rising by 9 percent. Industry grew by 3.4 percent, below the rate recorded in 2017 and with a significant shift from mining to manufacturing. Mining output contracted by 14 percent, mostly due to the suspension of operations at one large copper mine since February 2018. Manufacturing output, dominated by food and tobacco products, expanded by 10 percent. For the third year in a row, output from the agriculture sector (particularly horticulture) contracted, declining by 8.5 percent.

With demand pressures moderating in the second half of the year and external inflationary pressures low, average annual inflation was 2.5 percent in 2018, just at the lower band of the Central Bank of Armenia's (CBA) inflation target range (4 percent +/- 1.5 percent). In response, in late-January 2019 the CBA cut the refinancing rate by 25 basis point to 5.75 percent, its first correction in two years.

The fiscal deficit was 1.6 percent of GDP in 2018, well below the budget deficit

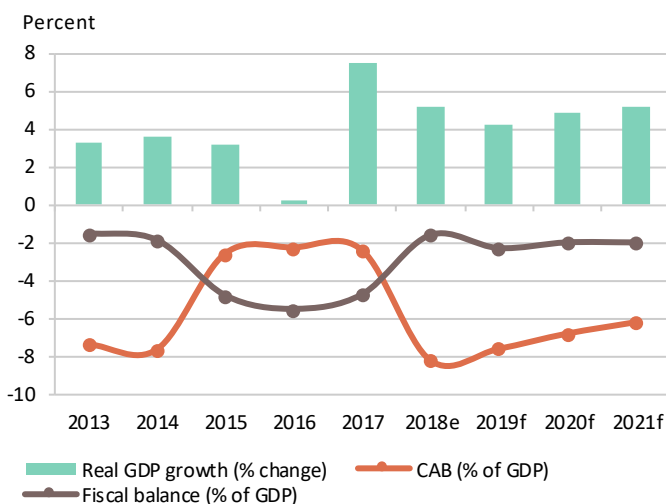
target of 2.6 percent, reflecting an 8 percent increase in revenue collection, sound control over current spending as well as significant underperformance on capital expenditures. As a result, the public debt to GDP ratio fell from 58.9 percent of GDP in 2017 to 55.8 percent of GDP (51.4 percent excluding the CBA), the first reduction since 2013.

The current account deficit is estimated to have widened to above 8 percent of GDP as goods imports grew almost three times faster than goods exports. Half of the growth in imports was due to imports of machinery and transport means. On the other hand, the main driver of the 8 percent export growth in 2018 were textile exports, which rose by 65 percent year on year reflecting also new investment in the sector. The recovery in remittances stalled in the second half of the year, mainly due to volatility in the Russian ruble. Tourism and IT services exports increased markedly but were insufficient to offset the larger goods trade deficit. Foreign direct investment (FDI), mostly in the mining and energy sectors, remained low (2.3 percent of GDP).

The exchange rate of the dram against the U.S. dollar remained broadly stable, but modest inflation caused an appreciation of the real effective exchange rate in 2018. Pressures on the dram increased slightly in early 2019. Foreign exchange reserves stood at \$2.2 billion in December 2018, providing a cover of around 3.8 months of next year imports.

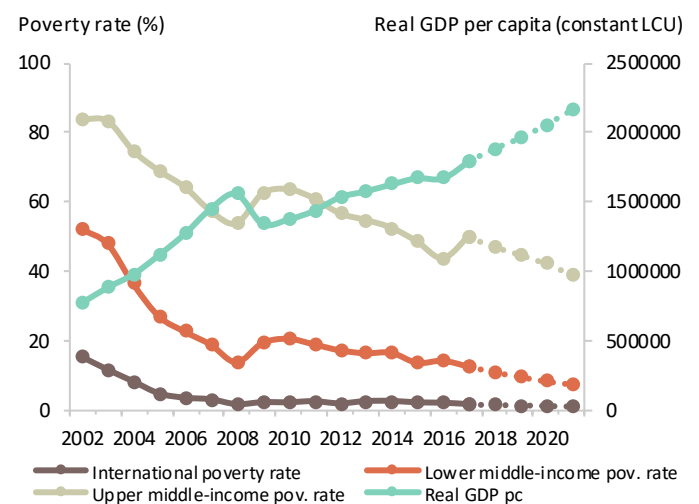
The banking sector remains liquid and broadly sound with a capital adequacy ratio of 17.4 percent in November 2018.

FIGURE 1 Armenia / GDP growth, fiscal and current account balances



Sources: National Statistics Service of Armenia; Central Bank of Armenia; World Bank staff projections.

FIGURE 2 Armenia / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see table 2.

Still, profitability is low. Non-performing loans remain below levels registered during 2015–16 but have edged up in recent months. Also, while declining, dollarization is high (56 percent of lending and 60 percent of deposits at end-2018).

Two consecutive years of solid growth and low inflation have contributed to an improvement in living conditions. The unemployment rate declined from 17.8 percent in 2017 to 15.3 percent in the third quarter of 2018. The absolute poverty rate, measured at the \$3.2/day PPP 2011 lower-middle-income poverty line fell to 12.3 percent in 2017 and is estimated to have continued to decline in 2018. In 2017, economic growth translated into higher consumption levels for those at the bottom 40 percent of the distribution, breaking the pattern observed in 2011–16, when growth benefited more the upper deciles.

Outlook

The baseline scenario for Armenia's outlook envisages slower, but still robust, growth, amid a supportive macroeconomic environment of low inflation and

sustainable public finances. The macroeconomic foundations are expected to be strengthened further through structural reforms to create a fairer and more competitive business environment. Growth is projected to reach 4.2 percent in 2019, and gradually accelerate to around 5 percent in medium term. Private consumption will continue to drive growth, followed by further expansion in exports of goods and services. In line with the fiscal rule, the budget deficit is projected to stay at around 2 percent of GDP over the medium term, further lowering the public debt-to-GDP ratio to below 55 percent in 2021. Meantime, government capital spending is projected to rebound and support efforts to improve the productivity of the Armenian economy and push up its potential growth. The current account deficit is envisaged to decline gradually, subject to structural reforms which will stimulate further exports of goods and tourism.

The absolute poverty rate (at \$3.2 PPP 2011) is expected to fall below the 10 percent mark in 2019, assuming the economy continues to grow, incomes from labor markets rise, and social transfers are sustained.

Risks and challenges

The uncertainties for Armenia's outlook are increasing, taking into account Armenia's limited market and product diversification and moderating global and regional economic activity. Regional currencies could come under renewed pressure; intensification of trade restrictions remains possible, while geopolitical risks could further escalate. The realization of these risks will put the external accounts under pressure and lower Armenia's economic growth prospects. On the other hand, the resumption of copper mine operations could push exports and growth rates higher.

Domestically, the new government has an opportunity to push key governance and business environment reforms to facilitate job creation, better address social issues and attract investment. While some of these reforms will be challenging, they can also help produce the results needed to mitigate social and political tensions and thereby lower economic uncertainty.

TABLE 2 Armenia / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	0.2	7.5	5.2	4.2	4.9	5.2
Private Consumption	-1.0	9.4	5.3	5.4	5.5	5.8
Government Consumption	-2.4	13.1	-6.4	6.0	6.2	4.5
Gross Fixed Capital Investment	-11.4	7.7	5.0	6.5	6.2	6.5
Exports, Goods and Services	19.1	18.7	5.2	6.8	9.6	10.2
Imports, Goods and Services	7.6	24.6	10.9	6.6	9.7	10.0
Real GDP growth, at constant factor prices	0.6	7.2	4.8	4.2	4.9	5.2
Agriculture	-5.0	-5.3	-8.5	2.9	2.7	2.5
Industry	-0.3	5.4	3.4	5.1	5.2	5.5
Services	3.3	12.5	9.3	4.0	5.3	5.7
Inflation (Consumer Price Index)	-1.4	1.0	2.5	4.0	4.0	4.0
Current Account Balance (% of GDP)	-2.3	-2.4	-8.2	-7.6	-6.8	-6.2
Net Foreign Direct Investment (% of GDP)	2.6	2.0	2.3	2.6	2.9	3.3
Fiscal Balance (% of GDP)	-5.5	-4.8	-1.6	-2.3	-2.0	-2.0
Debt (% of GDP)	56.7	58.9	55.8	56.0	55.3	54.3
Primary Balance (% of GDP)	-3.6	-2.6	0.5	0.1	-0.1	-0.1
International poverty rate (\$1.9 in 2011 PPP)^{a,b}	1.8	1.4	1.2	1.1	0.9	0.7
Lower middle-income poverty rate (\$3.2 in 2011 PPP)^{a,b}	14.1	12.3	10.8	9.5	8.3	7.5
Upper middle-income poverty rate (\$5.5 in 2011 PPP)^{a,b}	43.5	50.0	47.1	44.8	42.2	39.0

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.

Notes: e = estimate, f = forecast.

(a) Calculations based on ECAPOV harmonization, using 2017-ILCS. Actual data: 2017. Nowcast: 2018. Forecast are from 2019 to 2021.

(b) Projection using neutral distribution (2017) with pass-through = 0.7 based on GDP per capita in constant LCU.