

- *The recovery remains tepid; the Economic Activity Index (EAI) contracted by 8.8 percent yoy in December, and high-frequency data suggest mobility in Yerevan stabilizing at around 75 percent of pre-COVID levels in the first week of February.*
- *Inflation picked up sharply to 4.5 percent in January, due to exchange rate pass-through and rising global food prices.*
- *The trade deficit narrowed, as exports grew while imports remained subdued.*
- *The annual budget deficit for 2020 reached 5.5 percent of projected annual GDP.*
- *The expansion of the banking sector slowed.*

The pace of contraction moderated in December (8.8 yoy decline in EAI) following a sharp contraction in November (11 percent yoy decline). Despite a slowing COVID-19 outbreak and the return of peace following the ceasefire, the recovery was held back by a rise in domestic political tensions. Trade (17 percent yoy decline) and industry (5.8 percent yoy decline) showed a lower pace of contraction in December. In contrast, construction sector contracted in December (3 percent yoy decline) after growing by 2 percent yoy in November. Non-trade services contracted at a faster pace (23 percent yoy) in December as compared to November. On an annual basis, the EAI contracted by 7.5 percent in 2020. Agriculture was the sole bright spot, growing at 1.4 percent in 2020 after four consecutive years of decline.

Mobility in Yerevan stabilized around 75 percent of the pre COVID-19 level in the first week of February, as the outbreak continues to ease. Active COVID-19 cases fell to around 4,500 in early February as compared to 10,000 in early January. However, daily test positivity rates, while declining, remained higher than the region, at close to 8 percent. Connectivity is gradually normalizing, with more flights expected to resume between Armenia and countries in the region, such as Russia and Iran.

Inflation picked up from 3.7 percent yoy in December to 4.5 percent yoy in January. Two-thirds of January inflation was accounted for the increase in food (6.4 percent yoy) and alcoholic beverages and tobacco prices (11 percent yoy). These, in turn, were driven by higher import prices, an increase in excise rates and pass-through from exchange rate depreciation. Health and transport price increases also contributed to inflation. In response, the Central Bank of Armenia (CBA) Board increased the refinancing rate by 25 basis points to 5.5 percent.

The trade deficit narrowed as exports rebounded and import contracted further in December. The December trade deficit almost

halved on a yoy basis, driven by a 9 percent yoy growth in exports. Exports of products of animal origin tripled on yoy basis, food products increased by 8 percent yoy and non-precious metals by 59 percent yoy, while copper exports fell by 18 percent yoy due to decline in volumes. Imports contracted by 30 percent yoy due to a base effect related to high import of vehicles at the end of 2019 as well as sluggish demand. The annual trade balance improved by 30 percent yoy in 2020 (by USD 874 million) as exports declined by 4 percent yoy and imports fell more sharply, by 18 percent yoy.

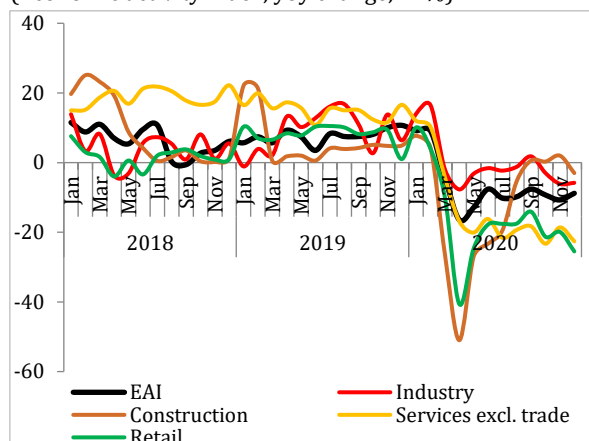
The pressure on the dram eased slightly in the second half of January. The dram depreciated by 10 percent against the USD as of mid-January 2021 compared to the level at the start of the escalation of the conflict in end-September 2020. The currency has since appreciated by 1 percent and stabilized reflecting interventions from the CBA to smooth exchange rate fluctuations. Net money transfers from abroad were flat in December compared to a year earlier, as higher net inflows from the USA (by 60 percent) and flat net inflows from Russia were offset by increase in net outflows to other countries. Reserves decreased by USD 200 million in January, but at US\$2.4 billion at end-January still provided approximately 4.7 months of import cover. Reserves got a further boost in early February by the proceeds from the issuance of Armenia's fourth Eurobond in the amount of USD750 million Eurobond (10 years maturity and about 3.9 percent yield, the lowest achieved on issuances so far).

The budget deficit widened to AMD 91 billion in December. Revenues increased by 10 percent yoy in December, as higher grants offset the 5 percent yoy drop in tax receipts. Current expenditures were up 25 percent yoy as transfers to other government levels, social benefits, and health spending surged. The annual deficit for 2020 is estimated at 5.5 percent of projected GDP. Revenues were flat in 2020 compared to 2019, with higher grants from donors and Pan-Armenian funds compensating for a 5 percent decline in tax revenues, with all major taxes registering a decline. Expenditures were up by 17 percent yoy in 2020, with a 16 percent and 22 percent yoy increase in current and capital expenditures respectively. Despite the increase, capital budget execution remained below plans.

The banking sector expansion continued to slow. Credit (adjusted for exchange rate changes) contracted by 0.5 percent month-over-month in December driven by a decline in trade and consumer loans. The yoy credit growth rate continued to moderate, falling below 10 percent for the first time since late 2016. At the same time, deposit growth (adjusted for exchange rate changes) stagnated, mostly due to contraction in FX denominated deposits.

Figure 1. The economic recovery remains muted

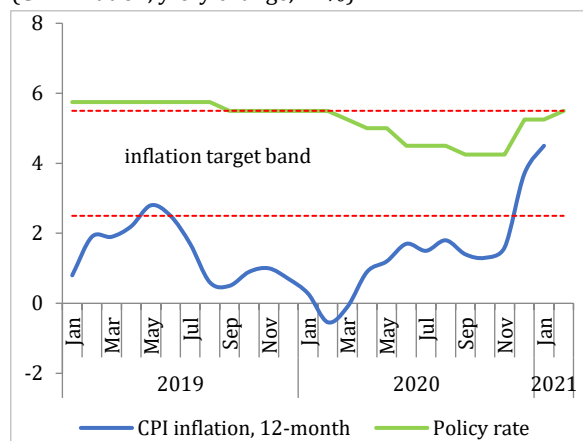
(Economic activity index, yoy change, in %)



Source: Statistical Committee of RA

Figure 2. Inflation continued to increase but remains within the CBA target range

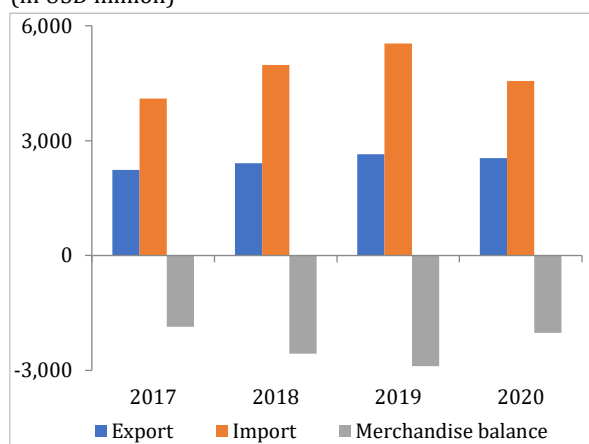
(CPI Inflation, y-o-y change, in %)



Source: CBA

Figure 3. The trade deficit narrowed in 2020 as imports contracted more than exports

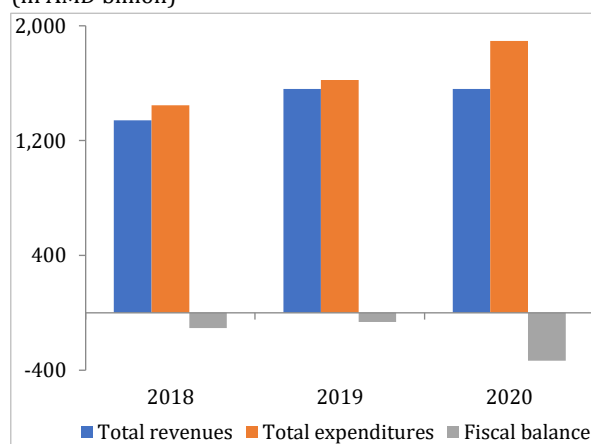
(in USD million)



Source: Statistical Committee of RA

Figure 4. The budget deficit widened in 2020 as revenues were flat while expenditures surged

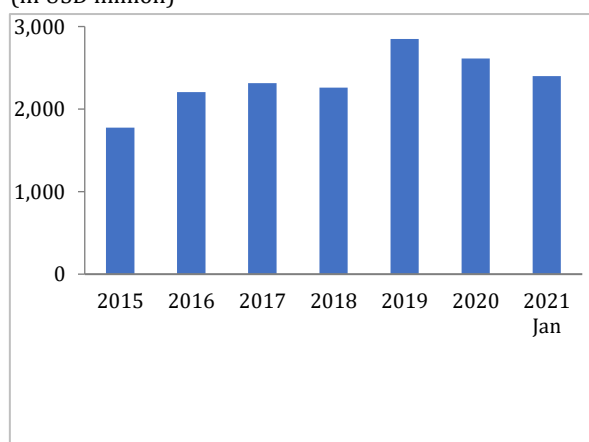
(in AMD billion)



Source: MOF

Figure 3. International reserves declined in January

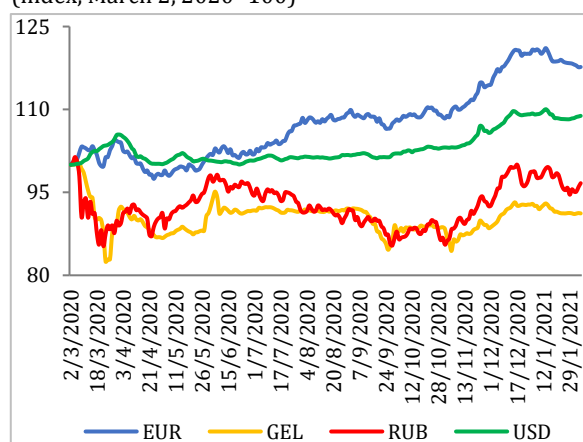
(in USD million)



Source: CBA

Figure 4: The dram stabilized since the second half of January

(index, March 2, 2020=100)



Source: CBA