

ARMENIA

Recent developments

Table 1 2019

Population, million	2.9
GDP, current US\$ billion	13.7
GDP per capita, current US\$	4655.3
International poverty rate (\$ 19) ^a	1.4
Lower middle-income poverty rate (\$3.2) ^a	9.4
Upper middle-income poverty rate (\$5.5) ^a	42.5
Gini index ^a	34.4
School enrollment, primary (% gross) ^b	92.7
Life expectancy at birth, years ^b	74.9

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

Notes:

(a) Most recent value (2018), calculated by the revised 2011 PPP conversion factor.

(b) Most recent WDI value (2018).

Armenia has been hit hard by the COVID-19 pandemic. The country has among the highest infection rates in ECA, its economy is projected to contract by 6.3 percent and the poverty rate (at the upper-middle income poverty line) is projected to increase by 4.8 percentage points in 2020. Recovery will be slow, with output not expected to recover to pre-COVID levels until at least 2022, and subject to severe downside risks, particularly from a further pick-up in COVID-19 infections.

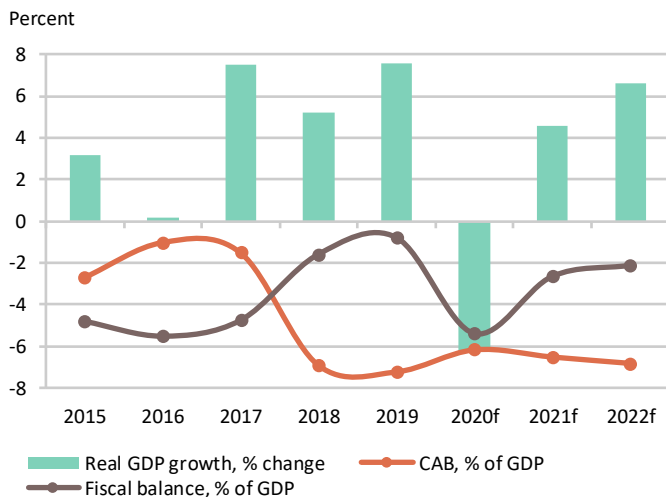
Armenia has been hit hard by the COVID-19 pandemic. The country registered the first infection on March 1, with the disease spreading rapidly thereafter, prompting tightening restrictions and eventually a full lockdown in April. Restrictions began to be eased in May, even as the infection rate remained elevated, which coincided with a subsequent surge in infections. Infection and fatality rates have declined since July, as implementation of control measures was tightened; however, these rates remain among the highest in the ECA region.

The economic impact of the pandemic has been severe. Following a strong start in the first two months of 2020 when the economy grew by 9.2 percent yoy, growth turned negative in March as businesses were forced to close and remittances and tourist arrivals dried up. A gradual recovery started in May; however, the spike in infections dented the revival. By mid-year, the economy had contracted by 5.7 percent yoy, driven by a sharp contraction of private consumption (8.9 percent yoy) and investment (30.7 percent yoy), only partially offset by higher government spending and import compression. On the supply side, construction and services were most affected, with financial and ICT sectors remaining more resilient due to their greater reliance on digital technologies. Agricultural output grew by 1.8 percent yoy in the first half of 2020 and a low base in 2019 pushed growth in mining to 21.7 percent yoy.

Inflation remains subdued, averaging 0.8 percent in the year to August, reflecting deflation in food and world oil prices and lower aggregate demand. In response, the Board of the Central Bank of Armenia (CBA) cut the policy rate four times in 2020, by a cumulative 125 basis point to 4.25 percent, its lowest level since 2006.

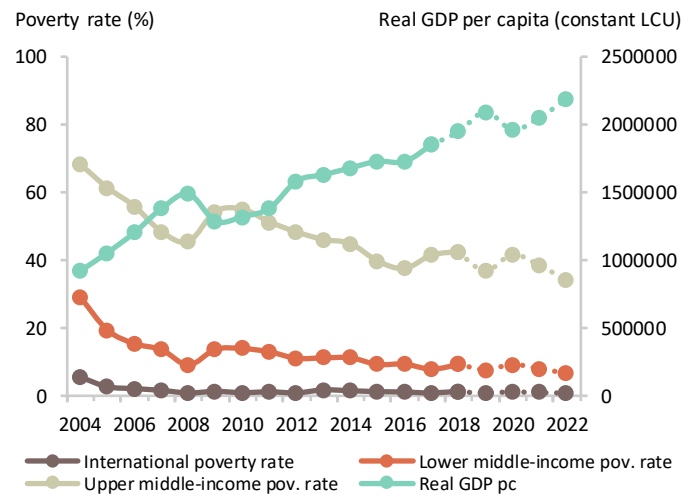
The government launched several economic and social measures to mitigate the pandemic at an estimated cost of around 2.3 percent of GDP and pushing current spending in the first seven months of 2020 up by 19 percent yoy. Capital spending increased by 62 percent, but from a low base in 2019 and it remains below budgeted levels reflecting persistent challenges in public investment management. Revenues fell by 6 percent yoy resulting in a deficit of around 1.7 percent of projected annual GDP in the year-to-July. Stepped up domestic and external borrowing financed the deficit and pushed public debt to approximately 60 percent of GDP, with the government invoking an escape clause in the fiscal rule allowing to increase debt during crises. The current account deficit is estimated to have narrowed but remains elevated. The goods trade deficit improved by 21 percent yoy in the year to July, as imports contracted by 13.7 percent yoy offsetting the 6.4 percent yoy decline in exports. The smaller trade deficit offset the decline in the services and income accounts, as tourism arrivals were suspended and money transfers from abroad declined (15 percent yoy). Despite slowing FDI inflows, support from IFIs financed the deficit and kept reserves at about five months of imports as of July 2020.

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



Sources: Statistical Committee 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.

After depreciating by 5.5 percent in March, following the initial COVID-19 related shock, the Armenian dram recovered in April and has remained largely stable since. The financial sector entered the pandemic with strong capital and liquidity levels. As a result, banks were able to offer moratoria on debt servicing to borrowers while continuing to extend credit. Credit expanded by 17 percent yoy as of end-July. Deposits growth, at 11 percent yoy, also remained healthy. While declining, 50 percent of the loan portfolio and 53 percent of deposits remain in foreign currency.

Outlook

In the baseline scenario, the economy is projected to contract by 6.3 percent in 2020, before rebounding by 4.6 percent in 2021. Output is projected to recover to pre-COVID levels only in 2022. This assumes that Armenia will continue to experience community transmission until mid-2021, but COVID-19 infections will remain largely stable and no further lockdowns are expected. This, in turn, implies that economic activity is not expected to fall to levels observed in the second quarter of 2020, but the recovery will be muted until mid-2021. Post mid-2021, if access to a

vaccine is in place and global trade and investment flows get restored, economic activity will normalize for the rest of the year and going into 2022.

The economic contraction in 2020 is expected to cause a sharp increase in unemployment. The upper-middle income poverty rate could increase by 4.8 percentage points.

Inflation will remain muted and converge to CBA's 4 percent target gradually. After narrowing in 2020 due to import compression, the current account balance is projected to widen in 2021 and 2022 as recovering demand translates into faster imports growth. The rise in the budget deficit to 5.4 percent of GDP, coupled with the decline in GDP is expected to push public debt up by 10 pp to 63 percent of GDP in 2020. The government's 2021-2023 Medium-Term Expenditure Framework, prepared in July 2020, envisages a strong fiscal consolidation bringing the deficit below 2 percent of GDP by 2023. This corresponds to a gradual decline in the debt to GDP ratio, consistent with the fiscal rule.

Risks and challenges

Risks are firmly on the downside, particularly from a potential pick-up in COVID-19

infections in the upcoming winter, from the lack or delay of availability of vaccines in 2021 and flare up of tensions with Azerbaijan. In this downside growth scenario, the economy will contract further in 2020 with a slower rebound in 2021 (around 3 percent), which will postpone the recovery of output to pre-COVID levels to 2023. Also, weaker-than-expected recovery in Armenia's economic partners, including Russia, and prolonged regional tensions could derail the recovery.

Domestically, governance gaps such as justice reform, low productivity, and weak connectivity result in limited integration and undiversified trade patterns. In addition, declining and aging population, low formal employment, spatial disparities and skills mismatches add to the challenges. The government has started to tackle a number of these issues but ensuring continued progress on reforms remains critical.

TABLE 2 Armenia / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

	2017	2018	2019	2020 e	2021 f	2022 f
Real GDP growth, at constant market prices	7.5	5.2	7.6	-6.3	4.6	6.6
Private Consumption	12.4	7.5	10.3	-9.1	5.9	7.6
Government Consumption	-2.1	-3.0	12.5	5.9	2.9	3.0
Gross Fixed Capital Investment	9.7	4.8	4.4	-16.8	8.1	10.9
Exports, Goods and Services	18.7	2.9	13.2	-12.7	5.3	7.7
Imports, Goods and Services	24.6	12.9	7.8	-15.1	7.8	9.3
Real GDP growth, at constant factor prices	7.3	4.9	7.6	-6.3	4.6	6.6
Agriculture	-5.1	-6.9	-2.6	1.7	2.5	3.5
Industry	9.0	3.7	7.1	-2.4	4.6	5.7
Services	10.6	9.0	10.4	-9.9	5.1	7.8
Inflation (Consumer Price Index)	1.0	2.5	1.4	1.3	2.9	3.5
Current Account Balance (% of GDP)	-1.5	-6.9	-7.2	-6.2	-6.5	-6.8
Net Foreign Direct Investment (% of GDP)	1.9	2.0	2.9	1.0	2.3	2.6
Fiscal Balance (% of GDP)	-4.8	-1.6	-0.8	-5.4	-2.7	-2.1
Debt (% of GDP)	58.9	55.7	53.5	63.8	63.6	61.6
Primary Balance (% of GDP)	-2.6	0.7	1.6	-2.7	-0.6	-0.1
International poverty rate (\$1.9 in 2011 PPP)^a	0.9	1.4	1.1	1.4	1.2	1.0
Lower middle-income poverty rate (\$3.2 in 2011 PPP)^a	8.1	9.4	7.7	9.3	8.0	6.7
Upper middle-income poverty rate (\$5.5 in 2011 PPP)^a	41.5	42.5	37.0	41.8	38.7	34.3

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.

(a) Calculations based on ECAPOV harmonization, using 2018-ILCS. Actual data: 2018. Nowcast: 2019. Forecast are from 2020 to 2022. Projection using neutral distribution (2018) with pass-through = 0.87 based on GDP per capita in constant LCU. The trends in international poverty (revised 2011 PPP) and national poverty diverge because of methodological differences in the aggregates and the position of the poverty line.