



# The Economic Situation in Armenia: Opportunities and Challenges in 2017

COMPASS CENTER, ARMENIA

February 2017

- Since 2 January 2015, Armenia is a member of the Customs Union of the Eurasian Economic Union (EEU). After trade turnover with 4 EEU member states decreased by 17,1% in 2015, it started to increase again over the period of January-September 2016. As compared to the same period of the previous year, exports grew by 55,2%.
- Money transfers by individuals play a great role in Armenia's economy. Over the past 10 years the inflow of remittances amounted to an annual average of 20% of the GDP. In 2015, there was a substantial decline in private transfers: 11.4% less inflow compared with the previous year. 62% of remittances came from the Russian Federation and the deterioration of Russia's economy is the primary reason for the decline of cash inflow. This trend continued in 2016.
- There is serious distrust in society towards the current authorities over economic issues. After 3% GDP growth in 2015 the index of economic activity in Armenia started to decrease again. Unemployment is rising and amounted to 18,5% in 2015, which is the highest rate within the past 5 years. Emigration is a consequence of the socio-economic situation. According to estimations, 25% of the country's population lived abroad in 2015. 2017 will be full of new challenges for Armenia, which will once again test the will and the flexibility of the authorities to impose economic reforms.

## 1. The Current Economic Situation of Armenia

### 1.1 Economic Growth and GDP

In 2015 the actual value of the Gross Domestic Product in Armenia was 5.032 trillion AMD. In 2016 the GDP of the three quarters constituted 3.543 trillion AMD.

The recession in economic growth in Armenia over the past two years is continuing in 2016. The economic growth in 2014 was recorded at 3.5% in comparison with the previous year's 7.2%. In 2015 it was 3.0%<sup>1</sup>. In 2015 the GDP per capita constituted 1 million 674 thousand AMD or 3504.3 USD.

According to the published data of the first three quarters in 2016, the actual growth over the same period of the previous year was recorded as 0.41%. An actual GDP growth of 4.3% was registered in the first quarter compared with the same period in the previous year; in the second quarter it was 1.5%, and a 2.6% downturn in the third quarter. From July 2016 the index of economic activity, compared with the same period of the previous year, registered lower than 100%, decreasing to 92.2% in October<sup>2</sup>. In order to achieve the 2.2% economic growth forecast by the Government for the fourth quarter, a domestic product no lower than that of the same period in 2015 must be created. Taking into account the growth in economic activity being recorded in the RA during the final months of the year, we estimate the real GDP growth in 2016 will be registered at 0.8-1%.

### 1.2 Inflation

Deflation has been recorded in Armenia for the

first time since 2000. Over the period of January to November 2016, a deflation of 2.2% was observed in Armenia compared with December of 2015<sup>3</sup>. Beginning in February, the highest deflation - 2.3% - was observed in July. A certain amount of inflation was registered in the subsequent period. This reached 1% in November, as compared to October. Three percent inflation was recorded in 2014, with 3.7% in the previous year. According to the state budget law for 2016, the inflation target was 4+/-1.5%.

In the current year deflation was largely conditioned by the deflation in prices of food and non-food items as well as that of consumer goods. Services registered only 0.9% deflation, while alcoholic drinks and tobacco registered 1% inflation.

### 1.3 Current Account and Foreign Trade

Trade turnover in Armenia over the period of the first three quarters in 2016 increased by 5.7% compared to the same period of the previous year, reaching 3 billion 588 million dollars<sup>4</sup>. The import index in the first 9 months (2.295 billion dollars, 0.8% decline) hasn't changed substantially following the 29% reduction in 2015, while exports have increased by 19.6% and constitute 1.293 billion dollars. However, over the past 4 years, exports continue to fluctuate around the 1.5 billion dollar mark.

The trade balance continues to be negative; however, for the second year, it is showing a tendency to decrease. As opposed to the previous year, in 2015 the trade balance deficit decreased from 2.8 billion dollars to 1.7 billion dollars. As a result of the first three quarters of 2016, the deficit comprises 1 billion dollars – 230 million dollars less than that of the same period of the previous year. Unfortunately the

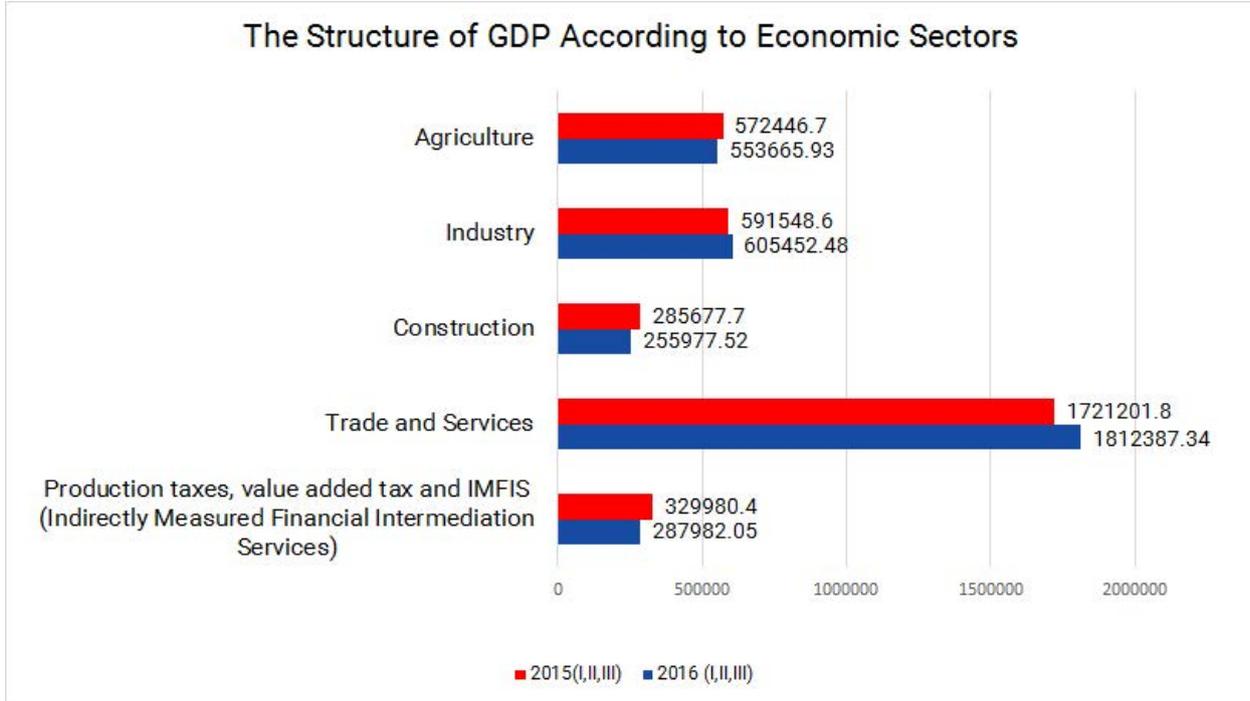
1. RA Statistical Yearbook 2016, NSS: [www.armstat.am/file/doc/99499428.pdf](http://www.armstat.am/file/doc/99499428.pdf)

2. Socio-Economic Situation of RA in January-October 2016, NSS: [www.armstat.am/am/?nid=82&id=1842](http://www.armstat.am/am/?nid=82&id=1842)

3. Consumer Price Index (prices) in the Republic of Armenia in January-November 2016, NSS: [www.armstat.am/file/article/cpi\\_11\\_2016.pdf](http://www.armstat.am/file/article/cpi_11_2016.pdf)

4. Socio-Economic Situation of RA in January-October 2016, NSS: [www.armstat.am/file/article/sv\\_10\\_16a\\_411.pdf](http://www.armstat.am/file/article/sv_10_16a_411.pdf)

Figure 1. The Structure of GDP According to Economic Sectors



deficit reduction is due to the reduction in imports, while export growth is not generating a significant change.

Among the sectors of commodities with significant weight in the export structure, in particular, the production of precious and semi-precious stones, and precious metals, has recorded a growth of 89.6%, and prepared food products have recorded a 27.6 % growth. The export of mining products, the largest sector in the export structure, has decreased by 4.7%.

Mining production is also the leader in the import structure, constituting 17.76%; moreover, their imports have also recorded a downturn of 10.3%. Among the biggest import commodities, products of plant origin have registered a reduction of 18%; non-precious metals and items prepared from them by 20.6%; and means of transportation by land, air and water 17.9%.

The largest volume of exports from RA continues to be directed to Russia, constituting only 20.1% of exports during the period of January-September.

In the same period of the previous year, exports to Russia increased by 44.8%. It is worth noting that exports to EU countries continue to exceed the volume of exports to CIS countries.

Again, the Russian Federation’s share in the import structure is dominant at 21.4%; the volume of imported goods and services from there in the period of January-September 2016, as compared to the same period of the previous year, recorded a slight growth of 1.2%. In the mentioned period, a 50% growth in imports from Georgia was registered, reaching 168 million dollars, which constitutes 7.8% of imports. The United Arab Emirates is the third in the import structure with 5.54%, which is the result of an increase of 27.1% of imports from this country. Germany, China, Iran and Switzerland continue to maintain about a 4-5% market share in the import structure. Imports from CIS countries have increased by 5.4%, and decreased from EU countries by 5.2%; nevertheless, CIS and EU countries have an almost 25% share each in the RA import structure.

The negative current account balance of payments in Armenia has constantly been decreasing in recent years. In 2010 it constituted 1.26 billion dollars, equivalent to -13.62 % of the GDP of the same year<sup>5</sup>.

Until 2014 it decreased to -7.5%, while in 2015 it

dropped sharply down to -2.64%, constituting only 279 million dollars. The reduction of the current account deficit occurred because of the unprecedented decline of import volumes mentioned above. The same trend was also observed in the first quarter of 2016 when the current account deficit dropped by 29.67%, again as a result of a trade deficit decrease.

Figure 2. The Real Growth Index of GDP According to Economic Sectors

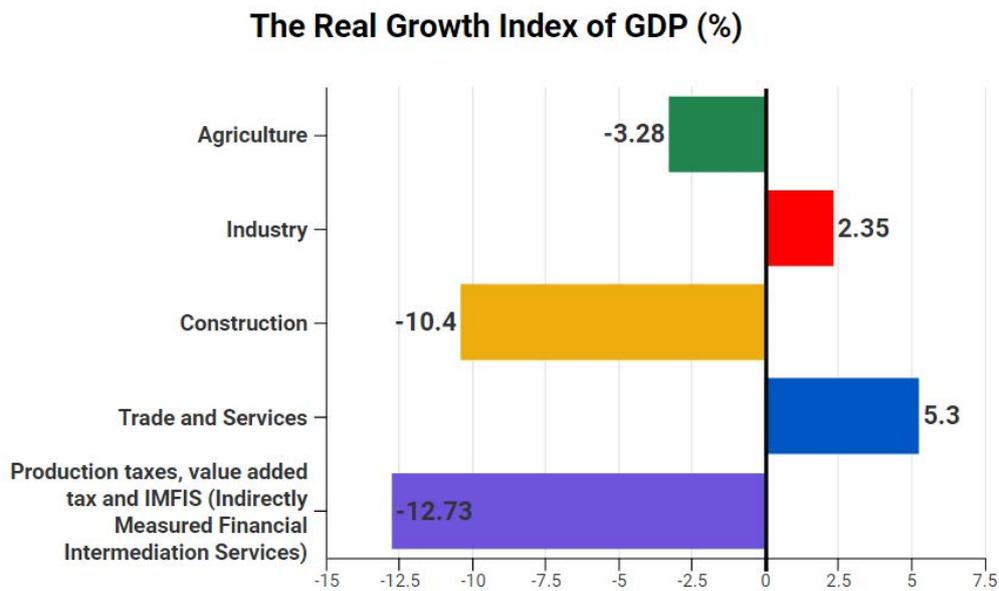
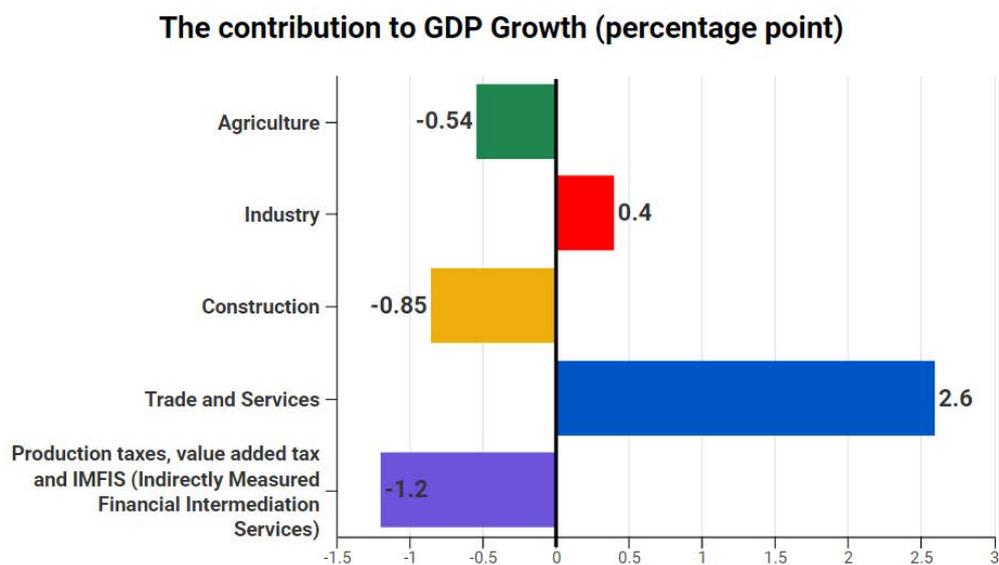


Figure 3. The Contribution to GDP Growth



5. Balance of Payments of RA, CB; [www.cba.am/Storage/AM/downloads/stat\\_data\\_arm/BOP\\_1993-2016\\_arm\\_for%20siteBPM6\\_rev.xls](http://www.cba.am/Storage/AM/downloads/stat_data_arm/BOP_1993-2016_arm_for%20siteBPM6_rev.xls)

Table 1. RA Exports by Commodity Divisions

Exports by Commodity Divisions over the Period of January-September 2016				
	Volume (thou.USD)	Growth (%)	Weight (%)	
Mining Products	341691.4	↓ -4.7	26.4	
Prepared Food Products	283202.4	↑ 27.6	21.9	
Precious and Semi-Precious Stones, Precious Metals and Items	267788.2	↑ 89.6	20.7	
Base Metals and Articles of Base Metal	158052.6	↓ -8.7	12.2	
Textile Items	72203.8	↑ 46.2	5.6	
Other Product Categories	170122.7	↑ 23.8	13.2	
<b>Total</b>	<b>1293061.1</b>	<b>↑ 19.6</b>	<b>100</b>	

Figure 4. The Growth of Exports of RA by Countries

### The Growth of Exports by Countries over the Period January-September 2016 (%)

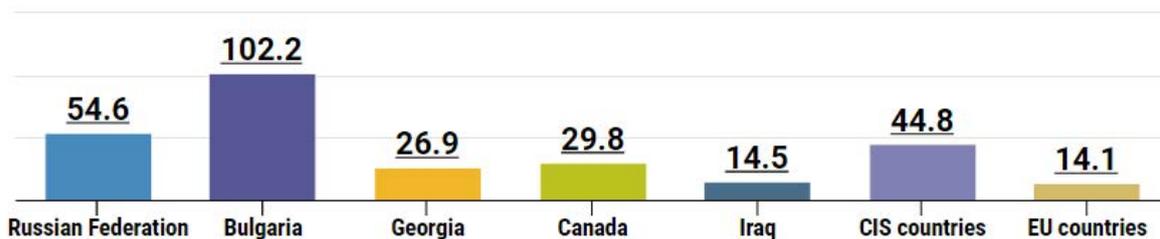
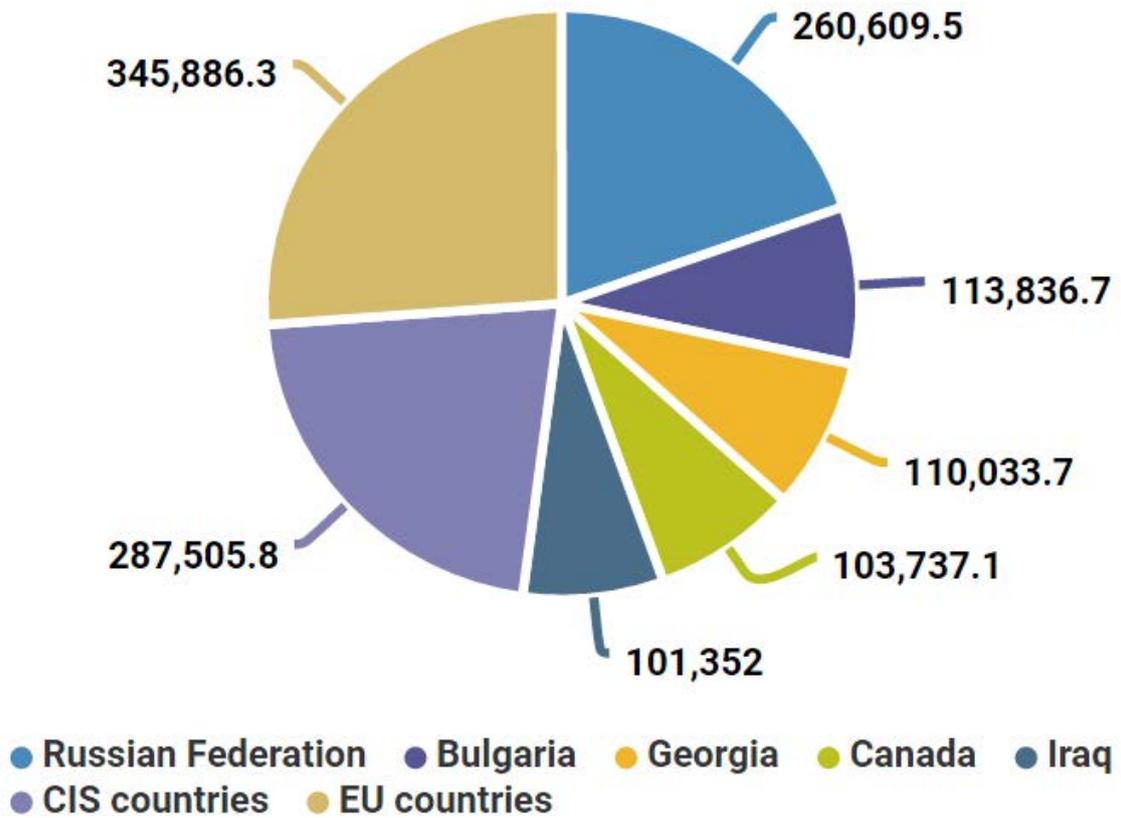


Figure 5. The Volume of RA Exports by Countries

### Exports by Countries over the Period January-September 2016 (Thou. USD)



#### 1.4 External Debt

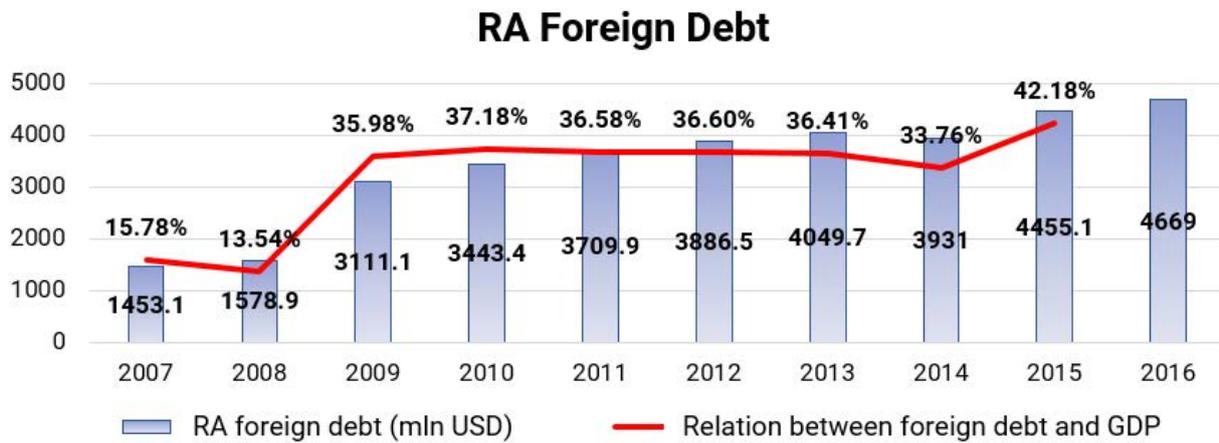
As of December 31, 2015 the RA gross external debt amounted to 8.927 billion dollars; as of June 30, 2016 it was 8.950 billion dollars<sup>6</sup>. At the end of 2015, 49.9% of the RA external debt - amounting to 4.455 billion dollars - was the debt of the Government and Central Bank (3.854 and 0.6 billion dollars, respectively). This had reached 4.590 billion dollars by the end of September 2016. At the end of 2015, the external debt of the

RA Government and Central Bank constituted 42.18% of the GDP of the same year.

The funds borrowed from the World Bank and the Agricultural Development Agency constitute 49.07% in RA state credits and loans structure, and the loans from the IMF and Asian Development Bank constitute 12% each. Japan and Germany also carry a large weight in the state external debt structure (7.83% and 5.5%, respectively).

6. Gross External Debt Position of RA, CB: [www.cba.am/Storage/AM/downloads/stat\\_data\\_arm/ExD\\_1999-2016\\_arm\\_for%20site%20BPM6\\_rev.xls](http://www.cba.am/Storage/AM/downloads/stat_data_arm/ExD_1999-2016_arm_for%20site%20BPM6_rev.xls)

Figure 6. RA Foreign Debt

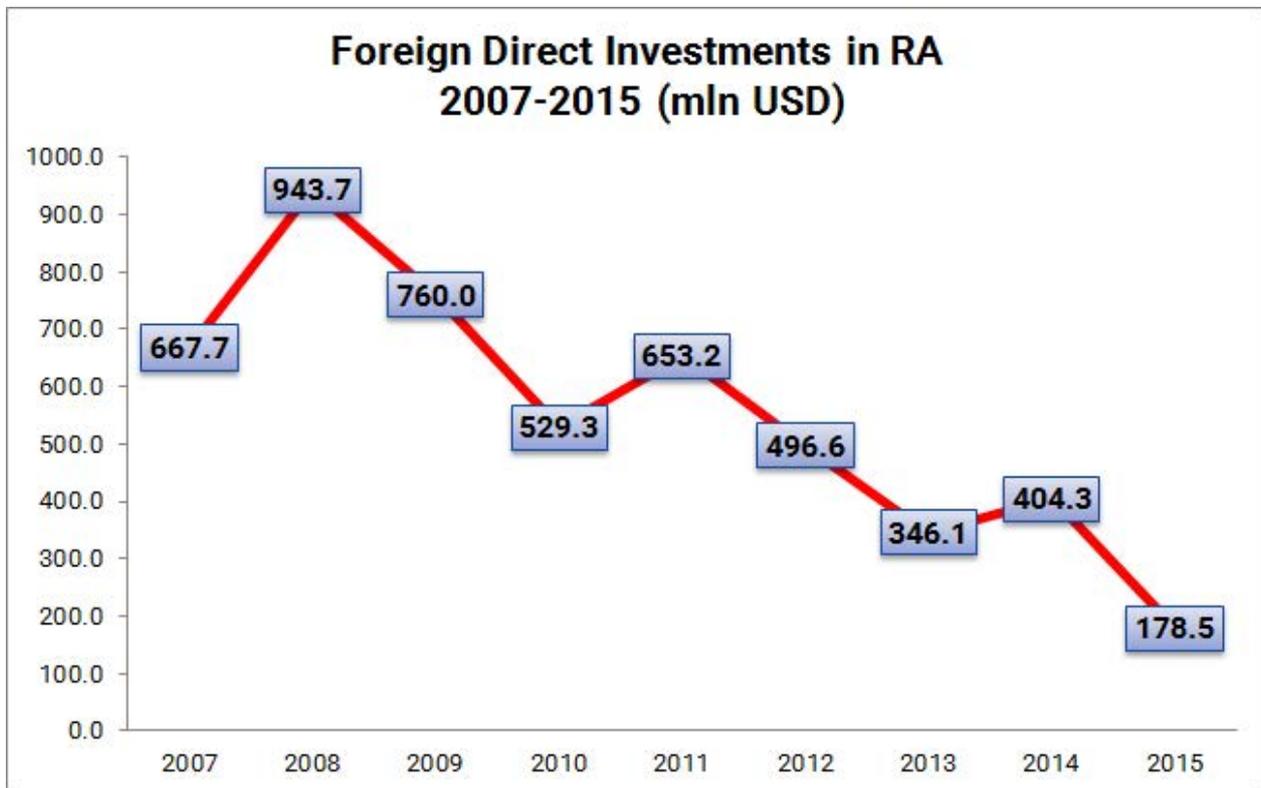


1.5 Foreign Direct Investment

In 2015 the volume of foreign direct investment in Armenia went down by 223.8 million dollars and constituted 180.5 million dollars. In the same year, the net flow of foreign direct investment in the real sector averaged 70.418 billion AMD

- 46.783 billion drams less than in 2014. The decline in investment continued in 2016; specifically, over the period of January-September, the net flow of foreign direct investment constituted only 44.432 billion AMD, dropping 44.6% as compared to the same period of the previous year.

Figure 7. Foreign Direct Investments in Armenia



Since the methodological changes made by the National Statistical Service of Armenia in 2014 do not allow us to compare the current indicators with those in previous years, we have utilized the statistics provided by the World Bank. Thus, as of 2009 foreign direct investment in Armenia, measured annually, has only shown increases in 2011 and 2014. Overall, compared to 2007, the volume of investment in 2015 has experienced a downturn of 73%. The largest drop (55.87%) was recorded in 2015<sup>7</sup>.

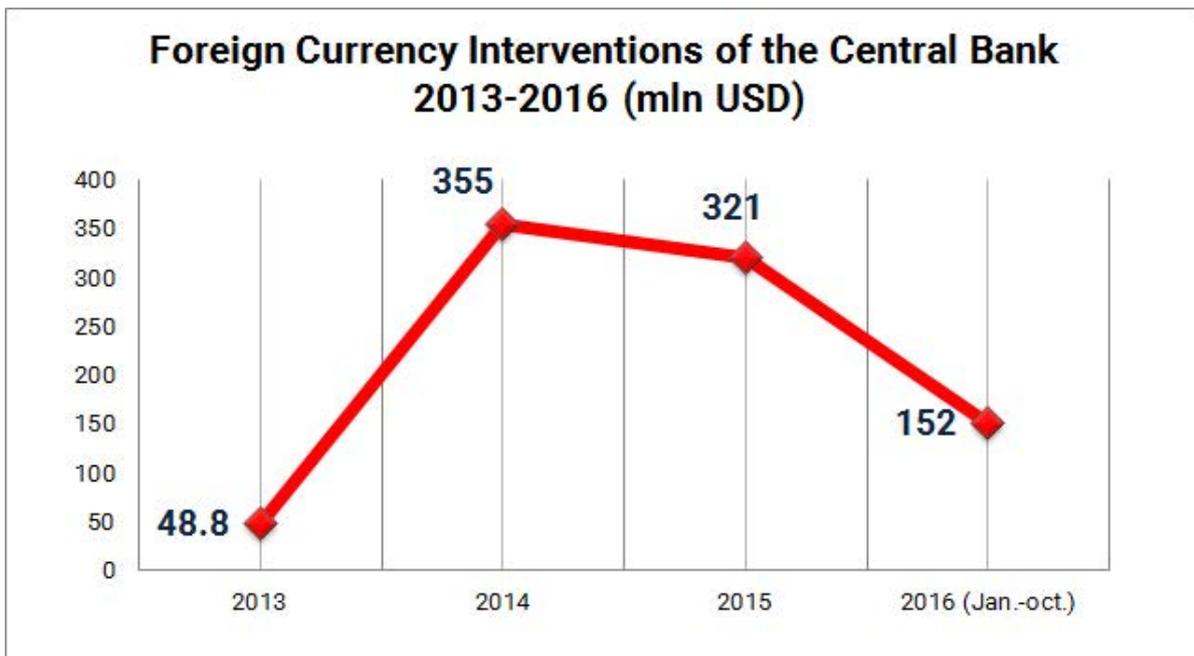
According to the data of the period January-September 2016, the leading countries in the foreign direct investment structure are Cyprus (34.878 billion AMD), the United Kingdom (32.276 billion AMD) and Luxembourg (29.049 billion AMD). The index of net flows of the foreign investment structure with the leader, Russia, from 2006 to 2011 has a negative value of -55,379 billion AMD. As compared to the period January-September of the

previous year, the largest drop in foreign direct investment volume (-69.814 billion AMD) was from Russia.

### 1.6 Foreign Exchange Policy

The Central Bank of the Republic of Armenia, whose function is foreign exchange regulation, maintains a floating exchange rate policy<sup>8</sup>. On December 31, 2015 the value of 1 U.S. dollar was 483.75 AMD and on November 30, 2016 it was 478.52 AMD. On November 30, 2016 the exchange rate had increased by 31.6%, compared to the last day of 2010, with an average annual exchange rate of 28.5%. The biggest shock for the Armenian dram was recorded in December of 2014 when, as a result of the fall in oil prices, a drop in the Russian ruble exchange rate and other economic issues, the U.S. dollar exchange rate rose from 409.98 to 463.53 AMD within two months. The increase continued in 2015-2016 and reached 493.64 AMD on February 29, 2016. Subsequently, the Armenian dram appreciated somewhat, and

Figure 8. Foreign Currency Interventions of the Central Bank of RA



7. World Bank Databank, Foreign direct investment, net inflows (BoP, current US\$), accessed: 14/12/2016

8. RA CB official website: [www.cba.am/am/SitePages/mpforeignexchangeconomy.aspx](http://www.cba.am/am/SitePages/mpforeignexchangeconomy.aspx)

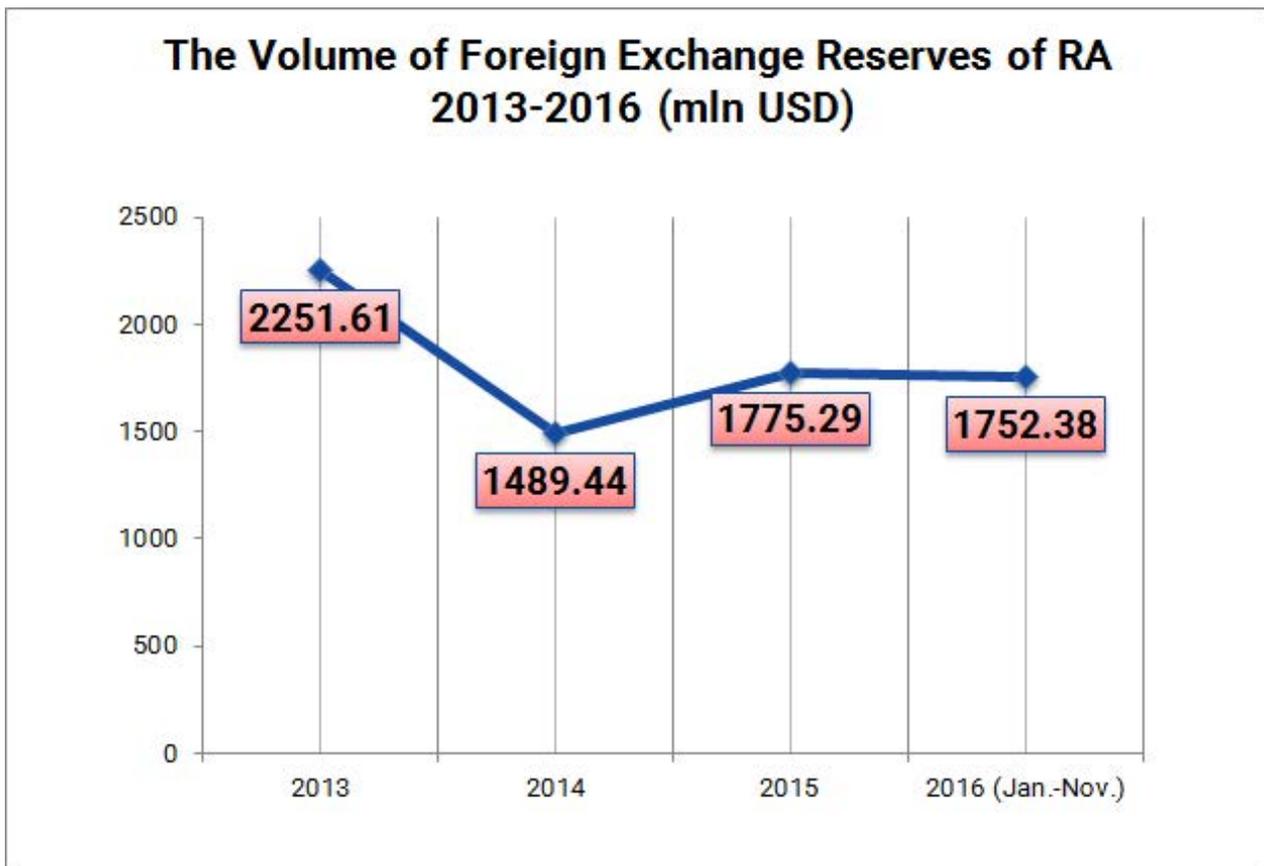
9. The Average Monthly Rate of Some Currencies to AMD, CB: [www.cba.am/Storage/AM/downloads/stat\\_data\\_arm/8.%20Exchange%20rates\\_arm.xls](http://www.cba.am/Storage/AM/downloads/stat_data_arm/8.%20Exchange%20rates_arm.xls)

the exchange rate was 478.52 AMD at the end of November9.

A number of tools, specifically foreign currency interventions, have been used by the Central Bank to regulate the currency. Thus, in 2014 during the depreciation in the Armenian dram, CB conducted the sale of 355 million USD, more than 7 times that of 2013. Almost the same amount (321 million dollars) was sold in 2015, and only in 2016 did the sales volume decrease to 152 million dollars during the first 10 months. However, a greater volume of interventions is expected in the last months

of the year, when pressure grows on the Armenian dram. Despite the high volume of currency interventions, CB has managed to keep the RA foreign exchange reserves at a relatively stable level. In December 2013 the volume of foreign exchange reserves was 2251.61 million dollars, while in December 2014 it had dropped to 1489.44 million dollars. In 2015, foreign exchange reserves stood at 1775.29 million dollars, while in November 2016 they stood at 1752.38 million dollars. It should be noted that 99.6% of the RA international reserves are comprised of foreign currency reserves and 0.4% of SDR funds. The Republic of Armenia does not have gold in international reserves<sup>10</sup>.

Figure 9. The Volume of Foreign Exchange Reserves of RA



10. The Structure of International Reserves in RA (monthly), CB: [www.cba.am/Storage/AM/downloads/stat\\_data\\_arm/7.International%20reserves\\_arm.xls](http://www.cba.am/Storage/AM/downloads/stat_data_arm/7.International%20reserves_arm.xls)

## 1.7 Money Transfers

Money transfers by individuals also play a great role in the economy in Armenia, as is the case in most post-soviet countries. Studies show that the GDP of RA is directly dependent on the volume of remittances into the economy<sup>11</sup>. Over the past 10 years the inflow of remittances by individuals amounted to an annual average of 20% of the GDP. It should be noted that the statistics only apply to money transfers through banks, whereas quite significant amounts of remittances are sent by the working migrants to Armenia in cash.

In 2015, there was a substantial decline in private transfers. In comparison with the previous year, the inflow of the remittances declined by 11.4% and amounted to 780 billion AMD, which constitutes only 15.5% of the GDP. Moreover, a decrease of 6.55% in remittances from abroad had also been recorded in 2014.

The decline in the volume of remittances continued in 2016. Over the period of January-October the inflow of monetary funds was 574 billion AMD, which was 9.9% less than in the same period of 2015. Transfers in January-October of the current year have been 23% less than in the same period of 2014.

It should be noted that, as opposed to the inflow of remittances, the volume of their outflow in recent years has been relatively stable. 2015 recorded a 3.9 billion AMD outflow, which was only 3.44% less than in 2014. In 2015 the net inflow constituted 416 billion AMD.

In Armenia, the major directions of monetary flows by individuals are the Russian Federation and the U.S.A. In 2015, 62% of inflow of cash was from Russia, and 10.8% from the U.S.A. The recent sudden changes in the volume of money

transfers have been primarily due to the deterioration in the Russian economy. In 2015, the inflows from this country were cut by 25%, and in the first 10 months of 2016 they have been cut by an additional 13%. At the same time cash outflow from this country in 2015 increased by 29.6%, and in January-October 2016, an additional 29.9%. As for the U.S., the opposite has occurred: there has been an increase in the inflow and a decrease in the outflow. However, those changes have not had a significant impact on the final net inflow index.

## 1.8 Economic Consequences of EEU membership in 2016

Since the second of January, 2015 Armenia has become a member of the Customs Union of the Eurasian Economic Union. Membership of this economic union implied the cancellation of custom tariffs between member states and application of common customs tariffs with third countries. However, Armenia already had free trade agreements with almost all the CIS countries prior to that and trade with them was being conducted at either relatively low or zero rates, while in trade with third countries that are not members of Customs Union, Armenia gained concessions to apply the same rates as were specified before EEU membership, on around 700 items, until 2017. For these reasons it is difficult to judge the consequences of membership of the Customs Union from the results of the turnover of 2015 and the first three quarters of 2016.

Thus, according to the results of the first year of Customs Union membership in 2015, trade turnover with 4 member states decreased by 17,1%. In particular, exports decreased by 21% and constituted 256.2 million dollars, while imports went down by 16.1% amounting to 968.5 million dollars. Moreover, there has been a reduction in the indices of both exports and imports with all states, with the exception of imports from Kyrgyzstan, which is a very small figure with an absolute value constituting only 126.000 dollars<sup>12</sup>. The main reason for these

11. Remittances in Armenia: Dynamic Patterns and Drivers, IMF: [www.imf.org/external/country/arm/](http://www.imf.org/external/country/arm/)

12. RA Statistical Yearbook 2016, NSS: [www.armstat.am/file/doc/99499483.pdf](http://www.armstat.am/file/doc/99499483.pdf)

developments is the deterioration in the economic situation of all member states of the Customs Union.

Over the period of January-September 2016 a growth in volume of Armenian trade was observed within the territory of the Customs Union. As compared to the same period of the previous year, exports registered growth at 55.2%, constituting 274 million dollars, more than during the whole of 2015. Imports increased by only 2.9% and amounted to 719.1 million dollars<sup>13</sup>. While the increase in exports could be considered the first reaction of the business sector to the Customs Union, the reason for the insignificant change in imports is the reduction in final consumption volumes in Armenia.

It should be noted that membership of the Customs Union has not affected the volume of Armenian exports to the third countries. Thus in 2015, unlike the Customs Union member states, exports to third countries has grown at a rate of 0.5%, while in 2016 the increase in volume of exports in three quarters was 12.7%. Imports from third countries in 2015 went down by 30.5%, and from January-September 2016, by 2.8%. It should be remembered that it was accompanied by a decrease in the total volume of imports.

Customs Union membership has not registered any positive developments in terms of attracting direct investments (FDI). In 2015, in the case of 3 out of 4 member states, the net inflow of foreign direct investments had a negative value, while Kyrgyzstan doesn't have any capital invested in Armenia. In 2015, the net inflow of direct investments from Russia constituted -43,7 billion AMD; they were more in the first three months of 2016 than over the whole previous year – 55,3 billion AMD<sup>14</sup>.

## 1.9 New Tax Code

As of the first of January, 2018, the new tax code will be in force in the Republic of Armenia. Of the major amendments, the lowering of the turnover tax threshold should be mentioned (from 116,7 to 58,35 million AMD), new differentiated rates of income tax, an increase in excise tax, calculation of property tax and land tax according to market prices as well as other changes related to VAT, profit tax and other taxes. The new tax code aims at increasing tax revenues and promoting long-term economic growth; however, experts estimate that it in no way contributes to the development of the SME sector.

13. Official website of the Eurasian Economic Commission: [www.eurasiancommission.org/ru/act/integr\\_i\\_makroec/dep\\_stat/tradestat/tables/intra/Pages/2016/09.aspx](http://www.eurasiancommission.org/ru/act/integr_i_makroec/dep_stat/tradestat/tables/intra/Pages/2016/09.aspx)

14. Socio-Economic Situation of RA in January-October 2016, NSS: [www.armstat.am/file/article/sv\\_10\\_16a\\_420.pdf](http://www.armstat.am/file/article/sv_10_16a_420.pdf)

## 2. SOCIAL IMPACT

### 2.1 Household Incomes and Consumer Behavior Changes

Over the past 10 years, household incomes in Armenia have been continuously increasing; in particular, a significant increase of 11.29% was detected in 2012 and then one of 13.41% in 2014. Compared to the previous year, incomes increased by 4.48% in 2015 and constituted 52377 AMD per capita per month.

In 2015 about 55% of monetary income (28800 AMD) came from employment; the second largest source 17.7%, is pensions and subsidies (9284 AMD). Income from self-employment and remittances comprises 9% each.

According to the data of the National Statistical Service, in the period 2011-2015 people's

consumption volumes continuously increased. Compared to the previous year, monthly consumption per capita in 2015 increased by 3.9% and comprised 42867 AMD. Interestingly, World Bank data indicates an 8.2% decrease instead of an increase. According to the organization's data, the annual consumption per capita in 2015 was 2637 U.S. dollars, as opposed to the 2874 dollars of the previous year. In 2015 the ratio of total household consumption to GDP amounted to 77.3% instead of 84.6% in the previous year.

As for the structure of consumption, in 2015 the monthly consumption per capita for food was 14768 AMD (34.4%), for services 14437 AMD (33.7%), and for non-food products it was 8074 AMD (18.8%).

Figure 10. Household Monetary Incomes

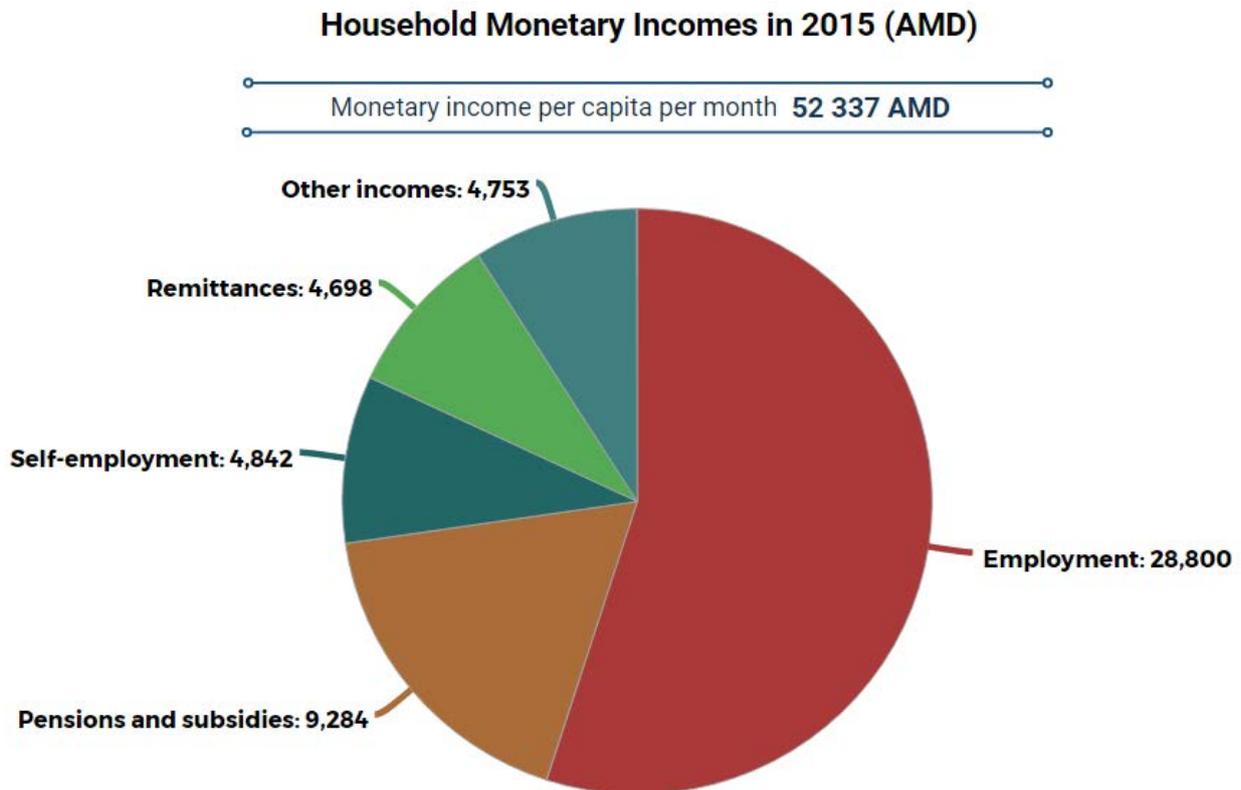
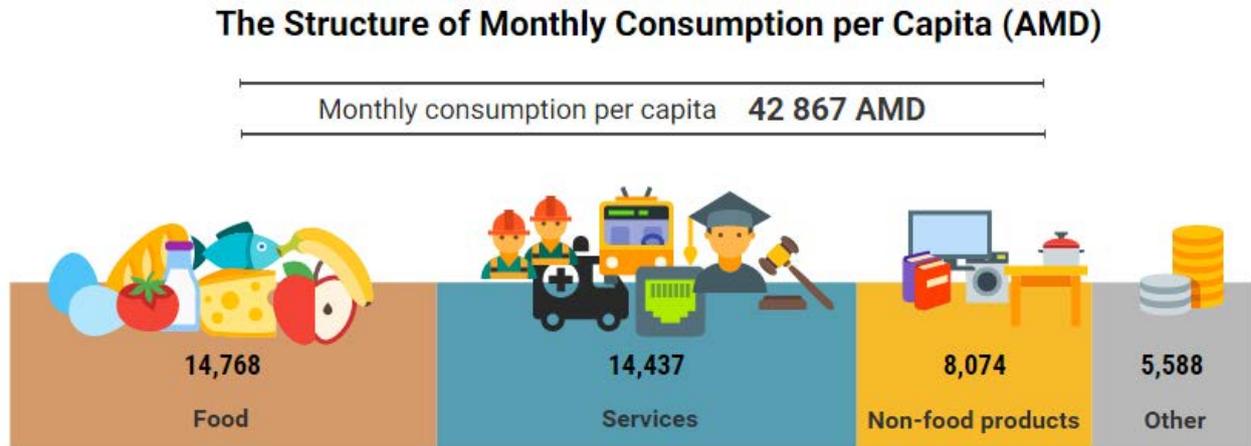


Figure 11. The Structure of Monthly Consumption per Capita



## 2.2 Changes in Poverty and Inequality

The largest reduction in poverty level, dropping from 53.5% to 27.6%, occurred in 2004-2008. The world economic crisis stopped that tendency toward poverty reduction, and since 2008 it has been possible to decrease poverty by only 4.3%. In 2015 the poverty rate constituted 29.8%, with the rate of extreme poverty at 2%.

The poverty rate differs significantly in different parts of Armenia. In 2015, poverty amounted to 29.4% in urban areas and 30.4% in rural areas.

However, the picture is completely different when we separate Yerevan from other urban areas: the poverty rate in the capital is 25%, while in other towns of the country the poverty rate is higher than in rural areas.

Poverty rates are also significantly different by regions (marzes). In 2015, the poverty rate in the Shirak region was 45.3% - which is 15.5% higher than the average index in the country - while in the Aragatsotn and Vayots Dzor regions, the same index was 16-17%.

Figure 12. The Poverty in Armenia

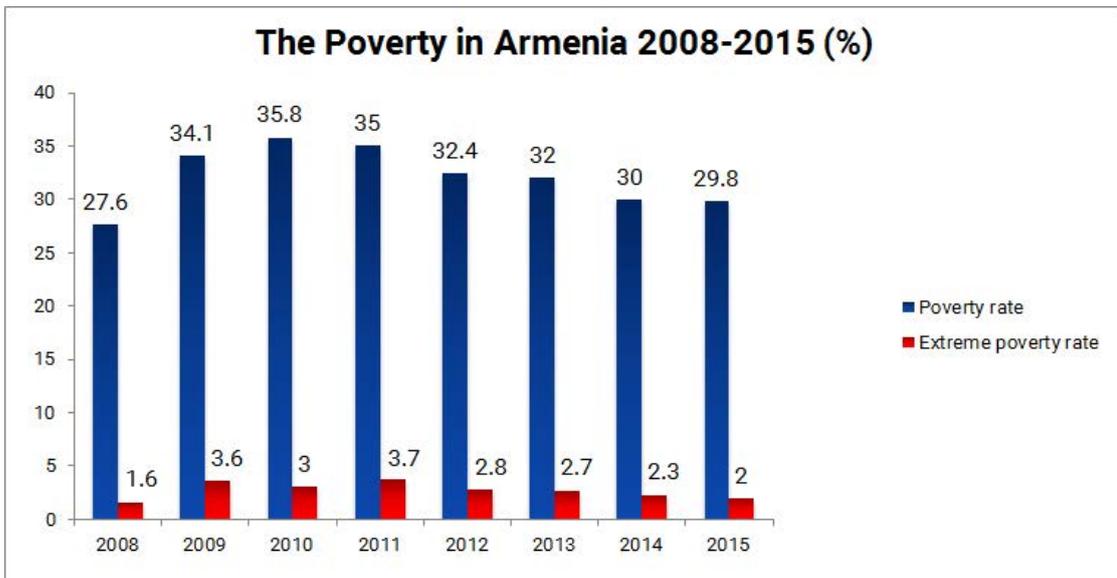


Figure 13. Poverty Gap and the Severity of Poverty in RA

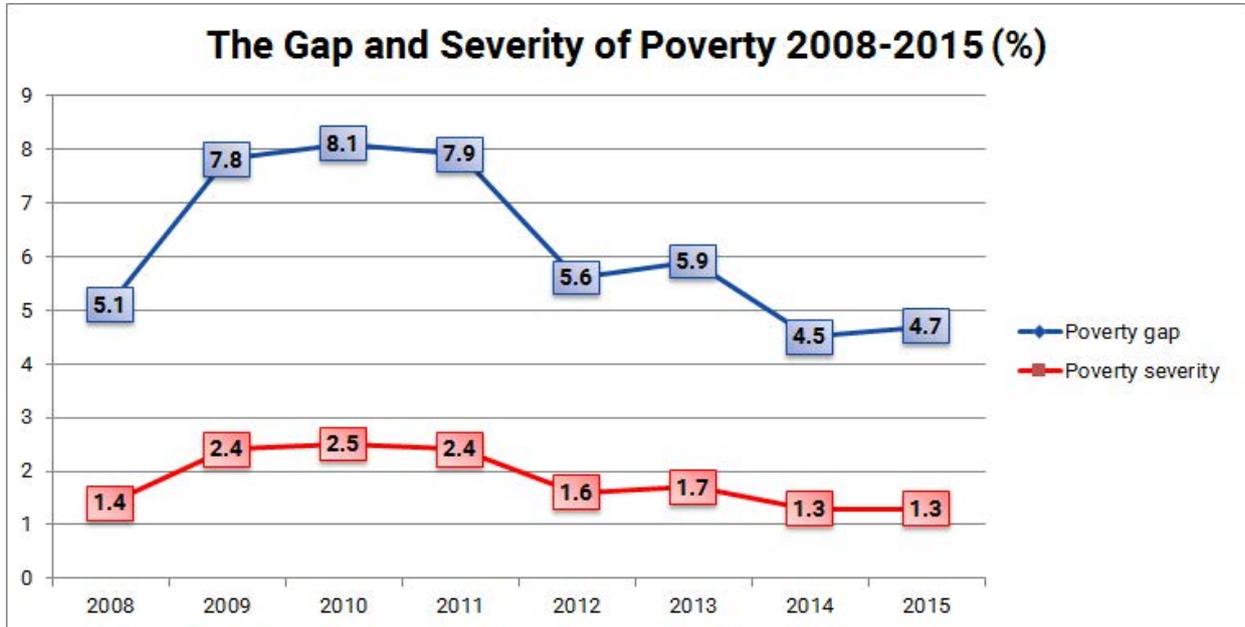
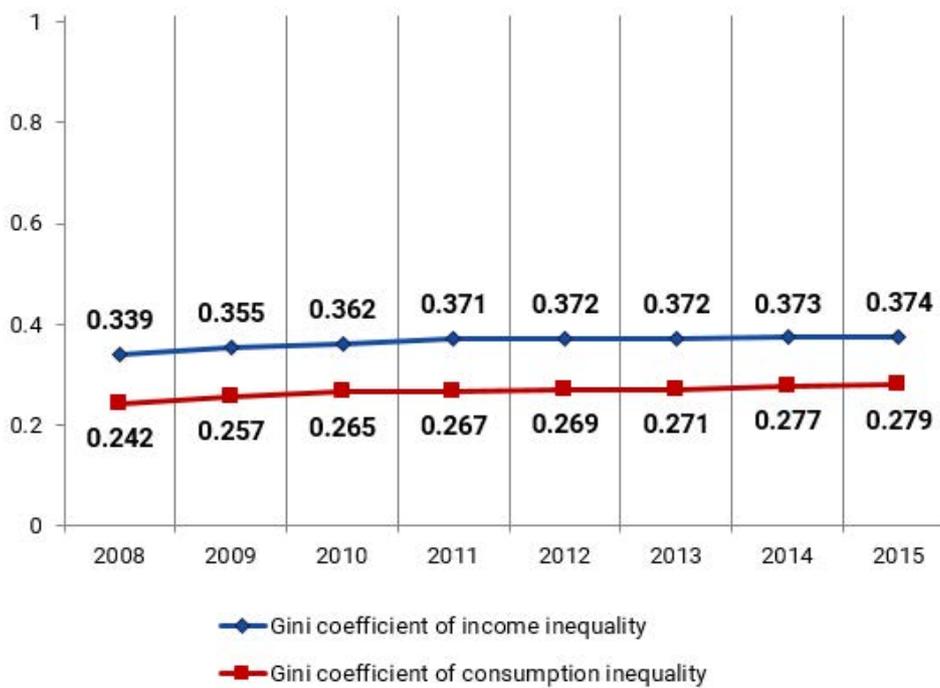


Figure 14. The Income and Consumption Inequality According to Gini Coefficient

### The Poverty in Armenia: Gini Coefficient (2008-2015)



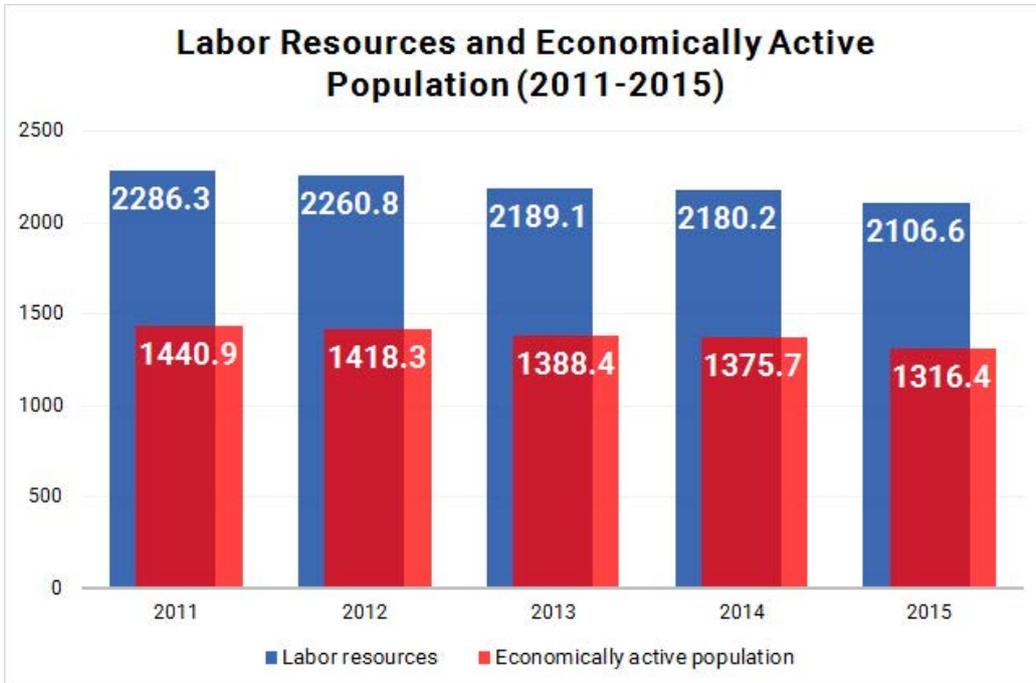
### 2.3 Employment and Unemployment Rates

Armenia's labor resources in 2015 constituted 2,106 million people, of which 1,316 million are economically active. The number of people employed was 1,072 million.

the past 5 years. In 2013, the unemployment rate had fallen to 16.2%; however, in recent years it has been continually growing. From January to June 2016 the unemployment rate in Armenia amounted to 18.4%<sup>15</sup>.

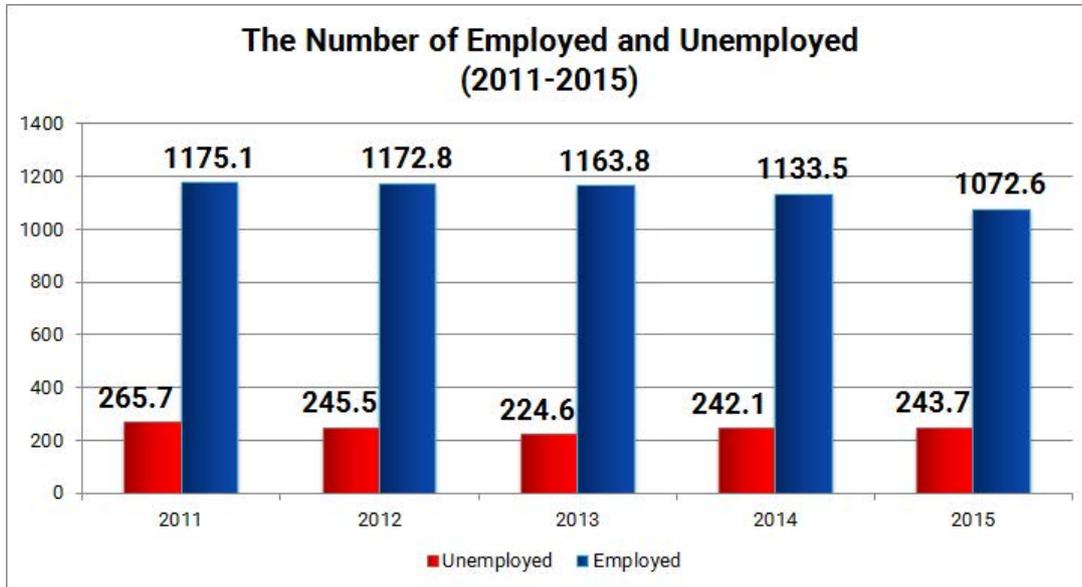
In 2015, the number of unemployed people constituted 243.7. The unemployment rate increased and instead of the 17.6% of 2014, it amounted to 18.5%. This is the highest figure in

Figure 15. Labor Resources and Economically Active Population in Armenia



15. [www.armstat.am/file/article/sv\\_09\\_16a\\_510](http://www.armstat.am/file/article/sv_09_16a_510)

Figure 16. The Number of Employed and Unemployed in Armenia

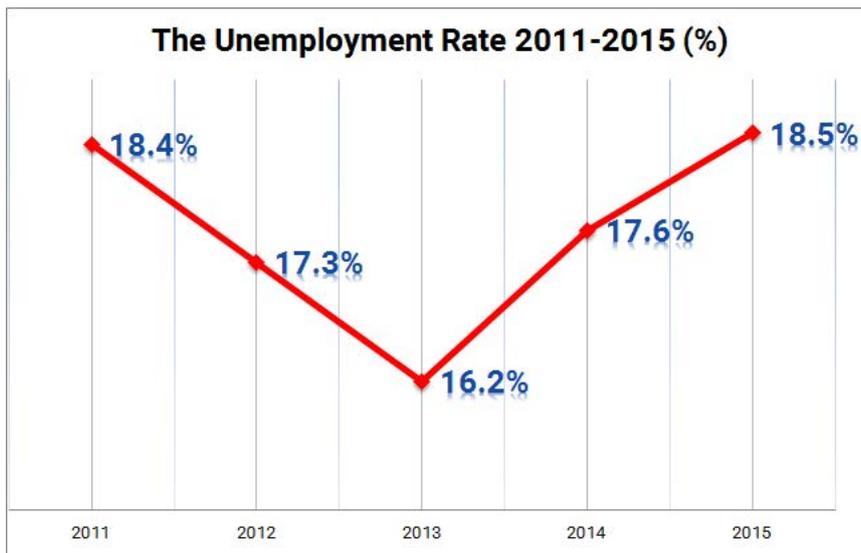


2.4 Other Consequences

Emigration is the most important of the consequences arising from the socio-economic situation in Armenia. According to official statistics, under conditions of positive index of

natural flow (from 2011 to 2015 an average 14.8 thousand people annually) the permanent population number has decreased from 2011 to 2015 by 228 thousand people. During this period an average of 40 thousand RA citizens crossed the border annually and did not return<sup>16</sup>. According to the estimates of the World Economic Forum, Armenia has lost 25% of its population due to emigration<sup>17</sup>.

Figure 17. The Unemployment Rate in Armenia



16. RA Statistical Yearbook 2016: [www.armstat.am/file/doc/99499383.pdf](http://www.armstat.am/file/doc/99499383.pdf)

17. [www.weforum.org/agenda/2016/12/fifth-of-people-from-these-countries-live-abroad](http://www.weforum.org/agenda/2016/12/fifth-of-people-from-these-countries-live-abroad)

### 3. WHAT IS EXPECTED IN 2017?

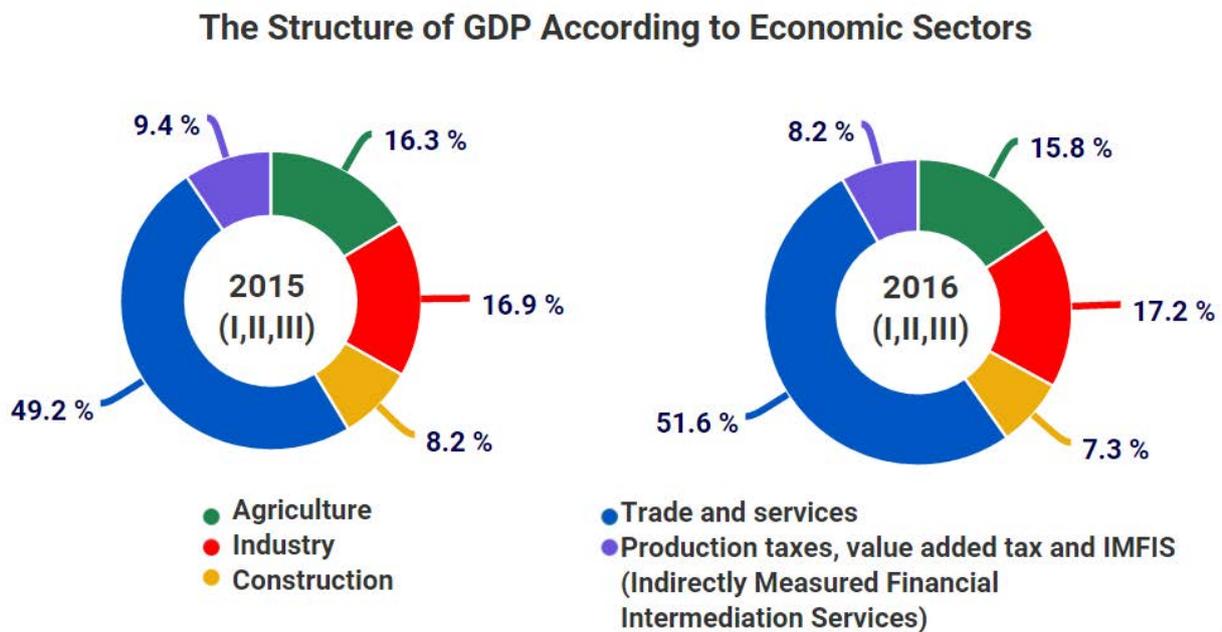
After 3% GDP growth in 2015 the index of economic activity started to decrease, especially in the second half of 2016. Foreign direct investments in the Armenian economy have been decreasing for the second year and Russian capital has been withdrawing particularly actively. The industrial sector of the economy continues to shrink, as is evidenced by the decline in volumes of industry, agriculture and construction in the GDP structure. In the second half of 2016, the Government and Central Bank started to take measures to restore economic activity and their results will already be reflected in 2017. The industry sector can have a positive impact on GDP if the high prices of non-ferrous metals, in particular copper, are maintained in the world market. However, GDP production primarily relies on trade and the service sector, the shares of which have already exceeded 50%. It is this sector that the GDP is going to be mainly dependent on in 2017.

The Government and the International Monetary Fund forecast a GDP growth of 3.2 to 3.4%<sup>18,19</sup> in 2017. However, the current economic situation allows us to conclude that it is going to be very difficult to achieve such growth. It is more likely that economic growth in 2017 will fluctuate around 2%.

In the list of economic realities of 2016, one of the positive developments was the growth in exports, which was around 20% more in the first three quarters than over the same period of the previous year. Moreover, unlike 2015, a 55.2% growth in exports to the Eurasian Economic Union zone has been observed, which has not affected export volumes to the third countries. Exports can have a real impact on the economy of RA, if the trend for growth accelerates even more in 2017.

The relative stability of the exchange rate of the Armenian dram over the past two years was possible to maintain in conditions of drastic reduction in imports and increase in exports.

Figure 18. The Structure of GDP of RA According to Economic Sectors



16. 2017 RA budget message

17. [www.weforum.org/agenda/2016/12/fifth-of-people-from-these-countries-live-abroad](http://www.weforum.org/agenda/2016/12/fifth-of-people-from-these-countries-live-abroad)

However, the outflow of foreign capital and the start of foreign debt repayments in 2017 will again subject the dram to shocks and possible further depreciation, especially if transfers do not increase.

In general, as a result of the dramatic fall in imports and transfers it becomes clear that the population has consumed less. This is substantiated by World Bank data and indicates a decline in living standards. In 2017, growth in the income of the population is possible, contingent on increased volumes of remittances, for which conditions have been created to improve the Russian economy and to maintain the recent increase in the ruble exchange rate. A certain increase in disposable income will boost domestic consumption.

Deflation was recorded in Armenia in 2016. This was attributed to the decrease in disposable income. A certain increase in prices can be expected in 2017 due to the increase in income. However, inflation can be somewhat curbed in the case of a decline in gas prices. A reduction in consumer prices without reducing consumption itself is only possible by the de-monopolization of a number of wide consumption commodity markets, about which the RA Prime Minister has regularly promulgated. However, despite a few isolated cases, this process is likely to be of a limited nature.

#### 4. CAN THE CURRENT ECONOMIC SITUATION ENCOURAGE CHANGES IN ECONOMIC AND POLITICAL THINKING?

The developments of recent years show that society in Armenia shows a much stronger reaction to those actions of the authorities that are directly related to the income of the population. The large-scale rallies against Yerevan transport price increases in 2013 and the electricity tariff hike in 2015 - both of which achieved some success - are proof of that. There is serious distrust in society of the current authorities over economic issues. However, experience shows that this distrust does not have a decisive impact during the elections. The point is that the social tensions created by the difficult economic situation continue to be exploited by the current authorities and transformed into electoral votes, through the application of election bribes and the use of administrative leverage. The high level of poverty, the population's low level of income and the limited sources of the latter, leave citizens with only two options: to adapt or to emigrate.

Over many years during the governance of these authorities, the economic system of the country has been viewed as a prop on which the power system was woven and developed, and around which the mechanisms for the reproduction of the authorities have been worked out and introduced. The imperative of economic reforms stemmed from this need, which is also evidenced by the intensive pre-election period of reforms and the adoption of the most difficult economic decisions in the post-election period.

2016 changed the attitude towards economic issues. The 4-day conflict in April shook the existing system and brought forward new priorities for Armenia's economy. It became obvious that Armenia's economy has some shortcomings to respond to the security challenges which, willingly or unwillingly, Armenia will have to face. This redefined the government's attitude towards the economy to a certain extent. Optimization measures at different levels and scales of state administration began to be taken.

In September a new government was appointed, which again adopted cost optimization and the increased efficiency of the use of government funds as an important principle. The existence in the country of corruption, economic monopolies, and numerous other phenomena and the struggle against them, began to be openly spoken about.

Although the effectiveness of the measures taken has not been outstanding so far, it is obvious that the issue of ensuring security can reinvent the ways of organizing the economy and the existing culture in the country. It is also the security issue that has directed the vectors of economic relations towards Russia, and the political dependence of Armenia on this country is gradually also evolving in the economic field; Armenia has almost nothing to offer to Russia in terms of economy. It is sufficient to mention that, over the period from January to October 2016, the trade turnover between RA and the EEU countries did not exceed 1% of the total turnover within the structure<sup>20</sup>. However, parallel to the political influence, RA is now also dependent on this country economically, due to the energy supplies, trade volumes, the large volume of transfers, as well as the large share of Russian capital in the Armenian economy. All of this got its formal expression within the scope of the Eurasian Economic Union.

2017 will be full of new challenges for Armenia, which will once again test the will and the flexibility of the authorities to impose economic reforms. The rapid decline of the economy and the parallel danger of possible military actions demand that serious steps be taken for the recovery of the economy. At the same time, parliamentary elections are scheduled for April, 2017. Only in the second half of the year will it be possible to assess what steps the authorities have taken to improve the economic situation and whether they were only pre-election measures or the beginning of real changes.

20. Mutual Trade, January-February 2016, Eurasian Economic Commission: [www.eurasiancommission.org/ru/act/integr\\_i\\_makroec/dep\\_stat/tradestat/tables/intra/Documents/2016/10/I201610\\_1.pdf](http://www.eurasiancommission.org/ru/act/integr_i_makroec/dep_stat/tradestat/tables/intra/Documents/2016/10/I201610_1.pdf)

## 5. WHAT ARE THE MAIN IMPERATIVES FOR THE RECOVERY OF THE ARMENIAN ECONOMY?

Serious and bold measures, requiring political will, are necessary for the recovery of the Armenian economy. Firstly, it is necessary to free the economy from the derivative role of the political system and make it a separate system which can develop and become established independently, eventually also contributing to the improvement of the political system.

The first step in the recovery of the economic system is the elimination of corruption in various state bodies. Transparency International's Corruption Perception index ranked Armenia 95th among 167 countries in 2015<sup>21</sup>. Big business in Armenia is interwoven with the system of government and benefits from a number of illegal privileges, which undermines economic competition in the country. The justice system, which fails to provide an appropriate legal framework for business, stands out with its high level of corruption.

The next biggest hindrance to the development of the economy is the existing monopoly in a number of markets. The export or import of a wide range of consumer products is controlled by a few companies in Armenia; this in itself hinders the development of the given sector, raises the prices of the specific products and leads to the growth of centralizations and an increase in income inequality.

For many years now, Armenian exports haven't succeeded in recording a significant leap and taking an essential role in the development of the economy. It is necessary to create a state export support system and also to make Armenia's potential export markets more diverse.

Recent years stand out in the outflow of foreign capital from Armenia. It is important to create an effective system of legal protection and a level

21. [www.transparency.org/cpi2015](http://www.transparency.org/cpi2015)

playing field for foreign investors. It is possible to attract a new wave of investments to Armenia by improving the environment, as well as by using the resources of the Armenian Diaspora.

The diversification of economic ties from the EEU to the EU, the Middle and the Far East is also essential for Armenia. In particular, the further development of economic ties with Iran and specifically, the strengthening of transport communication as a result of the use of the North-South highway and the operation of the railway (which is in its planning phase) can bring about significant changes. This will enable the south to be linked to Russia via Georgia and to Europe via the Black Sea, thus stimulating the

Armenian economy and strengthening the standing of the country in the region. After the failure of signing the Association Agreement in 2013, the establishment of a new level of economic relations with the EU could be an important step.

Structural transformation in the energy system may also become one of the tools for reviving the economy. Today, the economy of the RA is greatly dependent on Russia for its sources of energy; however, the involvement of an alternative gas supplier, as is Iran, and a wider application of Armenia's own means of electricity can significantly increase the independence of the energy system and promote economic development.

## About the author

Research, training and consulting center **"COMPASS"** was registered as an NGO in February 2014. The main aims of the center are directed to effective economic, social, political development through educational projects, implementation of different researches and providing consultancy services in Armenia.

## Imprint

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