- *Economic activity is showing signs of recovery, with the pace of contraction easing in February and mobility improving more recently, but the recovery may be tempered by rising COVID-19 infections.*
- *Inflation increased to 5.8 percent in March affected by international food price increases and dram depreciation.*
- *Trade balance improved, with exports recovering and imports remaining weak due to gradual pick-up in domestic activity.*
- *The budget turned to deficit in February mostly due to higher spending.*
- *The economic outlook continued to weigh on the banking sector, as intermediation slowed and soundness indicators weakened.*

The Economic Activity Index (EAI) registered a 5.3 percent yoy contraction in February, recovering from a 8.2 percent yoy decline in January. Industry (5 percent yoy decline) showed a slower pace of contraction in February, while the construction sector grew by 1.1 percent yoy. Services (12 percent yoy decline) and trade (11 percent yoy decline) remain hard hit. On a cumulative basis, the EAI contracted by 6.7 percent in the first two months of 2021. As the COVID-19 induced slowdown in economic activities started in March 2020, yoy growth is expected to improve in the coming months. GDP growth is projected at 3.4 percent in 2021[1] assuming no new lockdowns and resolution of the political tensions.

Economic recovery may be weakened by rising COVID-19 cases. Armenia registered around 900 infections daily in recent weeks compared to around 200 in February as daily test positivity rates increased from 6 percent in February to above 20 percent in early April. However, case increases have not been accompanied by additional restrictions, and mobility increased from an average of 75 percent of pre-COVID levels in February to 86 percent in early April. Vaccination commenced in March, but the pace has been hindered by limited vaccine supply. To date, Armenia has received 17000 doses of the Sputnik V vaccine and 24,000 doses of the Astra Zeneca vaccine.

Inflation increased further to 5.8 percent yoy in March, breaching the CBA target higher band. This has been driven by higher international prices, particularly of food, and by pass-through from dram depreciation. Almost all consumer basket items saw price increases, with the price of food and non-alcoholic beverages up by 7.4 yoy in March (following a 7.8 percent yoy increase in February). Prices of some food items, such as eggs, almost doubled prior to the Easter holiday. Taking into account the policy rate hike by 25 bps in February and overall weak demand, the Board of Central Bank of Armenia (CBA) decided to leave the policy rate unchanged at 5.5 percent on March 16.

Exports declined marginally by 2 percent yoy in February, while imports remained weak, resulting in further improvement in trade balance. Higher mineral exports, driven by higher copper prices (even as copper export volumes declined), offset a decline in exports of food products and precious stones, Imports contracted by 13.6 percent yoy in February, reflecting the slow revival of domestic demand. The trade deficit in the first two months of 2021 declined by 30 percent yoy. Based on the recently published Balance of Payment (BOP) data for 2020, the current account deficit improved from 7.2 percent of GDP in 2019 to 3.1 percent of GDP in 2020 as strong import compression was partly offset by a 12 percent yoy decline in remittances in 2020.

The dram remained under pressure. By April 8, the dram lost 2 percent of its value compared to a month ago, prompting intervention by CBA to smooth the exchange rate adjustment. International reserves peaked at US$3.2 billion in February due to the receipt of Eurobond funds, but declined to US$3 billion by end-March. Still, reserves provide about 7 months of import cover. Money inflows increased by 7 percent yoy (increased inflows from USA offset decline from Russia) while outflows declined by 4 percent yoy in February.

The budget registered a AMD47 billion deficit in February after registering a AMD65 billion surplus in January. The deficit was driven by a sharp increase in spending (10 percent yoy for social and 75 percent yoy for capital) and a 6 percent yoy decline in revenues. VAT collections plummeted by 18 percent yoy in February, which was offset in part by higher excise (16 percent yoy increase) and customs duties (21 percent yoy) collections. The cumulative fiscal balance as at end-February stood at AMD 18 billion surplus.

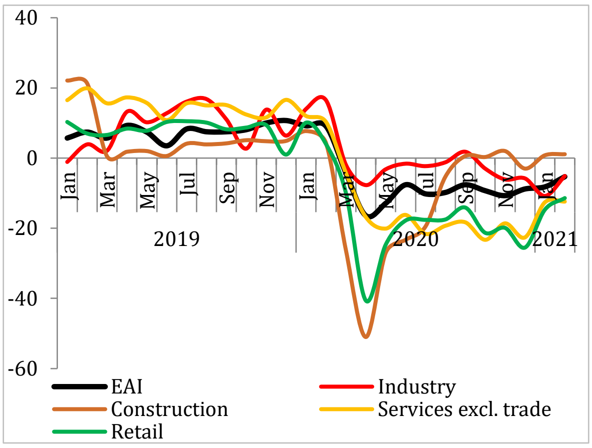
Banking sector growth continued to slow and soundness indicators weakened in February. Credit (adjusted for exchange rate changes) contracted by 2 percent yoy, despite an increase in loans to the construction sector and mortgages. Deposits also contracted by 2 percent yoy. NPLs edged up to 7.5 percent at end February while profitability indicators declined. Capital adequacy ratio remains around 17 percent, well above the 12 percent minimum threshold.

[1] See latest World Bank projections at: https://openknowledge.worldbank.org/bitstream/handle/10986/35273/9781464816987.pdf?sequence=4&isAllowed=y

Prepared by: Armineh Manookian, Economist, amanookian@worldbank.org

Figure 1. The economic activity remains very gradual

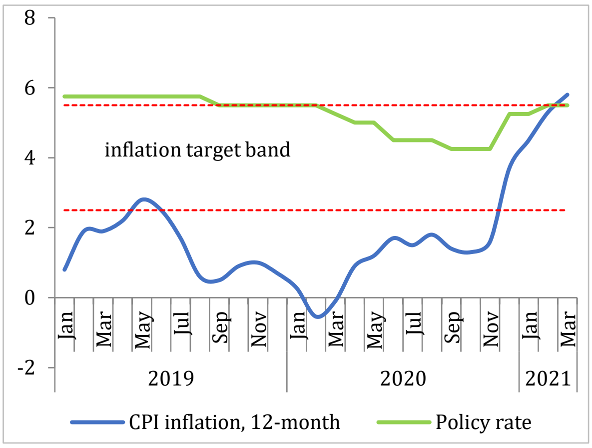
(Economic activity index, yoy change, in %)



Source: Statistical Committee of RA

Figure 2. Inflation inreased sharply, crossing the CBA target higher band

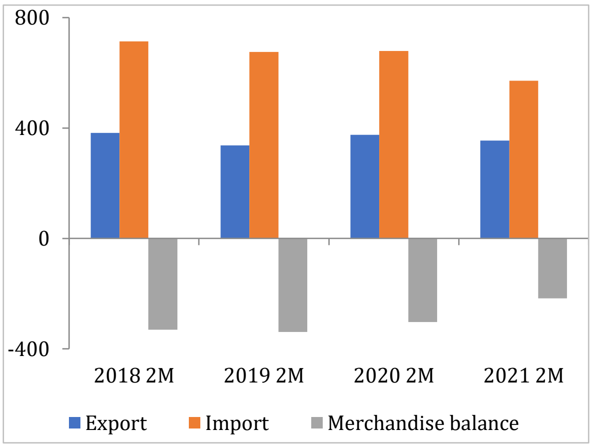
(CPI Inflation, y-o-y change, in %)



Source: CBA

Figure 3. The trade deficit continued to narrow as imports contracted more than exports

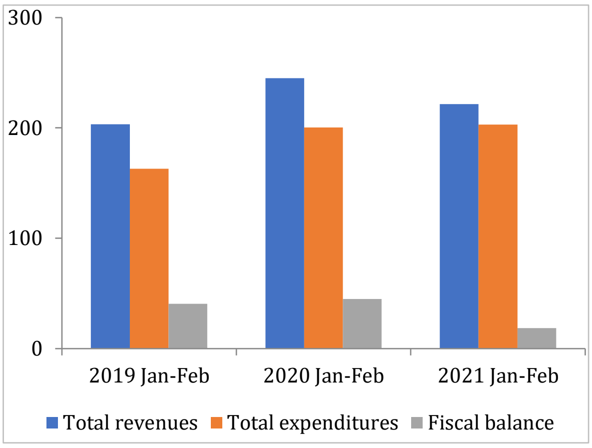
(in USD million)



Source: Statistical Committee of RA

Figure 4. The budget surplus declined due to higher spending in February

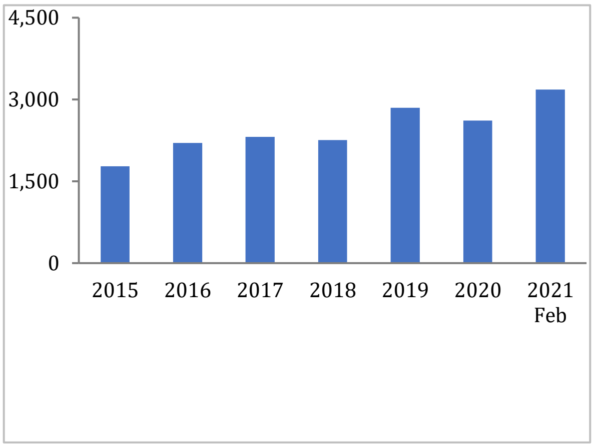
(in AMD billion)



Source: MOF

Figure 3. Reserves increased in February due to receipt of Eurobonds, but declined in March

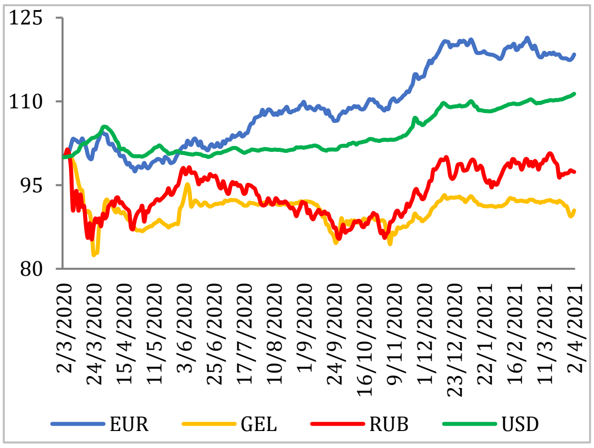
(in USD million)



Source: CBA

Figure 4: The dram continued to depreciate against the USD

(index, March 2, 2020=100)



Source: CBA