- *Growth was robust and broad based in January at 15.4 percent year on year (yoy), and the COVID-19 infection wave abated.*
- *Inflation fell to 6.5 percent yoy in February, but is expected to increase.*
- *Goods trade turnover increased by 60 percent yoy in January and the deficit almost doubled.*
- *The budget surplus fell marginally in yoy terms in January, as both capital expenditures and tax revenues increased substantially.*
- *Given the strong links with Russia, the Armenian economy will be adversely impacted by the Russia-Ukraine conflict through several channels – trade, remittances, commodity prices and FDI.*

The economy grew robustly by 15.4 percent yoy in January, up from 9.9 percent yoy in December 2021. Growth was broad-based: services (excluding trade) grew by 21 percent yoy, industry by 17 percent yoy and trade by 12 percent yoy, while construction grew more modestly by 3 percent yoy. Industrial output was supported mostly by manufacturing (25 percent yoy growth) and electricity generation (21 percent yoy) growth, while mining output remained flat. The fifth wave of COVID-19 infections abated in Armenia by end-February but vaccination coverage remains low, with only 42 percent of the adult population fully vaccinated as of March 6th.

Annual inflation continued to moderate though it remains above the target and inflationary pressures are expected to rise. After peaking at 9.6 percent yoy in November 2021, inflation fell sharply to January and slightly further to 6.5 percent yoy in February. However, inflation remains 1 percentage point above the upper band of the Central Bank's inflation target range (4+/-1.5 percent), while inflationary pressures are expected to increase with elevated international commodity prices, and possible supply disruptions related to the war.

Foreign goods trade picked up in January and the trade deficit widened. Both imports and exports grew sharply (by 65 percent and 53 percent yoy, respectively), but higher import prices and base meant that the trade deficit doubled in yoy terms. Imports of chemical products, machinery and minerals accounted for half of the increase in imports. On the export side, half of the export growth was driven by an increase in export of minerals (molybdenum and precious metal concentrates) and food products. Net transfers of individuals from abroad increased by 25 percent, yoy in January, driven by a 48 percent yoy increase in net inflows from USA, while transfers from Russia declined by 7 percent yoy.

The dram was stable until end-February, but has depreciated since the start of the Russia-Ukraine war. Since February 24th, the dram has depreciated by about 10 percent against the USD (at the exchange points as of March 10th), in line with trends observed in other countries with close links to the two economies. International reserves fell by USD 125 million in February, but at USD 3 billion at end-February still provide a healthy 6 months of import cover.

The budget traditionally records a surplus in the first month of the year. Tax revenues increased by 10 percent yoy in January 2022 on account of improved collection of indirect taxes (VAT and excises) and state duties. This offset a sharp yoy increase in spending, although from a low base in January 2021. Current expenditures increased by 17 percent yoy, while capital expenditures increased by ten-fold in yoy terms.

The economic impact of the Russian-Ukraine conflict remains fluid but is likely to be significant. Globally, the war and sanctions are expected to disrupt commodity and energy trade, increase related prices, disrupt financial flows, and add to the heightened level of uncertainty caused by COVID. In terms of commodities, Russia and Ukraine are major wheat exporters, accounting together for 25 percent of global exports, and have a significant share in global exports of natural gas, fuel, metals, seeds oil and corn. The impact on the Europe and Central Asia region will be amplified by the strong trade links with Russia and Ukraine, and also through remittances and tourism.

The Armenian economy will be adversely impacted by the conflict through several channels. Higher global food prices are likely to increase inflationary pressures in Armenia. In addition, Armenia's economy is closely linked to Russia through trade, remittances and FDI. In 2021, nearly 30 percent of Armenia's exports (6.1 percent of GDP) were bound for Russia with a diversified export basket including alcoholic spirits, textiles and food products. Declining economic activity in Russia may lower demand for these products, while the relative higher depreciation of the ruble may make Armenia's exports less competitive. Russian tourists accounted for 40 percent of the total tourist arrivals to Armenia in 2021. While the number of tourists is likely to decline, temporary relocation of people from the affected countries could result in increased arrivals. Remittances from Russia as a share of GDP have declined in recent years, but nonetheless remain significant at close to 5 percent of GDP, financing nearly one third of the deficit in merchandise trade. These flows are likely to decline with weaker economic activity in Russia, depreciating ruble, and restrictions on financial flows from Russia. Under a more severe contraction in Russia, many migrants may be forced to return to Armenia putting pressure on labor markets and fiscal spending.

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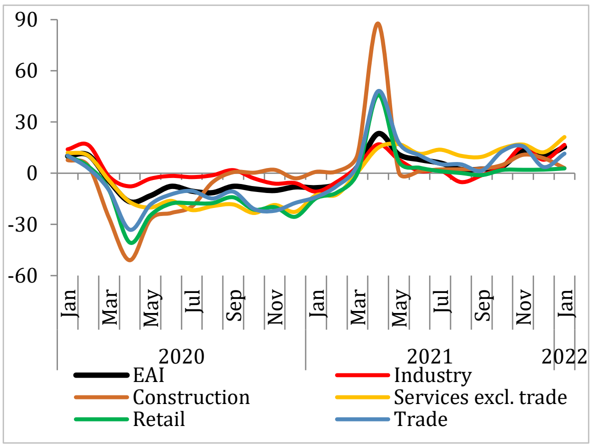
Figure 1. Economic growth was robust in January

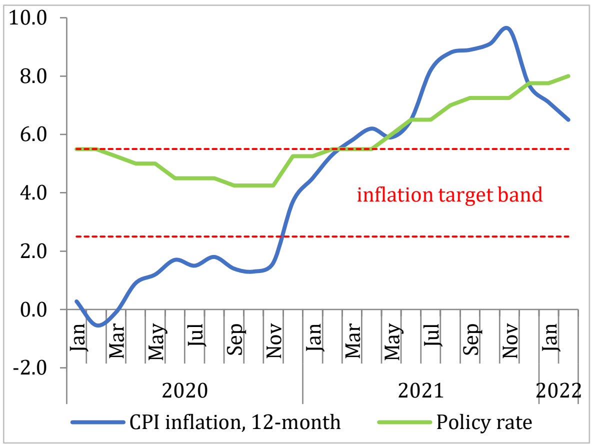
(Economic activity index, yoy change, in %)



Source: Statistical Committee of RA

Figure 2. Inflation continued to decline in February but remained above the target

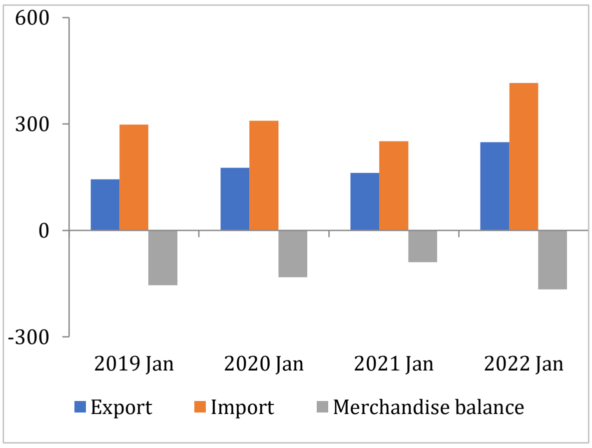
(CPI Inflation, y-o-y change, in %)



Source: CBA

Figure 3. Imports grew faster than exports and the trade deficit almost doubled

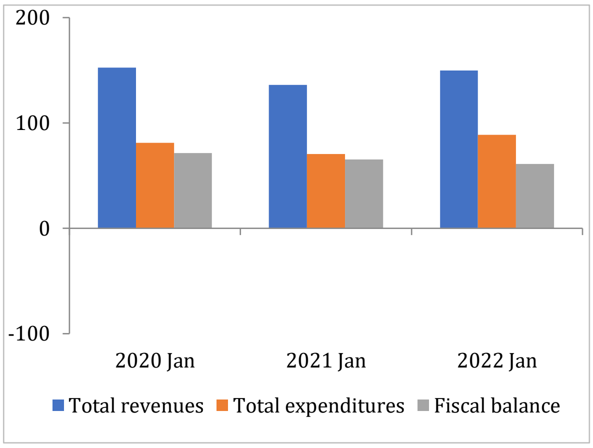
(in USD million)



Source: Statistical Committee of RA

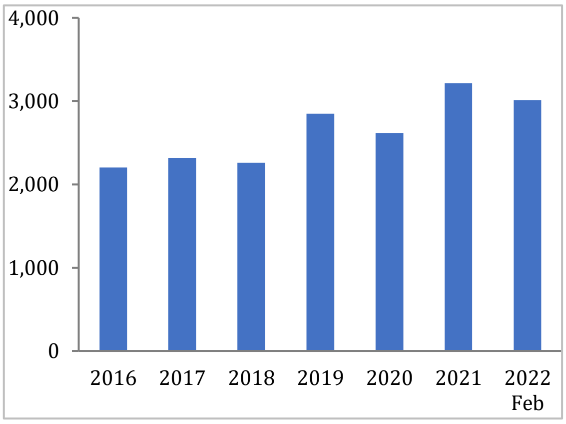
Figure 4. Both revenues and expenditures grew in January, with the budget recording a surplus

(in AMD billion)



Source: MOF

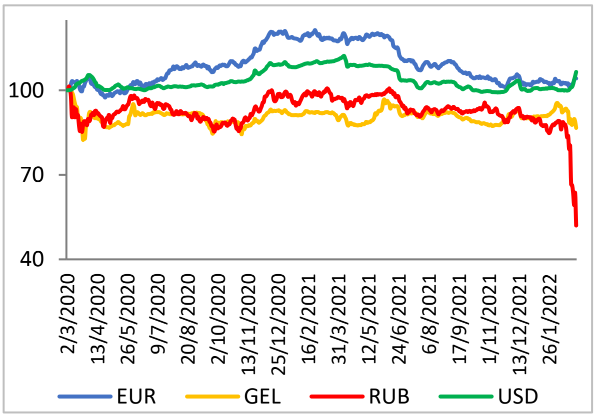
Figure 5. International reserves continue to provide a reasonable cover of imports



Source: CBA

Figure 6: The dram came under pressure since the start of the Russia-Ukraine conflict

(index, March 2, 2020=100, Index decline is depreciation against dram)



Source: CBA