

Subject: ARMENIA: Economic Report for April 2024

Summary

1. Armenia's economic activity index surged an impressive 14.3% in the first quarter of 2024. Foreign trade exhibited significant expansion, increasing by 210.0%, with exports and imports climbing by 270.0% and 175.8%, respectively. However, deflationary pressures persist, with the consumer price index declining by 1.2% and the industrial product index by 0.3%.
2. The International Monetary Fund (IMF) forecasts Armenia's GDP to grow by 6% in 2024, up from the previous prediction of 5%, with inflation expected to rise to 3.1% in 2024 and unemployment projected to reach 13%. The current account deficit is anticipated to increase to 2.8% of GDP in 2024.
3. The World Bank (WB) projects Armenia's economy to grow by 5.5% in 2024, surpassing earlier estimates, yet warns of security and geopolitical risks as regards the peace and normalisation process with Azerbaijan, while also forecasting a gradual increase of inflation to 4% by 2026, alongside a budget deficit of 4.7% in 2024 due to refugee support measures, necessitating increased capital expenditures for infrastructure development.
4. The Central Bank of Armenia reduced the core interest rate to 8.25%.
5. The Armenian dram strengthened over 20% since spring 2022 due to a floating exchange rate policy and an influx of Russian businesses, benefiting importers but challenging exporters and foreign investment.
6. Armenia's energy strategy involves diversifying gas supplies, prioritizing nuclear and renewable energy, and aiming to improve self-sufficiency by 2040-2050 through expansion of solar and wind power capacity, amidst infrastructure challenges and geopolitical complexities.
7. Prime Minister Pashinyan raised concerns regarding the "Mars" plant transfer to Russia in 2022 as part of Armenia's debt repayment strategy.

Details:

Macroeconomic developments

1. Armenia's economic activity index¹ grew by 14.3% in the first quarter of 2024² compared to the same period of 2023. It increased by 15.3% in March alone, compared to the same month of 2023, and grew by 10.4%, juxtaposed to February 2024. All the sectors of the economy have shown growth except for electricity production, which declined by 1.4%. **Foreign trade turnover increased by 210.0%. The exports increased by 270.0%, and the imports grew by 175.8%.** The trade balance remains negative at USD 324.1 million. Exports make up 93.2% of imports. **The deflation continues, with the Consumer price index down by 1.2% and the industrial product index by 0.3% in the mentioned period.**
2. The IMF forecasts Armenia's GDP to grow by 6% in 2024, up from the previous prediction of 5%, with a slowdown to 5.2% in 2025. Inflation is expected to rise to 3.1% in 2024 and further to 3.7% in 2025. Unemployment is projected to reach 13% in 2024 and

¹ **Economic Activity Index** is a monthly aggregate indicator of change in output real volume in economy

² **Armstat report EAI** - <https://armstat.am/file/doc/99546663.pdf>

13.5% in 2025. According to IMF forecasts, the current account deficit is anticipated to increase to 2.8% of GDP in 2024 and to 3.6% in 2025.

3. **The WB's latest economic update for Armenia** paints a promising picture, anticipating a robust growth trajectory. Projections indicate that the **Armenian economy is poised to expand by 5.5% in 2024, a notable uptick from the previously estimated 4.7%**. WB experts state that poverty and unemployment continue to decline. However, alongside these optimistic forecasts, the report underscores lingering risks, including ongoing tensions with Azerbaijan and broader geopolitical instabilities, potentially impacting Armenia's economic stability.
4. The **WB report also delves into inflationary trends, forecasting a gradual increase to 3% in 2024**, then to the inflation target of 4% in 2026. **Armenia's budget deficit is projected to reach 4.7% in 2024**, primarily attributed to support measures for refugees, necessitating a focus on fiscal consolidation in the medium term. Concurrently, capital expenditures are expected to rise as a percentage of GDP, reflecting efforts to address critical infrastructure gaps and bolster long-term economic resilience.
5. The **CBA decreased the refinancing rate by 0.25 percentage points to 8.25% on 30 April 2024**. The CBA also reduced the Lombard repo rate to 9.75%. This marks the eighth decrease in the refinancing rate since June 2023.
6. **For nearly two years, the Armenian dram (AMD) has consistently exhibited strength in its exchange rate dynamics**, notably against the main hard currencies, including EUR and USD, with a more than 20% increase observed over spring 2022. Against a backdrop of global dollar appreciation, this strengthening is attributed to Armenia's floating exchange rate policy and liberalized capital market. Demand for the dram surged in 2022 due to Russians relocating businesses and subsequent income flows from third countries, while a transition to ruble payments for gas contracts reduced USD demand. The stronger dram benefits importers through reduced costs and deflation but poses challenges for exporters and foreign investment attractiveness. Nonetheless, it aids in servicing foreign debt, paying for imported arms and may face potential weakening tied to the Russian ruble's performance.

Energy

7. **Current Energy Landscape.** Armenia's energy sector operates within a blend of domestic production and external dependencies. With an installed capacity of approximately 1.3 thousand megawatt (MW) Armenia's energy system is a mix of nuclear, thermal, hydroelectric, and renewable sources. Notably, solar energy has seen significant growth, contributing 480 MW to the overall capacity. However, despite these strides, Armenia remains heavily reliant on imported energy resources, sourcing 73% of its energy needs from external suppliers in 2022. This dependency, particularly on gas imports from Russia and Iran, underscores vulnerabilities to geopolitical tensions and market fluctuations in supplier countries.
8. **Gas Supply Diversification.** Babken Tunyan, head of Armenia's Parliament Standing Committee on Economic Affairs, emphasizes the need to diversify gas supplies for enhanced energy security. While Armenia currently relies on gas imports from Russia and Iran, Tunyan highlights the importance of exploring alternative sources, including potential purchases from Azerbaijan. Deputy Minister Hakob Vardanyan also underscores Armenia's readiness to restore gas pipelines from Azerbaijan, pending diplomatic relations between the two countries, illustrating geopolitical complexities.
9. **Transition to Nuclear and Renewable Energy.** Tunyan outlines Armenia's commitment to reducing gas dependency by prioritizing nuclear, renewable, and solar energy. The Government aims to increase the share of solar energy to 15% by 2030, aligning with efforts to enhance energy sustainability and mitigate environmental impact. Investing in renewables not only reduces reliance on imported gas but also yields long-term economic and

environmental benefits.

10. **Infrastructure Challenges and Regional Cooperation.** Armenia's energy sector faces challenges in infrastructure development and regional cooperation, notably regarding the North-South energy corridor project. Delays in completing the power line construction between Iran, Armenia, and Georgia underscore the complexities of cross-border energy initiatives, necessitating coordinated efforts among stakeholders.

The EU is providing a grant of EUR 10 million to the Caucasus Transmission Network project, originally estimated to cost EUR 127 million. KfW is implementing the project and has suffered many delays. The market situation of these infrastructures is currently very difficult due to the energy crisis that erupted after Russia's invasion of Ukraine. FICHTNER, the consultancy company hired by the implementer, estimates that the value of the project will be much higher than foreseen, and it will require additional financial resources. The Armenian Government has decided to proceed with the original plan following successful negotiations with the German KfW bank and has requested an accelerated implementation plan, a discussion on which has already started. Meanwhile, the Armenia – Iran high-voltage line, funded by Iran, confronts challenges due to US sanctions, raising concerns about its viability.

11. **Nuclear Power Plant Development.** To enhance energy independence, Armenia plans a new nuclear power plant with a capacity of 600 MW. A new plant will take 8-10 years to build. Feasibility studies are underway, with involvement experience from Russia, US, and South Korea. Despite aging infrastructure, Armenia reaffirms its commitment to nuclear energy, as evidenced by extending the lifespan of the Metsamor Nuclear Power Plant (NPP) until 2026 following extensive modernization and technical upgrades. The current NPP, the sole facility in the South Caucasus region, contributes less than 40% of Armenia's electricity. Mikhail Chudakov, Deputy Director of the IAEA reaffirming its safety.
12. **Future Energy Outlook.** In its Energy Sector Development Strategic Programme Armenia aims to improve its energy self-sufficiency by 2040-2050 through a mix of nuclear and renewable sources. Plans include expanding solar and wind power capacity to reach 2000 MW by 2040. However, challenges persist, with the country currently importing a significant portion of its energy resources, indicating a need for increased energy independence.

Debt repayment

13. **Armenia's Prime Minister Nikol Pashinyan, in a parliamentary address, discussed the transfer of the Mars plant to Russia.** Despite the plant's considerable capacity, only a small portion is currently operational for production, prompting Pashinyan to advocate for its full utilization to benefit Armenia's economy. This transfer was a result of an agreement signed in 2002 between Armenia and Russia, known as the assets-for-debt deal, to settle Armenia's USD 93 million state debt to Russia.

Armenia's debt settlement strategy during presidency of Robert Kocharyan has raised concerns about increased Russian influence in its energy sector, particularly regarding thermal power plants and hydroelectric plants. While other ex-Soviet states like Ukraine and Georgia, which also owe significant debts to Russia, have managed to reschedule repayment of their debts.

Sign-off: Vassilis Maragos, Head of Delegation