

# ARMENIA

Despite headwinds, the economy grew strongly in 2022 on rapid expansion in consumption and services reflecting an influx of people and capital from the Russian Federation. Fiscal and current account deficits narrowed, but inflation accelerated. Growth is expected to moderate in 2023 and 2024 as stimulus from inflows of capital, people, and firms from the Russian Federation wanes. Inflation is expected to moderate, and the current account deficit to widen slightly. Strengthening education is critical for inclusive and sustainable growth.

## Economic Performance

### Economic growth more than doubled from 5.7% in 2021 to 12.6% in 2022, the highest rate since 2008.

Rapid growth came from buoyant demand and soaring investment that reflected a large influx of people and capital from Russia.

### On the supply side, a pickup in consumption

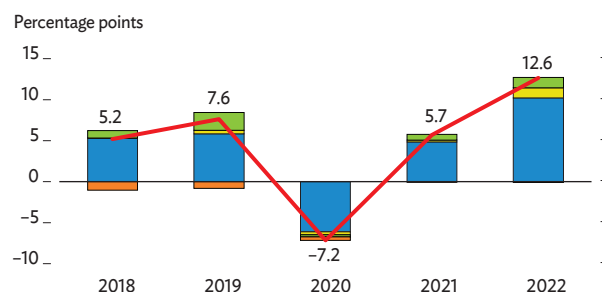
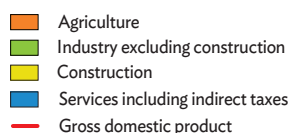
**boosted services.** Expansion in services jumped from 6.9% in 2021 to 17.7%, contributing 10.2 percentage points to growth in 2022 with increases in all subsectors except health (Figure 2.1.1). Transportation, information and communication, and financial services continued strong double-digit growth for a second consecutive year at an annual rate of 45%–47%, reflecting a further spike in domestic and external demand. Industry excluding construction grew by 6.4%, up from 3.5% in 2021, with growth in manufacturing and utilities offsetting a 3.4% decline in mining and quarrying. Construction expanded by about sixfold to 18.8% in line with a rise in public and private investment. However, agriculture contracted further by 0.7% in 2022, a similar drop as in 2021, from lower livestock production.

### On the demand side, growth was led by

**consumption.** Growth in private consumption more than doubled from 3.4% in 2021 to 8.2%, mainly reflecting a surge in money transfers including

### Figure 2.1.1 Supply-Side Contributions to Growth

Growth accelerated sharply in 2022, driven by consumption-led services.



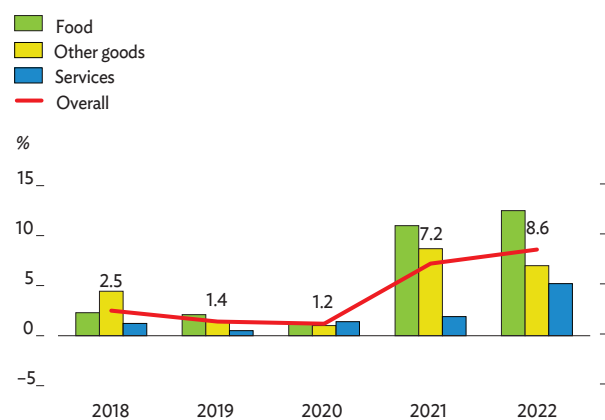
Source: Statistical Committee of Armenia.

remittances. Growth in public consumption slowed from 8.4% in 2021 to 6.5% in line with fiscal consolidation. Expansion in gross fixed capital formation increased from 6.3% in 2021 to 9.5% in 2022 on higher government allocations to infrastructure projects and increased private investment. The deficit in net exports of goods and services narrowed sharply as exports grew faster than imports.

**Inflation accelerated on strong demand and high food prices.** Average annual inflation accelerated from 7.2% in 2021 to 8.6% in 2022 as domestic demand strengthened and global commodity prices rose (Figure 2.1.2). Prices rose by 12.5% for food, 7.0% for other goods, and 5.2% for services. Inflation was 8.3% year on year in December 2022, well above the upper limit of the Central Bank of Armenia’s target range of 2.5%–5.5%. To restrain inflation, the central bank continued tightening monetary policy for a second consecutive year in 2022 by raising its policy rate a cumulative 300 basis points in six steps to reach 10.75% by year-end.

**Figure 2.1.2 Annual Inflation**

*Inflation accelerated further in 2022, following on high inflation in 2021.*

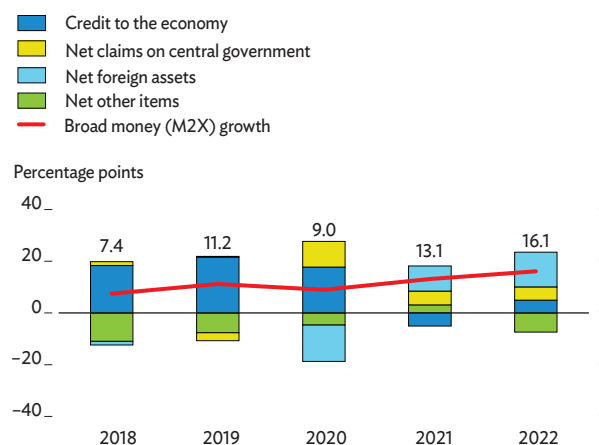


Source: Statistical Committee of Armenia.

**The financial system remains healthy.** Broad money growth accelerated from 13.1% in 2021 to 16.1% in 2022, fueled by higher economic activity and by strong money transfers and capital inflows (Figure 2.1.3). Net foreign assets turned positive for the first time since 2011, reflecting an 8.4% rise in the central bank’s net foreign assets and a 29.5% reduction in the negative balance of net foreign assets in depository institutions. Credit to the economy grew by 4.5%, driven mainly by 32.5% higher mortgage lending, following an already strong 34.7% rise in 2021, about 80% of which were mortgages denominated in Armenian dram. Higher transfers and average deposit rates helped increase local currency deposits by 15.9% in 2022 and foreign currency deposits by 21.0%. Bank profitability improved on higher foreign exchange gains, lower provisioning, and other noninterest income. Nonperforming loans rose slightly in 2022 but remained low at 2.6% of all loans.

**Figure 2.1.3 Contributions to Broad Money Growth**

*A significant rise in net foreign assets increased broad money supply in 2022.*

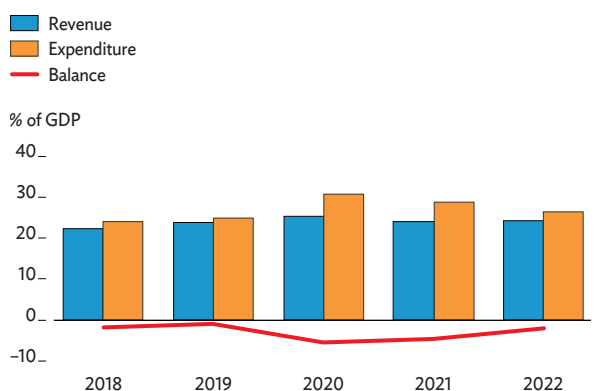


Source: Central Bank of Armenia.

**Gradual fiscal consolidation is under way.** Despite higher capital outlays to support long-term growth, fiscal policy tightened as the budget deficit narrowed from the equivalent of 4.6% of GDP in 2021 to 2.1% in 2022 (Figure 2.1.4). Robust growth, high commodity prices, and improved tax administration raised government revenue from 24.1% of GDP in 2021 to 24.3% in 2022. Budget expenditure grew by 11.9% but declined as a percentage of GDP from 28.7% in 2021 to 26.4%. Capital outlays grew by about 76% to equal 4.5% of GDP, in line with the government’s plan to spur public investment in infrastructure, but

**Figure 2.1.4 Fiscal Indicators**

*The fiscal deficit fell by more than half in 2022, reflecting improved revenue performance.*



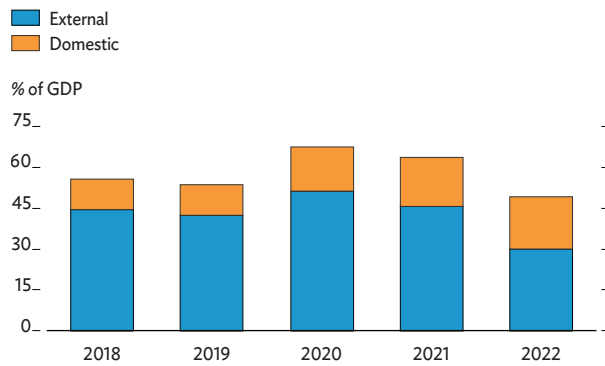
GDP = gross domestic product.

Sources: Ministry of Finance; Statistical Committee of Armenia.

current spending increased by only 4.2%. Reflecting high growth and currency appreciation, public debt declined sharply from 63.4% of GDP in 2021 to 49.3%, well below the official 60% ceiling despite rising in nominal terms (Figure 2.1.5). External public debt declined by 3.0% to \$6.5 billion, equal to 29.9% of GDP, while domestic public debt climbed by 62.5% to \$4.2 billion. The share of domestic debt in all debt increased by 11.4 percentage points to 39.4%, in line with the government’s strategy to shift its borrowing to domestic sources.

**Figure 2.1.5 Public Debt**

Public debt declined sharply in 2022 on higher economic growth and appreciation of the Armenian dram.

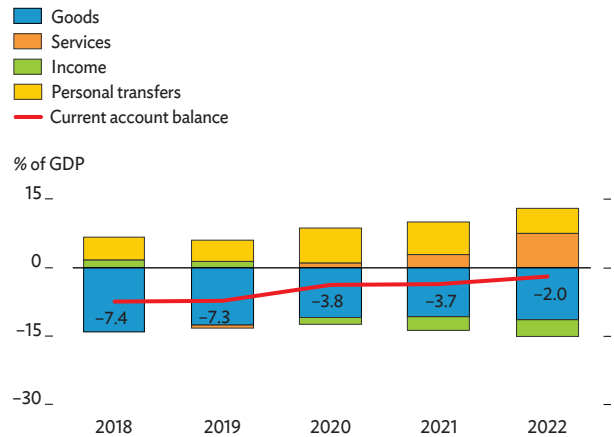


GDP = gross domestic product.  
Sources: Ministry of Finance; Statistical Committee of Armenia.

**Armenia’s external position improved, reflecting a marked surplus in services and higher money transfers, mainly from Russia.** The current account deficit narrowed from the equivalent of 3.7% of GDP in 2021 to an estimated 2.0% (Figure 2.1.6). The merchandise trade deficit widened from 10.9% of GDP to an estimated 11.5% with the rise of what appears to be transit trade through Armenia, spurring double-digit growth in both exports and imports. The surplus in services grew roughly fourfold in 2022, reflecting gains in finance and in travel and tourism services. The income deficit widened slightly on a larger deficit in investment income and employee compensation from abroad. However, net money transfer inflows by individuals through banks tripled to \$2.6 billion. The current account deficit in 2022 was financed by modest public sector borrowing but mainly by foreign direct investment, which rose from the equivalent of 2.5% of GDP a year earlier to an estimated 4.0%. Growth in gross international reserves rose from 23.5%

**Figure 2.1.6 Current Account Components**

The current account deficit narrowed as surpluses in services and personal transfers increased sharply.



GDP = gross domestic product.  
Source: Central Bank of Armenia; Statistical Committee of Armenia.

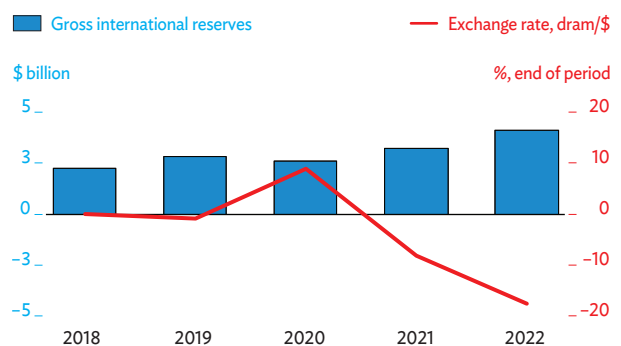
in 2021 to 27.2% to reach an all-time high of \$4.1 billion at the end of 2022, providing cover for 4.6 months of imports of goods and services (Figure 2.1.7). The dram appreciated in 2022 by 20.9% in nominal effective terms and by 27.6% in real effective terms.

## Economic Prospects

**Growth will slow to 6.5% in 2023 and 5.5% in 2024, reflecting base effects from last year’s exceptional performance** (Figure 2.1.8 and Table 2.1.1). Both domestic and external demand will support growth. However, external demand should grow more slowly

**Figure 2.1.7 Reserves and Average Exchange Rates**

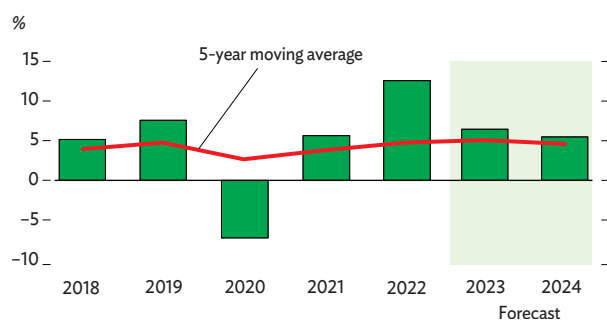
Reserves are at a historic high.



Source: Central Bank of Armenia.

**Figure 2.1.8 Gross Domestic Product Growth**

Growth is expected to moderate over the next 2 years.



GDP = gross domestic product.

Sources: [Statistical Committee of Armenia](#); Asian Development Bank estimates.

**Table 2.1.1 Selected Economic Indicators, %**

Growth and inflation are projected to slow during 2023 and 2024.

	2021	2022	2023	2024
GDP growth	5.7	12.6	6.5	5.5
Inflation	7.2	8.6	7.0	6.2

GDP = gross domestic product.

Source: Asian Development Bank estimates.

considering adverse economic prospects in Russia and an expected slowdown in other trade partner countries. Uncertainties stemming from the Russian invasion of Ukraine may include a continued influx of people, firms, and capital, spurring domestic demand.

#### **On the supply side, services will remain the key driver of growth.**

Services are projected to grow by a further 9.4% in 2023 before moderating to 5.4% in 2024, reflecting gains in finance, recreation, retail trade, and transport and communications. Industry excluding construction is projected to grow by 3.5% in 2023 and 5.5% in 2024 as manufacturing expands further, benefiting from higher output of processed foods, textiles, and other nonmetal products. Growth in construction is projected at 17.6% in 2023 and 12.9% in 2024, primarily on increased government capital expenditure in 2023 and 2024 and as planned substantial public investments on the north–south regional road take place. Agriculture is projected to rebound by 1.1% in 2023 and 2.2% in 2024, assuming favorable weather and higher spending on government programs that offer subsidies for smart livestock

buildings and intensive gardening. A pilot program of land consolidation, to be implemented in 2023–2025, will likely support long-term growth in agriculture.

#### **On the demand side, consumption and investment will again contribute to growth, though to a lesser extent.**

Growth in private consumption is projected to moderate to 6.9% in 2023 and 5.1% in 2024 as money transfers including remittances fall off their record high in 2022. Public consumption is projected to grow by 4.1% in 2023 and 4.7% in 2024 on public salary increases in January 2023, larger pensions from July 2023, and higher social spending. Growth in investment is projected at 7.4% in 2023 and 7.1% in 2024, reflecting a roughly 40% rise in capital outlays from the state budget in 2023.

**Inflation will gradually moderate.** With lower growth, a smaller budget deficit, monetary tightening, and a smaller rise in international commodity prices, average inflation is projected to slow to 7.0% in 2023 and further to 6.2% in 2024. The projection assumes normal weather and no steep currency depreciation. By the end of the year, inflation is forecast to be almost within the 5.5% upper limit of the central bank's inflation target. Monetary policy is expected to remain tight throughout most of 2023 to curb inflation, easing gradually toward the end of 2023 and in 2024 as both domestic and external demand moderate.

#### **The pace of fiscal consolidation will ease to accommodate targeted support to the economy.**

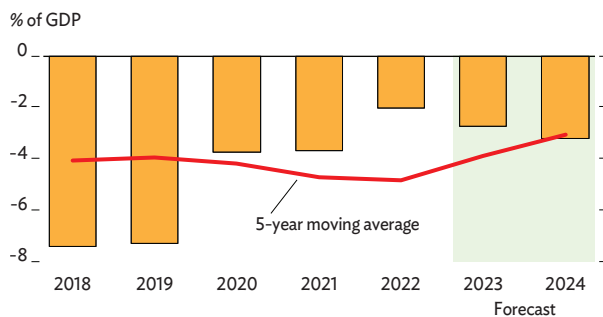
The 2023 budget projects a deficit equal to 3.1% of GDP and revenue increasing to 24.7% of GDP as growth moderates, and tax administration is further improved. The government's goal is to increase capital spending gradually to support and sustain long-term growth while further reducing the ratio of public debt to GDP. In July 2022, a legal requirement was introduced that no transactions equivalent to more than \$750 be paid in cash, which is expected to raise tax revenue. Expenditure is forecast to reach the equivalent of 27.8% of GDP with plans to raise salaries, pensions, allocations for social expenditure, and capital outlays, which are projected to reach 5.7% of GDP in 2023. Barring sharp depreciation of the dram, public debt is expected to remain around 50% of GDP at the end of 2023.

**A widening current account deficit is projected to equal 2.7% of GDP in 2023 and 3.2% in 2024.**

The surplus in services and money transfers including remittances is expected to moderate after exceptional performances in 2022 (Figure 2.1.9). The merchandise trade deficit is forecast to widen further to 12.6% of GDP in 2023 and 14.2% in 2024. Despite continuing transit trade, growth in merchandise exports is projected to moderate to 14.5% in 2023, with higher exports of processed food, agricultural products, nonferrous metals, machinery, and equipment. And, despite new infrastructure projects, growth in imports is expected to moderate to 16.5% in 2023 in line with slower growth in private consumption.

**Figure 2.1.9 Current Account Balance**

The current account deficit is projected to widen slightly over the next 2 years.



GDP = gross domestic product.

Sources: Central Bank of Armenia; Statistical Committee of Armenia; Asian Development Bank estimates.

## Policy Challenge—Strengthening Education for Inclusive and Sustainable Growth

**Armenia has made real achievements in education, but challenges remain.** Despite significant reform in recent decades, numerous issues remain regarding the accessibility, quality, and efficiency of education. Low educational attainment leaves students with skills that are inadequate and do not match labor demand. The Human Capital Index of the World Bank scored Armenia at 0.58 in 2020, significantly below the

0.69 average for Europe and Central Asia. The score indicates opportunities for students stagnating, and that children born in Armenia today will only be 58% as productive as they could have been had they received a full set of health and education services. While gross enrolment ratios for lower secondary education are unchanged over the past decade, those for primary and upper secondary school have declined, education reform is thus essential to boost productivity and promote sustainable and inclusive long-term growth.

**Armenia needs education standards that meet the requirements of post-secondary institutions and the labor market.** Further improvement and full implementation of the national qualification framework will ensure that achievements are comparable with the comprehensive framework of European qualifications. Also important are increasing access to e-learning, especially in rural areas, through distance learning services, open resource online applications, and online courses at all levels of education. Recognizing the importance of providing high-quality and continuing education while ensuring continuity in formal schooling, the government tapped experience gained under the COVID-19 pandemic and introduced in 2022 a comprehensive distance education platform as an alternative to offline education under certain conditions. It is essential to expand existing innovative and creative multidisciplinary centers for education outside of conventional school buildings.

**Armenia annually invests 2.2% of GDP on average in education, below the 4.1% average in upper-middle-income countries.** Because financial resources for education are limited, they require an evidence-based system to efficiently manage education that includes the key indicators needed for proper program budgeting. For efficiency, the government has initiated a process of separating administrative and economic management functions in schools from course content management, and of centralizing administrative and economic management. Meanwhile, investment in school infrastructure and physical conditions for learning is also important to improved accessibility and quality. This requires increased capital outlays to build earthquake-resistant schools across the country.