Armenia:
A Cloudy Outlook

WORLD BANK GROUP
Macroeconomics & Fiscal Management

Armenia Economic Report No.6
Fall 2014

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Government Fiscal Year:	January 1 – December 31
Currency Equivalents:	Exchange rate as of September 17, 2014
	Currency unit = Armenian Dram (AMD)
	US$1 = AMD 408.36
Weights and Measures:	Metric system

Abbreviations and Acronyms

ADS	Armenia Development Strategy
AMD	Armenian dram
CAD	Current account deficit
CBA	Central Bank of Armenia
CGE	Commonwealth of Independent States
CIS	Computable General Equilibrium
CIT	Corporate income tax
CPI	Consumer Price Index
DB	Doing Business
DCFTA	Deep and Comprehensive Free Trade Agreement
DPO	Development Policy Operation
ECA	Europe and Central Asia
ECU	Eurasian Customs Union
EEU	Eurasian Economic Union
EFF	Extended Fund Facility
EU	European Union
FDI	Foreign direct investment
GEP	Global Economic Prospects
GCI	Global Competitiveness Index
GDP	Gross domestic product
IMF	International Monitory Fund
JICA	Japan International Cooperation Agency
MOF	Ministry of Finance
m-o-m	Month-on-month
MTEF	Medium-Term Expenditure Framework
NPL	Nonperforming loans
NSS	National Statistics Service
SES	State Employment Service
SITC	Standard International Trade Classification
STRI	Services Trade Restrictiveness Index
WITS	World Integrated Trade Solutions
WTO	World Trade Organization
VAT	Value-added tax
y-o-y	Year-on-year

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Acknowledgements

This issue of the *Armenia Economic Report* was prepared by the World Bank economic team of Ulrich Bartsch (senior country economist), Donato De Rosa (senior country economist), Gohar Gyulumyan (senior economist), and Tigran Kostanyan (economist). Comments from Nvard Manasyan and Nistha Sinha are gratefully acknowledged. The authors are also grateful to Ivailo V. Izvorski (practice manager) and Rashmi Shankar (program leader for the South Caucasus Country Management Unit) for general supervision.

Overview

Economic growth slowed to 3.5 percent in 2013 and 2.7 percent year-on-year in the first half of 2014. The slowdown is the result of a number of factors such as slackening foreign direct investment (FDI), dependence on a limited number of commodity exports, and a difficult external economic environment. Consumer lending and remittances continued to support private consumption, but under-execution of government spending suppressed aggregate demand. On the supply side, the mining and energy sectors performed particularly badly, offsetting positive developments in manufacturing.

Year-on-year inflation reached close to zero in August 2014, following a long decline since energy price increases caused it to flare up in July 2013. Twelve-month inflation slowed to 0.8 percent in August, well below the central bank's 2.5–5.5 percent target range. The decline came despite new electricity price increases in the same month. On the whole, second-round price pressures were minimal. Core inflation, excluding prices for food and fuel, was being held below headline inflation in the second half of the year.

The expectation of accession to the Eurasian Economic Union (EEU) has not yet had much impact on Armenia's trade profile. In fact, exports to the EEU declined. Among the developing Commonwealth of Independent States (CIS), trading partner slowdowns, geopolitical tensions, declining metal and mineral prices, and domestic capacity constraints have been slowing growth this year. The anticipated shift to the EEU will undermine Armenia's medium-term export prospects because demand will grow more rapidly in the EU. Rising demand from advanced countries in Europe contributed to export growth of 11.5 percent in March (year-on-year).

During the first half of 2014, political developments complicated the environment for economic growth. A new cabinet was formed when the prime minister resigned in April after a long period of sluggish economic reforms. Though initial expectations were that it could be effective in the first half of 2014, Armenia's accession to the EEU is still pending. It is now foreseen that Armenia will sign the accession treaty in October and join on January 1, 2015. Meanwhile, regional tensions have increased geopolitical and economic uncertainty, and growth in Russia—Armenia's most important trading partner—is forecast to decline to 0.5 percent for 2014 as a whole.

The incidence of poverty is recovering slowly from the 2009 economic crisis, in line with growth dynamics. The composition of the consumption basket for both poor and non-poor groups of Armenians to some extent offset poverty pressures related to price increases. Employment is not a sufficient safeguard against poverty; the poverty rate among the employed grew from 22.2 in 2008 to 26.1 percent in 2012. Up to 2009, the shared prosperity, or growth in average consumption of the bottom 40 percent, experienced high annual growth of 4.3 percent. Then came a large contraction of 7.5 percent during the crisis and a subsequent recovery to growth of 3.4 percent between 2010 and 2012.

A. Recent Political Developments

Regional tensions and a slowdown in economic growth in Russia are the most crucial challenges to investment sentiment and trade patterns in the region. The crisis impacted the Armenian economy through lower Russian and EU demand for its exports and a slowdown in FDI and remittances.

In the first half of 2014, political developments made economic growth difficult. After Prime Minister Tigran Sargsyan resigned in early April, parliament confirmed the new cabinet formed in May and approved the Government Program for 2014–17. The program reaffirms the government's commitment to structural reforms, shows a high degree of policy continuity, and emphasizes implementation.

In mid-June the National Assembly amended the controversial reform of the national pension system. Heavy opposition to the reform had contributed to the cabinet's resignation in April, and the Armenian Constitutional Court had declared certain provisions unconstitutional. The new bill allows Armenians working for private entities to opt out of the retirement plan until July 2017, but the reform will be mandatory for about 65,000 public employees.

Armenia's accession to the EEU is still pending although previously it was expected to become effective in the first half of 2014. The meeting of the prime ministers of Armenia and Russia in Sochi on July 11th set a new target date of January 1, 2015, for accession, with the treaty on accession to be signed in October.

A significant flare-up of tensions in late July-early August between the two sides in the Nagorno-Karabakh conflict led to fears of full-scale escalation. Military engagements resulted in a few dozen casualties on both the Armenian and the Azerbaijani sides. Financial markets reacted immediately to the heightened risks, and the Central Bank of Armenia (CBA) stepped in to mitigate depreciation pressures through open market operations. Calm was restored after reinstatement of the commitment to the cease-fire regime at the August 9th meeting of the presidents of Armenia and Azerbaijan in Sochi under the auspices of the Russian President.

Armenia is heading into another round of constitutional reforms. A preliminary version of the reform concept statement called for curtailing the sweeping powers enjoyed by the president and building up the government and parliament. The statement also proposed a "possible alternative" that would make Armenia officially a parliamentary republic with a powerful prime minister and a largely ceremonial head of state. The Commission on Constitutional Reforms will present the final version of the reform concept paper to the president by October 15th. Its submission will be followed by broad consultations with parliamentary and extra-parliamentary political forces on which necessary agreements on constitutional reforms can be based.

B. Recent Economic Developments

Economic Growth and Domestic Demand

With a difficult external environment and amid geopolitical uncertainty, Armenia's growth faltered in 2013 and the first half of 2014. It took the economy four years to recover from the 2009 recession, and only in 2013 real GDP surpassed the pre-crisis level (by a modest 2 percent). The length of the recovery was largely caused by a rebalancing of the economy away from the previous construction-led growth model. The construction sector continues to decline, a trend made worse by under-execution of government capital spending; sticky housing prices are also suppressing residential construction as private demand weakens, which contributes to lower-than-expected growth for 2014 as a whole (figure 1).

On the demand side, real GDP growth is also hampered by low inflows of FDI and minimal global demand for Armenian exports. Russia, Armenia's most significant trade partner and the major source of its FDI, registered less than 1 percent growth in the first half of 2014, and that figure is projected to sink to 0.5 percent for 2014 as a whole. Relatively better performance in the euro area was not sufficient to offset what has been happening in Russia, partly because the main item of Armenia exports to European markets is copper and global demand and prices for metallic commodities are subdued.

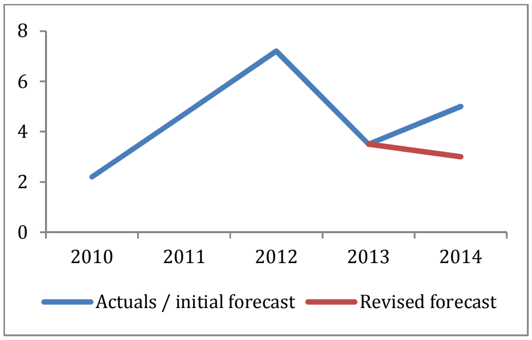
In the reporting period, real GDP expanded by only 2.7 percent, largely based on non-tradable services (figure 4). Low demand kept prices for base metals heading downward in the first half of 2014 and shrank mining value-added by 9.2 percent year-on-year (y-o-y), holding back GDP growth by 0.3 percentage points. Along with contraction of the energy sector because of a price hike in mid-2013, this resulted in stagnation of industrial value-added as a whole, offsetting a positive impulse from manufacturing. Agriculture contributed a modest 0.2 percentage points to growth and construction contributed 0.1 percentage point. In the services sector, the main contributors to growth were tourism, telecommunications, and real estate, which together contributed 1.3 percentage points.

Manufacturing growth was aided by expansion in processed food, tobacco, and base metals, but their contribution to growth was significantly depressed by slowdowns in jewelry, metallurgy, and nonmetallic mining products. Overall, in the first half of 2014 value-added by manufacturing grew faster than expansion of gross output (including intermediate consumption), which indicates that growth was driven by sub-sectors with relatively higher value-added (figure 2). The positive 2.8 percentage point difference in the growth rates of manufacturing value-added and gross output is the widest since the crisis.

The Armenian economy remains demand-based as consumer lending and remittances, despite some deceleration, continue to support private consumption. In the first quarter of 2014 private consumption accounted for 103.0 percent and imports for 59.7 percent of GDP. During the first two quarters, private fixed investments were persistently lower than expected (figure 3). CBA surveys have shown that high expectations for investments in the second quarter materialized only in trade and services.

Figure 1. Economic Growth in 2014 Will be Lower than Expected.

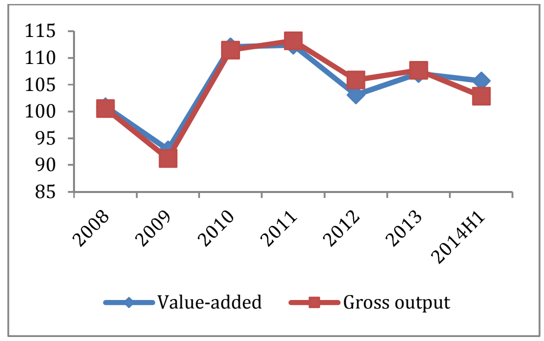
(Real GDP growth, percent)



Source: NSS data and World Bank staff calculations.

Figure 2. Higher Value-added Sub-sectors of Manufacturing Expanded.

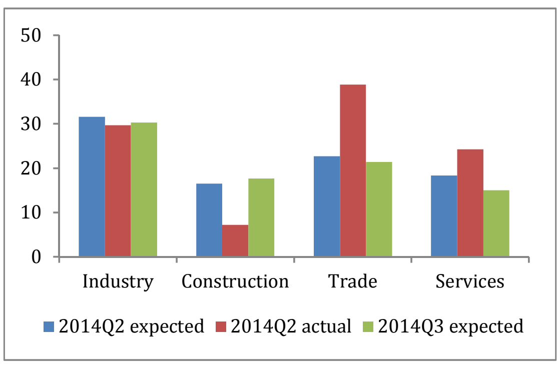
(In percent)



Source: National Statistics Service (NSS) and World Bank staff calculations.

Figure 3. Business Investment Is Falling.

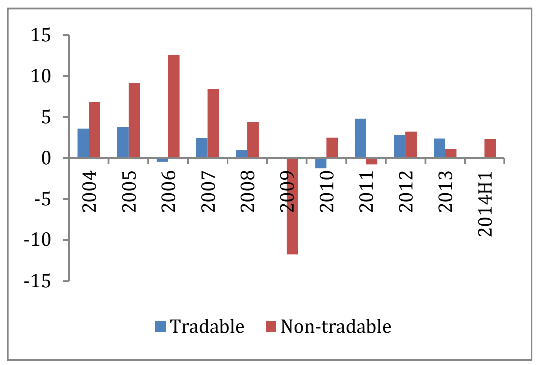
(Share of businesses ready to invest, percent)



Source: CBA.

Figure 4. The Tradable Sector Is Contributing Less to Growth.

(In percent)



Source: NSS and World Bank staff calculations.
Notes: Tradables – industry and agriculture; nontradables – construction and services.

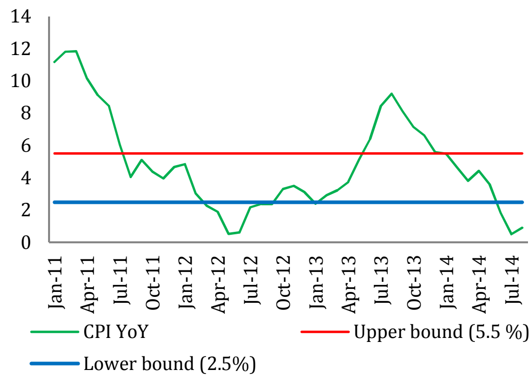
Inflation

Deflation of food prices and fading of the base effects of last year's utility price increases kept prices low (figure 5)**.** In August 12-month inflation slowed to 0.8 percent, well below the CBA 2.5–5.5 percent target range. Despite the poor harvest, prices for fruits declined by 0.3 percent in August month-on-month (m-o-m). The 12-month index of services prices increased 1.8 percent, capturing both the rise in electricity prices in August 2014 and the fading base effects of last year's gas and electricity price rises. Prices of non-food products held steady for the first eight months of the year, and the 12-month price index for this category increased by only 0.7 percent. Higher taxes on tobacco since January 1, 2014, pushed the 12-month CPI inflation for the alcohol and tobacco subgroup to 7.0 percent.

Monetary policy managed to contain second-round inflationary effects (figure 6). The contribution of non-food items to 12-month CPI declined to only 0.1 percentage points in August, down from the 0.5 percentage points registered for 2013 as a whole. Core inflation, excluding prices for food and fuel, stayed below headline inflation in the second half of the year.

Figure 5. Inflation Declines after the 2013 Summer Surge.

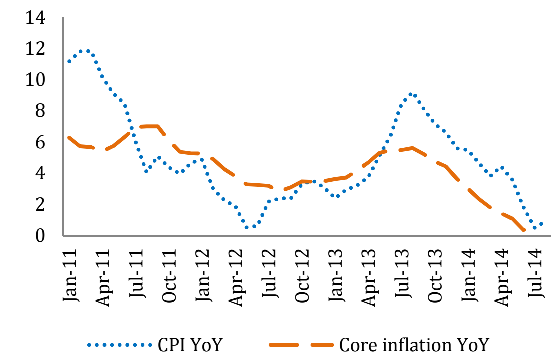
(12-month inflation, y-o-y, and target bounds, percent)



Source: NSS.

Figure 6. Low Core Inflation Indicates that Second-round Effects Have not Materialized.

(Actual and core inflation, y-o-y, percent)



Source: NSS, CBA.

External Accounts

The current account deficit (CAD) is estimated to have widened to about 14.6 percent of GDP in the first half of 2014 (figures 7–9) from the 14.1 percent registered in the same period a year earlier. Sluggish growth of exports and lower official transfers as the EU stopped the programs related to the signing of the Deep and Comprehensive Free Trade Agreement more than offset a modest 3.1 percent rise in remittances, which are beginning to be affected by the macroeconomic deterioration in Russia (figure 12). Imports grew by 1.1 percent, mainly as a result of higher net imports of diamonds for processing and re-export, passenger cars, and metallic products. Exports of processed food, textiles, and polished diamonds were the main drivers of export growth, while metallic and mining products tailed off by 4.4 percentage points. Overall, export diversification and concentration declined as the number of traded goods increased.[1]

Expected accession to the EEU has not yet had much impact on Armenia's trade profile (figure 10**).** In fact, the share of exports to both the EEU and the EU declined as exports to China grew. On average, in the medium term demand for exports will be stimulated by advances in the EU. In contrast, impulses from the developing CIS will be largely negative because of trading partner slowdowns, geopolitical tensions, sinking metal and mineral prices, and domestic capacity constraints. Thus, the anticipated shift to the EEU will undermine Armenia's medium-term prospects because demand will grow faster in the EU.

[1] Number of products refers to the goods (at a 3-digit level SITC, Rev. 3) that have an export value higher than US$100,000 or represent more than 0.3 percent of total exports.

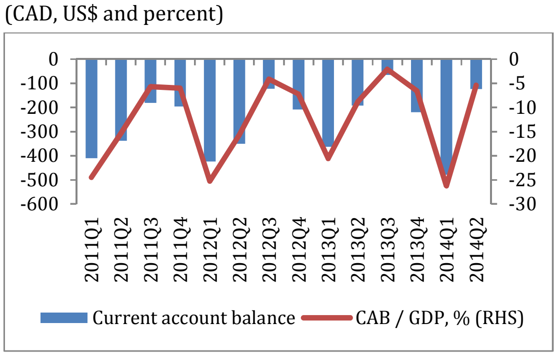
Inflows of FDI into the real sector of the economy are still subdued (figure 11)**.** In the first half of 2014, net inflows amounted to US$182.3 million, 4.4 percent of GDP. However, the bulk of those investments were earnings accruing to Russian investors in the energy sector, which attracted almost half of total FDI inflows, substantially surpassing mining and telecoms. Earnings accruing to foreign investors were up by US$141 million in the first quarter of 2014 compared with a year earlier, driving the CAD deterioration. Those earnings were reinvested, thus adding to the flow and stock of FDI and offsetting the accounting entry in the CAD.

External public debt decreased by 1.2 percent in the first half of 2014, reaching US$3.9 billion. Meanwhile, the Central Bank repaid about US$55 million of the Stand-by Arrangement with the International Monetary Fund (IMF), which accounted for most of the 8.2 percent decrease in CBA obligations to multilaterals and contributed 0.9 percentage points to the decline in external public debt. In the first quarter of the year, commercial banks reduced short-term obligations to nonresidents by US$66 million and long-term obligations to them of US$29 million. Private nonfinancial corporations were able to raise US$300 million in long-term loans on external capital markets.

Since mid-February Eurobonds have been available to domestic investors on the NASDAQ-OMX Armenia. Trading of Armenian Eurobonds in the Armenian financial market is supported by a link between the Central Depository of Armenia and Clearstream Banking in Luxemburg. The bonds were listed on the NASDAQ OMX Armenia on February 7, 2014, and became available for trading on February 12. This is another move toward increasing the access of Armenian investors to Eurobonds. Availability of the foreign exchange-denominated government securities to domestic investors affected debt structure in the first half of 2014. During this period, the stock of Eurobond holdings by residents increased more than five-fold, reaching 3.7 percent of total domestic debt.

Figure 7. The CAD Widened both in Nominal Terms and as a Share of GDP.

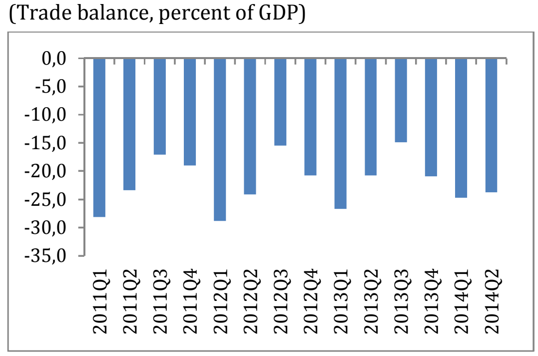
(CAD, US$ and percent)



Source: NSS and Bank staff calculations.

Figure 8. The CAD Widened Because Trade Balance Developments Were Unfavorable.

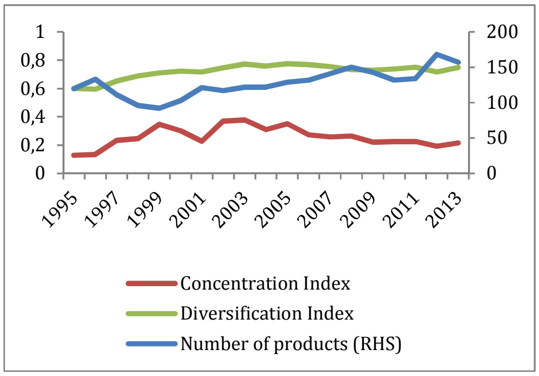
(Trade balance, percent of GDP)



Source: NSS data and Bank staff calculations.

Figure 9. However, Exports Became More Diversified.

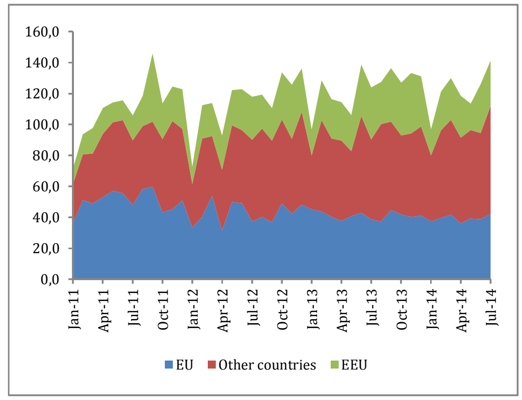
(Number of exported products, export and diversification indexes)



Source: UNCTAD.

Figure 10. Coming Accession to the EEU Is Not Driving up Exports to EEU Countries.

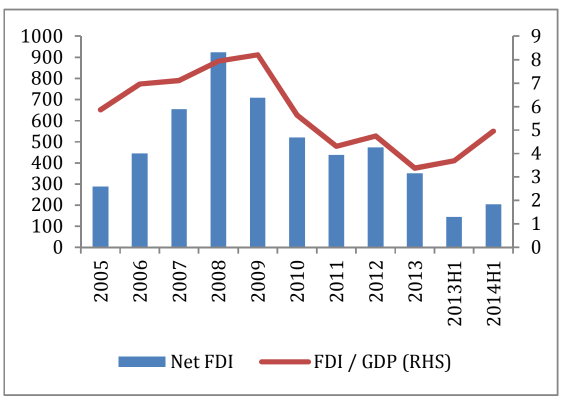
(Merchandise exports by country group, US$ million)



Source: NSS data and World Bank staff calculation.

Figure 11. Slower Growth in Russia Depressed FDI Inflows.

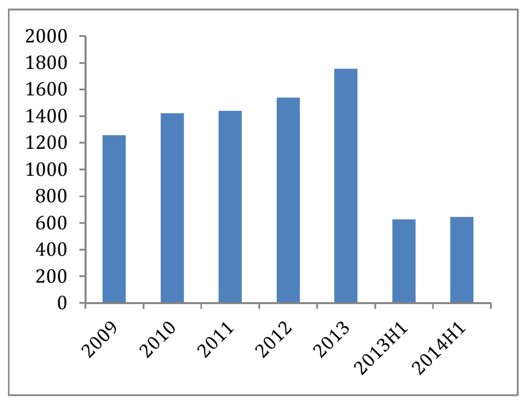
(Net FDI, US$ million and percent)



Source: NSS data and World Bank staff calculations.

Figure 12. Russia's Situation also Depressed Growth in Remittances.

(Net remittances, US$ millions)



Source: NSS data and World Bank staff calculations.

Employment and the Labor Market

The labor market has not yet fully recovered from the global crisis, and sluggish economic growth is contributing to high structural unemployment and gender disparities. In March 2014 unemployment hit 17.8 percent, up from 16.2 percent in 2013.[2] The total number of job-seekers officially registered at the State Employment Service declined by 9.6 percent from a year

[2] The unemployment rate is calculated using International Labor Organization methodology, which rather than being limited to those registered with the State Employment Service includes all types of job-seekers.

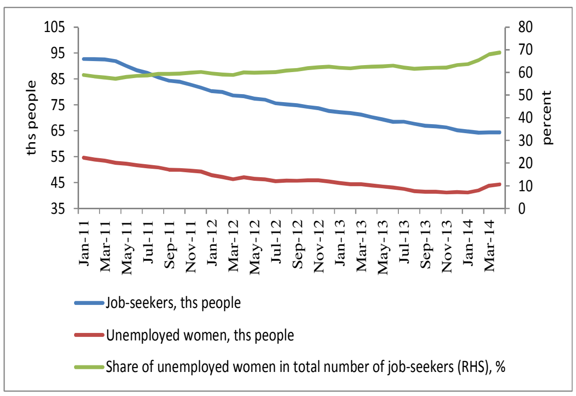
earlier, to 64,400 people. However, about 72 percent of them were women and their share has been increasing (figure 13).

The gap between private and public wages held steady in the first quarter of 2014. Average wages in the private sector exceeded those in the public sector by about 37 percent. In 2014, average annual monthly wages has grown by 1.8 percent, driven largely by private sector wages, which grew at a rate around 2.5 percentage points higher than in the public sector. However, higher public sector wages in the second half of 2014 may affect the overall wage structure (figure 14).

The labor market has not yet fully recovered from the global crisis, and employment does not prevent poverty. According to a recent survey, the poverty rate among employed Armenians grew to 26.1 percent in 2012, from 22.2 in 2008, even though nominal wages grew faster than prices. Poverty lines (extreme and general)[3] increased by 23–24 percent between 2008 and 2012—less than overall price dynamics as measured by the CPI.

Figure 13. Gender Disparities in the Labor Market Continue.

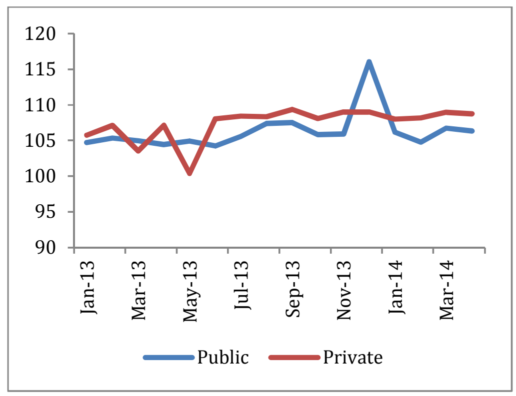
(Percent)



Source: NSS and World Bank staff calculations.

Figure 14. Private Wage Growth Stabilized; Yearend Bonuses Pushed up Public Wages.

(Percent)



Source: NSS data and World Bank staff calculations.

Poverty and Shared Prosperity

The incidence of poverty has been receding slowly since the 2009 economic crisis. In 2012, 32.4 percent of Armenians were living in poverty, about the same as in 2009. In contrast, in 2008 27.6 percent of Armenians were considered poor. In 2012, the incidence of poverty was about 32 percent in both rural and urban areas, but was about 34 percent for female-headed households.

The composition of the consumption baskets for poor and non-poor Armenians to some extent offset the price increase pressures toward poverty. The fact that, as noted, poverty increased less than overall price dynamics reflects the fact that items in the minimum consumption basket used to measure poverty were not as affected by price increases as the CPI basket. Poorer groups consume mostly food products; better-off groups consume more non-food products and

[3] Poverty is considered extreme if it does not cover the costs of food; general poverty refers to the overall cost of poverty basket.

services. In the first eight months of this year, inflation in the prices of food products was significantly less than inflation for non-food products, tobacco, and utilities. In 2014, therefore, price dynamics have been relatively favorable for the poor, since more expensive tobacco and services are mainly consumed by the better-off.

Between 2011 and 2012, economic growth was a much larger driver of poverty reduction than social transfers. There was a near one-to-one match between changes in GDP and poverty reduction. Cities other than Yerevan benefited even more from growth, with elasticity 10 percent higher. Surprisingly, poverty reduction in rural areas appeared to be more responsive to general economic growth than to real growth in agriculture; the elasticity of poverty reduction over agricultural value-added growth was only –0.8. This likely reflects the fact that because agriculture is not a major source of income, that spurs migration from rural to urban areas to take advantage of income-earning opportunities there. Micro-decomposition of the sources of poverty reduction indicates that household labor market outcomes (employment rate and wages) are major contributors to poverty reduction. Nevertheless**,** employment does not prevent poverty: the poverty rate among the employed grew from 22.2 in 2008 to 26.1 percent in 2012 even though nominal wages grew faster than prices.

Reducing poverty by perfectly targeting redistribution of income would require substantial fiscal efforts. The poverty gap of 5.6 percent indicates that, if the country were to mobilize resources equivalent to 5.6 percent of the poverty line for each individual, both poor and non-poor, and if these resources were accurately allocated to the poor, poverty would theoretically be eliminated. The resources needed to eliminate poverty would be about AMD70-75 billion, 1.5–1.6 percent of 2014 GDP. The theoretical cost of eliminating extreme poverty is much lower AMD2 billion, less than 0.1 percent of 2014 GDP.

Shared prosperity (growth in the average consumption of the poorest 40 percent) shows mixed performance between 2006–07 and 2012. Consumption spending by the bottom 40 percent grew at 1.44 percent annually—marginally less than the 1.61 percent spending growth for the population overall. Average consumption of the bottom 40 percent experienced high annual growth of 4.3 percent up to 2009, contracted by 7.5 percent during the crisis, and then recovered to grow 3.4 percent between 2010 and 2012.

C. Economic and Structural Policies

Fiscal Policy

In the first half of 2014, fiscal policy continued to suppress aggregate demand. For 2014–15, tax administration was focused on reducing the stock of accumulated tax credits. However, while this in itself would have had an expansionary effect on domestic demand, at the same time the authorities closely followed nominal targets for tax revenues despite lower than expected growth in nominal GDP and under-executed capital expenditures. As a result, in the first half of 2014 Armenia had a fiscal surplus of 1.3 percent of GDP, against an initially estimated deficit of 3.1 percent.

The fiscal results were generally in line with the depressed macroeconomic environment. In the first half of the year taxes grew by 2.6 percent, and more than half of the increase was attributable to direct taxes. In June, however, indirect taxes grew by 2 percent, contributing 1 percentage point to the growth of tax revenues for the first half of 2014. On the spending side, under-execution of the capital budget continued, although social spending was in line with the budget. Capital spending is still low even though works on the North-South corridor project have resumed.

The government compensated farmers for the losses they suffered from late-March hail storms. It waived land taxes and half of the irrigation water costs for those affected. Together with the CBA and other stakeholders, the government also provided other support, such as extending the terms for loans and subsidizing diesel fuel, seeds, and fertilizer.

On May 26th, the Ministry of Finance (MoF) announced the launch of the VAT refund system. Armenia is thus the second CIS country to feature this system, which uses the "by destination" principle for charging VAT. This will allow tourists to claim VAT for purchases of goods with a total cost of €200; the ministry expects to refund about AMD 1.5 billion (US$3.5 million) by yearend. According to the MoF, the Armenian system is the simplest; only the passport is needed at the point of sale, and the information is then transferred automatically to all customs points.

Low growth is the main macroeconomic risk, especially to the fiscal accounts. With economic growth for 2014 expected to be about 3 percent, following the nominal collection target would raise the tax-to-GDP ratio by 0.6 percentage points, which could further constrain growth. However, a revenue collection effort in line with expected GDP growth would lead to a budget shortfall of about US$60 million. To offset the revenue loss and minimize deviations in planned spending, the government needed additional budget support, which was partly accommodated through increased allocation for the Second Development Operation (DPO-2).

Monetary and Exchange Rate Policies

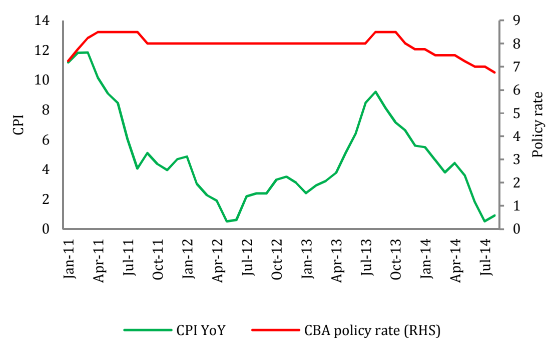
Moderation of inflationary pressures since the end of 2013 has allowed the CBA to loosen its monetary stance. In the first half of 2014, the CBA reduced its policy rate in four 25-basis point steps (figure 15). Since September 2013, the CBA has thus reduced the policy rate by 175 basis points, bringing it back down to 6.75 percent. This monetary loosening is aimed at stimulating consumption when tight fiscal policy reduced aggregate demand.

Favorable price dynamics allowed the CBA to accumulate reserves through open market operations. Starting in the second quarter of 2014, the CBA intervened in the foreign exchange market mainly to buy currency. This procedure was in line with the expansionary policy manifested in its policy rate decreases. Net purchases of foreign exchange totaled US$28.3 million for April–August and brought international reserves up to US$1,751.2 million. The accumulation of reserves was also stimulated by disbursements from the World Bank, the European Investment Bank (third tranche of the Border Crossing Project), and the Asian Development Bank (North-South Transport Corridor Project).

Nonperforming loans (NPLs) rose as credit to the private sector expanded. In July, lending by commercial banks to the private sector expanded by 10.4 percent year-on-year (y-o-y) in line with the CBA's expansionary monetary stance (figure 16). However, the credit expansion boosted private consumption rather than business investments; households absorbed 6.2 percentage points of the growth of lending to residents. Sluggish growth and few investment opportunities affected the quality of commercial bank loan portfolios as NPLs increased by almost 1 percentage point to 8.93 in July 2014 y-o-y.

Figure 15. The Policy Rate Fell as Inflationary Pressure Moderated.

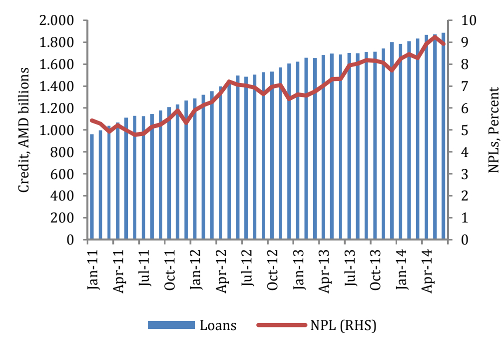
(CPI and policy rate, percent)



Source: NSS and World Bank staff calculations.

Figure 16. As Credit to the Private Sector Expanded, so Did Nonperforming Loans.

(Credit to the private sector, AMD billions; the level of NPLs, percent)



Source: CBA and World Bank staff calculations.

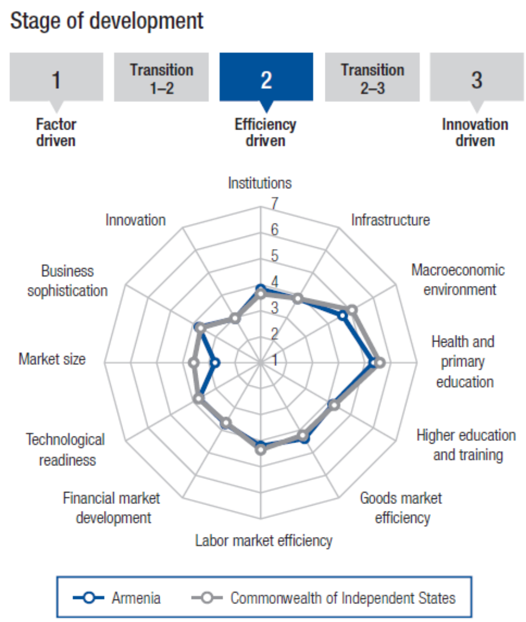
Structural Reforms

In the Doing Business 2014 report, Armenia improved its rating by three places, to 37th among 189 countries. It went up a notable 9 positions on Paying Taxes, as well as 5 positions on Enforcing Contracts and 4 positions on Starting a Business. The government made it easier to pay taxes by merging employee and employer social contributions with the individual income tax to form a single unified income tax, and starting a business became easier because company registration fees were eliminated. The Doing Business report ranked Armenia fifth with regard to property registration, which can now be completed in only three steps taking just seven days.

Armenia lost 6 positions in the World Economic Forum's Global Competitiveness Index (GCI), dropping to 85th place out of 144 countries in 2014–15 (figure 17)**.** The downgrade was recorded in almost all categories, but most significant was a drop of 24 places in the category of labor market and 21 for financial market efficiencies. Armenia improved by modest one or two places in the categories of Infrastructure, Higher Education and Training, and Technological

Readiness. Its lowest score came on Size of the Market, where it ranked 118th, down one position from the 2013–14 GCI. Its highest GCI scores came in Health and Primary Education (5.3), Macroeconomic Environment (4.6), and Goods Market Efficiency (4.4).

Figure 17. Armenia's Rankings on the 2014–15 Global Competitiveness Index.



Source: World Economic Forum.
Notes: Benchmarks are the average scores for all economies in transition.

The government continued to liberalize the aviation sector. It issued a decree declaring a new policy on aviation, posted on the website of the General Department of Civil Aviation air services agreements and respective amendments to raise transparency in the sector, and published a study on policy options for liberalizing air transport. Liberalization has raised the numbers of both flights and air carriers. According to Zvartnots International Airport data, the passenger turnover grew by 28.5 percent January through August, reaching 1.4 million passengers. Two more carriers, Etihad Airways and Vueling, have entered the Armenian market and others have increased their flight frequencies.

Almost half a million tourists visited Armenia in the first half of 2014. Tourism increased by 17.3 percent (year-on-year), stimulated by such enabling policies as adoption of "open skies" principles and visa facilitation as well as improvement in the quality of services provided by private tour operators and hotels. Russia and Georgia still accounted for almost two-thirds of incoming tourists; tourists from Europe constituted only 12 percent in the first half of 2014.

The Public Services Regulatory Commission increased the electricity tariff in line with the tariff sustainability assessment conducted by the World Bank's energy team. Tariffs needed to be increased by 10 percent (3.8–4.3 AMD per 1 kWh, depending on consumer category). The rise was directed both to adjusting the profit margin of the electricity distribution company and factoring in repayment of the Japan International Cooperation Agency (JICA) loan for modernization of the Yerevan Thermal Power Plan now that the grace period is over. While the tariff increase responds to the tariff sustainability assessment, its macroeconomic and social impacts still need to be thoroughly assessed; August's CPI estimated a direct impact on inflation of 0.5 percentage point, but the 10 percent increase will also have second-round effects that could worsen poverty.

D. Outlook and Risks

External Economic Environment

Global growth will remain moderate through the medium term. After expanding by an estimated 3.6 percent in 2013, GDP growth for the Europe and Central Asia (ECA) region is projected to slacken to 2.4 percent in 2014 owing to an abrupt slowdown in large economies in the region, such as Russia, Kazakhstan, and the Ukraine.[4] The slowdown will be worse in the CIS (2.2 percent) because of the slowdowns in Russia and China—the region's most important trading and investment partners—and an easing trend in key commodity prices. Even after a rebound in 2015–16 CIS growth in 2014 will not exceed 4 percent. This will lessen demand for Armenian exports and deter FDI inflows.

The slowdown in Russia poses a significant risk for growth in Armenia. Like Tajikistan, the Kyrgyz Republic, and Moldova, Armenia is vulnerable to dislocations in the Russian labor market because remittances from Russia account for some 15 percent of its GDP. While the World Bank Global Economic Prospects (GEP) Report does not foresee remittances slowing much—remittances to the CIS are projected to increase by 8.3 percent in 2014—the risks are still substantial.

Armenia expects to attract FDI of about 4 percent of GDP over the medium term, half the level before the crisis. However, even this modest expectation seems optimistic considering the reduced FDI inflows into the ECA region, which will remain subdued through the medium term. According to the1atest GEP report, FDI will stabilize at 2.4–2.5 percent of the region's GDP over the medium term, down from 3.7 percent in 2012.

Tapering of quantitative easing is limiting capital flows to developing countries. Capital flows in developing ECA countries declined, especially among the larger countries; gross capital flows fell by 42 percent to US$26 billion in the first five months of 2014 compared to the same period a year earlier. Equity issuance dried up entirely in early 2014 as 2013 weakness persisted.

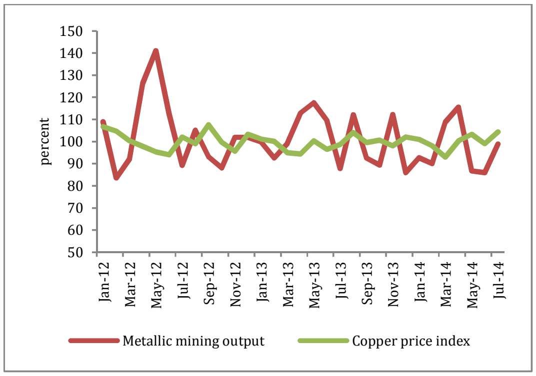
Armenia's terms of trade will likely deteriorate over the next year due to unfavorable international dynamics in prices for metals, energy, and food (figure 18). Futures markets show the prices of metal commodities declining over the next 12 months, though prices of most agricultural commodities are expected to rise. Brent oil prices are also expected to go up slightly because of concerns about instability in oil-producing regions. It is estimated that the net impact of terms of trade deteriorations could reduce Armenian GDP by 0.2 percent in 2014.

Armenia is exposed to the slowing of growth in Russia through the remittances channel. While the resilience of those remittance flows so far is reassuring, a deeper recession in Russia might even reverse the significant rising trends in remittance inflows (figure 19). Given the importance of remittances, that would have a major impact on the country's current account balance, household consumption, and poverty dynamics.

[4] This section is based on the analysis in the latest Global Economic Prospects (GEP) report of June 2014 (http://www.worldbank.org/en/publication/global-economic-prospects).

Figure 17. Metallic Mining Production Tracks International Copper Prices.

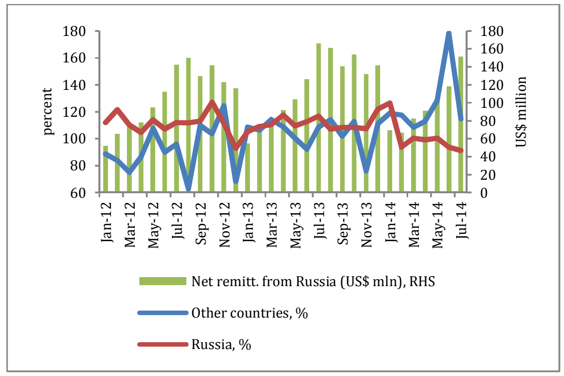
(Dec 2010=100, percent)



Source: NSS, IMF, and World Bank staff calculations.

Figure 18. Remittances from Other Countries Rose Relative to the Slowdown in Russia.

(US$ millions; year-on-year growth of remittances from Russia and other countries, percent)



Source: CBA and World Bank staff calculations.

A Georgian company, Anaklia IEP, is considering an investment of some US$600 million in construction of a new thermal power plant in Armenia. According to a government statement, the natural gas-fired plant will be designed for a capacity of 540 megawatts, making it more powerful than the nuclear power plant at Metsamor, which generates about 40 percent of Armenia's electricity. The company expects tax preferences and government guarantees of sufficient volumes of gas supplies for the facility. Construction of the thermal power plan has become more urgent now that the Ministry of Energy and Natural Resources estimates that major repair of the Metsamor nuclear plant will cost about US$300 million and construction of a new one could cost as much as US$5 billion.

Armenia's Outlook

The government approved its MTEF for 2015–17 on July 3rd. It envisages a gradual recovery of economic growth to 5.7 percent, which is half a percentage point higher than the medium-term growth forecast that underlies the Extended Fund Facility (EFF) program that the IMF Executive Board approved in March 2014. Yet it assumes investment will be lower than those in the EFF program, which suggests the government is expecting higher returns per investment. While the fiscal consolidation path is in line with the IMF program, reduction of the CAD is slower, in line with current trends.

Armenia's potential to benefit from a rise in external demand is limited given weakening trade links with the euro area and the deteriorating outlook for Russia. The negative fiscal impulse in the first half of the year will constrain domestic demand in 2014 as a whole. Deceleration of remittances will also constrain private demand. Overall, Armenia must thus be prepared for considerable risks, especially prolonged weakness in the euro area and in Russia, a disorderly adjustment of the economy to higher global interest rates, and further declines in metal prices.

With the outlook for construction modest and the agriculture sector's return to trend, the main drivers of growth will have to be industry and modern services that compete in

international markets. Within industry, manufacturing is the most likely sector to create employment. Labor productivity is significantly higher there than in, for example, agriculture, and its production technology is more labor-intensive than that of heavy industry and modern services. Manufacturing is therefore appropriately targeted in the Armenia Development Strategy (ADS; box 1) as the sector in which high-quality, decent-paying jobs will be created. Higher productivity in this context means higher growth and faster poverty reduction.

Box 1. Armenia's Long-Term Development Policy

The government has approved the Armenian Development Strategy (ADS) for 2014–25. The ADS will inform the budget process (preparation of annual budgets and Medium-Term Expenditure Frameworks), as well as other sectoral strategies and policies. The macroeconomic framework laid out in the ADS is ambitious: It assumes that economic growth will recover to 6 percent by 2017 and to 6.5 by 2025. In 2025 the government plans to increase taxes to 27.4 percent of GDP—an average of about 0.3 percentage points a year. The fiscal deficit is in line with the debt-stabilizing level and is projected to decline to 1.3 percent of GDP by 2025. For the same period, the current account deficit is projected to fall to 3.8 percent of GDP because the external sector scenario assumes that Armenia will become a member of the Eurasian Economic Union with access to the markets of other member countries. The World Bank baseline scenario is more cautious, predicting a slower path for the growth of recovery and current account consolidation and taxes not substantially higher than their statutory rates.

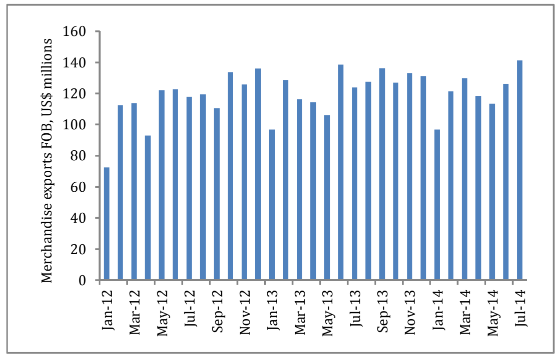
Source: Government Decree № 442-N, March 27, 2014.

Manufacturing and services will drive medium-term growth; construction is the riskiest sector. The contribution of manufacturing (figure 20) and services to economic growth is projected to increase from 50 to about 60 percent. This assumption is consistent with recent trends and Armenia's economic policy, which is directed to expanding tradable sectors. The growth of agriculture is forecast to be at the bottom of its long-term average. However, the volatility of the construction sector presents major risks to the growth outlook: its contribution to growth has declined in real terms every second year since the crisis. After dropped by 47 percent in 2009–11, construction grew marginally in 2012, which was a hopeful indicator that the crisis in that sector had bottomed out. However, it reversed again, by 10.8 percent, in 2013, and no real growth for construction is expected for 2014.

The CAD is expected to improve as a result of growing remittances and structural shifts in the economy. Policies geared to industrial development and export promotion should lead to faster growth in tradable sectors. Together with lower demand for imports, this will support a single-digit CAD as a percentage of GDP. The macroeconomic framework also takes into account a gradual depreciation of the exchange rate to support improvement in the current account balance. The CBA will have to stay alert to ensure adequate foreign exchange reserves and manage domestic liquidity.

Moderation in growth will ease domestic pressures on inflation because international food prices are likely to remain low, gas prices to remain stable (thanks to agreement with Russia), and depreciation pressure to abate because of the lower CAD. As a result, in the medium term inflation is expected to stabilize around the CBA target of 4 percent, aided by lower-than-expected pass-through impact. The CBA's monetary policy stance is consistent with these trends; it has lowered its policy interest rate to stimulate demand.

Figure 19. Though Growth in main Trading Partners Is Slower, Armenia's Merchandise Exports Are Holding Steady.



Source: NSS and World Bank staff calculations.

Fiscal Policy

The 2015–17 MTEF foresees higher revenue and a slight recovery in capital spending (see table 1). It assumes annual average GDP growth of 5.3 percent for the period, compared with the 6.4 percent envisaged in the ADS and the World Bank forecast of 4.7 percent. In light of higher expected growth, the MTEF tax projections are less ambitious. The nominal targets imply that taxes (net of VAT refunds) will reach about 23.3 percent of GDP, which is consistent with the World Bank low-growth scenario. Capital spending will hold at 2.4–2.5 percent of GDP for 2015–16 before recovering to 2.7 percent in 2017.

The government will continue to reduce the stock of tax credits. Current accumulated tax credits of about 5 percent of GDP are widely perceived to be an impediment to effective business because they lock up working capital that could otherwise be used for expansion. On the other hand, tax credits do address short-term pressures on fiscal accounts, though they undermine fiscal sustainability in the longer run because eventually they are subtracted from future taxes. For those reasons this seems an opportune time to gradually reduce the stock of tax credits, given that tax revenues have grown by a healthy amount in recent years. For 2014–15, the government therefore aims to keep the tax-to-GDP ratio constant while at the same time decreasing the stock of tax credits by an amount similar to the usual tax increase. In other words, tax administration will continue to be improved, but the gains will materialize not as higher taxes (as would usually be the case) but as a lower stock of tax credits.

Table 1. Fiscal Indicators, 2012–14
(In percent of GDP)

	2011	2012	2013	2014	2015	2016	2017
		Actual		Est.		Projected	
Overall Balance	-2.8	-1.5	-1.7	-2.3	-2.0	-2.3	-2.3
Primary balance	-1.9	-0.5	-0.6	-1.0	-0.5	-0.8	-0.8
Total Revenues and Grants	22.7	23.0	24.5	24.5	24.1	24.0	24.3
Tax revenues	20.0	21.4	22.8	22.8	23.0	23.4	23.8
Nontax revenues	1.2	1.2	1.3	1.2	0.5	0.4	0.3
Grants	1.6	0.5	0.3	0.4	0.6	0.2	0.2
Expenditures	25.5	24.5	26.2	26.8	26.2	26.3	26.6
Current expenditures	20.9	21.3	23.2	24.0	24.2	24.1	24.2
Wages and compensation	2.2	2.2	2.4	2.6	2.3	2.3	2.3
Goods and services	8.4	8.2	9.9	9.3	8.9	8.9	8.8
Interest payments	0.9	1.0	1.1	1.4	1.5	1.5	1.5
Current transfers	8.8	9.4	9.2	10.1	10.9	11.0	11.1
Pensions	4.9	4.9	4.6	5.3	4.7	4.3	4.4
Social assistance	3.9	4.5	4.6	4.8	6.2	6.6	6.7
Capital expenditures	4.7	3.3	3.0	2.8	2.0	2.2	2.4
General government deficit financing	2.8	1.5	1.7	2.3	2.0	2.3	2.3
External (net)	1.1	1.4	1.9	0.6	0.2	0.6	0.3
Domestic (net)	1.7	0.1	-0.3	1.8	1.8	1.6	2.0
Functional Classification							
General services	3.5	3.4	3.8	4.3	4.1	3.8	3.8
Defense	3.9	3.8	4.3	4.2	4.0	4.1	4.1
Public order and safety	1.9	1.9	2.1	2.3	1.7	1.7	1.7
Economic affairs	2.2	1.8	3.0	2.4	2.6	3.1	3.1
Health	1.7	1.6	1.5	1.9	1.7	1.6	1.6
Education	2.8	2.6	2.4	2.8	2.5	2.6	2.6
Cultural, sports, recreational, religious	0.5	0.6	0.4	0.5	0.4	0.4	0.4
Social protection	6.8	7.3	7.0	7.9	7.9	8.1	8.2

Sources: Armenian authorities and World Bank staff calculations.

Along with reduction of tax credits, revenue mobilization remains a medium-term priority for fiscal policy. To raise revenue the government is acting on the conclusions of its review of tax exemptions and excise rates. The administration has submitted to parliament draft amendments to remove the exemption from VAT of financial brokerage services, and an explanatory note in the 2015 State Budget provides estimates of the revenue impact of major tax expenditures. The amendments to the tax law are meant to be growth-conducive. Starting next year advance payments for the corporate income tax will be abolished, and as of October 1, 2014, the turnover tax rate for small and medium enterprises with the annual turnover of less than AMD58.35 million is lowered from 3.5 to 1 percent.

Social spending will remain a priority in the medium term. In 2015–17 allocations for social sectors (health, education and social protection) are planned to grow by half a percentage point more than total spending. Social protection will drive the increase of medium-term allocations for social sectors, primarily because the government is committed to raising the minimum wage and pensions. By 2017 the minimum wage will have gradually increased to AMD 65,000 (about US$160 at the current exchange rate). In the medium term wage policy will be affected by the recent public pay reforms, which should harmonize wages across all categories of public employees. Pensions will also increase over the medium term with the ultimate target of providing 125 percent of the poverty line. Allocations for the Family Benefit program will remain unchanged, assuming the same number of beneficiaries and the same average amount of the benefit.

The European Commission has decided to provide EU funding to Armenia in the EU Neighborhood in the coming years. Between 2014 and 2017 the EU will provide €140–170 million to Armenia to be used to build up the private sector and reform the public administration and justice systems. Priorities for financing have been decided in close cooperation with authorities, representatives of civil society, and other stakeholders.

Risks

The significant slowdown of economic activity in Russia—the main destination for Armenian labor migrants and the largest market for its agricultural and manufacturing exports—has already curtailed remittances and export proceeds. A Russian ban on some food imports from the United States, the EU, Australia, Canada, and Norway has adversely affected those economies, further constraining demand for Armenian exports. However, Armenia could also benefit from higher Russian demand for food stuffs if it can boost its exports to fill the gap.

Risks to commodity prices and further weakening of remittance inflows from Russia represent the major sources of uncertainty for developing CIS members. Armenia is heavily dependent on copper exports, which increases its susceptibility to copper prices, which will be declining over the medium term. Russia is also the most important export market for a majority of CIS countries, as well as the most important source of inward remittances and FDI.

After the military confrontations in the Nagorno-Karabakh zone in late July and early August, possible escalation of tensions should also be considered a major risk. Involvement in large-scale military actions may carry with it reallocation of budget spending to military needs, damage to physical infrastructure, and a higher pace of emigration. Over the longer term this could lower Armenia's credit rating, further deterring inflows of investment and business activity. However, the recent meeting of the presidents of Armenia and Azerbaijan in Sochi seems to have calmed tensions.

As the risks have materialized, the World Bank Armenia team has revised its medium-term growth forecasts. Growth for 2014 is now expected to be 3 percent rather than the 5 percent projected early in the year. Projected medium-term economic recovery is also more conservative. Possible negative effects on Armenia's economy of the continuing crisis in Ukraine and the depreciation of the Russian ruble range from lower demand for exports to how a weak ruble will affect dollar-denominated remittances sent home by Armenian migrant workers in Russia.

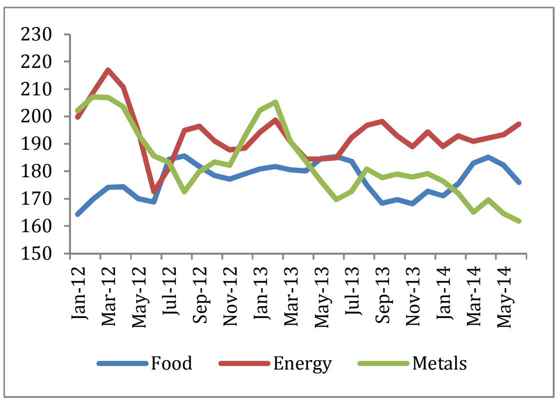
Higher levels of private or short-term debt or deterioration in the quality of bank loan portfolios may raise additional difficulties. In particular, high debt increases a country's susceptibility to changes in external financing conditions and currency mismatches. However, the team assesses this risk as low because in the first quarter of 2014 private debt accounted for about 48.6 percent of total external debt and because the share of short-term external debt declined to 13.2 percent from a pre-crisis level of 17 percent; public debt is largely concessional. NPLs increased in the first half of the year to reach 8.9 percent in July 2014. However, the share of NPLs is still relatively low, and the CBA is not requiring commercial banks to restructure their debt holdings.

On the upside, more growth than the baseline envisaged could boost developing countries. A stronger than anticipated recovery in high-income economies could heighten external demand for the ECA region, helping to offset downward adjustments in domestic demand triggered by rising global interest rates. The estimated output gap in Russia is negative and widened between 2010 and 2013. Closing that gap will increase remittances, which are correlated with Russian GDP growth and are about quadruple the value of Armenia's exports to Russia. Declining global food prices should also reduce inflation pressures and food import costs, although for food exporters they are a negative development.

The baseline scenario here is consistent with recent development and the risks identified in the GEP report. It is built on the assumption that a slowdown in Russia would depress Armenian exports and remittance inflows. Domestic factors underpinning the scenario include government initiatives related to Armenia's export-led industrial development strategy, further improvement of the business environment, and reduction in the stock of tax credits. The upside risks pertain mainly to the pace and success of reforms; the downside risks relate to developments in the global economy, particularly in Ukraine. Thus, the baseline scenario also assumes unfavorable price dynamics in global markets, with a risk of a negative terms-of-trade shock (figure 21).

Figure 20. Higher Food and Energy Prices and Low Metals Prices May Trigger a Terms-of-Trade Shock

(Food price and energy price indexes, 2005=100)



Source: IMF.

To mitigate the impacts of external shocks it is important to properly identify risks and their transmission channels. For instance, the short-term dynamics of high-frequency indicators may sometimes be misleading, considering that exports from and remittances to Armenia are still growing despite diminished growth in Russia. The decline of 12-month inflation to below the target band is probably concealing adverse impacts on poverty. The government is rebuilding macroeconomic buffers to cushion the economy against possible external shocks. It has reduced the fiscal deficit significantly since 2009 and its MTEF envisages a gradual reduction in the public debt-to-GDP ratio. The flexible inflation targeting regime and flexible exchange rate are well-suited to coping with external shocks, and foreign exchange reserves will be kept at a comfortable level.

E. Special Topic: Anticipated Trade Impact of Joining the Eurasian Customs Union

The Bank team assessed the likely effects of Armenia's accession to the ECU, whose current members are Russia, Kazakhstan, and Belarus, and how related tariff changes might affect trade. Two scenarios were considered: (1) elimination of current tariff differentials between Armenia and the ECU, and (2) a transition scenario in which Armenia retains lower tariffs than those current in the ECU given Russia's commitments to the WTO to lower its own tariffs by 2020. The analysis will use the partial equilibrium toolkit and data from World Integrated Trade Solutions (WITS). The goal is high disaggregation to highlight potential differential effects on investment and consumption goods.

Business climate reforms have been much more successful in Armenia than in Russia. Armenia is currently ranked 37th in the Doing Business Indicators compared with Russia's 92nd position. This section gauges opportunities for Armenia to attract investors targeting the ECU market. Using a dynamic-recursive computable general equilibrium (CGE) model, it looks at the economy-wide effects of new trade, FDI, migration, and remittances flows associated with ECU membership.

Armenia's trade policy is relatively liberal compared to that of the ECU. Currently, the average import tariff rate is 3.1 percent and Armenia's Services Trade Restrictiveness Index (STRI) is 11.4 percent tariff equivalent. Import tariffs fluctuate within a range of 0 and 10 percent; in the ECU tariffs can range as high as 30 percent (see Table 2). Adoption of the ECU tariff structure would imply an increase in Armenia's average applied tariff rate and its dispersion. Moreover, Armenia is also committed to the WTO, with an average bound tariff rate of 8.5 percent, and the schedule of commitments on services has relatively few limitations. Armenia also has free trade agreements with some other CIS countries. Upon accession, Armenia will have to adopt the ECU common external tariff, which averages 9.18 percent.

Table 2. Shares of Products by Import Tariff Category in Armenia and ECU, 2011–12
(In percent)

		ECU Tariff Lines									
		0<3	**3<5**	**5<8**	**8<10**	**10<15**	**15<20**	**20<25**	**25<30**	**>30**	**Total**
Armenia tariff lines	0<3	9.3	0.3	26.3	0	9.3	16.3	2.6	0.1	0.1	64.1
	3<5	0.1	0	0.4	0	0.6	0.5	0.2	0	0	1.8
	5<8	0.4	0	0.9	0	0.6	1.1	0.3	0	0	3.3
	8<10	1.6	0	5.6	0.1	9.8	8.4	4.9	0.3	0.2	30.8
	Total	11.4	0.3	33.2	0.1	20.2	26.2	8	0.4	0.2	100

Source: World Bank staff calculations based on WITS and SMART Toolkit.
Notes: Tariffs applied at the HS six-digit level; partner=world.
Tariff category = range presented for Armenia's current import flows (see first column).
Upper row contains import tariff structure (tariff range) for the ECU countries.

The trade effects from tariff policy changes can be decomposed into trade creation and trade diversion. Trade creation refers to the direct increase in imports after reduction of the tariff imposed on a good from any given country. If the reduction is preferential (i.e., it does not apply to other countries), tariff changes mean that imports of the good from other countries will decrease and those from the country with the preferential tariff will increase. This is considered a trade diversion effect. Effects of the ECU on Armenia would be negative, because the average tariff increases would lead to less trade overall, and trade diversion leads to substitution of inferior, more expensive goods from other ECU members for imports now coming from other countries.

The simulation analysis focuses on a core group of tariffs at the harmonized system HS six-digit level of disaggregation. The data on tariffs applied by Armenia and the trade volume for 2012 are from the WITS database. Tariff data for 2013 tariff data were taken from the ECU official website. About 15 percent of the tariff lines of Russia and the ECU use a "combined" tariff rate system.[5] Thus, due to the lack of data on product weights to calculate ad valorem, only the ad-valorem rate was used for mixed tariff information. A simple analysis like this is likely to underestimate the impact of the ECU tariff.

It appears from the simulation that the new import tariff structure would imply a negative welfare impact of 0.08 percent of GDP (US$7.94 million). The trade impact could reach 0.07 percent of GDP (US$6.46 million) in terms of trade creation and 1.12 percent of GDP (US$110.6 million) in terms of diversion of trade to ECU countries. The trade diversion and welfare losses are due to changes in the origin of imports due to tariff changes.

Trade creation as a result of reducing applied import tariffs from ECU members is likely to be very small. Armenia already has free trade agreements with several countries, including all three ECU members, so that import tariff rates with these countries are zero. There will be no difference in tariffs with the ECU members when Armenia joins. Expected benefits would rather be in terms of increased import flows due to reduced tariffs on certain products from other countries.

Negative values for trade creation signify a decrease in trade with non-ECU countries. Part of the decrease will be compensated for by higher intra-ECU trade; the rest could be replaced by an increase in domestic production (although higher domestic production is likely to be higher-cost and not completely substitutable). For example, for natural gas, after ECU accession Armenia's import tariff with Iran will increase from 0 to 5 percent, so imports from Iran are expected to decline; one part of that would be compensated by increased imports from Russia.

[5] Both ad valorem and specific tariff rate, i.e., US$X/kg + Y percent.

Appendix

Economic and Social Indicators: Armenia 2009–16

Selected Indicators	2006	2007	2008	2009	2010	2011	2012	2013	Projections 2014	2015
Income and Economic Growth										
GDP growth (% change, y-o-y)	13.2	13.7	6.9	-14.1	2.2	4.7	7.2	3.5	3.0	3.7
GDP per capita growth (% change, y-o-y)	30.5	42.9	27.2	-25.6	7.3	9.5	-2.0	4.5	7.5	8.1
GDP per capita (US$)	2154	3079	3917	2914	3125	3422	3354	3505	3766	4072
GDP per capita, PPP (current international $)	2010	2710	3510	3240	3370	3430	3710	3830	3930	4200
Private consumption growth (% change, y-o-y)	9.0	12.0	4.4	-5.9	4.5	3.0	8.7	1.9	2.4	4.8
Gross investment (% of GDP)	35.9	37.8	40.9	34.7	32.9	27.3	25.4	21.7	21.6	21.1
Public (% of GDP)	4.0	6.2	5.1	7.0	5.5	4.7	3.3	3.0	2.8	2.0
Private (% of GDP)	31.9	31.6	35.8	27.6	27.3	22.6	22.1	18.7	18.8	19.1
Money and Prices										
Inflation, consumer prices (% change, y-o-y, end of year)	5.2	6.6	5.2	6.5	9.3	4.7	3.1	5.6	4.4	4.0
Inflation, consumer prices (% change, y-o-y, period average)	2.9	4.4	9.0	3.4	8.1	7.5	2.5	5.7	3.1	4.7
Treasury bill rate (91-day, annual average)	6.7	6.9	8.3	12.1	14.0	13.8	14.4	13.1	..	..
Nominal exchange rate (LCU/US$, end of period)	363.5	304.2	306.7	377.9	363.4	385.8	403.6	405.6	407.7	409.7
Real e exchange rate index (1997=100)	113.7	128.4	136.8	128.6	129.3	128.1	122.5	124.4	126.3	128.2
M0 (% GDP)	8.0	10.4	8.9	9.0	8.8	9.2	9.6	9.0	13.6	13.1
M2 (% GDP)	12.9	17.8	15.1	14.4	15.1	17.5	18.4	19.8	22.2	21.2
Fiscal (% of GDP, unless otherwise indicated)										
Revenues	18.7	20.7	21.4	21.5	21.9	22.7	23.0	24.5	24.5	24.1
Expenditures	19.5	21.4	22.1	29.1	26.9	25.5	24.5	26.2	26.8	26.2
Current	17.8	18.0	16.0	15.9	16.8	16.0	15.8	19.5	22.4	21.4
Capital	4.0	6.2	5.1	7.0	5.5	4.7	3.3	3.0	2.8	2.0
Fiscal balance before grants	-1.3	-1.4	-1.1	-8.3	-5.9	-4.4	-2.0	-2.0	-2.8	-2.6
Fiscal balance after grants	-0.7	-0.7	-0.7	-7.6	-5.0	-2.8	-1.5	-1.7	-2.3	-2.0
Primary fiscal balance	-0.4	-0.4	-0.4	-7.1	-4.1	-1.9	-0.5	-0.6	-1.0	-0.5
Total public debt	21.9	18.4	16.3	38.9	41.1	40.7	44.4	44.4	41.7	40.1
Debt service ratio (% of revenues)	5.3	3.4	3.2	5.3	6.5	7.0	13.0	36.2	12.7	9.4
External public debt	18.9	15.7	13.5	34.3	35.6	35.2	37.5	37.4	34.3	32.4
External Accounts (current US$ millions, unless otherwise indicated)										
Export growth (% change, y-o-y)	6.3	15.8	-1.9	-22.4	44.6	24.9	3.5	7.0	3.3	4.7
Import growth (% change, y-o-y)	19.5	42.1	30.6	-23.1	13.9	8.0	2.2	2.6	4.5	4.7
Real export growth (% change, y-o-y)	-7.3	-3.5	-13.1	-10.4	26.5	14.7	8.4	16.3	0.3	4.7
Real import growth (% change, y-o-y)	3.8	13.0	7.3	-19.2	12.8	-1.4	-2.8	0.7	5.0	5.0
Merchandise exports	1053	1204	1106	774	1197	1432	1516	1636	1750	1898
Merchandise imports	2000	2921	3923	2864	3263	3541	3628	3728	3915	4110
Services, net	-182	-297	-398	-371	-317	-130	-148	-112	-172	-234
Workers' remittances, net	1020	1417	1662	1258	1422	1440	1540	1755	1822	1903
Current account balance	-247	-784	-1746	-1520	-1318	-1124	-1104	-839	-797	-826
Percent of GDP	-3.9	-8.5	-15.0	-17.6	-14.2	-11.1	-11.1	-8.0	-7.1	-6.8
Foreign direct investment	-445	-654	925	710	521	437	473	352	412	488
External debt, total	1739	2411	3053	4664	5659	6503	6693	7799	6920	6824
Percent of GDP	27.2	26.2	26.2	53.9	61.1	64.1	67.2	74.8	61.5	56.0
Multilateral debt (% of total external debt)	61.6	49.9	40.4	43.2	39.8	38.1	39.4	33.8	37.4	39.3
Debt service ratio (% of exports goods and nonfactor services)	4.7	4.1	4.5	7.0	6.8	6.3	11.6	34.2	12.4	9.3
Population, Employment, and Poverty										
Population, total (millions)	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Population growth (% change, y-o-y)	-0.2	0.9	-0.4	-0.3	-0.2	0.0	0.2	0.3	0.4	0.3
Unemployment rate (% of labor force)	27.8	28.7	16.4	18.7	19.0	18.4	17.3	..	..	..
Poverty headcount ratio at national poverty line (% of population)	..	..	27.6	34.1	35.8	35.0	32.4	..	..	..
Poverty headcount ratio at US$1.25 a day (PPP) (% of population)	3.0	3.5	0.2	0.2	0.5	0.3	0.2	..	..	..
Poverty headcount ratio at US$2.50 a day (PPP) (% of population)	18.8	20.5	12.1	17.4	19.7	17.5	12.2	..	..	..
Inequality—income Gini	32.8	30.2	33.9	35.5	36.2	37.1	37.2	..	..	..

Selected Indicators	2006	2007	2008	2009	2010	2011	2012	2013	Projections 2014	2015
Life expectancy	73.1	73.3	73.5	73.9	74.1	71.0	74.3	74.8	..	..
Other										
GDP (current LCU, billions)	2243	2656	3149	3568	3142	3460	3778	4001	4273	4576
GDP (current US$, billions)	6.4	9.2	11.7	8.6	9.3	10.1	10.0	10.4	11.3	12.2
Doing Business Ranking	..	..	..	..	..	..	50.0	40.0	37.0	..
HDI (Human Development Index)	..	..	0.722	..	0.720	0.724	0.728	0.730	..	..
CPIA (overall rating)	4.3	4.4	4.4	4.2	4.1	4.1	4.1	4.1	..	..
Economic management	5.3	5.5	5.5	5.0	4.7	4.7	4.7	4.5	..	..
Structural policies	4.0	4.0	4.2	4.2	4.0	4.0	4.2	4.3	..	..
Social inclusion and equity policies	4.2	4.2	4.1	4.1	4.1	4.0	4.0	4.0	..	..
Public sector management and institutions	3.7	3.7	3.7	3.7	3.7	3.6	3.7	3.7	..	..

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