

“Policy Challenges for Armenia in the Context of Regional and Global Economic Shocks: An Update”.

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Armenia

May 2016



Outline

The Global Environment

Regional Outlook

Responding to Shocks

Policy Priorities

Outline

The Global Environment

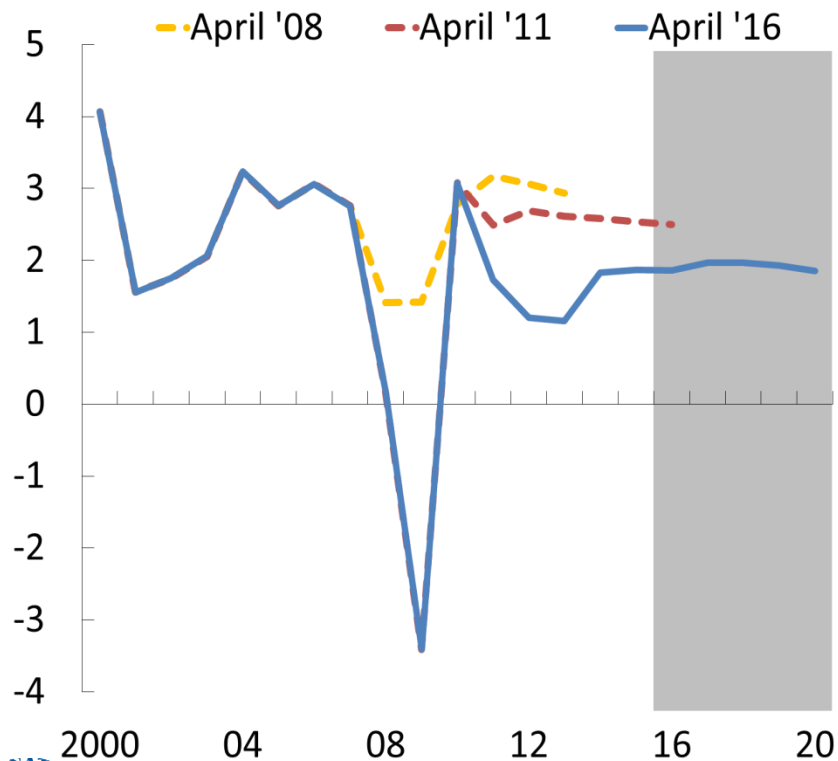
A modest recovery in global economic growth, albeit weaker than projected last October



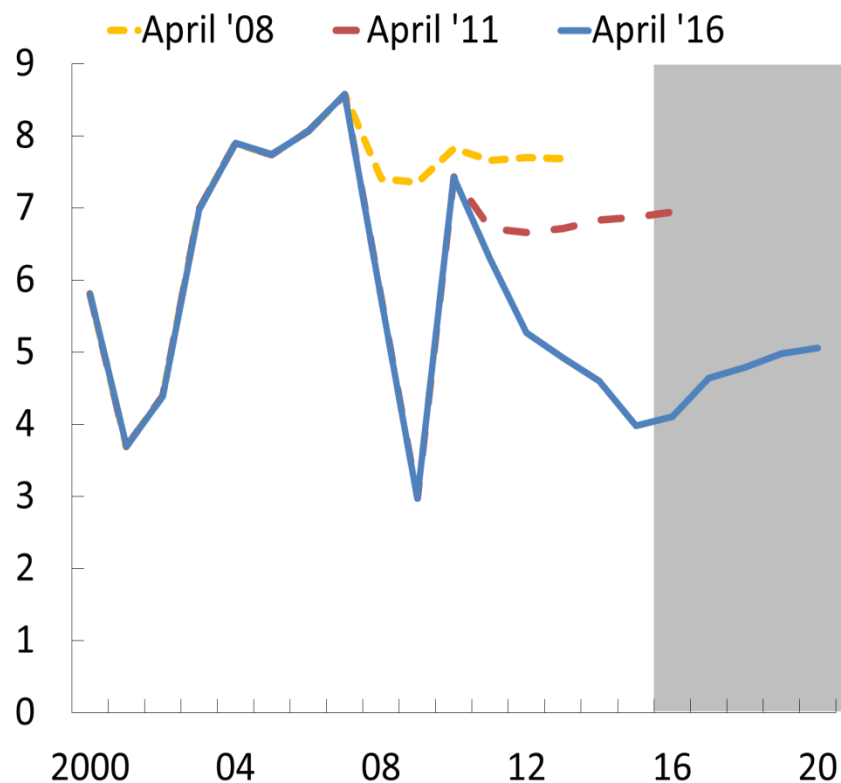
		World	U.S.	Euro Area	Emerging markets	China	Russia	Armenia
2015		3.1	2.4	1.6	4.0	6.9	-3.7	3.0
2016	Current Proj.	3.2 ▼	2.4 ▼	1.5 ▼	4.1 ▼	6.5 ▲	-1.8 ▼	2.2
	Oct. 2015 Proj.	(3.6)	(2.8)	(1.7)	(4.5)	(6.3)	(-0.6)	(2.2)
2017	Current Proj.	3.5 ▼	2.5 ▼	1.7	4.6 ▼	6.2 ▲	0.8 ▼	2.5 ▼
	Oct. 2015 Proj.	(3.8)	(2.8)	(1.7)	(4.9)	(6.0)	(1.0)	(2.8)

Major downward revisions in projections compared to previous vintages

Advanced Countries: Growth (percent; various WEO forecast vintages)



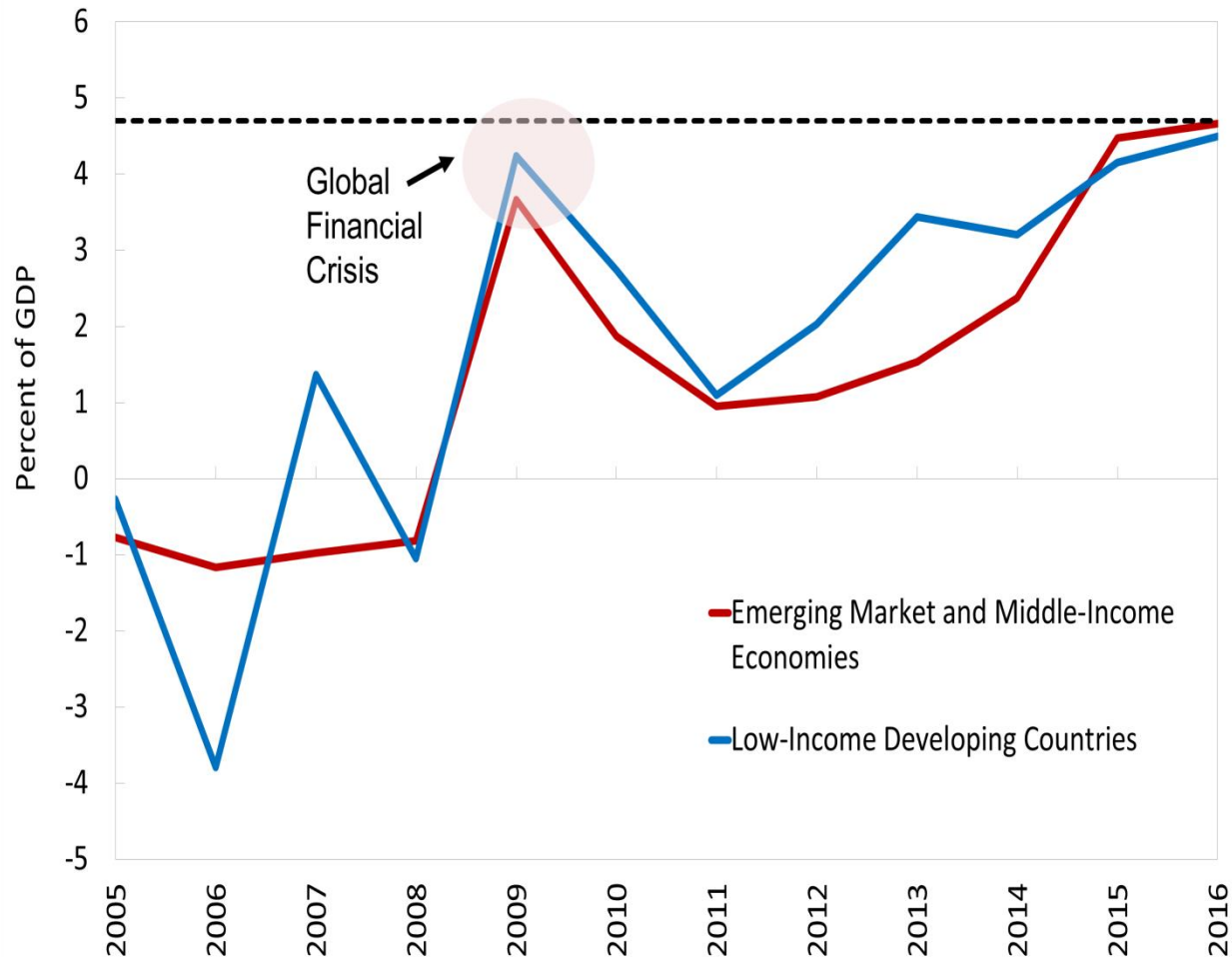
Emerging Markets: Growth (percent; various WEO forecast vintages)



Source: IMF, World Economic Outlook, April 2016.

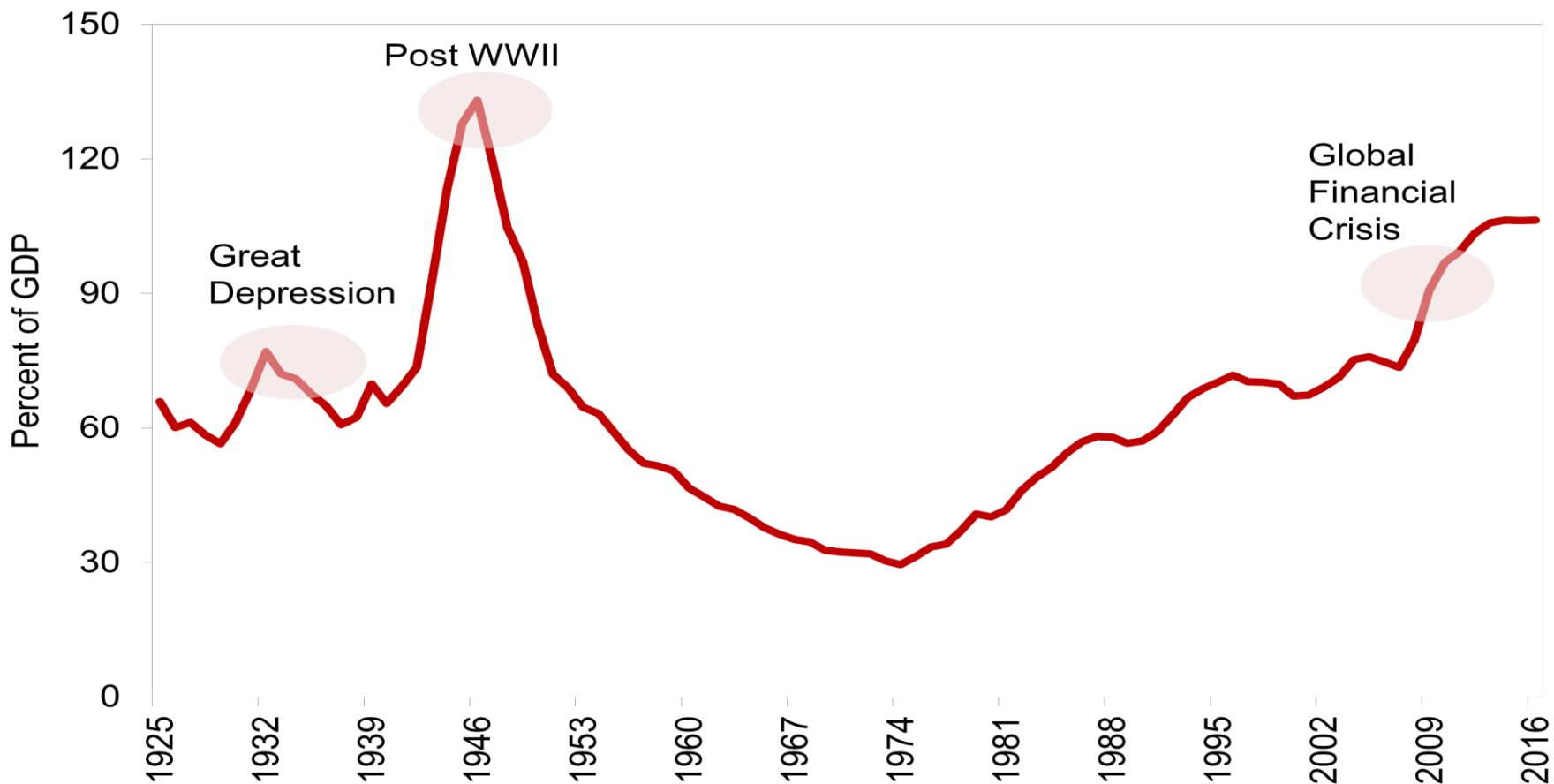


This slow growth is happening despite the large increase in fiscal deficit in most countries



Source: IMF, Fiscal Monitor, April 2016
www.jvi.org nfunke@jvi.org

...and the large increase in public debt-to-GDP ratio in Advanced Countries

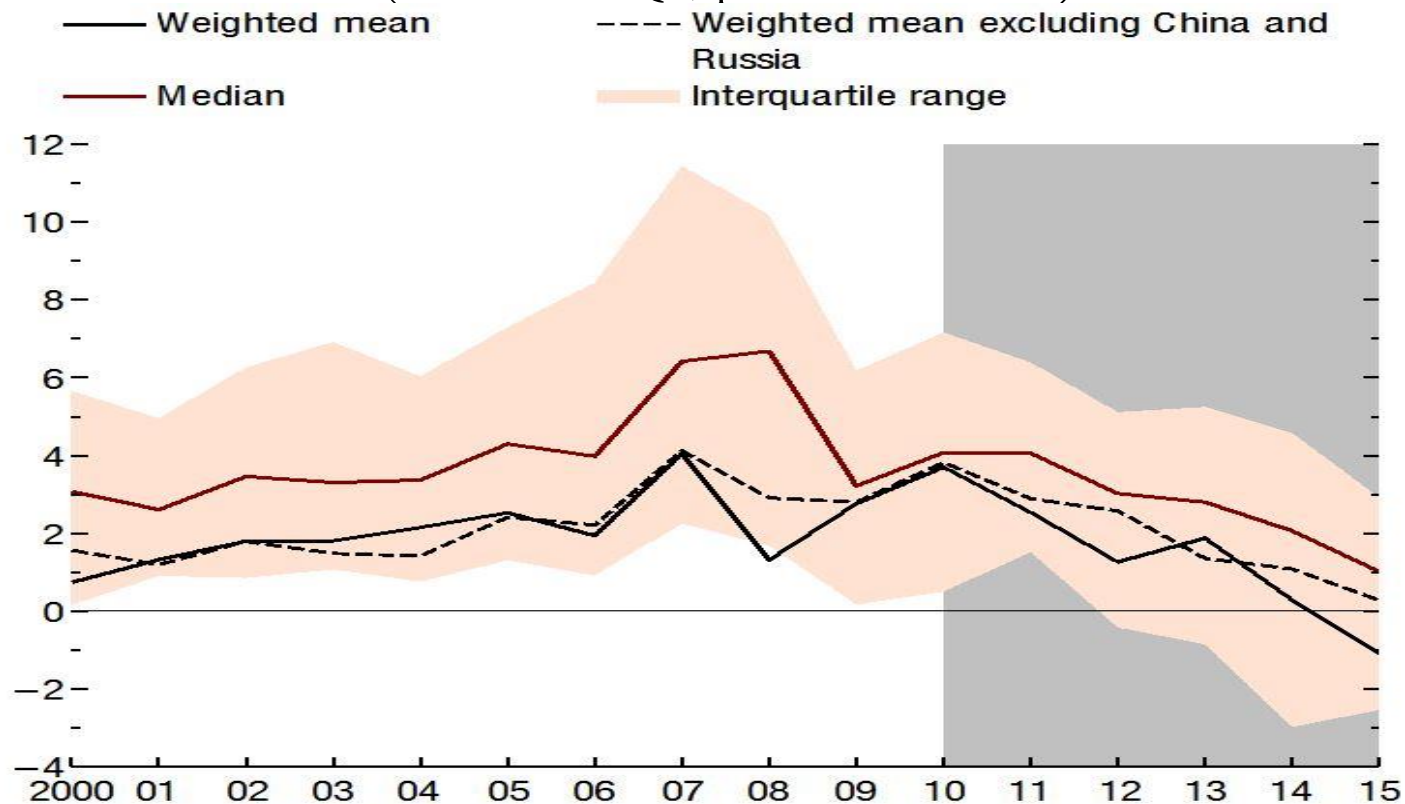


Source: IMF, Fiscal Monitor, April 2016.



Slow growth worldwide is leading to a broad-based slowdown in capital flows to Emerging Markets...

Net Capital Inflows to Emerging Market Economies (2000-2015:Q3, percent of GDP)

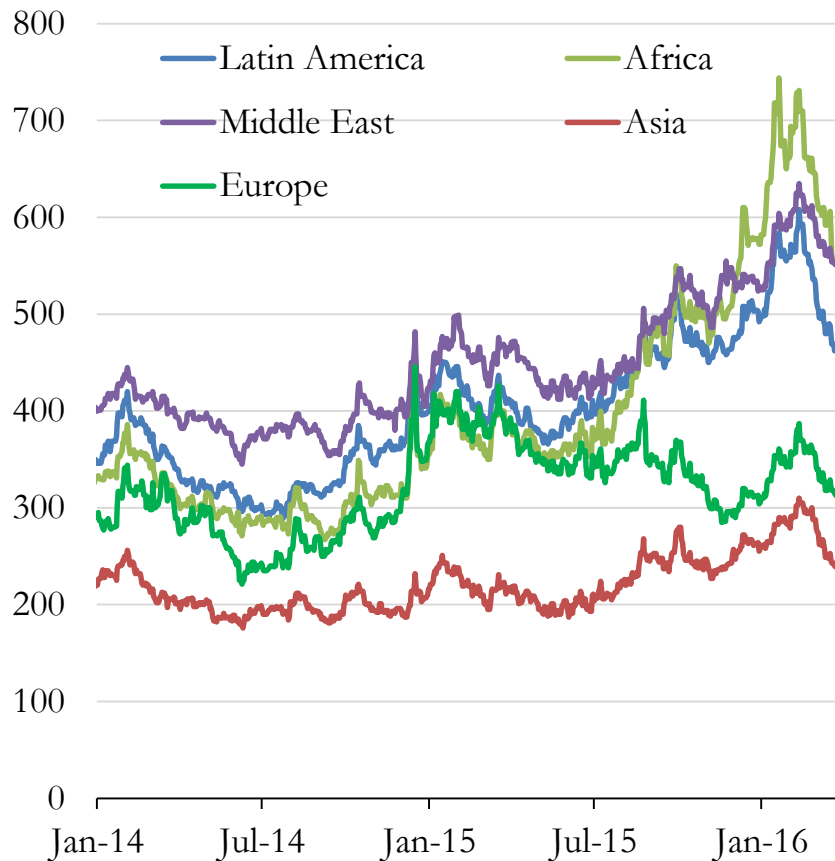


Source: IMF, World Economic Outlook, April 2016.

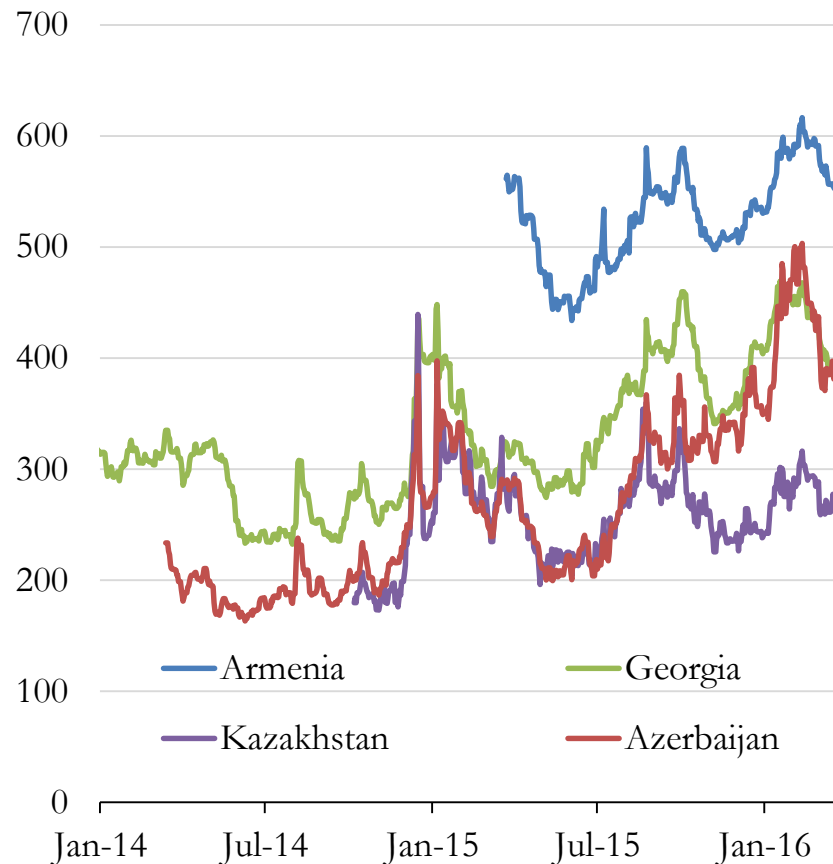


...and to an increase in risk aversion and tighter financial conditions

EMBIG Sovereign Bond Spreads (Basis Points)

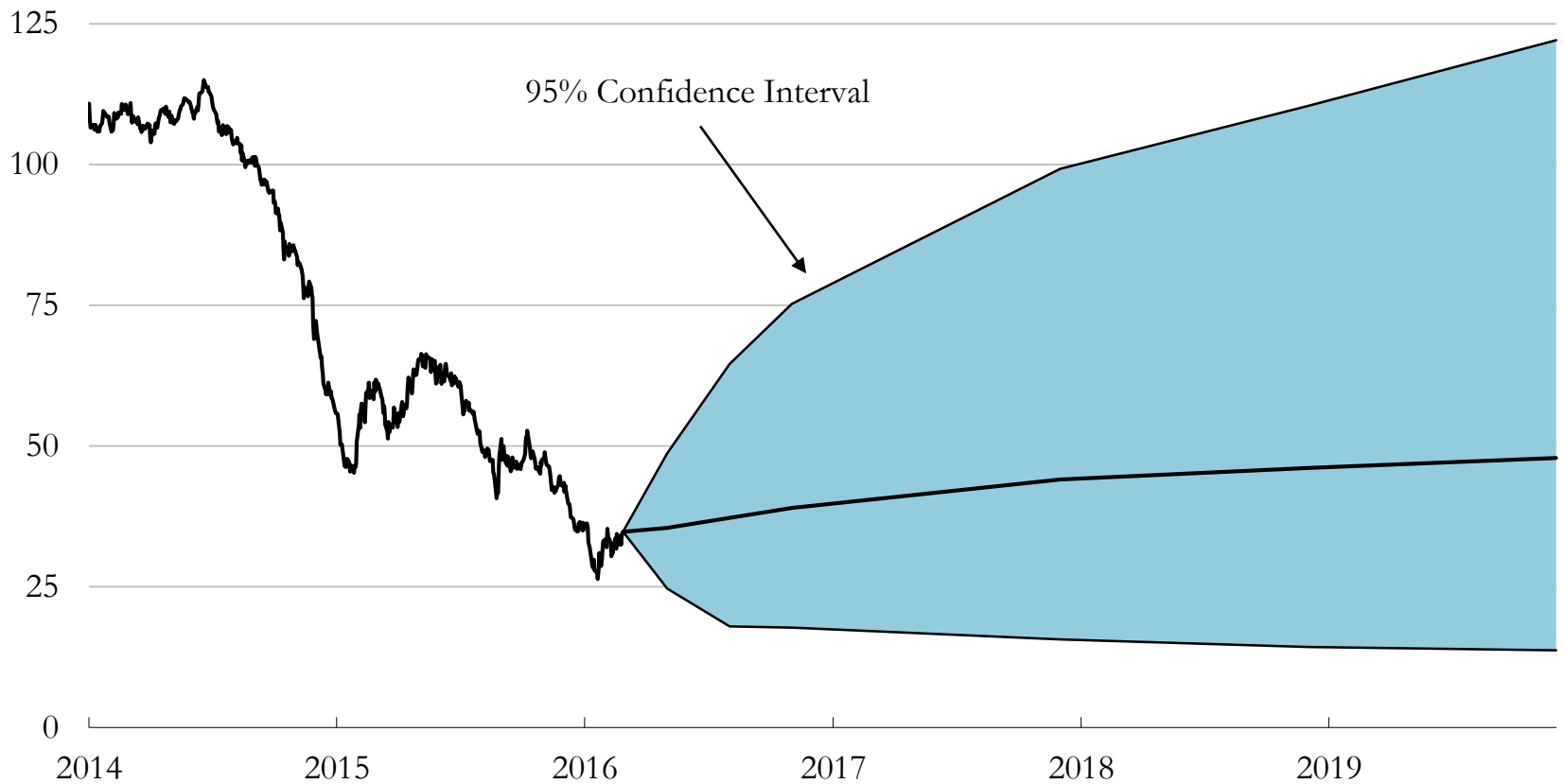


Sovereign Bond Spreads (Basis Points)



Oil price: declined further since October and expected to remain low for long

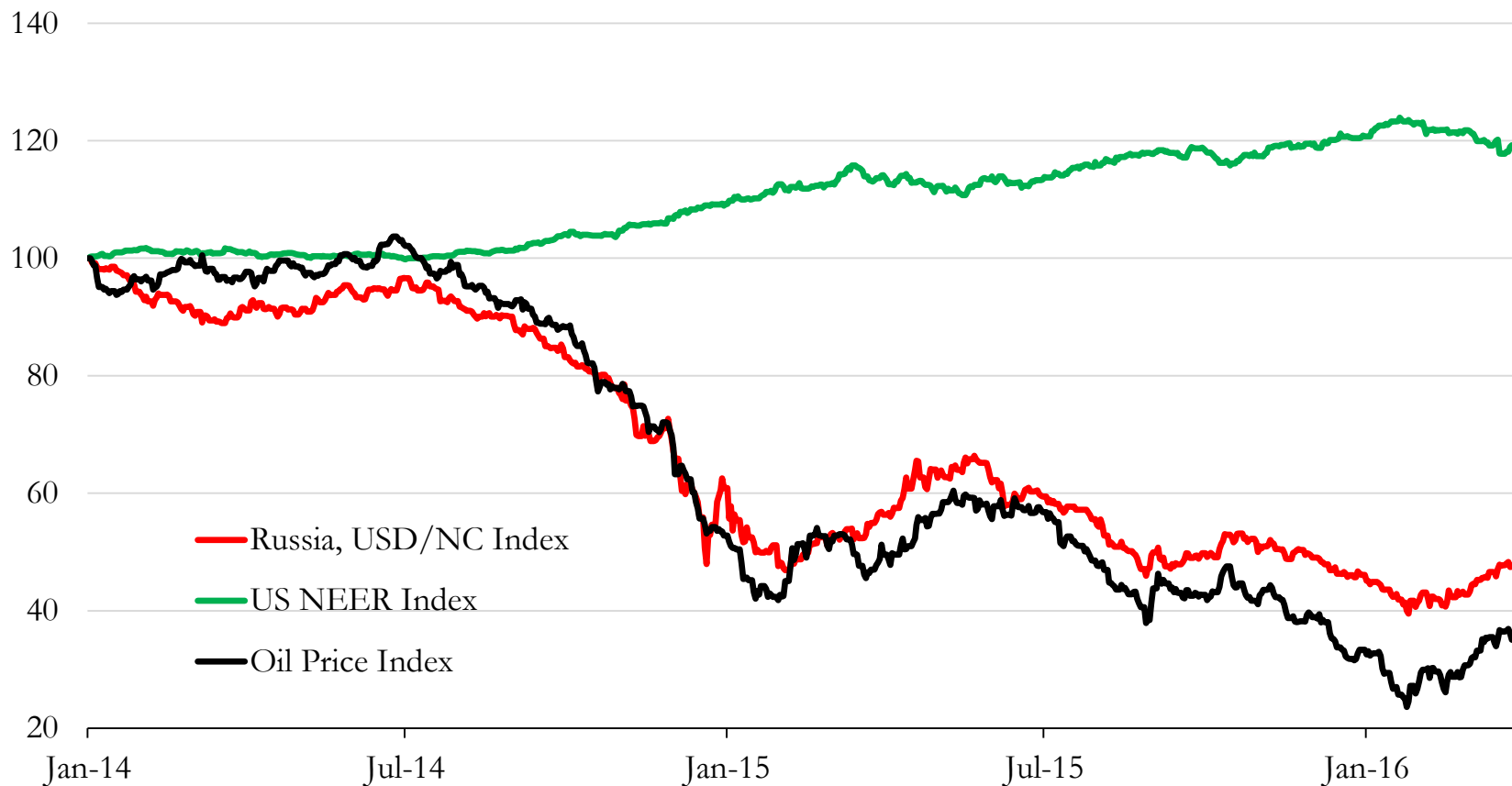
Brent Crude Oil
(U.S. dollars per barrel)



Large exchange rate movements

Nominal Exchange Rates and Oil Price

(Index, Jan 2014 = 100)



Outline

Regional Outlook

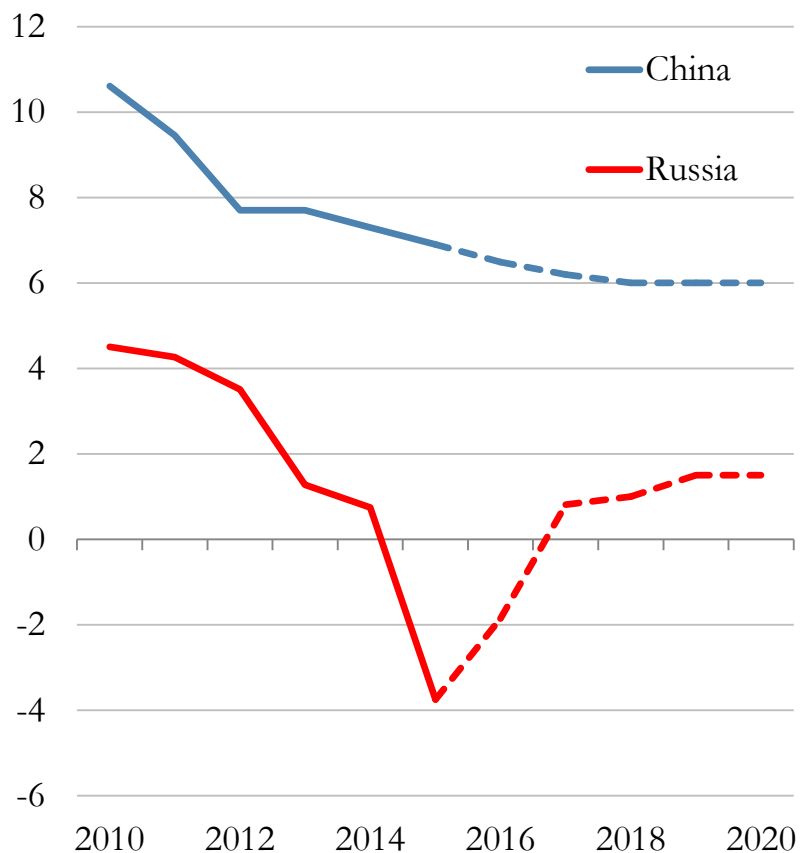
How is this affecting Armenia and the Caucasus and Central Asian Region?



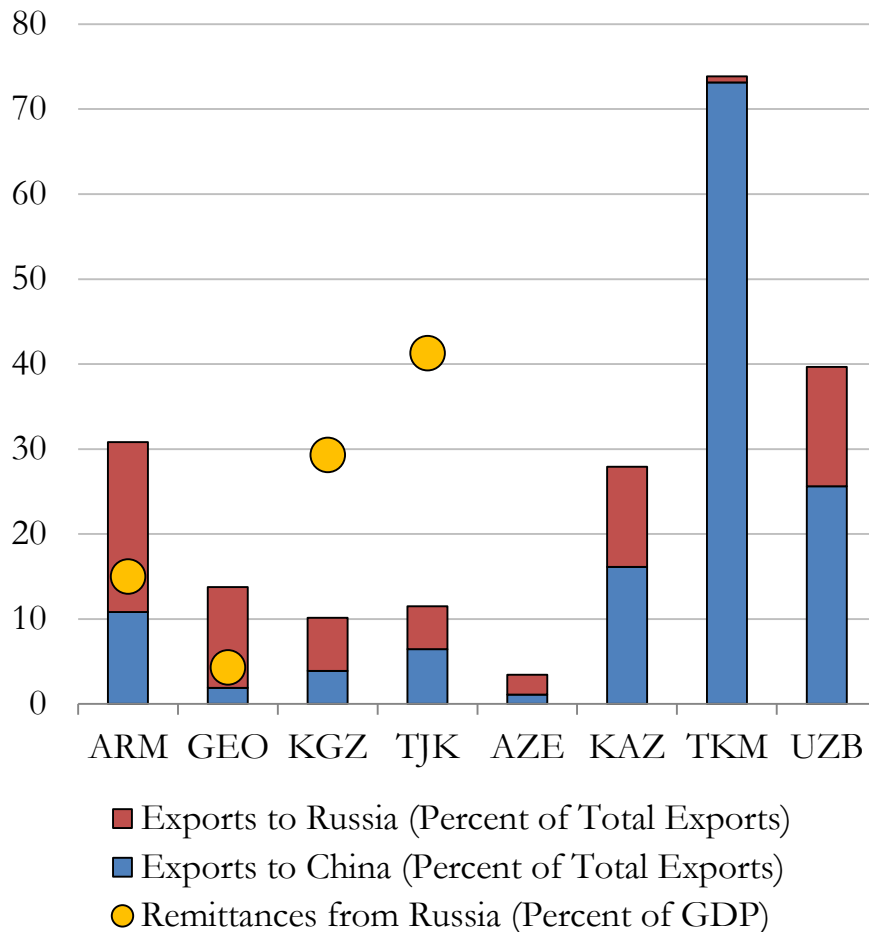
Weaker growth in key Emerging Markets

Growth in China and Russia

(Percent)



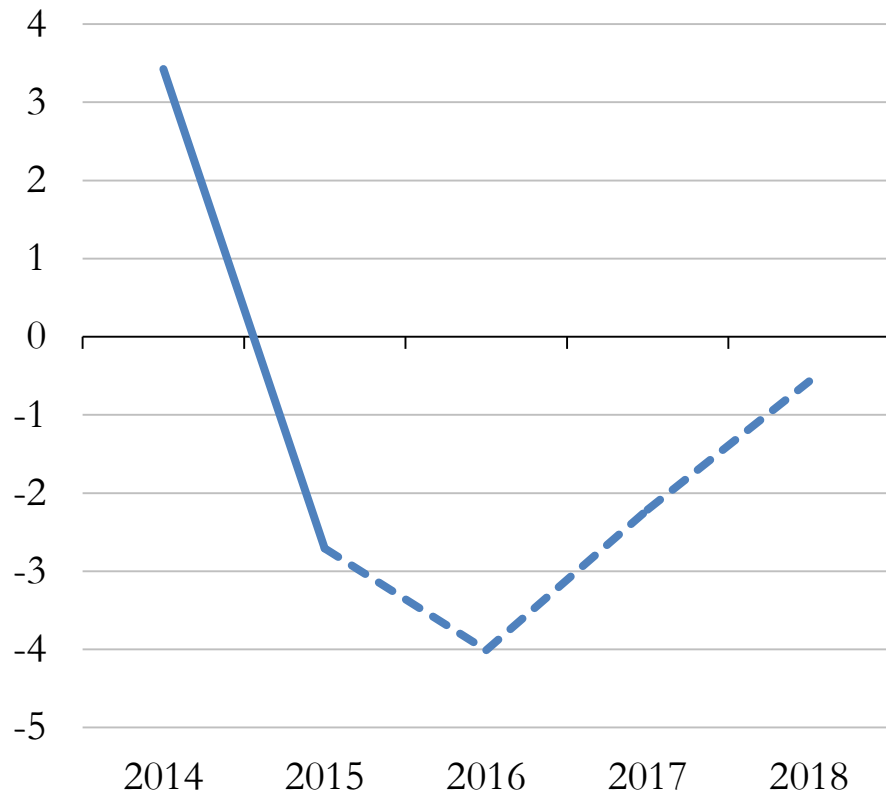
CCA Linkages with China and Russia



Oil exporters: large external and fiscal losses

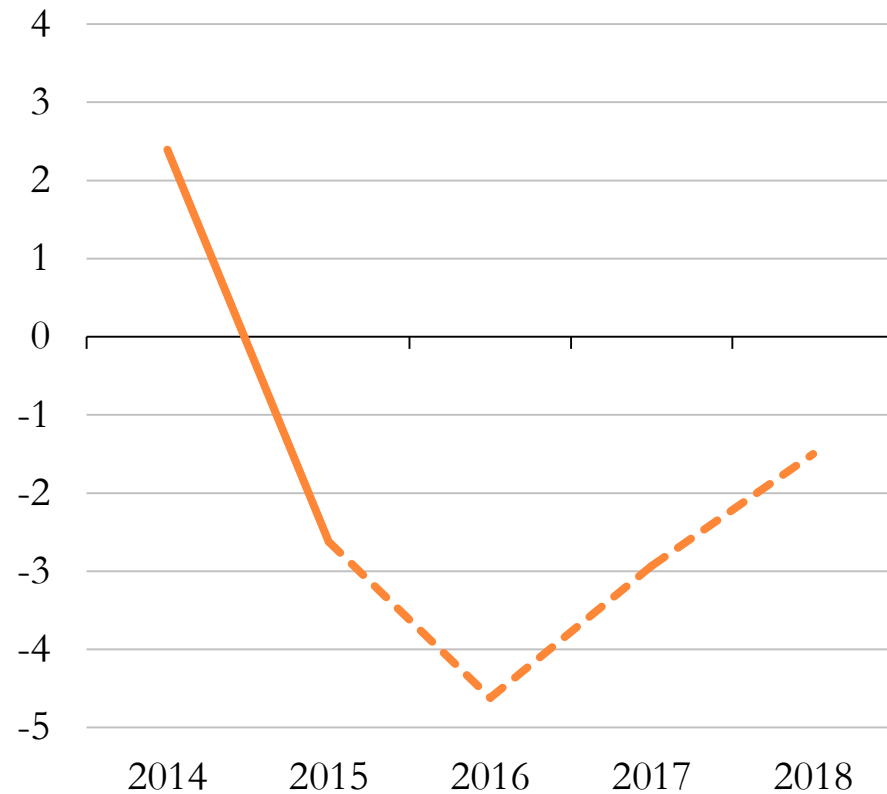
Current Account Balance

(Percent of GDP)



Fiscal Balance

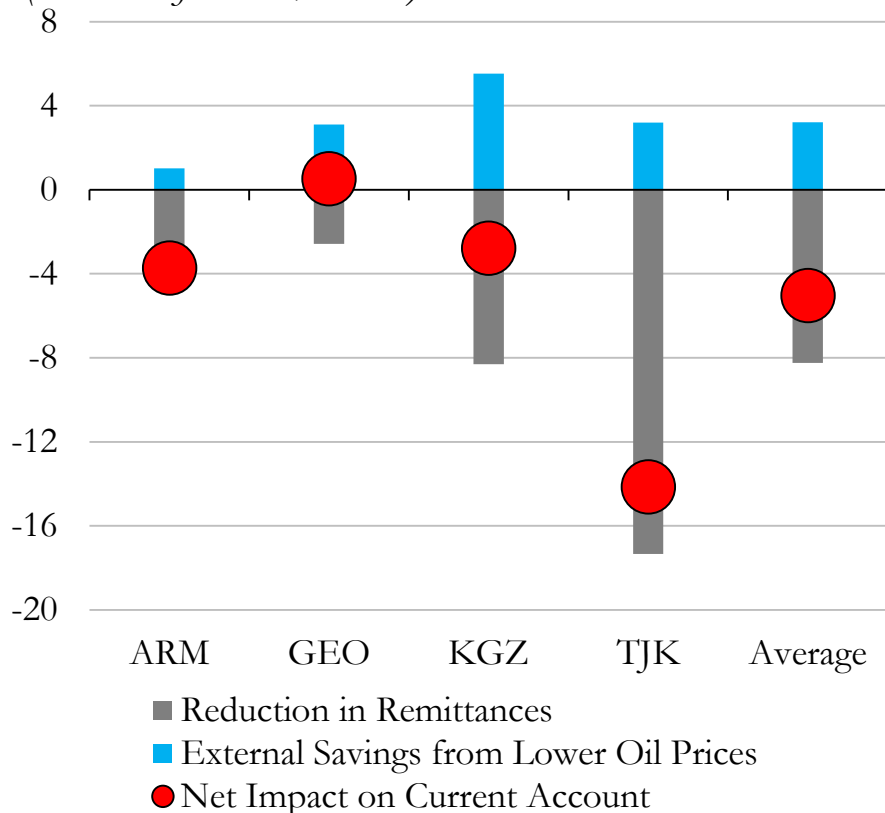
(Percent of GDP)



Oil importers: drop in remittances more than offsets gains from cheaper oil

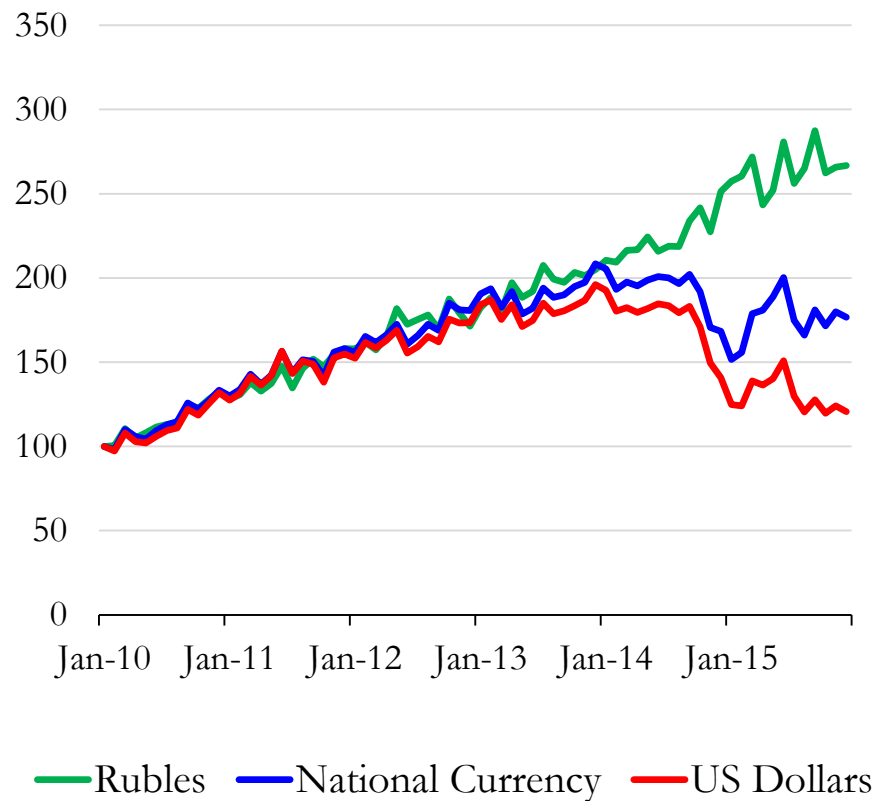
Decline in Remittances Compared to Gains from Lower Oil Prices

(Percent of GDP, 2015)



Remittances

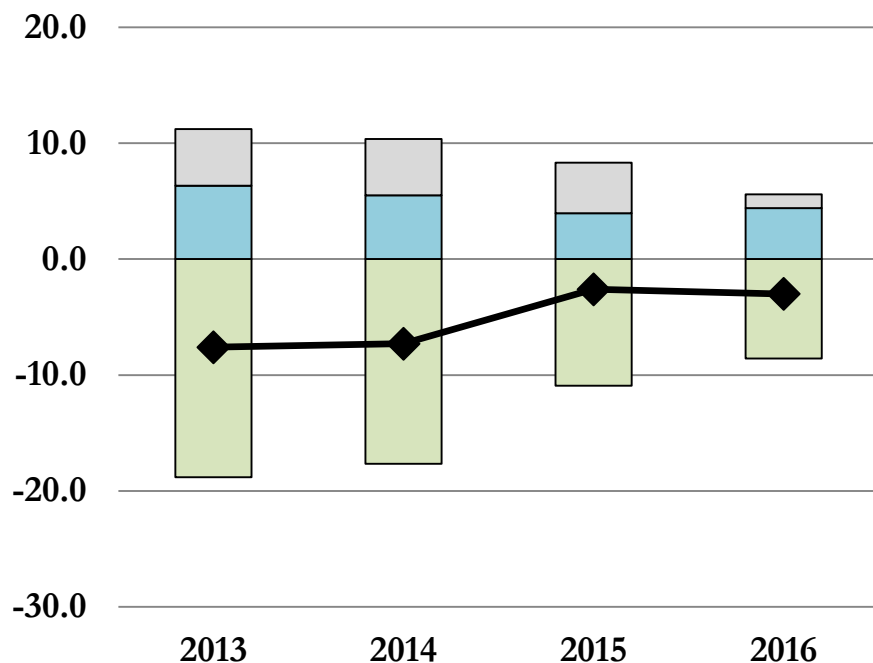
(Seasonally Adjusted Levels, Jan 2010 = 100)



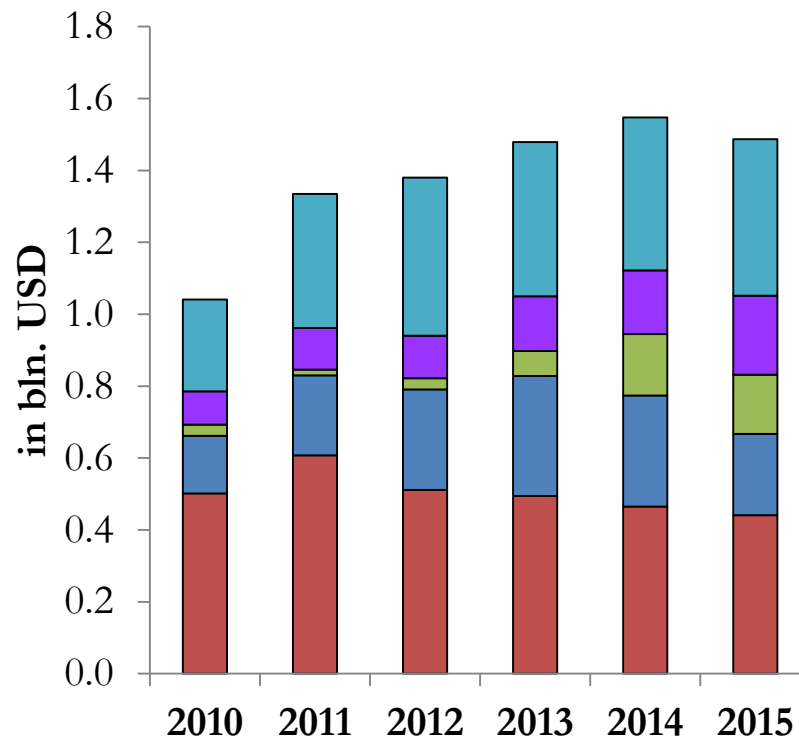
In Armenia, external shock compensated by lower imports and good performance of exports

Armenia: Current Account Decomposition

(Percent of GDP)



Armenia : Export of goods by destination



- Other
- Middle East (Iran Iraq UAE)
- China
- Russia

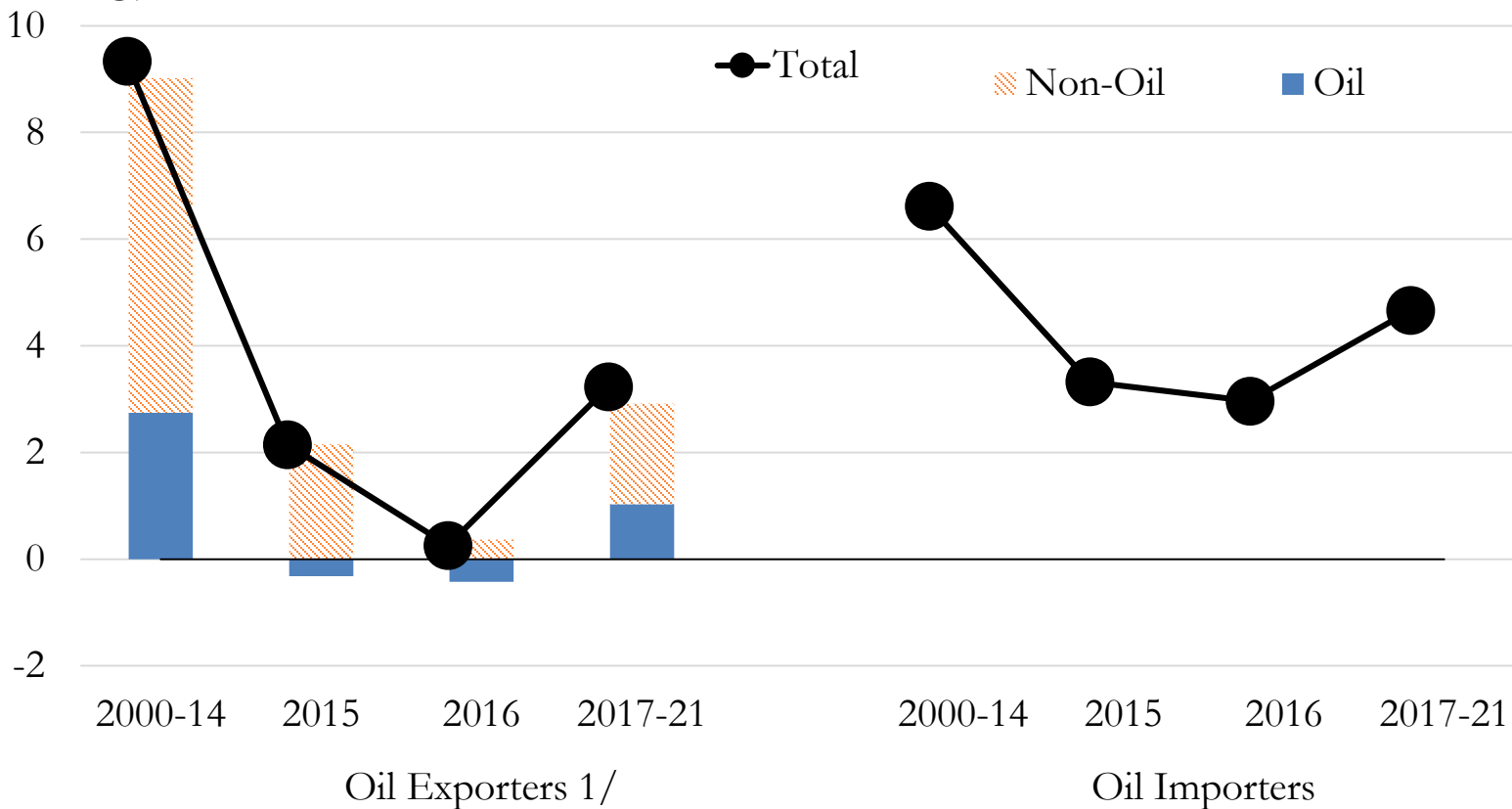
- Trade Balance
- Other

- Net Remittances 1/
- Current Account



With many countries relying heavily on oil and remittances, growth will recover only modestly

Real GDP Growth
(Percent Change)



1/ Excludes Uzbekistan.



How an already weak outlook could worsen

External

Weaker growth in key trading partners
(Russia, China, Europe)

Further weakening of prices for oil and other
commodities

Tighter global financial conditions

Domestic

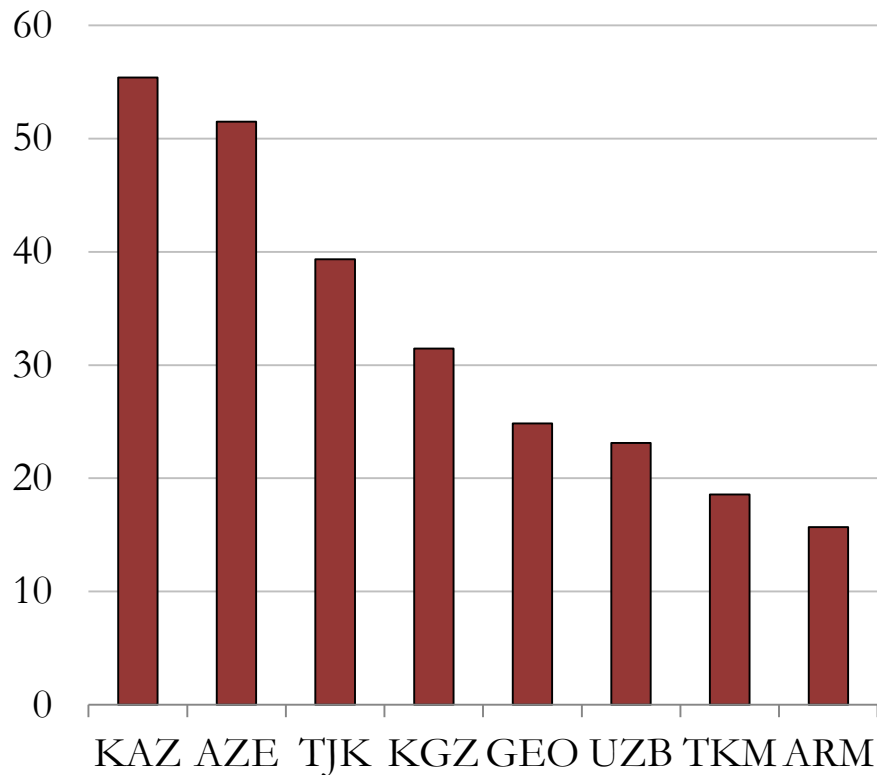
Financial sector vulnerabilities

Outline

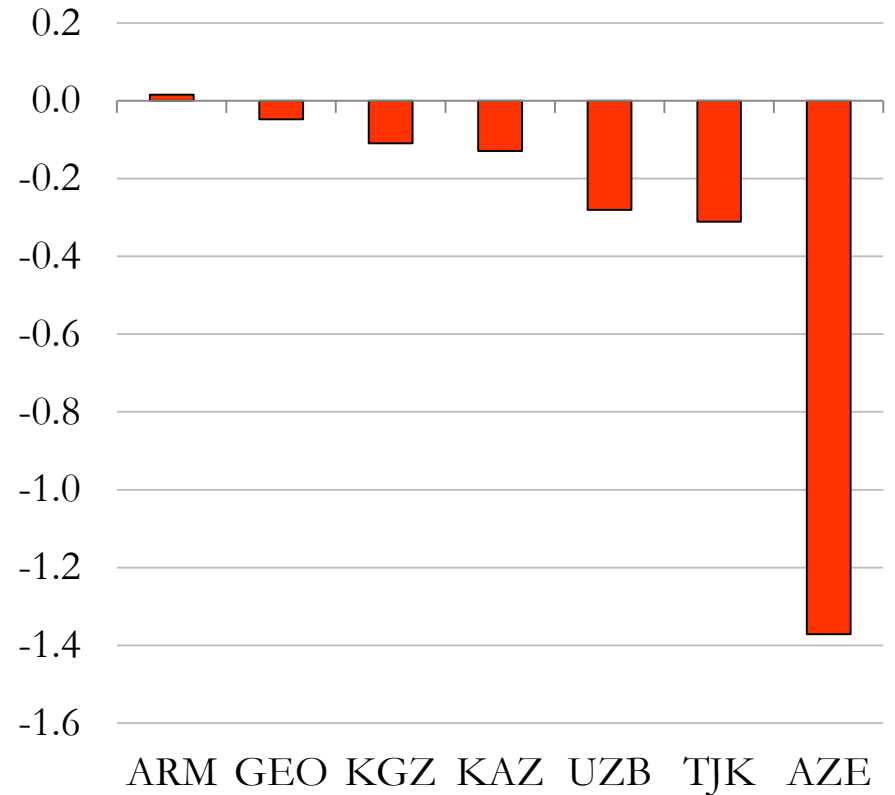
Responding to Shocks

Exchange rate adjustments have helped mitigate the impact of the shocks on the economy...

Depreciation vis-à-vis US Dollar
(Percent Change, January 2014-March 2016)



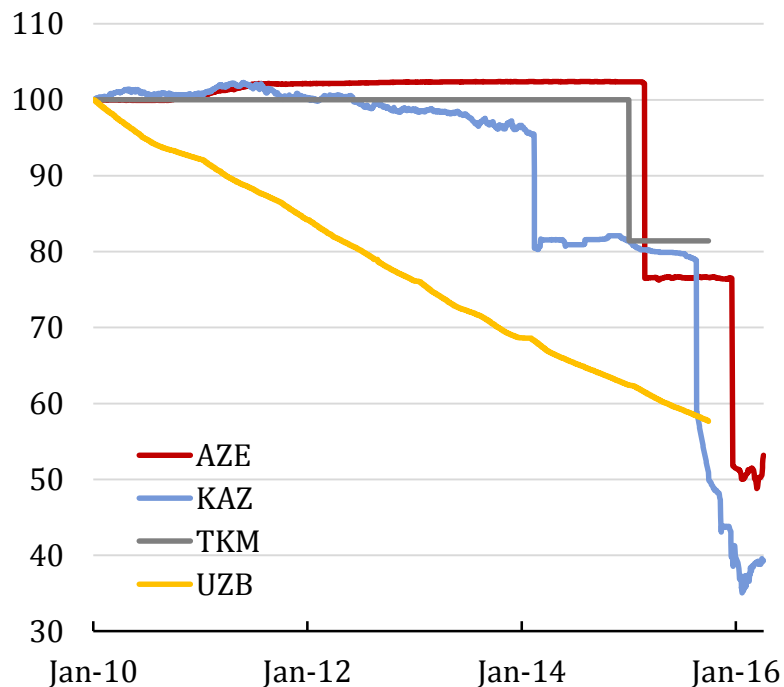
Change in International Reserves
(Months of Imports, 2016 vs. 2015)



Currencies are adjusting to new realities...

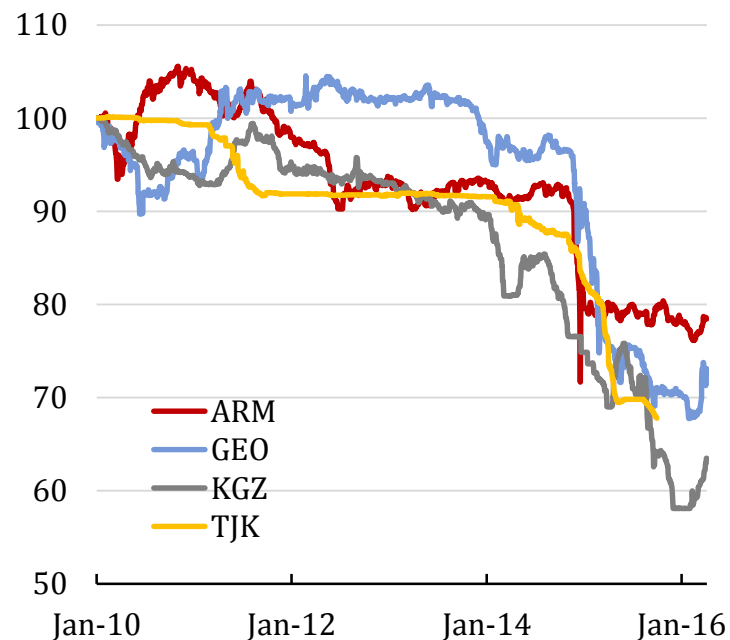
Oil Exporters

(U.S. dollars per National Currency, Jan. 1, 2010=100)



Oil Importers

(U.S. dollars per National Currency, Jan. 1, 2010=100)



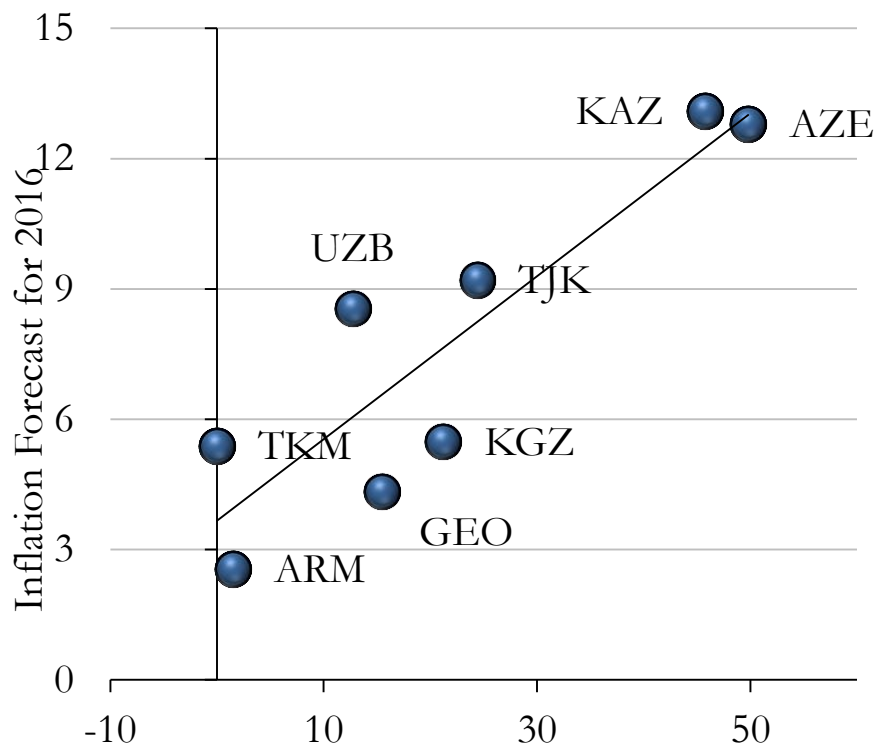
Sources: National authorities; and IMF staff calculations.



... but have raised inflation, except in Armenia

Depreciation and Inflation

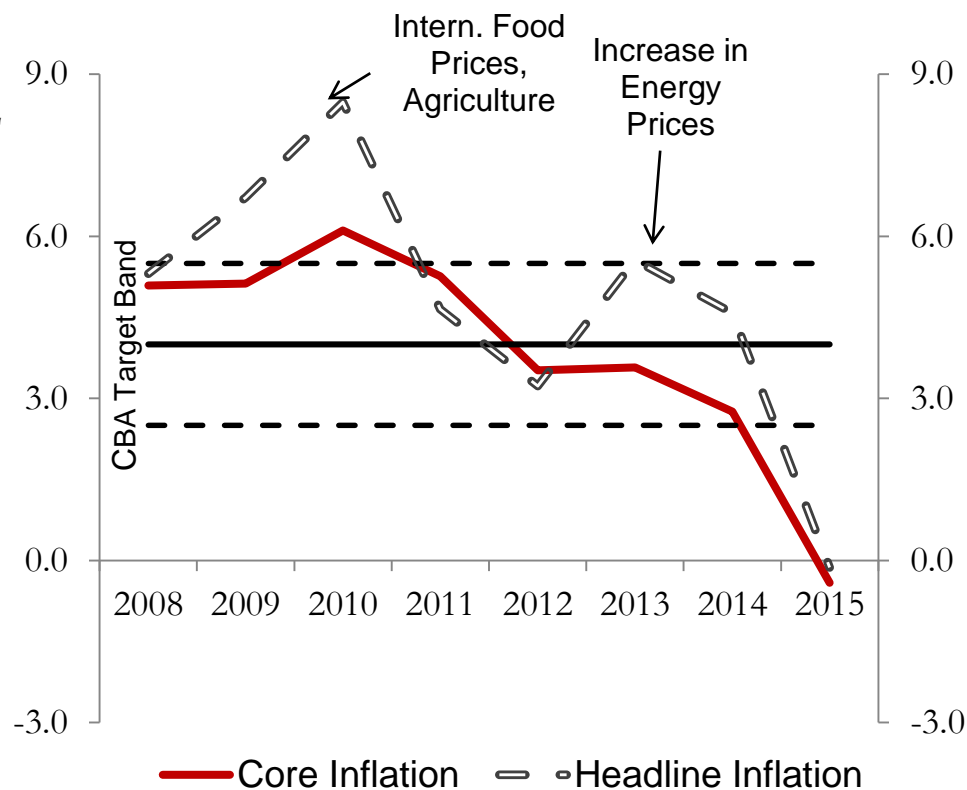
(Percent)



Depreciation vs. U.S. Dollar in 2015

Consumer Price Inflation

(In 12 month percent changes)



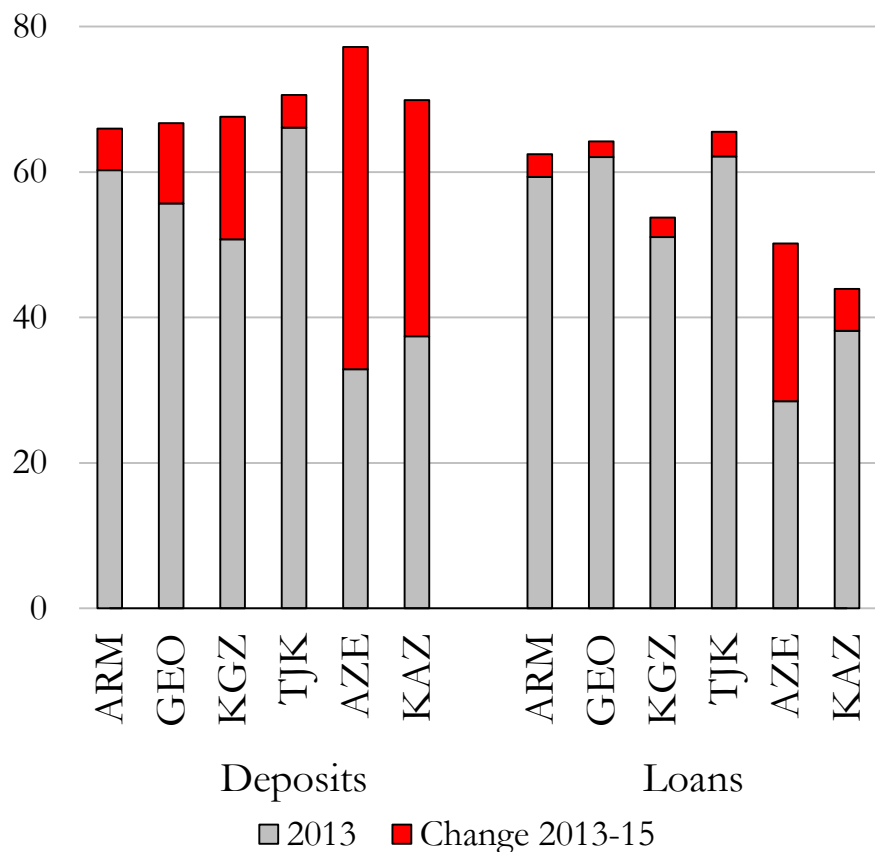
— Core Inflation - - - Headline Inflation



... and increased financial vulnerabilities

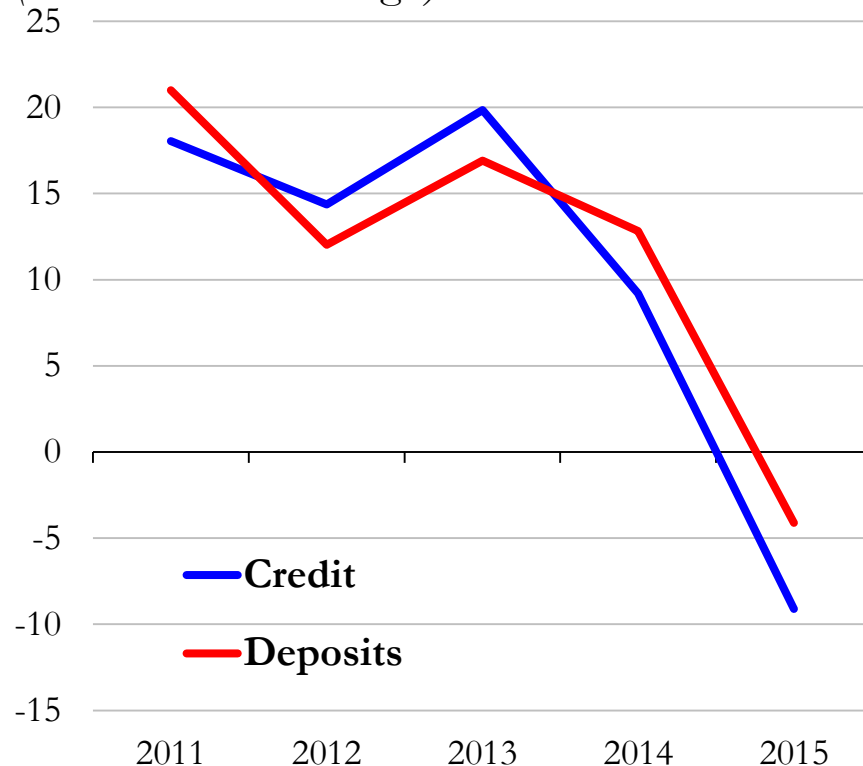
Dollarization

(Percent)



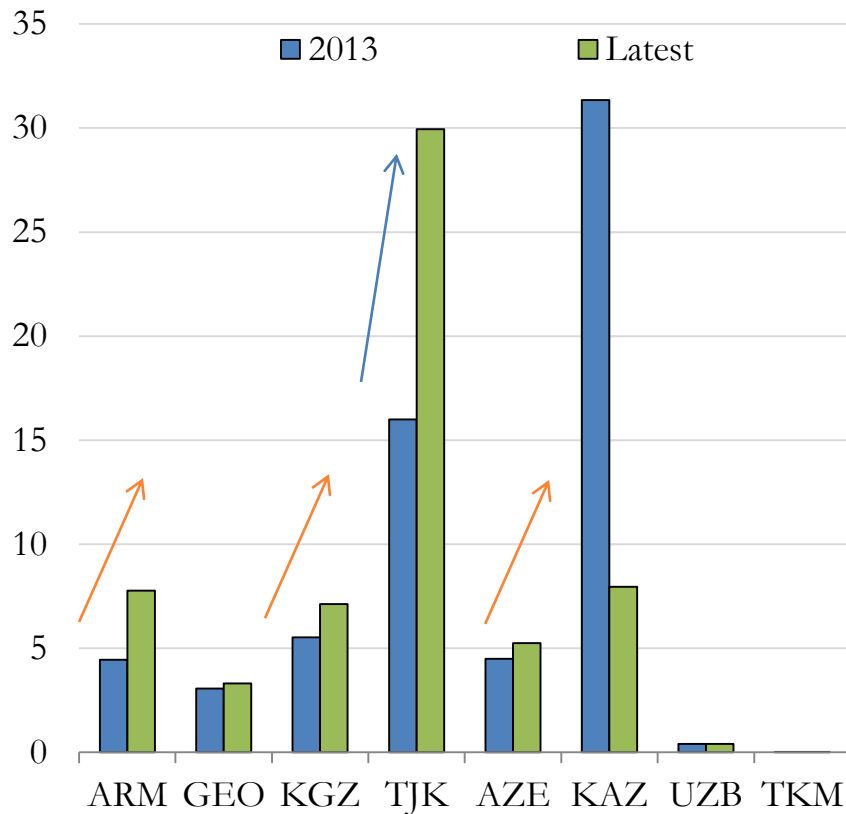
Private Sector Credit and Bank Deposits

(Annual Percent Change)

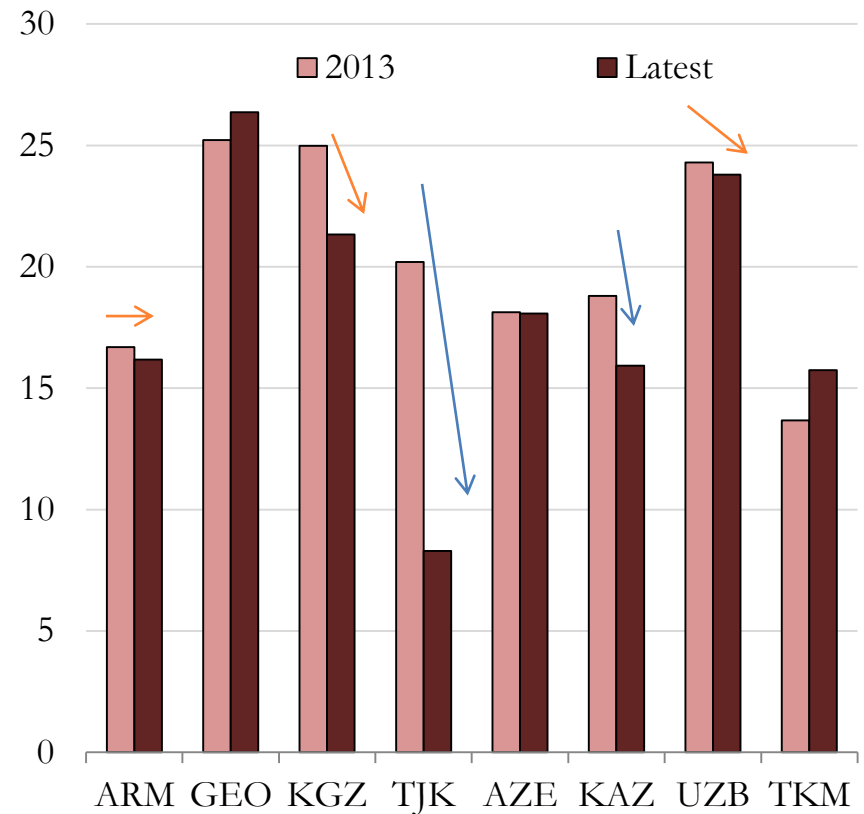


Bank asset quality is worsening and capital is eroding

Non-Performing Loans
(In Percent of Total Loans)

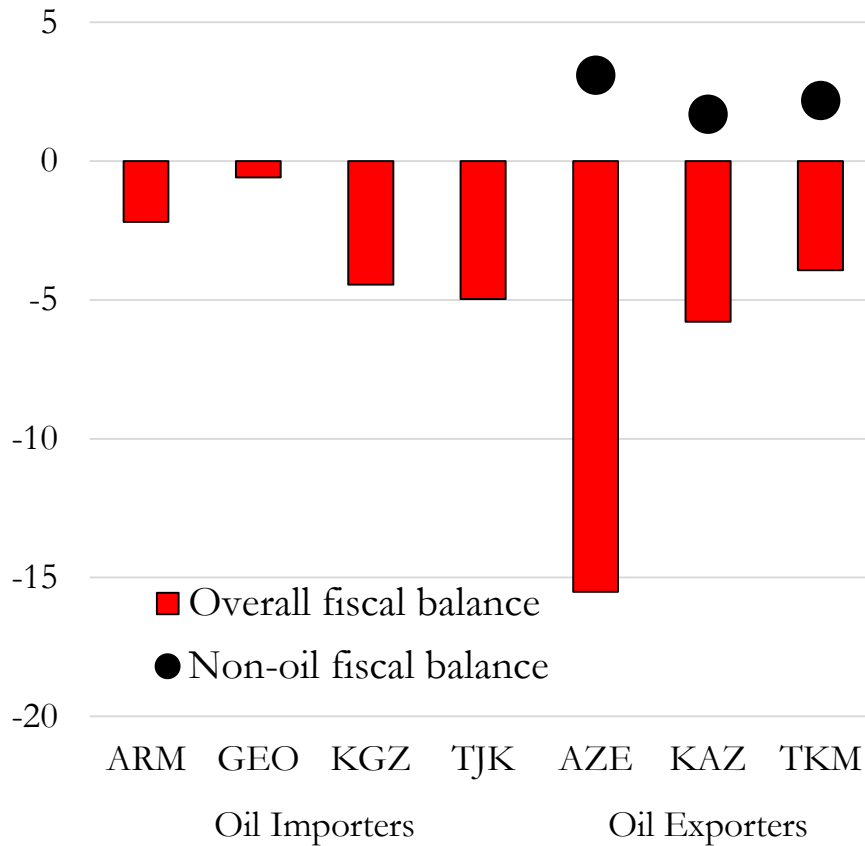


Capital Adequacy Ratios
(In Percent of Total Loans)

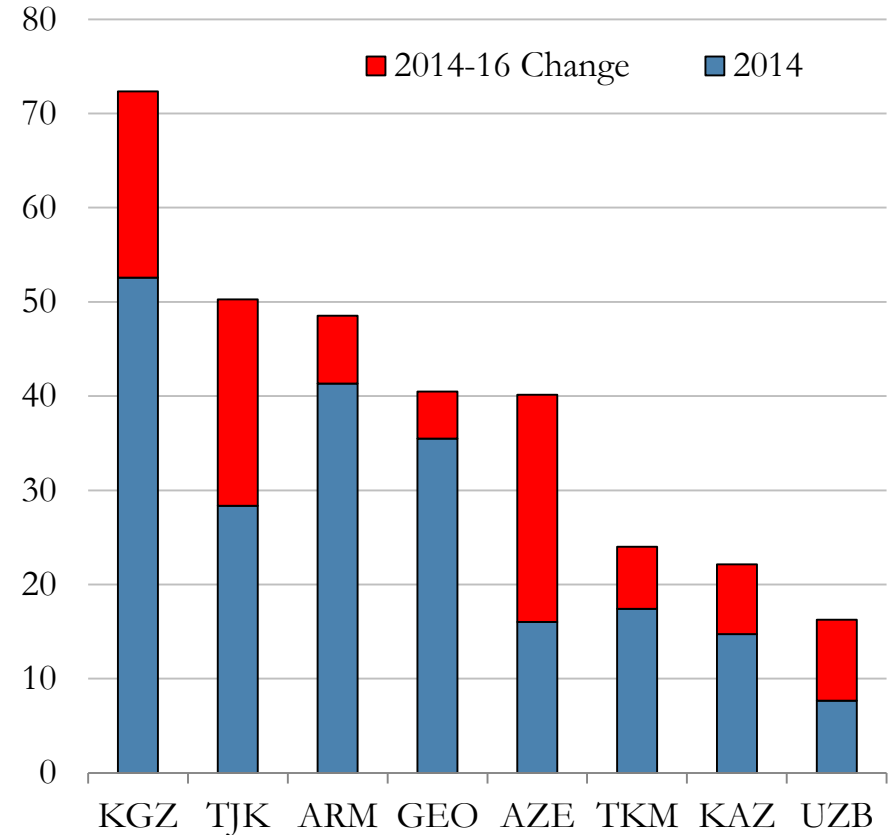


With public debt edging up, some countries have started tightening fiscal policy

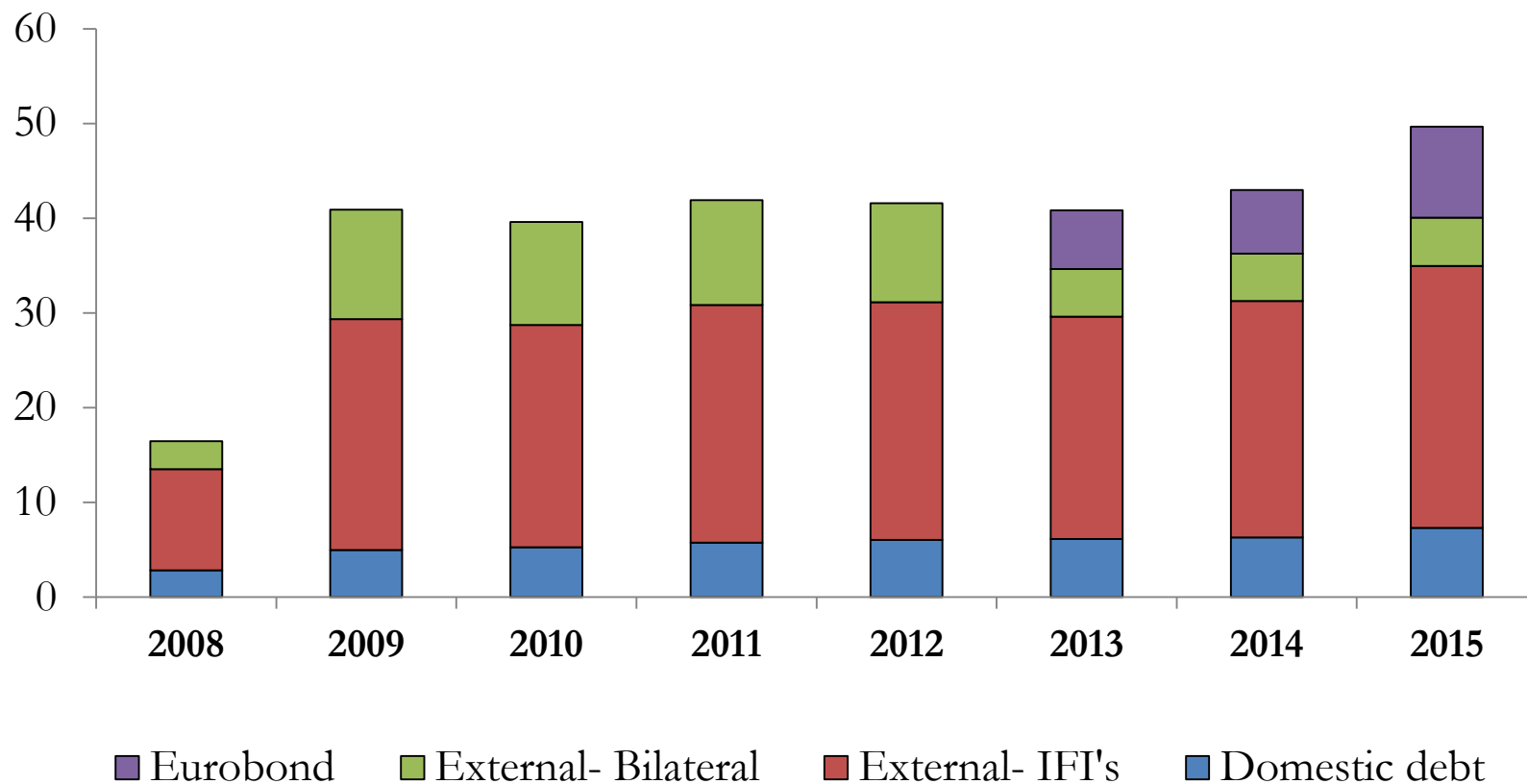
Change in Fiscal Balance, 2014-16
(Percent of GDP)



Public Debt
(Percent of GDP)



Armenia: Composition of Public Debt (in percent of GDP)...mostly IFIs debt



Outline



Policy Priorities



Policy Priority 1: Ensure Fiscal Sustainability

Near-Term
Growth

Debt Sustainability,
Saving for the Future

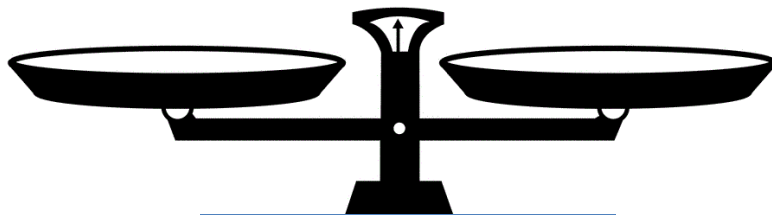


- Given the permanence of the shocks, medium-term consolidation plans are needed to ensure fiscal sustainability.
- The pace of consolidation depends upon availability of buffers and should avoid unnecessary drag on economic activity.
- Improving the quality of public expenditure, and preserving capital and social expenditure, will help to safeguard long-term growth potential and promote inclusion.

Policy Priority 2: Strengthen Monetary and Exchange Rate Policy Frameworks

Inflation

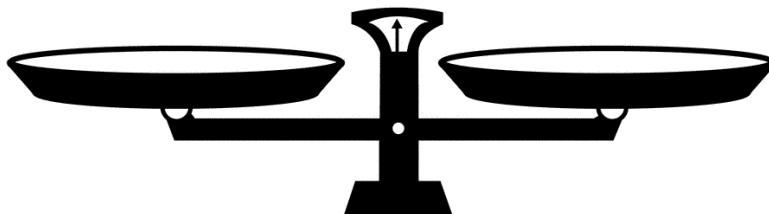
Financial Intermediation
and Near-Term Growth



Monetary Policy

Competitiveness, External
Buffers and Balance

Financial Stability
and Inflation



Exchange Rate Policy

- Exchange rate flexibility remains essential to mitigate the effects of external shocks, preserve competitiveness, and avoid foreign exchange reserve losses.
- An effective interest rate instrument is needed to replace the exchange rate as the nominal anchor.
- Policymakers should act to safeguard financial stability, including through stronger macroprudential regulations, supervision, and crisis management frameworks.

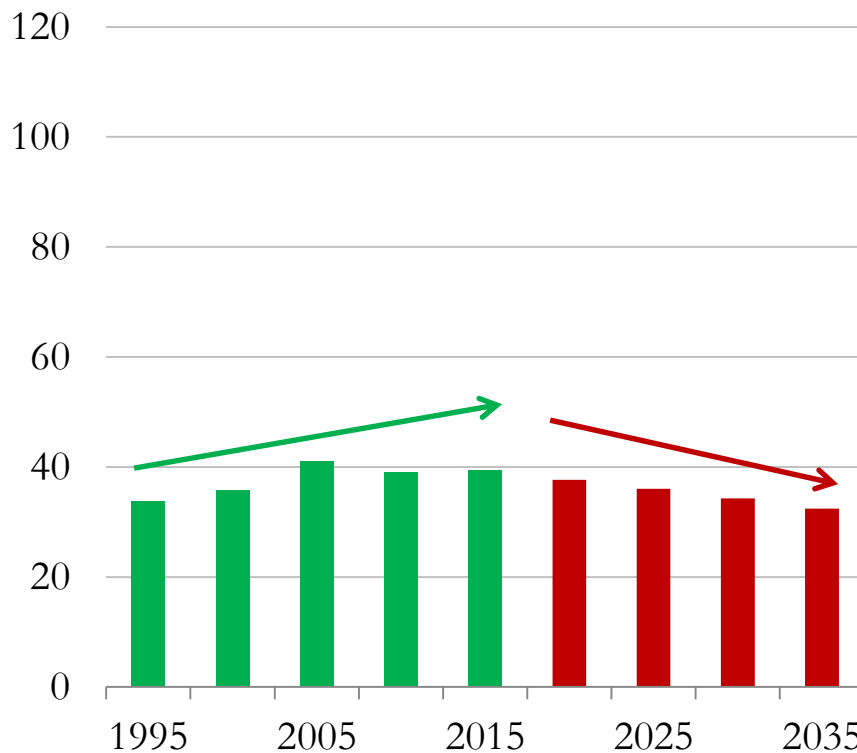
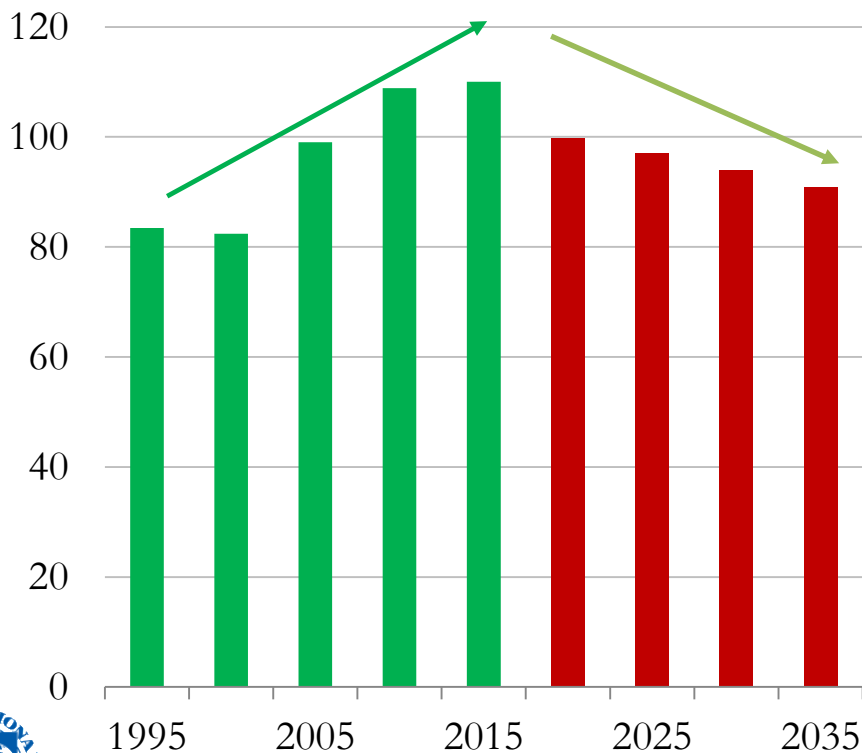
Policy priority 3: accelerating structural reforms to prevent a reversal in relative living standards

GDP Per Capita

(Relative to emerging market average, percent)

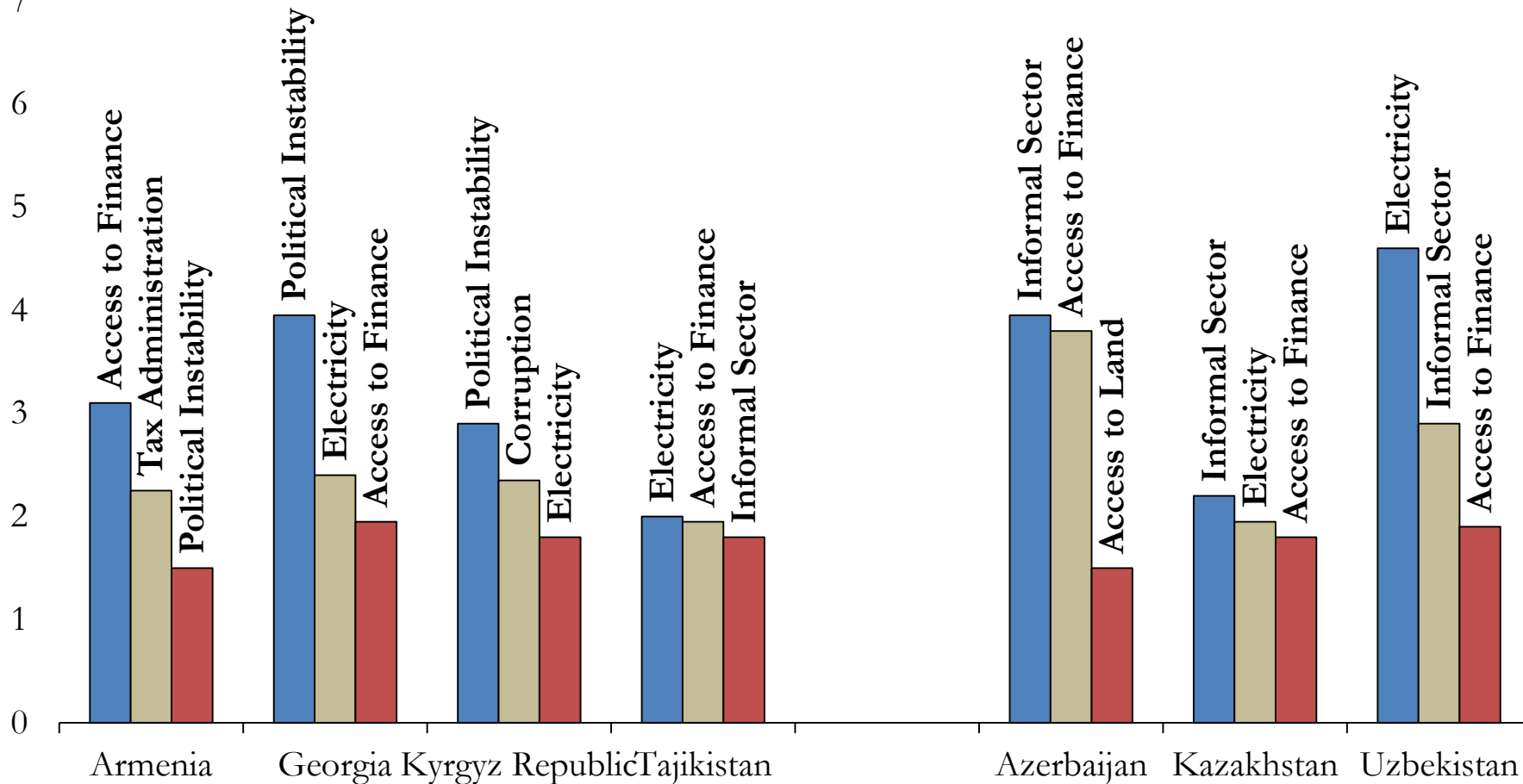
Oil Exporters

Oil Importers



Reforms should promote diversification and private sector development

7 Main Obstacles to Firm Operations



Source: EBRD



Key Takeaways

External shocks, which are likely to persist, have reduced CCA growth to a two-decade low and have weakened the medium-term outlook.

Exchange rate flexibility has helped, but strengthened monetary policy frameworks and improved financial sector oversight are needed.

Fiscal policy should be growth-friendly in the short term and ensure sustainability over the medium term.

Reforms to promote private sector development and reduce reliance on commodities are key to create jobs and improve living standards.



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<http://www.imf.org/external/pubs/ft/reo/2016/mcd/eng/pdf/cca0416p.pdf>

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