

Global and Regional Economic Outlook: Policy Challenges and Opportunities for Armenia

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Outline

Global Outlook

Armenia's Outlook from a Regional Perspective

Armenia Medium-Term Policy Priorities

An uneven global recovery continues

Real GDP Growth Projections

(Percent change from a year earlier)



World

U.S.

Euro Area

**Emerging
markets**

China

Russia

Armenia

2013

3.3

2.2

-0.4

4.7

7.7

1.3

3.5

2014

3.3

2.2

0.8

4.5

7.4

0.2

2.6

2015

3.8

3.1

1.4

5.0

7.1

0.5

3.5

Global recovery remains fragile

Geopolitical risks (Russia-Ukraine, Middle East)

Further risks to growth in emerging market economies

Risks related to normalization of monetary policy in advanced economies

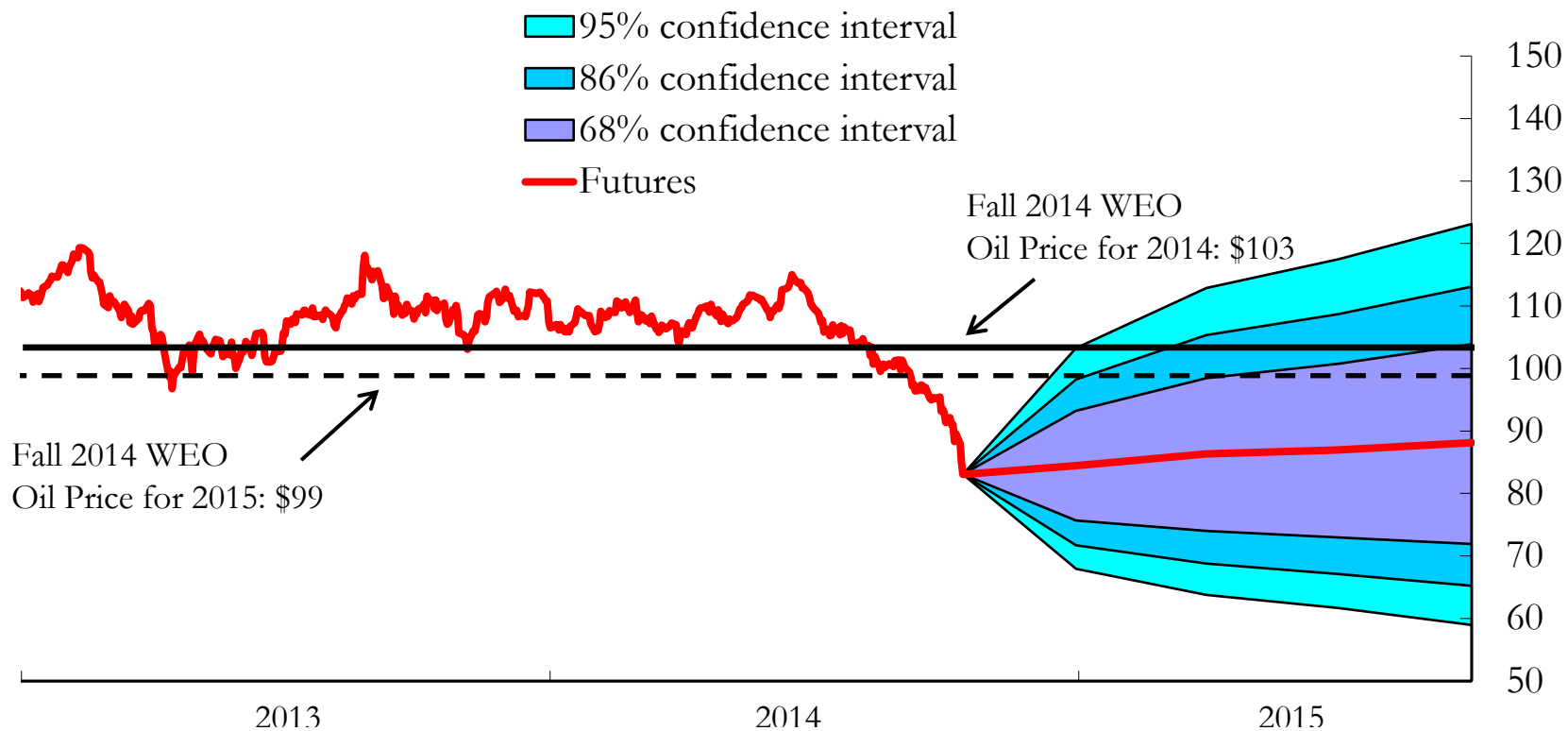
Protracted period of slow growth in advanced economies



Oil prices have declined considerably since projections were made; risks are high in both directions

Brent Crude Oil Price¹

(U.S. dollars per barrel)



Sources: Bloomberg; and IMF staff calculations.

¹Derived from prices of futures and options on October 15, 2014.



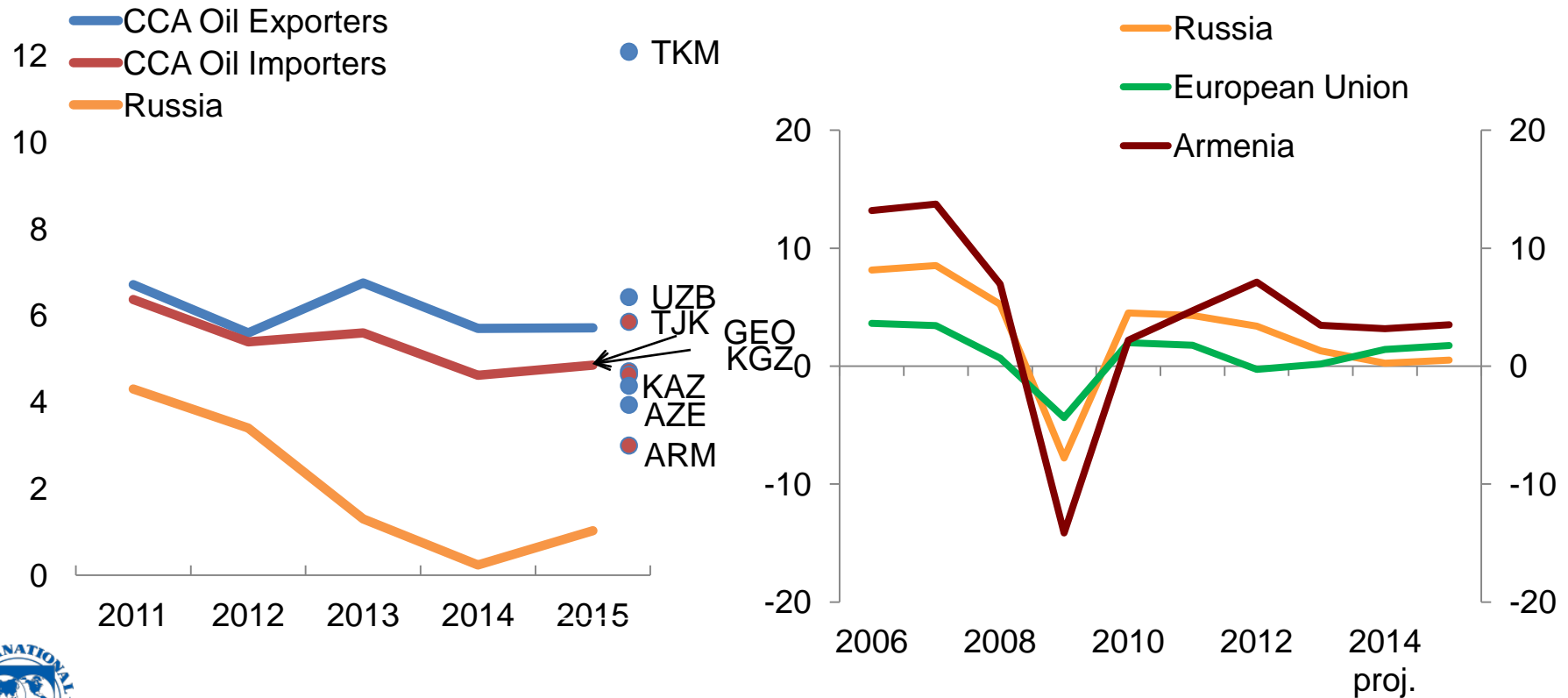
Caucasus and Central Asia



Growth is slowing in the context of Russia's slowdown...

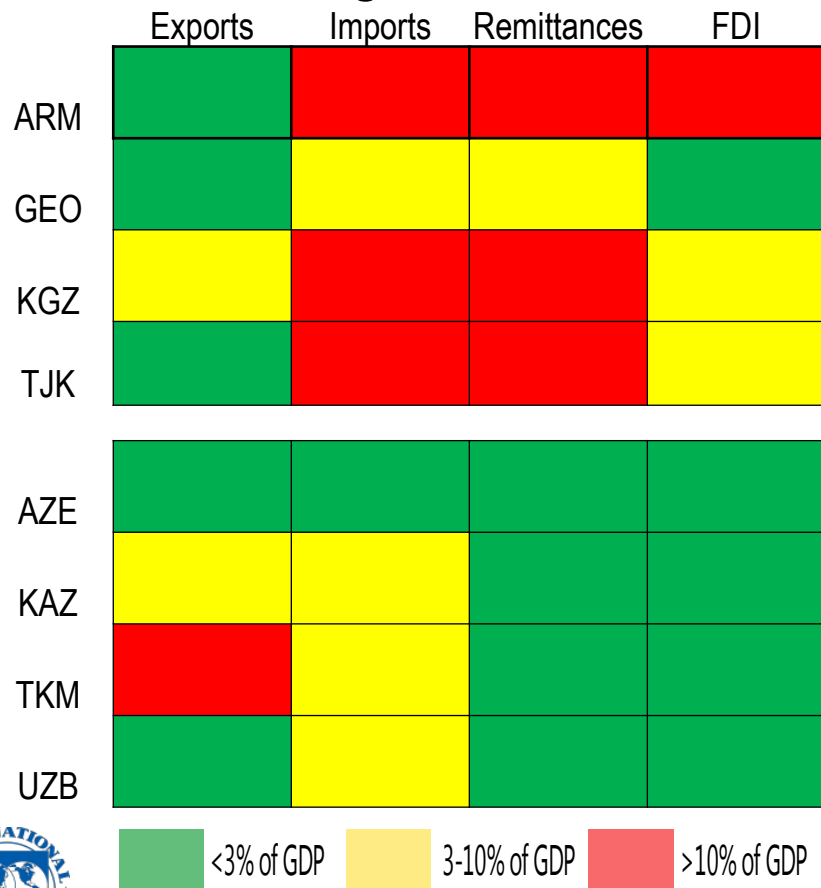
..the EU's still sluggish growth, and domestic weak demand.

Real GDP Growth (In percent) in Russia and Selected CCA countries

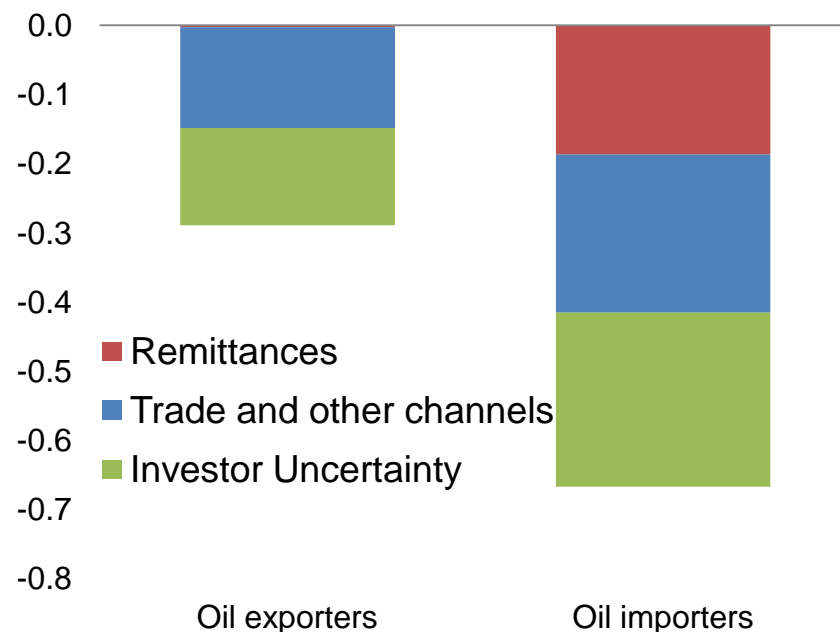


Close linkages with Russia create downside risks to the outlook

Linkages with Russia



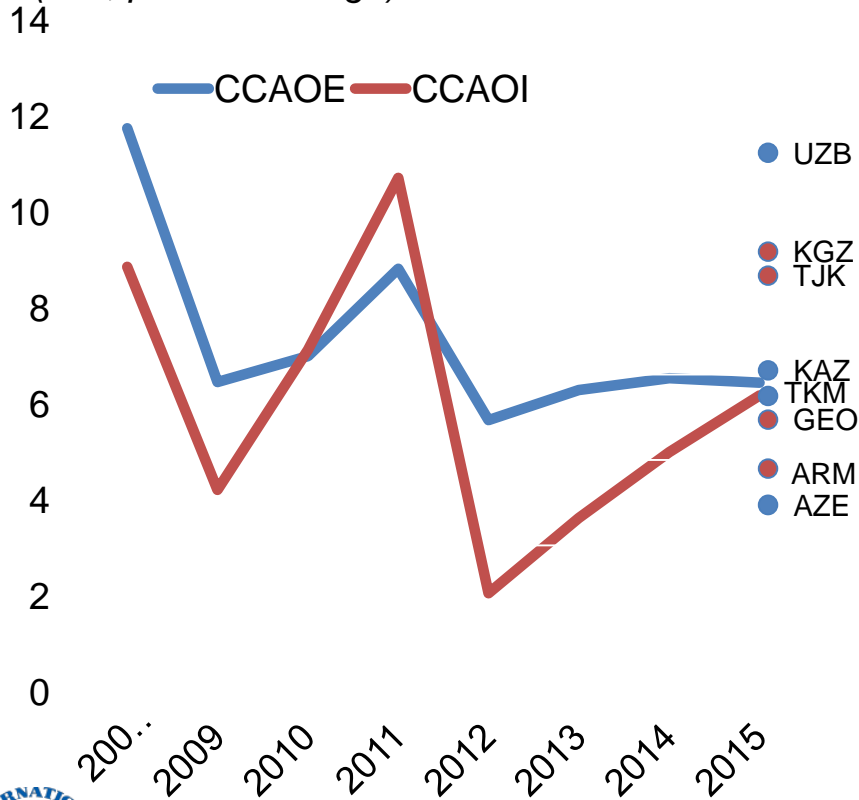
Impact of 1 percentage point fall in Russia's GDP growth and investor uncertainty on CCA GDP growth (percent)



Despite slowing growth, inflationary pressures are rising, with the exception of Armenia...

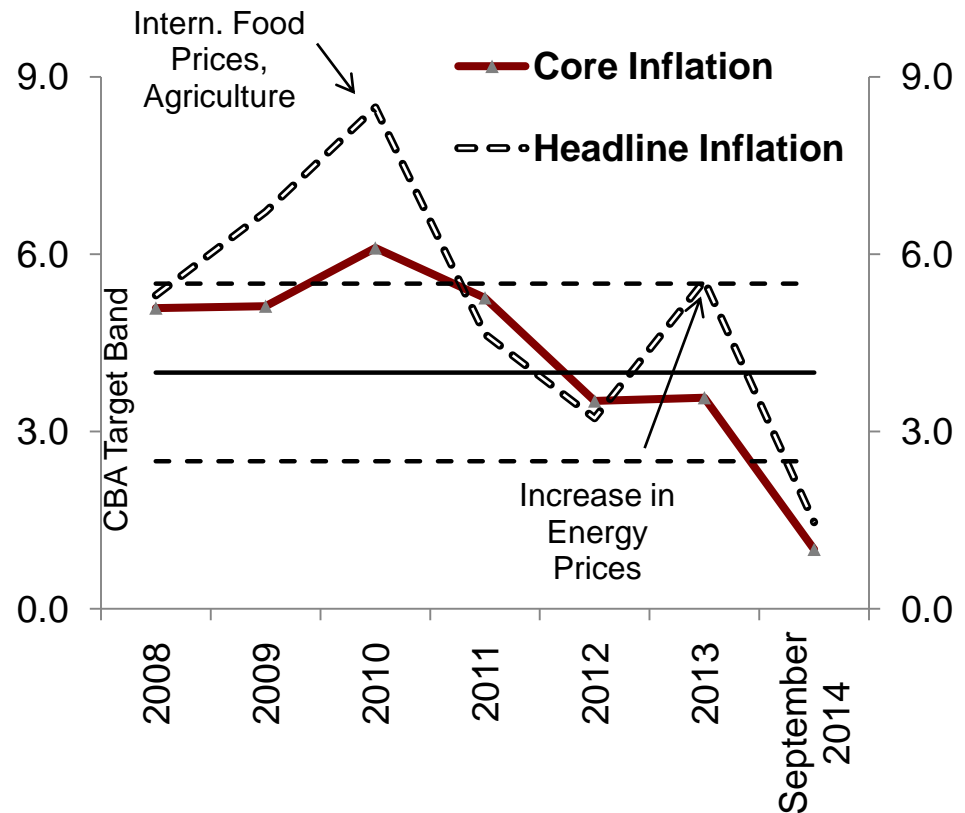
Inflation in CCA

(CPI, percent change)



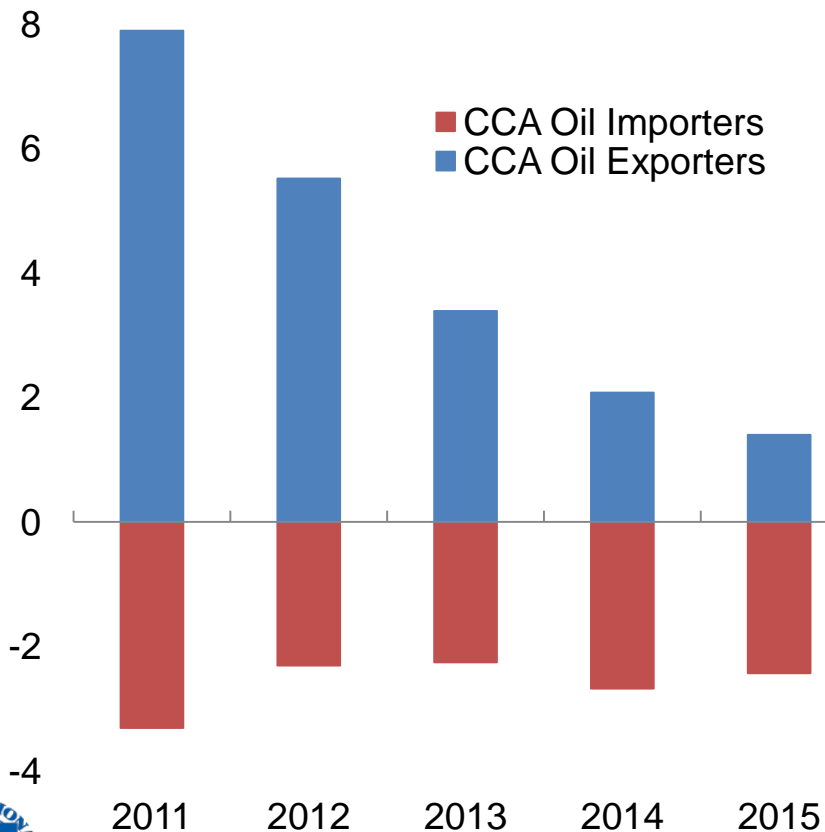
Consumer Price Inflation in Armenia

(In 12 month percent changes)

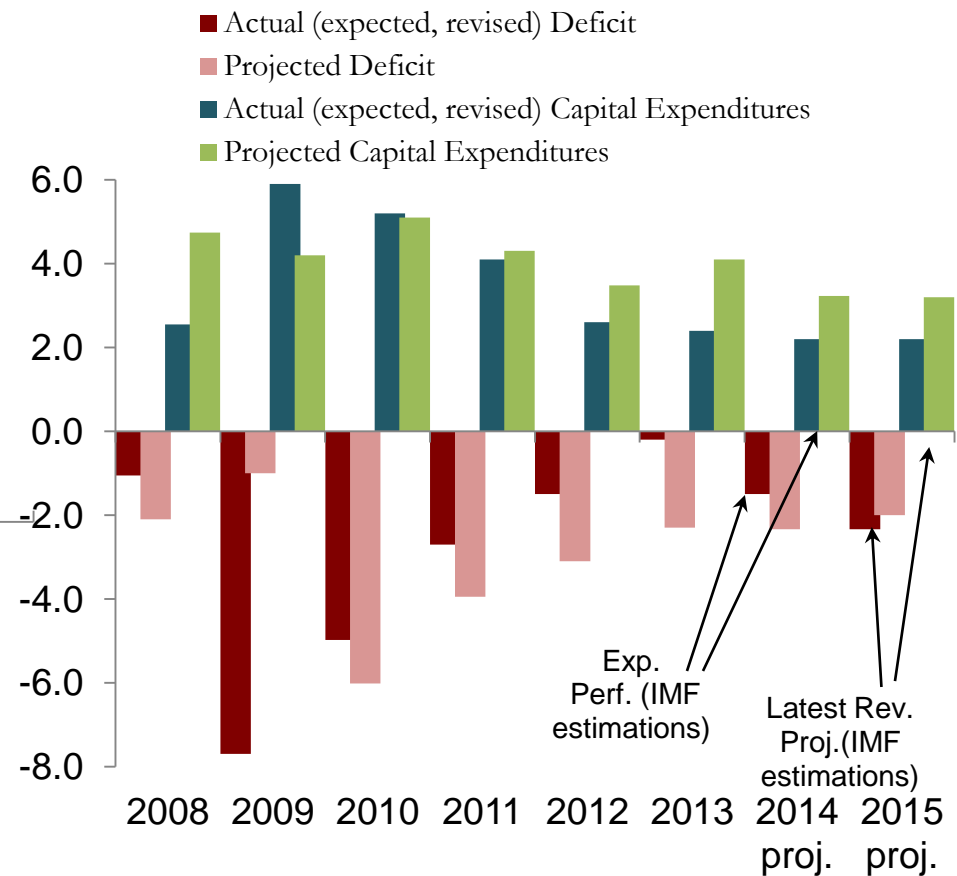


Fiscal positions are vulnerable, except in Armenia, although for the wrong reason...

Fiscal Balances
(In percent of GDP)

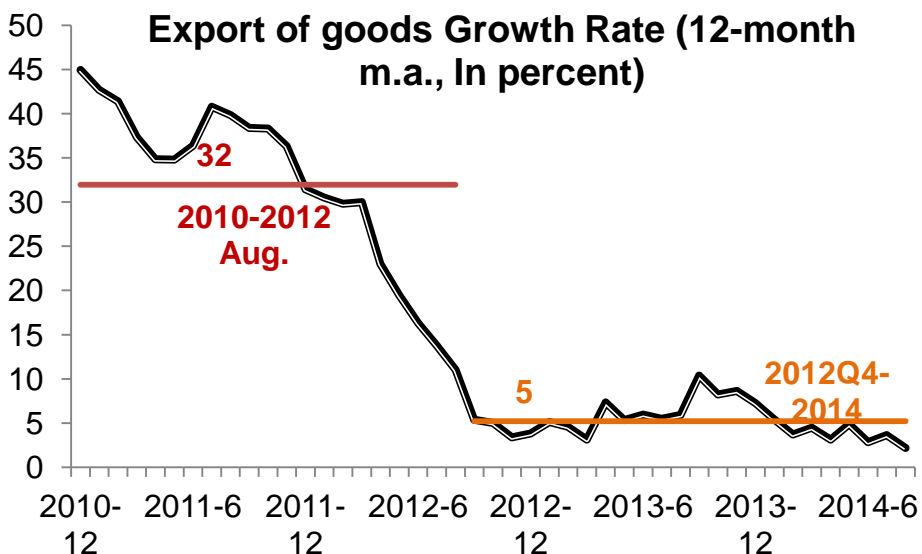
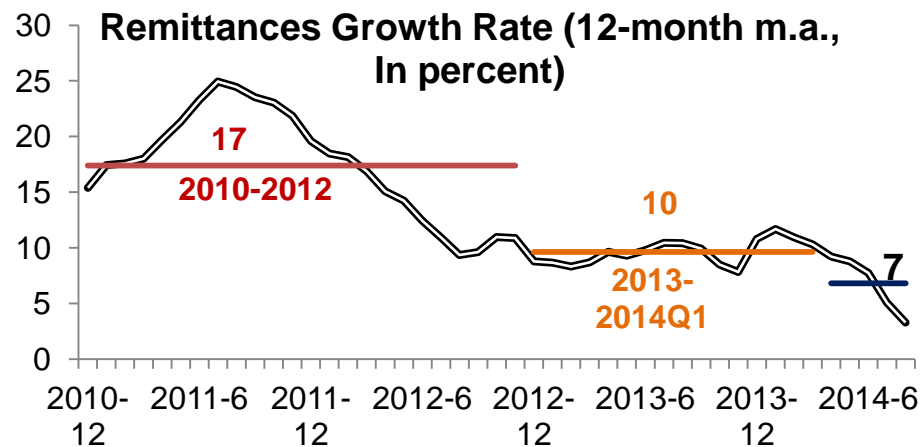
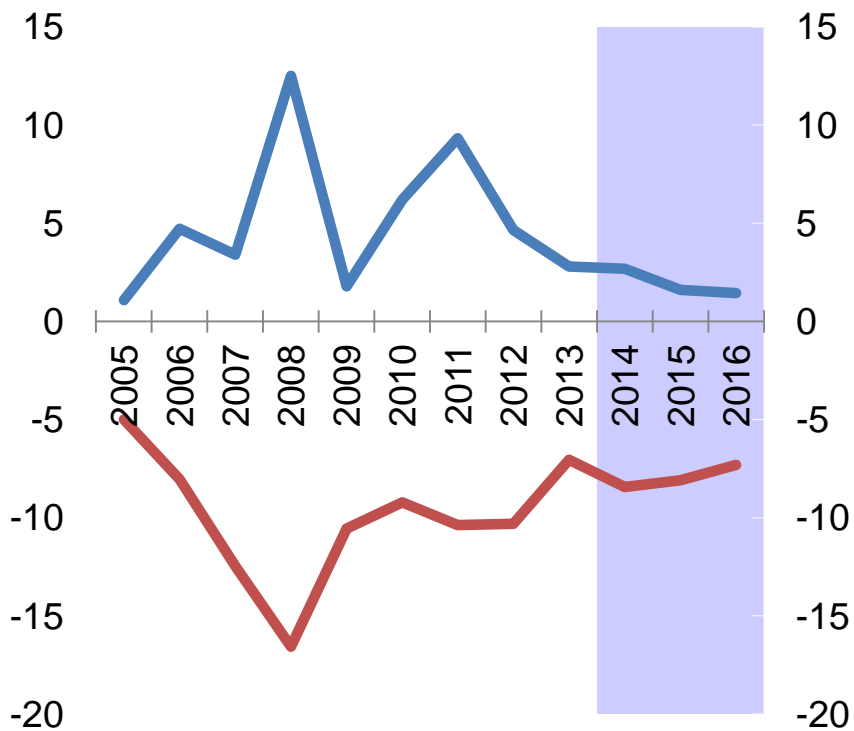


Deficit and Capital Expenditure in Armenia (In percent of GDP)



External positions are weakening in Armenia because of sub-par growth of remittances and exports

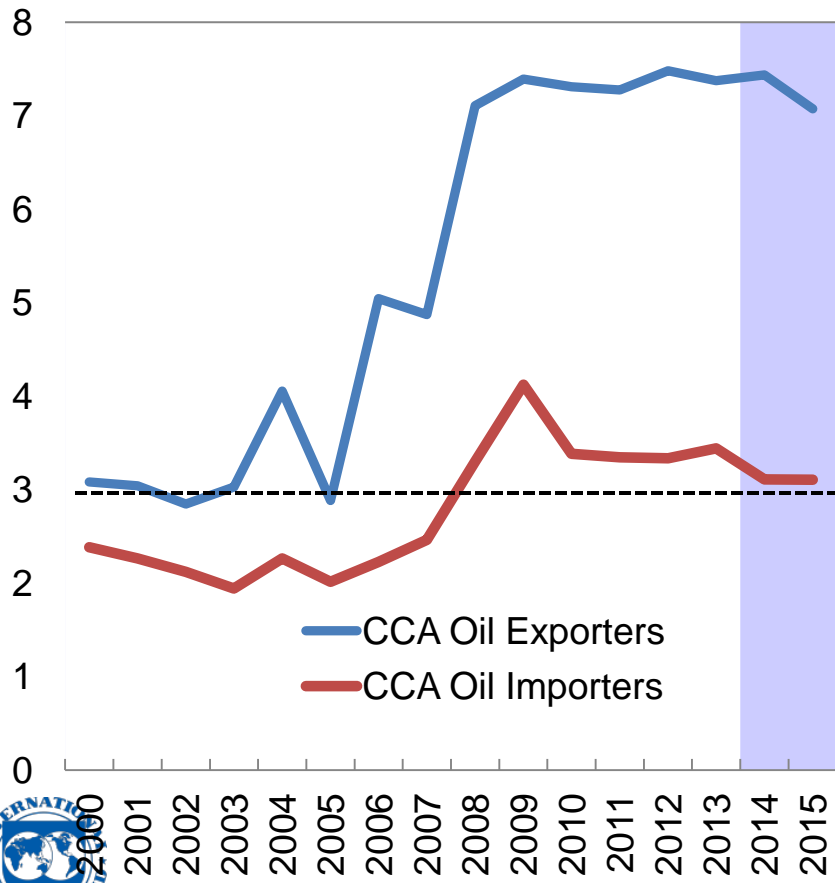
Current Account Balances
(Percent of GDP)



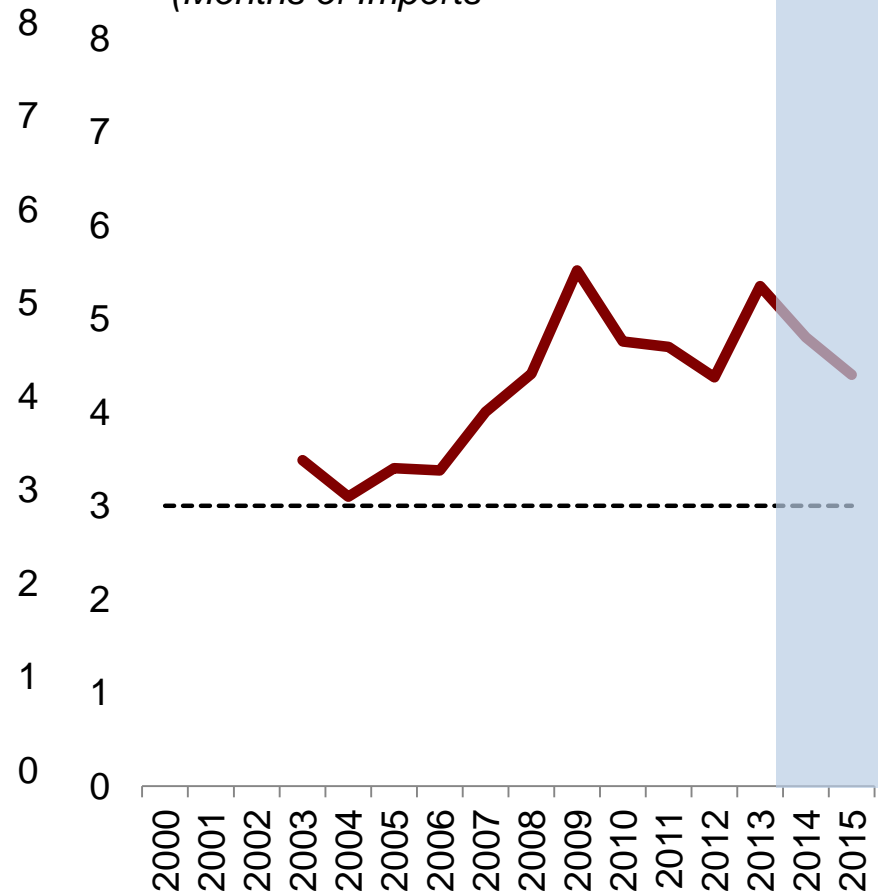
— CCA Oil Exporters — CCA Oil Importers

Buffers provided by international reserves are shrinking...although in Armenia remain high

Reserve Coverage
(Months of Imports)

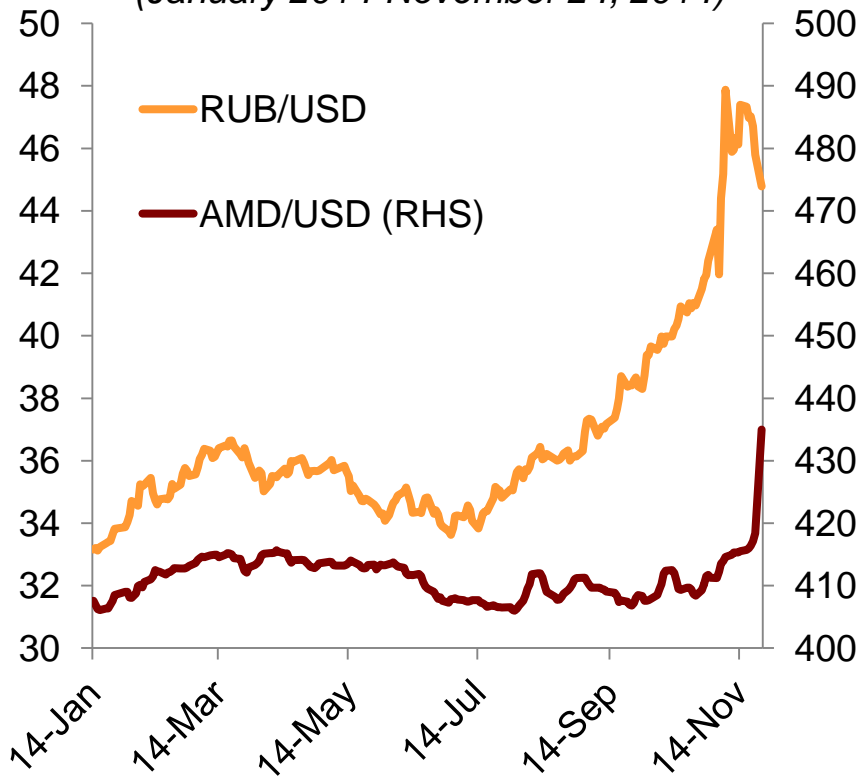


Armenia: Reserve Coverage
(Months of Imports)

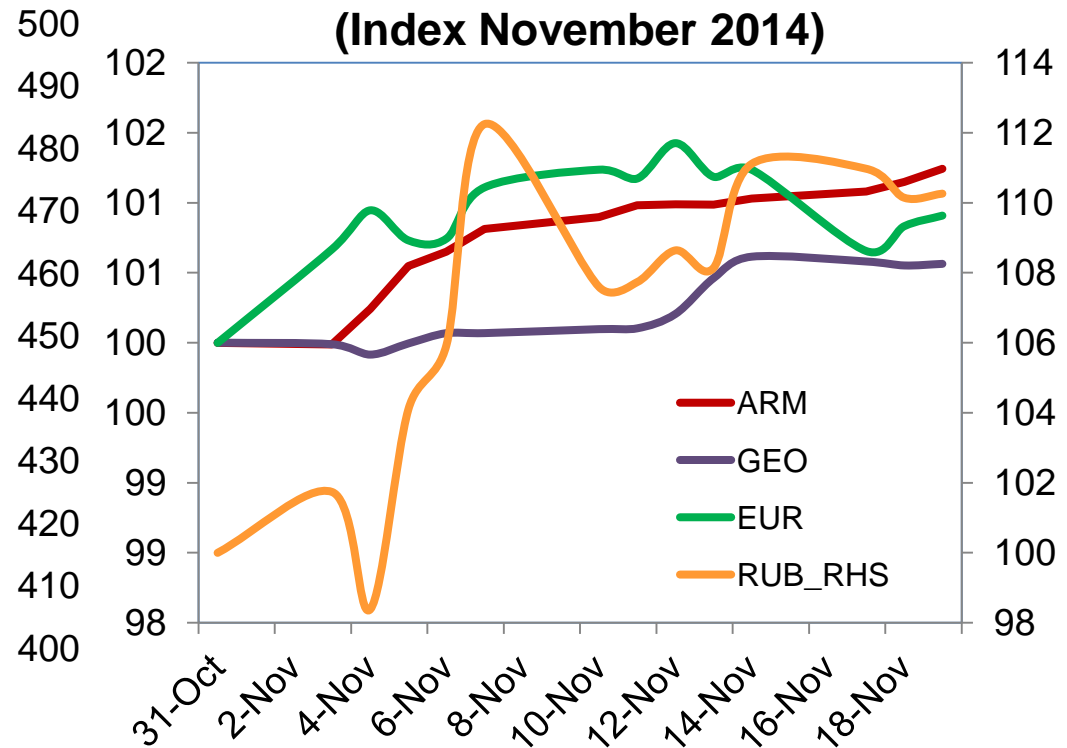


Exchange rates are adjusting in most CCA, in Armenia and almost everywhere in the world

RUB/USD and AMD/USD
(January 2014-November 24, 2014)



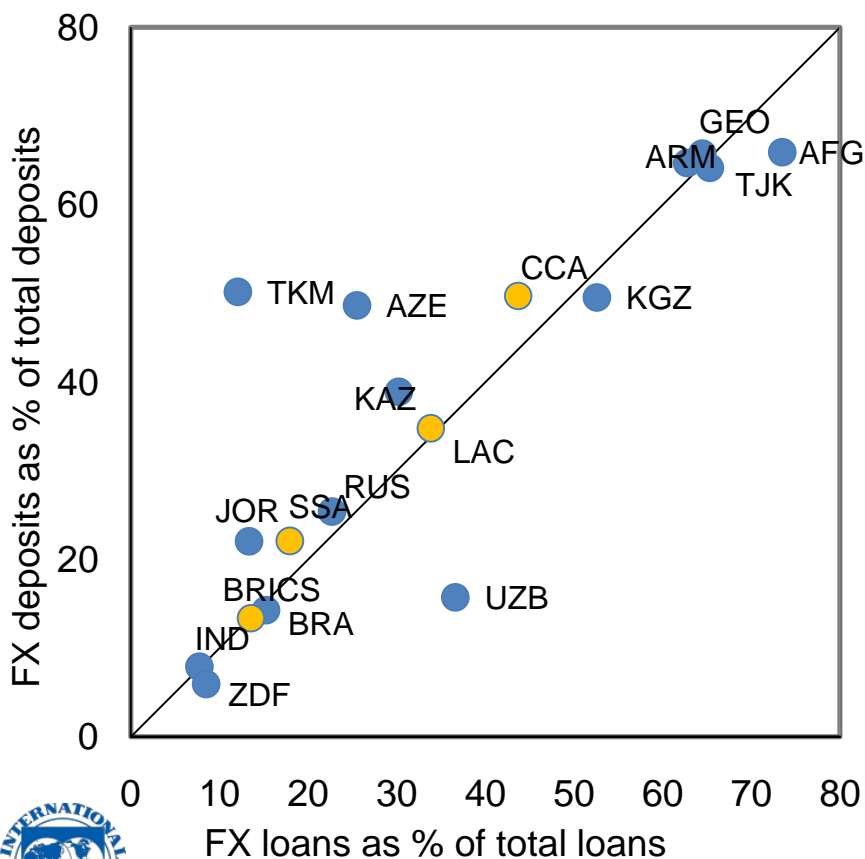
Exchange rates for Selected Currencies
(Index November 2014)



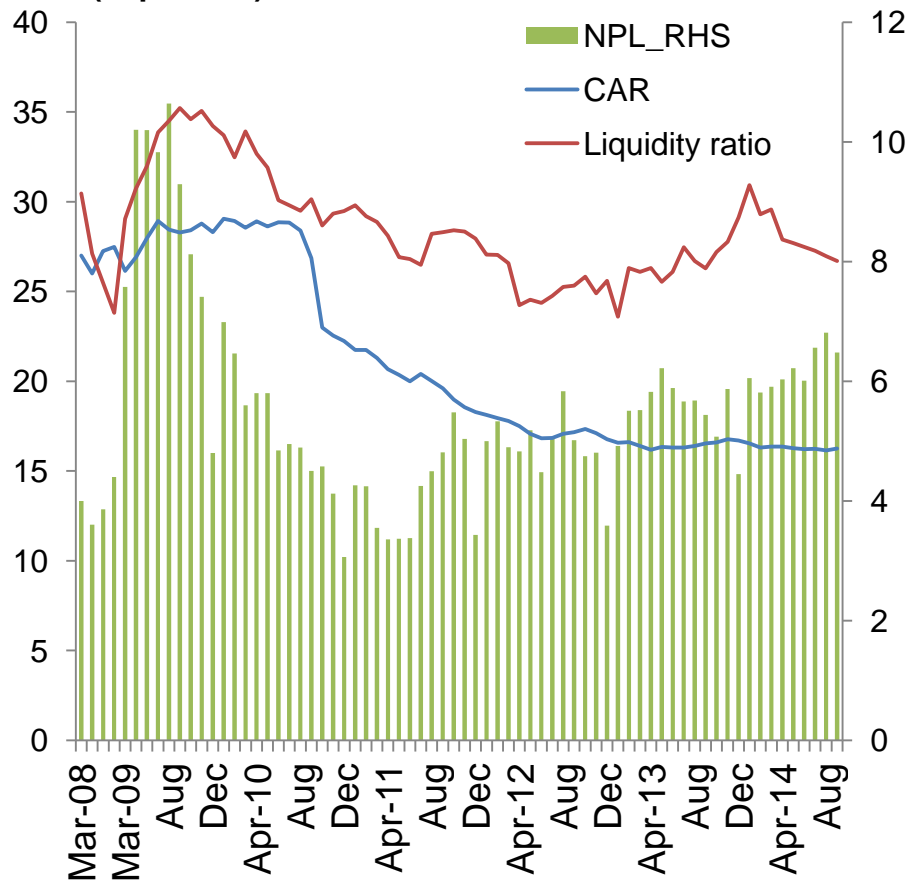
Dollarization continues to pose risks, mitigated in Armenia by comfortable buffers

High Dollarization

(latest year available)



Financial Soundness Indicators (In percent)



Policy Priorities for Armenia

Fiscal

- Temporary pause in fiscal consolidation in 2015, to support growth, given Armenia's available financial sources, in the context of a credible Medium-Term Expenditure Framework.
- Strengthening budget execution of capital spending projects

Monetary & External

- Given current low level of inflation and sound fiscal position, monetary policy can remain neutral.
- Exchange rate flexibility, which is critical to help buffer Armenia's economy against regional shocks, protect remittances' purchasing power, and spur exports.

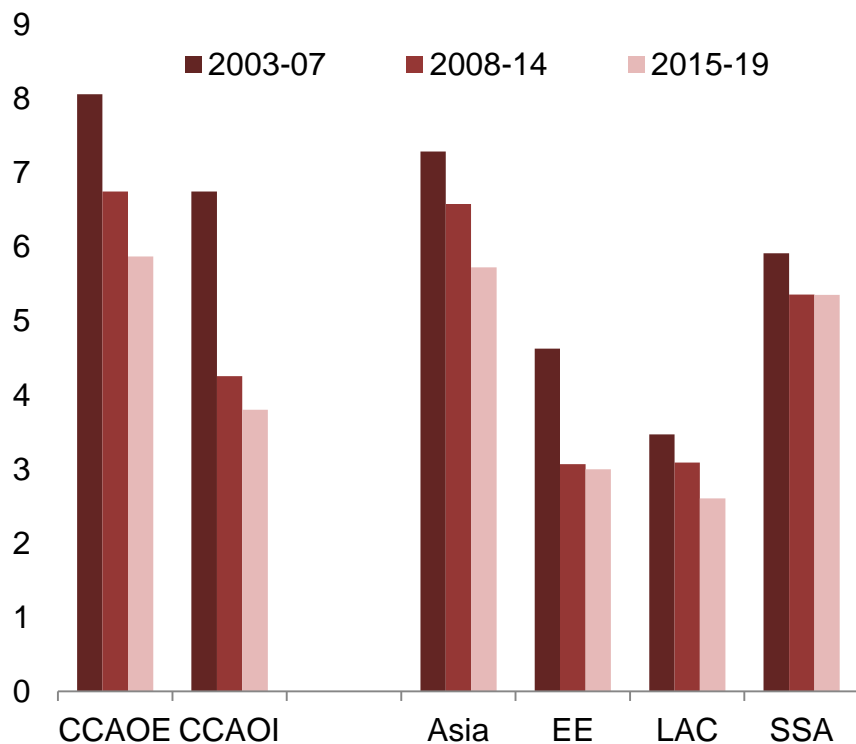
Financial

- Strengthening banking supervision and macro-prudential regulations to reduce NPLs
- Reduce dollarization through financial deepening.

Current level of subdued growth may have permanent consequences...

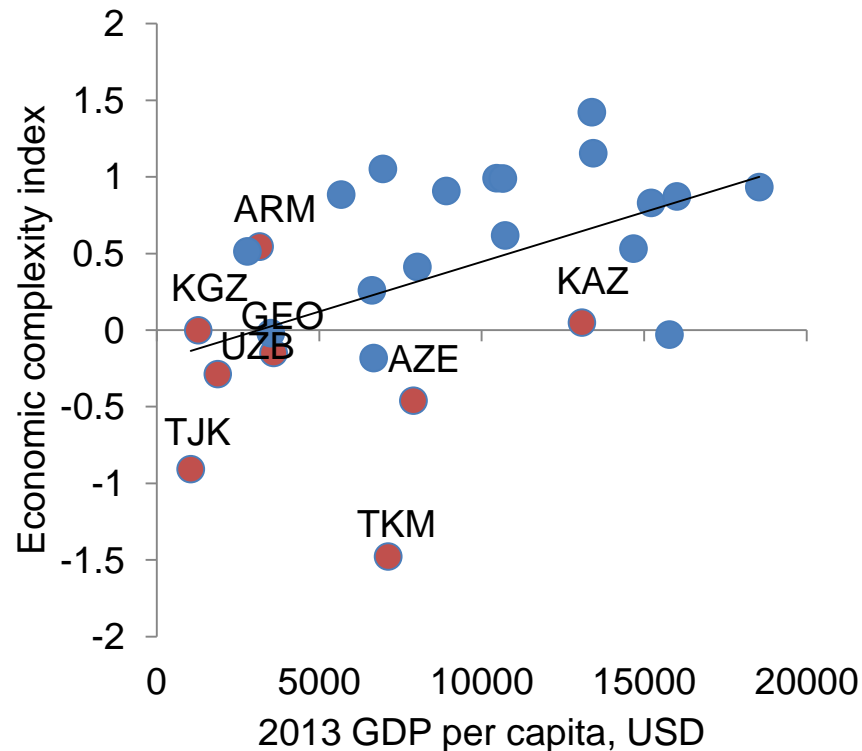
Potential GDP Growth

(Percent)



CCA vs. EMs: Economic Complexity

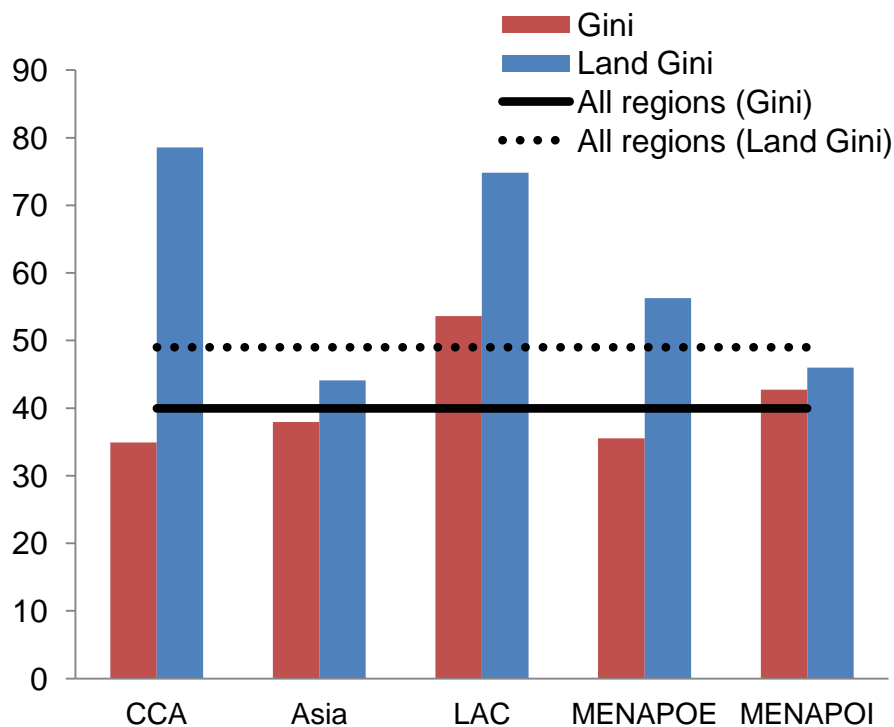
(-3 to +3 scoring scale; higher is better)



High unemployment and inequality suggest that growth has not been sufficiently inclusive

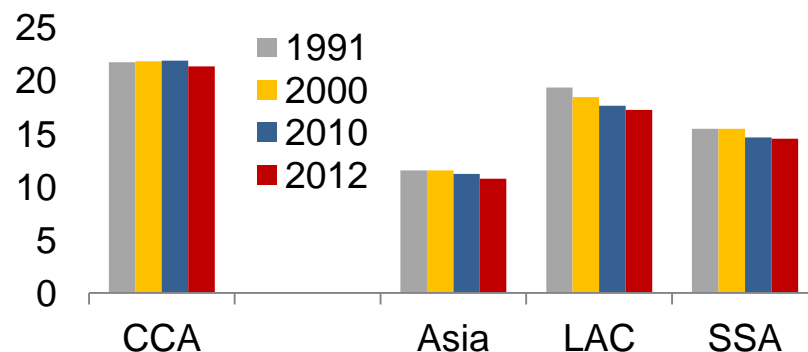
Gini and Land Gini Indexes

(Index, higher values are more unequal)



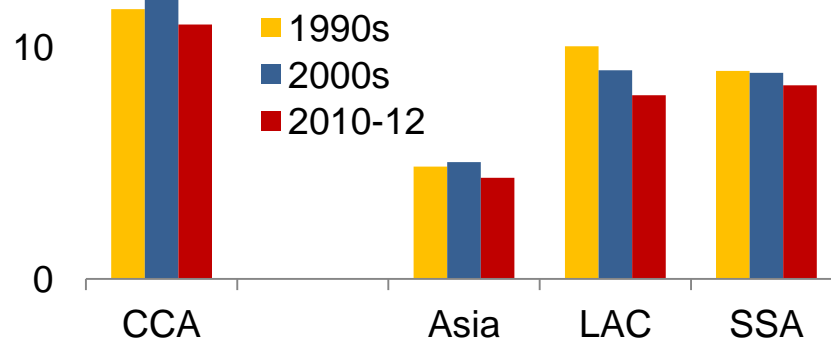
Youth unemployment rate

(percent)



Unemployment rate

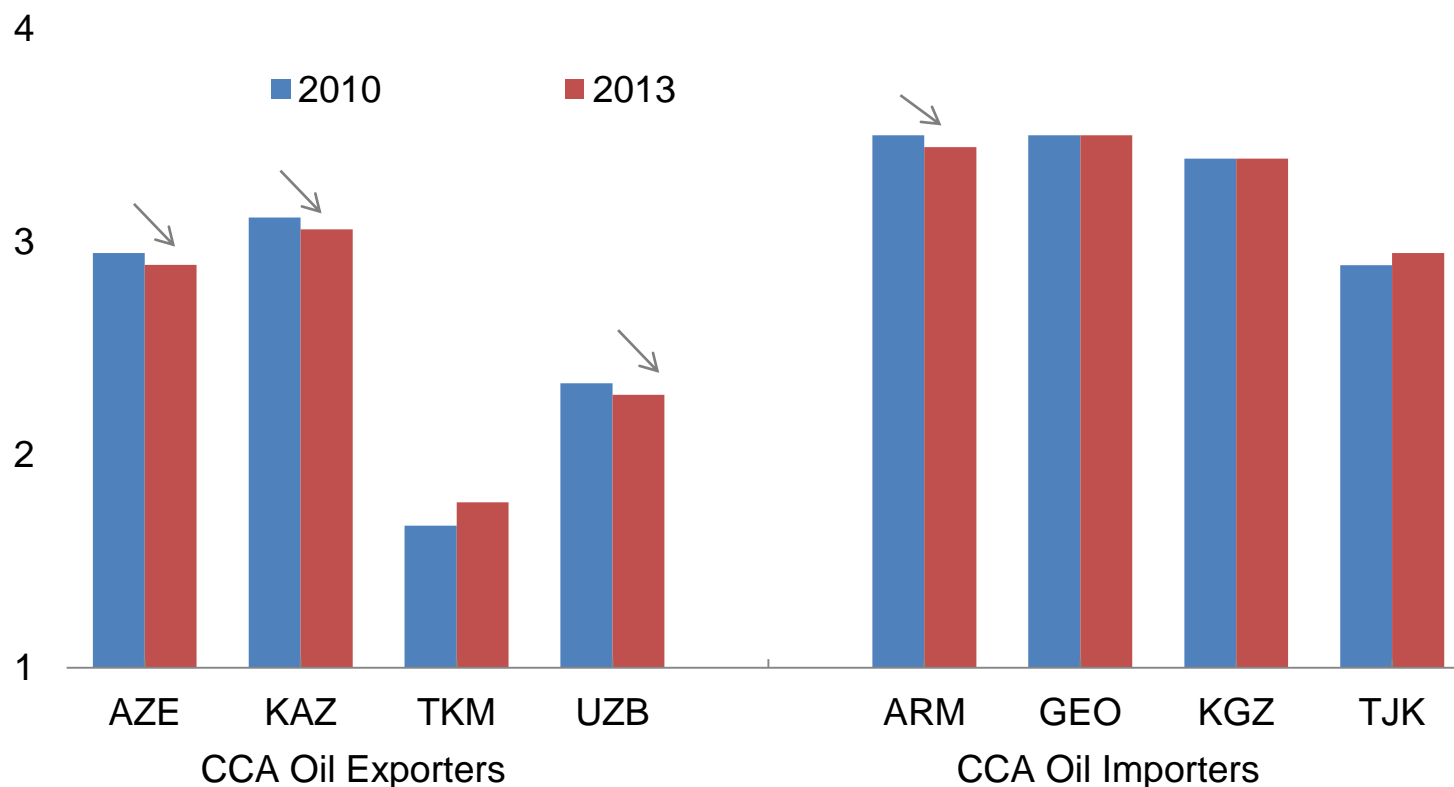
(Decade averages, percent)



Slowdown in structural reforms does not bode well for raising growth and inclusiveness

Reversals or delays in structural reforms

(1 to 4+ scale; higher is better)



A new economic model is needed



Medium-Term Policy Priorities

Bolder Structural Reforms

- Tax administration, business climate, energy, financial sector, and connectivity, regulations, etc, to address weak growth potential and low inclusiveness.

Wider Economic Integration

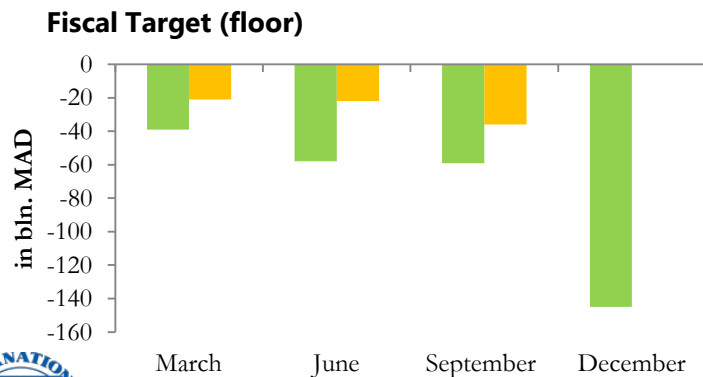
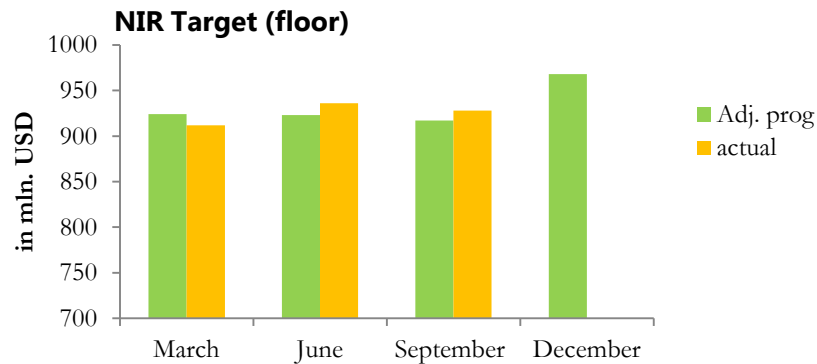
- Balanced regional and multilateral trade integration initiatives, to diversify economies and improve medium-term growth prospects.

Stronger Policy Frameworks

- Fiscal: More fiscal transparency, stronger medium-term budget frameworks, program budgeting
- Monetary: Greater exchange rate flexibility as a shock absorber and communication on policy actions to provide an anchor to the economy.

The policies envisaged under the IMF-supported program remain valid

Targets for fiscal deficits and international reserves

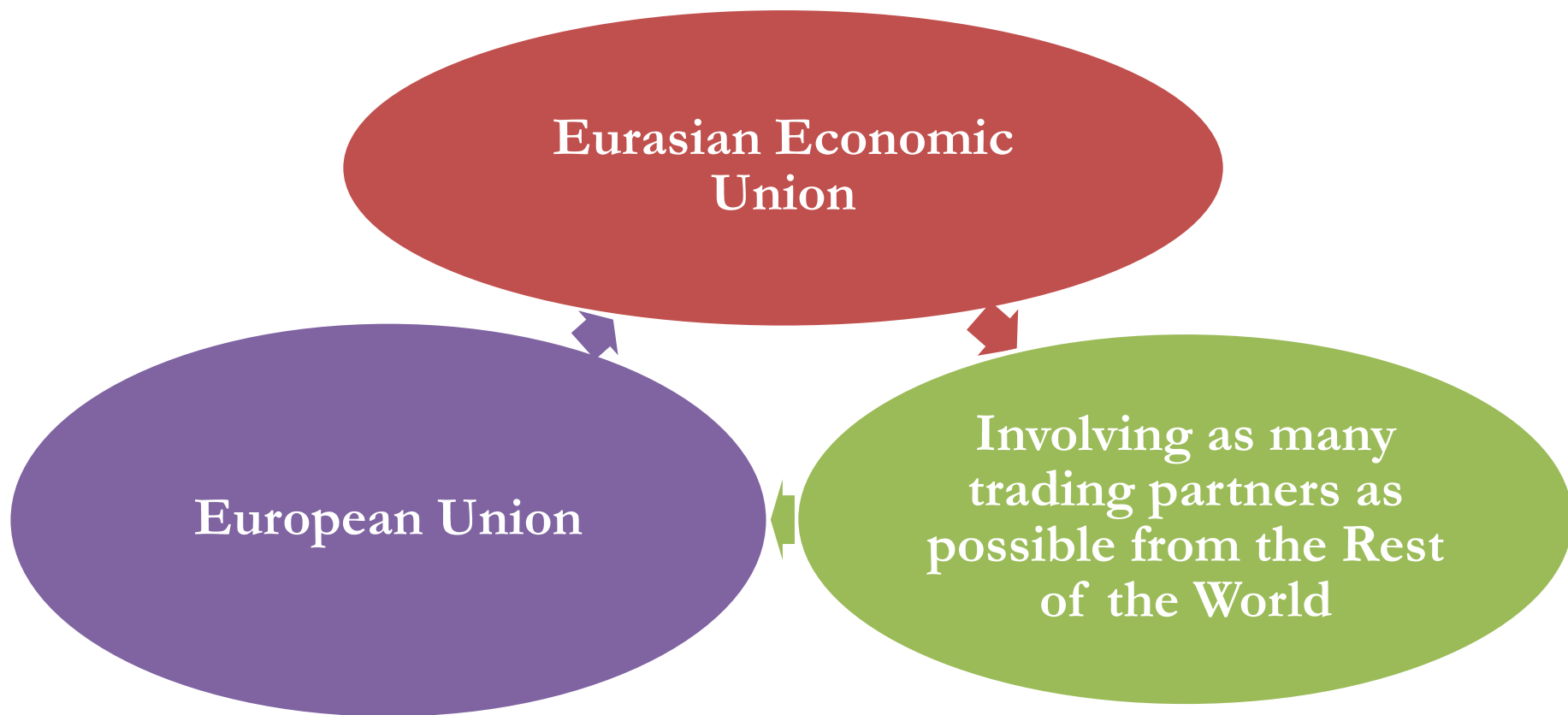


...and focus on key structural reforms

- Tax Administration
- Fiscal risks
- Financial sector
- Open Skies
- Overhauling of bankruptcy process
- Competition
- Inspections
- Energy



Successful economic integration in Armenia needs to be multilateral and diversified



Importance of continue working towards greater exchange rate flexibility to protect Armenian economy from unanticipated shocks

Monetary Policy Framework

Exchange Rate Arrangement

U.S. dollar or Euro anchor, Monetary Target, Other

Inflation targeting

Conventional peg, Stabilized arrangement, Crawl-like arrangement, Other managed arrangement

Angola, **AZE**, Bangladesh, Belarus, China, Congo, Croatia, **KAZ**, **KGZ**, **TKM**, Macedonia, Nigeria, Rwanda, Russia, **TJK**, **UZB**, Venezuela, Vietnam

ARM, Czech Rep., Dominican Rep.

Floating, Free floating

Brazil, Chile, **GEO**, Mexico, Poland, Romania, South Africa, Turkey



Takeaways

- Growth is slowing in Armenia, as well in the CCA region because of negative spillovers from Russia and weaker domestic demand, and risks are tilted to the downside.
- Countries with fiscal space and financing like Armenia could slow the pace of fiscal consolidation and keep monetary policy neutral, while maintaining credible medium-term plans. Meantime, macro-prudentials need to be strengthened.
- Potential growth risks to weaken. Inclusiveness remains an issue. In some countries, policy frameworks are not sufficiently robust to react to shocks.
- A new economic model is needed: structural reforms to make growth sustainable, more inclusive and diverse and supported by modern policy frameworks.

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