
COVID-19: THE POTENTIAL IMPACT ON THE ARMENIAN ECONOMY

CENTER FOR BUSINESS RESEARCH AND
DEVELOPMENT RESEARCH NOTE

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Key Findings

- Economic (including policy-related) uncertainty will lead to drop in investment
- The pandemic will mostly hurt the job prospects of low-skilled workers deepening inequality in the Armenian Economy

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The COVID-19 pandemic has already pushed the world economy into a recession worse than the global financial crisis of 2008-2009. The impacts of the health crisis are significantly hitting the economies all over the globe. The consequences of the crisis are already visible in the Armenian economy: there is approximately a 14% annual decrease in the Economic Activity Index in May. The cumulative drop from the beginning of the year is about 4%.¹ It is difficult to make any quantified forecasts on the further economic developments, as there exist numerous scenarios of how COVID-19 might evolve in the coming year(s). Nevertheless, some potential economic consequences of the crisis can be outlined.

The pandemic initially started as a supply-side disruption that quickly turned into a negative demand shock considerably depressing private sector demand. Consumer spending which represents about 80% of the GDP is further expected to contract. The decline in spending is likely to be reflected in durables and services. Moreover, the drop in consumption will be exacerbated as heightened unemployment risk will increase precautionary motives of the households. The latter will contribute to an increase in private savings.

Investment demand will shrink for several reasons. First, labor scarcity in the economy will suppress the need for high investment. Potential threats of supply chain disruption are another cause that will hold back investment. Finally, overall economic (including policy-related) uncertainty will lead the businesses to adopt a so called "wait-and-see" policy for investment. The pandemic has also created substantial uncertainty in global capital flows. According to UNCTAD, the contraction in global FDI flows can reach up to 40%², therefore it is unlikely to expect foreign investment inflows even after the eventual lifting of lockdown.

¹ Statistical Committee of RA. (2020) Socio-Economic Situation of RA, January-May 2020 (July 2020)

² UNCTAD. (2020) Impact of the Covid-19 Pandemic on Global FDI and GVCs. Global Investment Trends Monitor No. 35 (Special Issue March 2020)

Given the developments in the demand-side, the potential effects of the crisis on the external accounts are as follows. First, weak global and domestic demand will suppress both imports and exports. The final effect on the trade balance is ambiguous and depends on various factors, the potential for import substitution, commodity prices, real exchange rates, etc. The Armenian economy heavily relies on remittances (those account for about 12% of the GDP) largely coming from the Russian Federation. Travel restrictions, partial closure of businesses and industries in the Russian economy are expected to diminish the flows of remittances.

Weak foreign demand and significant drop in financial inflows may exert pressures on the national currency to depreciate with potential threats to financial stability. The latter has been a common issue for a number of developing countries. Interestingly, although the scale of the dollar appreciation until now is not as large as in the 2008-2009 financial crisis, the associated capital outflows from developing economies are nearly four times larger than at the peak of the previous crisis.³

The current crisis initially hit the productive base of the economy, which in principle could generate inflationary pressures. However, the large decline in demand—including foreign demand—will outweigh the impact of the supply-side. Therefore, inflation is expected to remain low for the current year, although price acceleration in a number of goods is possible.

Public spending will partially compensate the decrease in the private demand. However, it is unlikely to prevent the major drop in economic activity. Moreover, the potential increase in the government expenditures will necessarily lead to high levels of public debt. The latter will reduce the Government's fiscal space and slow down the speed of post-crisis recovery.

³ IIF. (2020) Sudden Stop in Emerging Markets. Capital Flows Report (April 2020)

The Covid-19 will potentially deepen inequality in the Armenian economy given the fact that the pandemic is mostly affecting employment prospects of low-skilled workers. While the Government has already acted to provide targeted stimulus to above mentioned segments of society, the current crisis will probably have significant distributional consequences, much larger than those during the 2008-2009 crisis.