

Republic of Armenia

Social and Economic Development in 2022 and Medium-Term Prospective

May 2023

* This Note was prepared by the Financial Credit Project Group, EFSD Project Unit, Eurasian Development Bank, including: Tigran Kostanyan (Director of the Financial Credit Project Group), Natalia Pisareva (Head of the Budget Sector), Elvira Kurmanalieva (Leading Expert), Evgeny Zhevnov (Chief Specialist), Yaroslav Baklzhansky (Chief Specialist), Alexandr Yanushkevich (Chief Specialist), Liana Harutyunyan (Leading Specialist). The Annex was prepared by Liana Harutyunyan. The Group gratefully acknowledges the comments provided by Sergei Ulatov (Advisor to the EFSD Project Unit) and the team of the EFSD Chief Economist.

The materials presented may not coincide with the official opinion of the EDB and the EFSD governing bodies.

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LIST OF ABBREVIATIONS

Armstat – Statistical Committee of the Republic of Armenia
CA – current account of the balance of payments
CBA – Central Bank of the Republic of Armenia
EAEU – Eurasian Economic Union
EFSD Project Unit – Project Unit of the Eurasian Fund for Stabilization and Development
FDI – foreign direct investment
GDP – gross domestic product
GIR – gross international reserves
IT – information technology
RA – Republic of Armenia
RF – Russian Federation
VAT – value added tax

In 2022, the economic growth accelerated significantly in the Republic of Armenia, reaching 12.6%, that was mainly a result of a substantial expansion of domestic demand. Despite initial scepticism about the prospects for economic growth, actual developments in 2022 resulted in positive externalities for the RA economy through an increase in the number of tourists, the relocation of highly qualified specialists from Russia, expanded exports of goods and services, and an increase in remittances. Inflation accelerated to 8.3%, driven by high prices on international commodity markets and stronger domestic demand. Under these conditions, the Central Bank of Armenia tightened the monetary conditions further, raising the refinancing rate by 300 basis points. The fiscal position improved, among other things, due to contractionary fiscal policies consistent with the Government's plans for smooth consolidation. The balance of payments strengthened as a result of a reduction in the CA deficit and a substantial inflow under the financial account.

The factors that led to positive externalities in 2022 are likely to persist in 2023. However, the influx of Russian tourists and capital is expected to slow down. Real GDP growth would decline by half to 5.9% in 2023, among other things, due to the high base of 2022. Higher capital expenditures would boost the budget deficit in 2023 to 2.7%, even against the background of the planned increase in tax revenues in accordance with the Budget Law. The CA deficit would expand slightly to 2.1% in 2023 amid a deterioration of the trade balance.

Real Sector and Labour Market

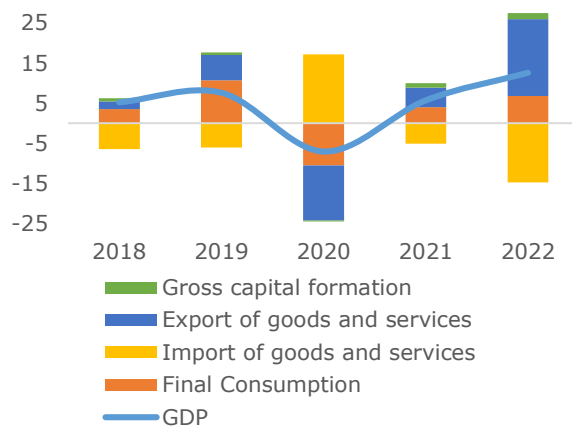
Stronger domestic and external demand contributed to a significant acceleration of economic activity in the Republic of Armenia. In 2022, the real GDP grew by 12.6% compared to 5.7% a year earlier (Figure 1). Domestic demand, the main driver of growth in the reporting period (a contribution of 6.7 p.p.), was supported by a substantial increase in the influx of tourists and the relocation of high-profile specialists from Russia, including those in the IT sector. Consumer demand was also supported by higher inward remittances and a significant increase in wages and salaries in the private sector, which contributed to the growth of imports of goods and services. The increase in exports of goods and services was attributable to favourable prices on exported goods, higher demand for certain goods on the Russian market, as well as stronger external demand (IT, growth of services provided to tourists). As a result, the contribution of exports of goods and services to the GDP growth was 19.2 p.p., and that of imports made 14.8 p.p. (net exports – 4.4 p.p.) Against the background of growing mortgage lending, the driver of investment demand (a contribution of 1.5 p.p.) was housing construction supported by a 29.7% increase in mortgage loans and a 10.9% increase in commercial loans in the construction sector. The EFSD Project Unit estimated the effect of the increased influx of Russian citizens and capital on the RA economic growth at approximately 4.0 p.p.

In terms of sectors, a positive effect on economic activity was generated by all sectors, excluding agriculture, but trade and services combined made the largest contribution of 9.4 p.p. of GDP (Figure 2). The contribution of wholesale and retail trade amounted to 1.9 p.p., although the growth was mainly due to wholesale trade. The main contributors to the growth of the services sector were finance and insurance (2.8 p.p.), information and communication (1.8 p.p.), transport and warehousing (1.3 p.p.), and real estate operations (0.5 p.p.). The large contribution of finance and insurance is attributable to the growth of bank loans by 13% (net of the Armenian dram appreciation) and the growth of profits of the banking sector by 63.9% (y-o-y).

The contribution of the manufacturing industry amounted to 1.3 p.p. against the background of the growth of food production (by 7.1%), other non-metallic minerals (by a factor of 2), and non-ferrous metals (by 16%) supported by strong domestic and external demand. It should be noted that in recent years, there was an increase in the number of enterprises in the manufacturing industry that benefit from the government programme of modernisation of the economy (subsidising the interest on loans to purchase new equipment and technologies). The mining industry, however, showed a negative trend in the context of suspended work at the Teghut mine (-3.2%).

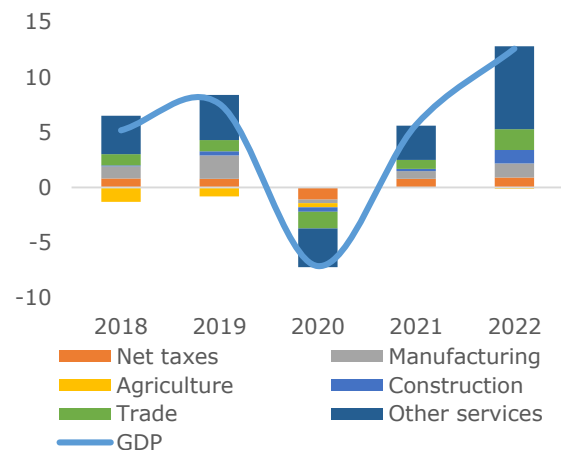
In the construction sector (a contribution to GDP of 1.2 p.p.), as noted above, the main driver was housing construction, supported by rapid growth of mortgage lending (29.7%).

Figure 1. Contribution to GDP growth, by expenditure components (p.p., y-o-y)



Source: Armstat

Figure 2. Contribution to GDP growth, by production components (p.p., y-o-y)



Source: Armstat

The acceleration of the economic activity had a beneficial effect on the performance of the labour market. In 2022, the number of employed persons increased by 4.7%, which resulted in a lower unemployment rate (calculated based on the ILO methodology), down from 15.5% to 13.0%. The rate of nominal wage growth accelerated to 15.5% compared to 7.6% a year earlier, mainly owing to the services sector. High wage growth rates were noted in information and communication, finance and insurance, wholesale and retail trade, transport and warehousing, and construction. As inflation accelerated, economy-wide real wages grew by 6.9% (compared to a 0.4% decrease in the previous year). In particular, they increased by 10.4% in the private sector, and decreased by 4.3% in the public sector.

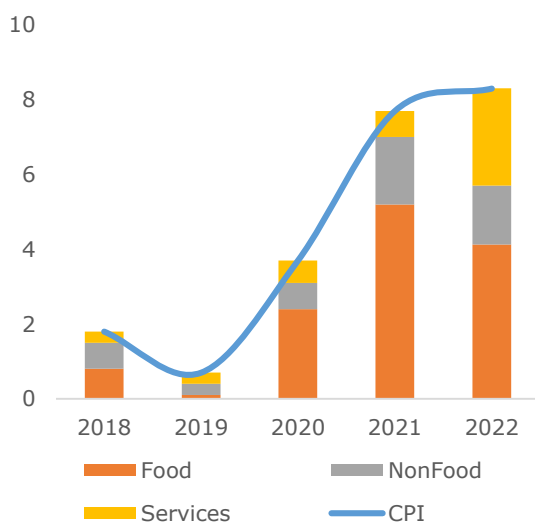
Inflation and Monetary Policy

There was significant inflationary pressure recorded in 2022 due to high world prices for food and commodities, as well as stronger domestic demand (Figure 3). In December, the 12-month inflation accelerated to 8.3% compared to 7.7% a year earlier, exceeding the upper limit of the Central Bank's target (4±1.5%). However, it was significantly lower than in the EAEU countries. The largest price increases were observed in the segments of "Food Products" (9.9%) and "Services" (7.2%), whose contribution to the consumer price index was 4.1 p.p. and

2.6 p.p., respectively. The Armenian dram appreciated by 18% during the 12-month period that facilitated deceleration of the price growth and a reduction of the contribution of non-food products to the consumer price index to 1.6 p.p. (1.8 p.p. a year earlier). Against the background of strong domestic demand, the core inflation also increased, reaching 9.5% at end-December 2022 compared to 7.3% a year earlier. To curb the inflationary pressure, the Central Bank of Armenia raised the refinancing rate on six occasions in 2022, by a total of 300 basis points to 10.75% per annum.

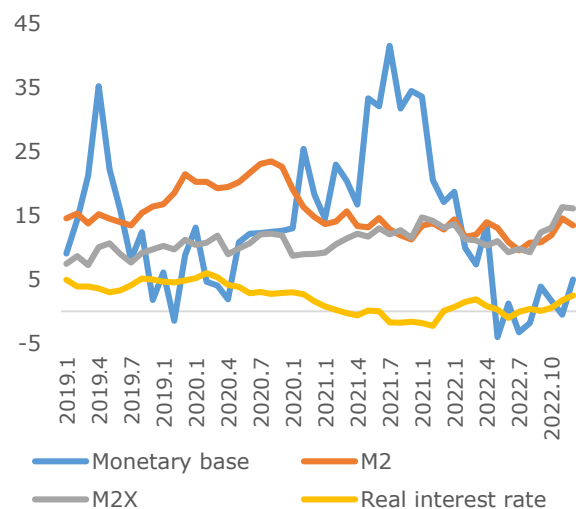
Despite the tightening of monetary conditions, the growth rate of money supply accelerated from 13.1% to 16.1% (Figure 4). The broad money supply growth was mainly driven by demand deposits in foreign currencies and drams, whose contribution amounted to 7.7 p.p. and 7.4 p.p., respectively (against 2.1 p.p. and 4.3 p.p. a year earlier), while the contribution of term deposits was insignificant. The contribution of cash in circulation was 1 p.p. (against a negative contribution of -0.6 p.p. a year earlier). Net of the significant appreciation of the exchange rate, the broad money supply growth would have been about 26%¹. The base money growth decelerated to 5% (against 17.1% a year earlier) due to revaluation of foreign currency assets, as well as a decrease in lending to commercial banks under the CBA repo line (-13.7 p.p.).

Figure 3. Inflation (in %, y-o-y, end of period)



Source: CBA, Armstat

Figure 4. Monetary indicators (in %)



Source: CBA

¹ EFSD calculations

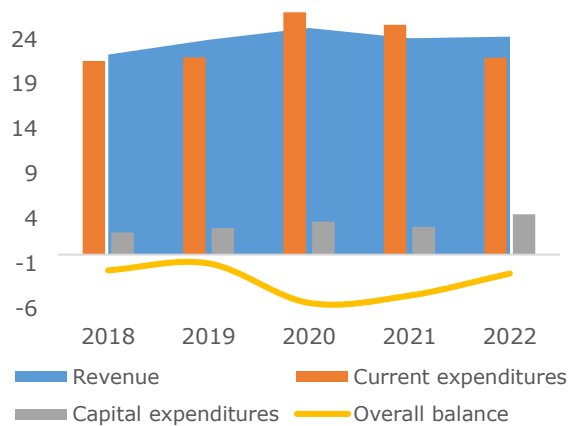
Budget Sector and Government Debt

A significant reduction in the share of expenditures in GDP as part of the Government's plans for gradual fiscal consolidation was the main factor contributing to an improvement of the fiscal position (Figure 5). In 2022, the state budget was executed with a deficit of 2.1% of GDP compared to a deficit of 4.6% of GDP a year earlier. Budget revenues increased slightly to 24.3% of GDP (24.1% in 2021) solely due to non-tax revenues (whose contribution increased by 0.2 p.p. to 1.4 p.p.), while tax revenues remained at the 2021 level (22.7% of GDP). Budget revenues were supported by higher profit tax revenues (up by 0.4 p.p.) against the background of an improvement in the financial position of enterprises; environmental fees and payments for natural resources (up by 0.2 p.p.); social benefits (up by 0.1 p.p.) due to a significant increase in salaries and wages in the private sector; and state duty (up by 0.3 p.p.). As to other types of taxes, there was a decrease or no increase – personal income tax revenues declined by 0.5 p.p. due to an annual reduction of the personal income tax rate from 22% to 21%; customs duties decreased by 0.5 p.p. due to a fall in imports to the RF and the resulting decrease in customs duties transferred by the RF to the EAEU pool of customs duties; and excise tax revenues declined by 0.1 p.p.

Budget expenditures declined to 26.4% of GDP from 28.7% a year earlier, despite their nominal growth by 11.9% compared to the previous year. As a result of the implementation of plans for gradual fiscal consolidation in the medium term, current budget expenditures fell significantly to 21.9% of GDP from 25.6% of GDP a year earlier. Current expenditures declined as a share of GDP under all items. Total capital expenditures increased by 75.8% compared to the previous year and amounted to 4.5% of GDP, mainly due to increased spending in the defence sector.

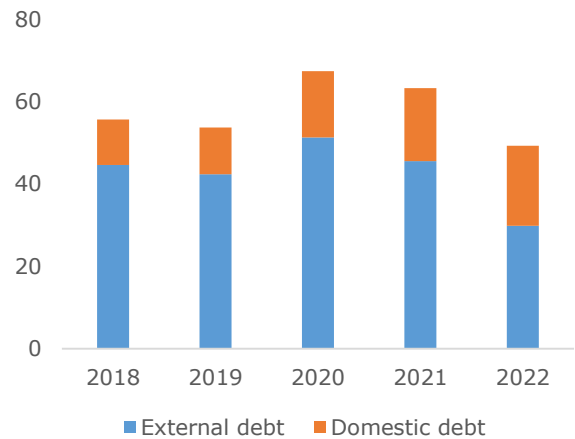
The appreciation of the exchange rate against the background of high economic growth led to a significantly lower level of the public debt (Figure 6). In 2022, the public debt decreased by 14 p.p. to 49.3% of GDP. As a result of the local currency appreciation, the external debt declined by 15.7 p.p. to 29.9% of GDP. The domestic debt, however, increased by 1.7 p.p. to 19.4% of GDP. As a result, the composition of the public debt changed, with the share of external debt in the total debt down to 60.6%, and that of domestic debt up to 39.4%, which is generally in line with the public debt management strategy in terms of changing its composition with a greater focus on domestic borrowings.

Figure 5. State budget (in % of GDP)



Source: MF RA

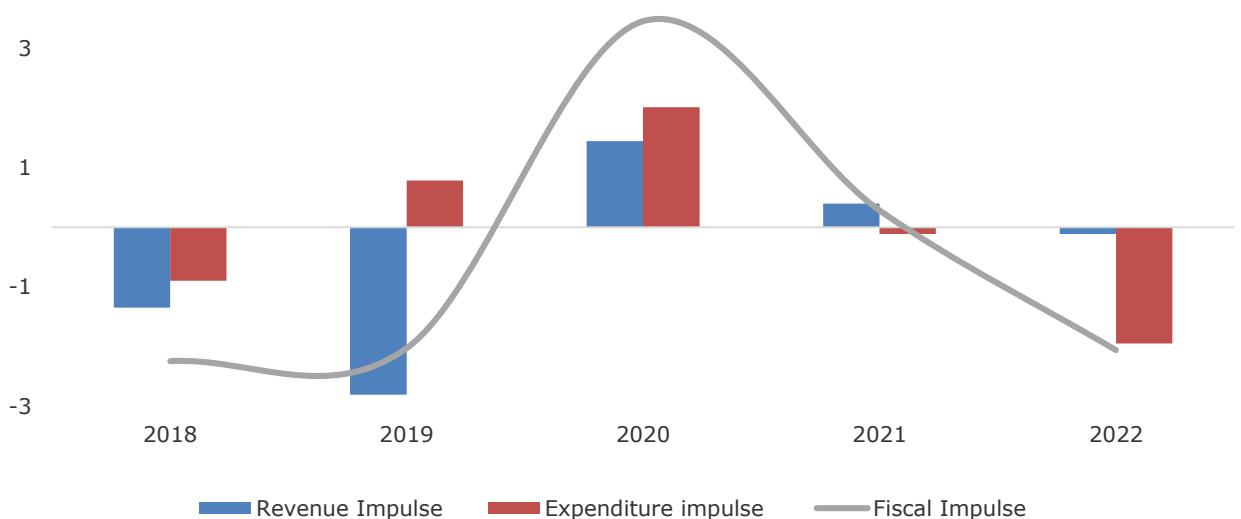
Figure 6. Public debt (in % of GDP)



Source: MF RA

Fiscal impulse: In 2022, in the context of a positive output gap, the government implemented countercyclical policies. The effect of the fiscal policy on aggregate demand is seen as restrictive – the fiscal impulse was negative (-2.1 p.p.), with the expenditure impulse at -1.9 p.p. and that of revenues at -0.1 p.p. (Figure 5)².

Figure 7. Fiscal impulse (in %)



Source: EFSD estimates

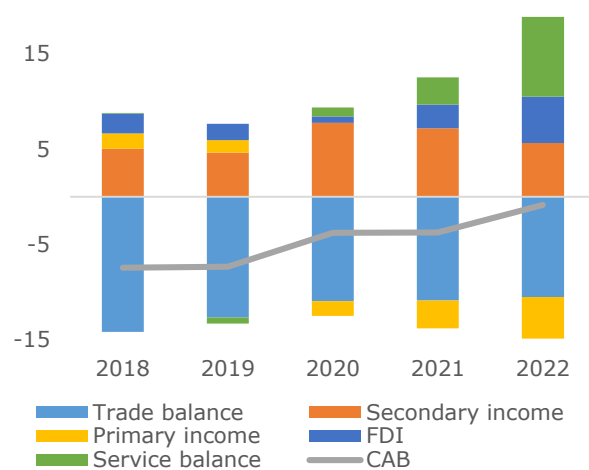
² Expenditures and revenues do not include components that have no effect on domestic demand (grants, interest payments on external debt, export credits).

External Sector

The balance of payments strengthened as a result of a decline of the CA deficit and a substantial inflow under the financial account. The CA deficit fell to 0.9% of GDP in 2022 compared to a deficit of 3.7% of GDP a year earlier (Figure 8). The CA deficit declined amid significant growth of remittances and a double-digit increase in exports of services (IT and tourism). In 2022, the number of tourists in the RA amounted to 1.7 million people (790,000 from the RF), up by 90.2% compared to 2021. Cross-border transfers of individuals made through the RA banking system in US dollars grew by a factor of more than 2.9 in 2022, among other things, due to the relocation of Russian capital (net inflow from the RF of US \$3.1 billion, about 16% of GDP). In the face of a significant inflow of foreign exchange, the Central Bank of Armenia intervened purchasing foreign exchange in an amount equivalent of US \$574 million to smooth out excessive appreciation of the local currency. As a result, gross international reserves increased to US \$4.1 billion (about 21% of GDP), or 4.9 months of imports.

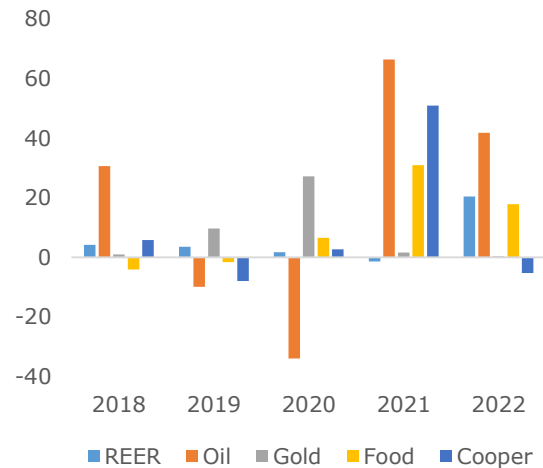
Higher imports of goods compared to exports resulted in a negative trade balance of US \$-3.4 billion. In value terms, exports of goods increased by 77.7% (real growth by 60.2%), which was facilitated by stronger external demand, high world prices for metals, as well as additional growth of exports of goods (including re-exports) to the Russian market as there were niches vacated against the background of sanctions. The largest contribution to export growth was made by precious stones (20.9 p.p.); machinery and equipment (20.2 p.p.); finished food products (4.6 p.p.); and land, air and water transport (8.2 p.p.). In addition, a significant influx of tourists, mainly from Russia, as well as re-exports of goods to the RF, supported a higher contribution of exports of services. Stronger consumer and investment demand led to significant growth of imports of goods, up by 63.5% in value terms (by 34.9% in real terms). The largest contribution to the growth of imports was made by machinery and equipment (8.8 p.p.); land, air and water transport (8.5 p.p.); precious stones and metals (4.9 p.p.); and base metals (3.3 p.p.).

Figure 8. Balance of payments (in % of GDP)



Source: CBA, EFSD estimates

Figure 9. Dynamics of price terms of trade (in %, y-o-y)



Source: CBA, World Bank

Financial Sector

Bank lending accelerated against the background of high economic growth. During the 12-month period, the total volume of loans provided by commercial banks increased by 6.1% compared to a 5.1% decline in the previous year (Figure 10). At the same time, the growth of loans in the local currency accelerated significantly, amounting to 21.2% (against growth by 6.5% a year earlier), while loans in foreign currencies fell by 12.9% (against a decrease by 16.6% a year earlier). The key factor contributing to the dynamics was revaluation of foreign currency loans as a result of significant appreciation of the Armenian dram. Net of this factor, total loans (including those in both foreign and local currencies) grew by about 13%³. In terms of sectors, loans increased owing to the growth of mortgage loans (5.4 p.p.), commercial loans in the construction sector (1.0 p.p.), and consumer loans (2.0 p.p.). The volume of lending declined in the transport and communication, services, and trade. A decrease in foreign currency loans contributed to lower dollarization of the loan portfolio, down from 44.2% to 36.3%.

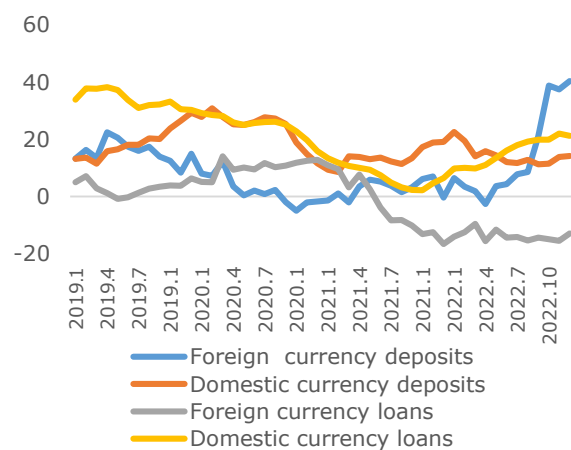
Against the background of an inflow of remittances, the deposit base continued to grow at a high rate (up by 27.3% against 8.5% a year earlier). Its growth was driven by deposits of residents, which increased by 17.5% (a contribution of 13.6 p.p.), and non-residents, which grew by 62.4% (a contribution of 13.6 p.p.). Residents' deposits grew mainly due to demand deposits. In terms of the currency

³ EFSD calculations

composition, the contribution of deposits in drams was 7.1 p.p., and that of deposits in foreign currencies – 20.2 p.p. The contribution of households and enterprises to the growth of residents' deposits amounted to 5.1 p.p. and 7.9 p.p., respectively. Net of revaluation of foreign currency deposits, the total growth of deposits in the reporting period was 40%⁴. Faster growth in foreign currency deposits by non-residents led to higher dollarization of deposits, up from 50% to 55.1% – compared to March 2022, foreign currency deposits by non-residents grew by 90% or US \$1.2 billion.

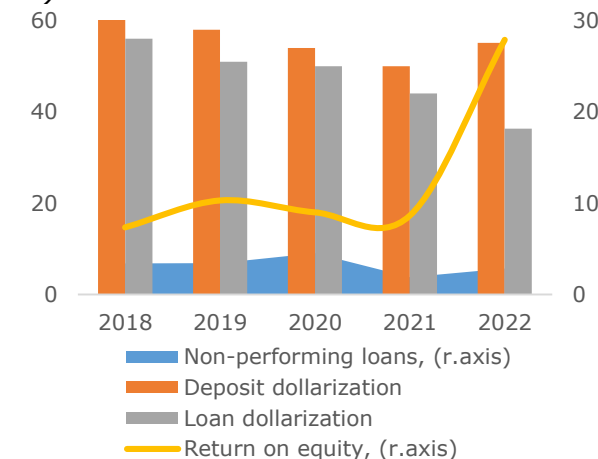
Financial soundness indicators of the banking system improved considerably. During the 12-month period, the return on equity increased from 8.6% to 27.9%, and the return on assets – from 1.1% to 4.1% (Figure 10). Higher profits and improved asset quality contributed to an improvement in the capital adequacy ratio from 17.2% to 20.3%. The quality of the loan portfolio deteriorated slightly due to an increase in the share of bad loans from 1.9% to 2.8%. The growth of profits of the banking system by 63.9% was driven by a 186% increase in non-interest incomes due to the opening of new bank accounts and foreign currency conversion fees. In addition, in Q4 2022, the CBA raised the countercyclical capital buffer rate to 1.5%, to be applied to commercial banks from August 2023 (see Box 1).

Figure 10. Bank lending (in %, y-o-y)



Source: CBA

Figure 11. Banking sector indicators (in %)



Source: CBA

⁴ EFSD calculations

Box 1: Countercyclical Capital Buffer

The use of a countercyclical capital buffer was recommended under Basel III. The CBA Board approved the "Procedure for Establishing and Calculating Ratios in Addition to Banks' Standard Capital Adequacy Ratio", which came into force on 1 April 2019 and established a counter-cyclical capital buffer, along with other ratios.

The purpose of the countercyclical capital buffer is to improve the ability of the financial system to withstand financial and economic shocks and ensure uninterrupted flows of financial resources in the form of loans to the economy.

A countercyclical capital buffer is aimed at addressing excessive credit growth, mitigating its negative impacts on stability of the financial system. To curb excessive credit growth, central banks raise capital requirements during a boom phase, creating an additional capital buffer. During an economic downturn, the buffer is used to protect financial institutions from potential losses, thereby reducing the need for large-scale curtailment of lending (deleveraging) by actors of the financial system and mitigating its undesirable impact on financial soundness and economic growth.

The CBA makes decisions on the countercyclical capital buffer on a quarterly basis. More details on the process of establishing the value of the countercyclical capital buffer by the CBA are presented in the thematic document "General Methodology for Setting Countercyclical Capital Threshold".

The countercyclical capital buffer rate is:

- Current rate: 0%
- Rate applicable from May 2023: 1.0%
- Rate applicable from August 2023: 1.5%

Medium-Term Prospective

The positive externalities that emerged in 2022 are likely to persist in 2023, but in combination with a relatively low growth rate of the influx of Russian tourists and capital. In 2023, demand is expected to gradually stabilise and the economic growth would slow down by half to 5.9%, among other things, as a result of a high base in 2022 (Figure 12). In 2023, domestic demand would be supported by rising salaries and wages in the private sector and inward remittances. Gross capital formation in the private sector would also have further positive effects on economic growth due to the growth of housing construction, the expected resumption of construction at the Amulsar mine (a contribution to the economic growth of about 1 p.p., as estimated by the CBA), and a rise in public investment due to the Government's plans to gradually raise its share to 6% of GDP in the medium term. Exports of goods and services would continue to grow at a high rate, supported by

stronger external demand, including that for certain goods on the Russian market (IT, growth of services provided to tourists).

According to forecasts of the EFSD Project Unit, in the medium term, economic growth rates would be within their long-term potential range of 4–5%⁵ (Figure 12).

Monetary policy would be aimed at keeping the inflation at the targeted level (4±1.5%). According to the EFSD Project Unit, inflation would be 4.3% (y-o-y) at end-2023 compared to 8.3% in 2022, against the background of stabilising international food prices and easing consumption pressure. In the medium term, inflation is projected within the targeted range that will facilitate gradual reduction of the refinancing rate by the CBA to a neutral level (Figure 13).

Figure 12. Real GDP forecast (in %)

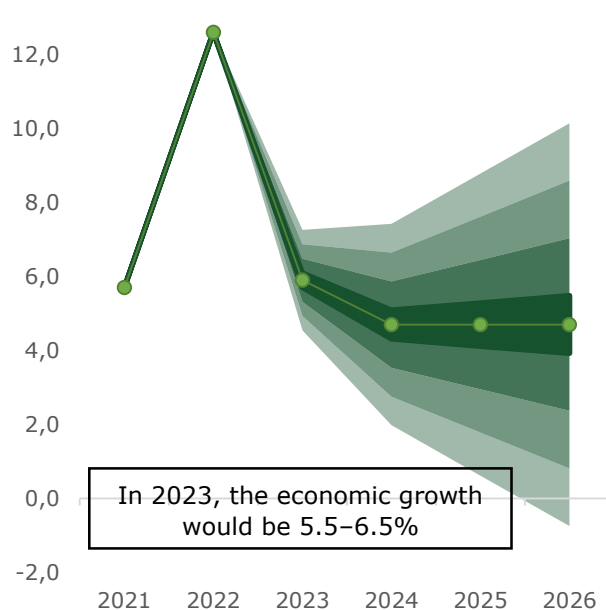
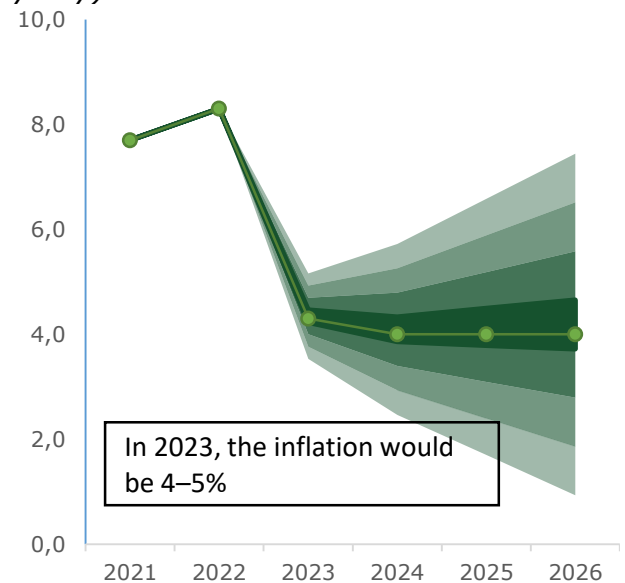


Figure 13. Inflation forecast (in %, y-o-y)



Source: EFSD estimates showing the likelihood of forecasts falling within specific intervals (see Annex 1 for more details.)

Higher capital expenditures would boost the budget deficit in 2023 to 2.7%, even against the background of the planned increase in tax revenues in accordance with the Budget Law. Tax revenues would increase approximately by 0.7–0.8 p.p. in 2023, of which 0.5 p.p. is expected due to improved tax administration, and 0.25 p.p. due to tax policies (revenues from e-commerce taxation, increased excise tax rates, increased tax burden on the gambling sector). In 2024–2025, tax revenues would grow by 0.5 p.p. annually.

⁵ The estimate corresponds to those of the CBA published in the “Inflation Report” of 27 December 2022

Under the baseline scenario of the EFSD Project Unit, the budget deficit would average 2.7% of GDP in 2023–2025, resulting in a financing gap. The financing gap is attributable to a lower projected rate of economic growth compared to that in the medium-term public expenditure framework and the Budget Law for 2023 (on average 5.3% and 7.0%, respectively).

The current account deficit would expand slightly in 2023–2025 to 2.4% (on average) due to projected deterioration in the trade balance. Substantial growth of imports in the forecast period would lead to a decrease in the adequacy of international reserves to 4.2 months of imports in 2025, compared to 4.9 months in 2022.

The EFSD baseline forecast scenario has both downside and upside risks. Downside macroeconomic risks include a potential outflow of RF capital and a decline in consumption by RF citizens temporarily residing in the RA. If realised, those risks may put pressure on the exchange rate and lead to depreciation of the Armenian dram, which, in turn, may result in accelerated inflation, weaker soundness indicators of the banking sector, and higher public debt. In addition, deteriorating macroeconomic conditions may have a negative impact on the formation of state budget revenues (see Table 2. Factors of risk).

Table 1. Forecast of key macroeconomic indicators

	2022 Actual	2023 Forecast	2024 Forecast	2025 Forecast
<u>National accounts and prices (in %)</u>				
Real GDP growth	12.6	5.9	5.0	5.0
CPI (y/y)	8.3	4.3	4.0	4.0
<u>Money and credit (end of period)</u>				
Broad money, percentage change	16.1	12.8	9.5	9.5
Refinancing rate (in %)	10.75	10.0	7.5	6.0
<u>Public finance (in % of GDP)</u>				
Revenues and grants	24.3	24.5	24.7	25.1
of which tax revenues	22.7	23.5	24.0	24.5
Budget expenditures	26.4	27.3	27.4	27.7
Current expenditures	21.9	21.4	21.4	21.5
Capital expenditures	4.5	5.8	6.0	6.2
Budget balance ("-" deficit/"+" surplus)	-2.1	-2.7	-2.7	-2.6
<u>External sector (in % of GDP)</u>				
Current account	-0.9	-2.1	-2.5	-2.6
Remittances	7.3	5.9	5.8	5.6
Foreign direct investment	5.1	5.3	5.6	5.6
Gross reserves, in months of imports of goods and services	4.9	4.4	4.3	4.2
Average exchange rate (per US \$)	435.7	388.2	397.9	407.9

Table 2. Factors of risks to the baseline forecast

	To GDP growth	To inflation
Upside risks (+)	<ul style="list-style-type: none"> • additional influx of capital, • implementation of the EU “Eastern Partnership” assistance package in the amount of EUR 2.6 billion (according to the CBA, the annual growth is expected to increase by about 1 p.p.), • accelerating investment owing to savings accumulated in the private sector, • operation of the Amulsar mine starting from 2024 (the contribution to economic growth is estimated by the CBA at about 2 p.p.), as well as the resumption of work at the Teghut mine. 	<ul style="list-style-type: none"> • duration of acceleration of private consumption, • growth of government expenditures, • duration of acceleration of wage growth, • rising prices on the international market for commodities and food, • depreciation of the Armenian dram (in case of an outflow of capital).
Downside risks (-)	<ul style="list-style-type: none"> • potential outflow of RF capital and a decline in the consumption by RF citizens temporarily residing in the RA, • risks associated with the effectiveness of capital expenditure execution as provided for by the medium-term budget plan, • risks associated with tensions at the border – there is a risk of economic stagnation (zero growth in the medium term). 	<ul style="list-style-type: none"> • duration of appreciation of the Armenian dram, • deceleration of private consumption, • full recovery of supply chain disruptions, • declining prices on the international market for commodities and food.

Annex 1. Distribution of alternative forecasts of real GDP growth and inflation

<i>Distribution of alternative forecasts of real GDP growth</i>				
Period	90% probability		30% probability	
	Min.	Max.	Min.	Max.
2023	4.5%	7.2%	5.5%	6.3%
2024	2.0%	7.4%	4.1%	5.2%
2025	0.5%	8.7%	3.9%	5.3%
2026	-0.7%	10%	3.6%	5.5%
<i>Distribution of alternative forecasts of inflation</i>				
Period	90% probability		30% probability	
	Min.	Max.	Min.	Max.
2023	3.5%	5.3%	4.0%	4.5%
2024	2.5%	6.0%	3.8%	4.4%
2025	1.8%	6.8%	3.7%	4.6%
2026	1.0%	7.8%	3.6%	4.8%

Annex 1 presents the likelihood of forecasts falling within specific intervals. Under the baseline scenario, growth would be 5.9% in 2023, slowing down to its potential level of about 5.0% in the medium term (Figure 12). Inflation would be 4.3% in 2023 and is projected to be within the targeted range in the medium term (Figure 13).

Annex 2: Assessment of Main Drivers of Inflation in the Republic of Armenia in 2022

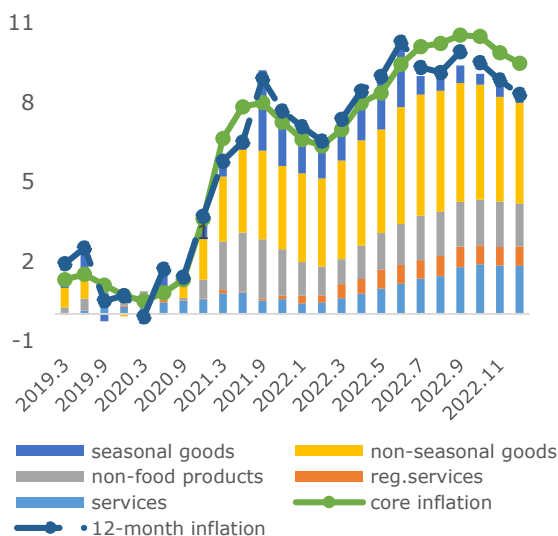
The main purpose of this analysis is to assess inflation in terms of supply and demand and identify the main drivers of inflation, since over the past two years, inflation in the RA has exceeded the targeted level ($4 \pm 1.5\%$).

In terms of demand

Demand expanded, driven mainly by a higher influx of tourists and relocation of specialists from Russia, that resulted in inflation accelerating sharply starting from March 2022. The main contribution to the 12-month inflation was made by higher prices for services and non-seasonal goods (Figure 1). As a result of the increased flow of tourists from Russia, prices for a number of services, characterised by relative rigidity, went up – rents grew by 63.0% (a contribution of 0.6 p.p.) and prices for air tickets increased by 47.1% (a contribution of 0.3 p.p.). Tariffs for banking and postal services also increased, and there was growth of prices of restaurants, hotels, and hairdressing service providers (Table 1). Over the past 10 years, there has been no such sharp increase in prices for this category of goods and services.

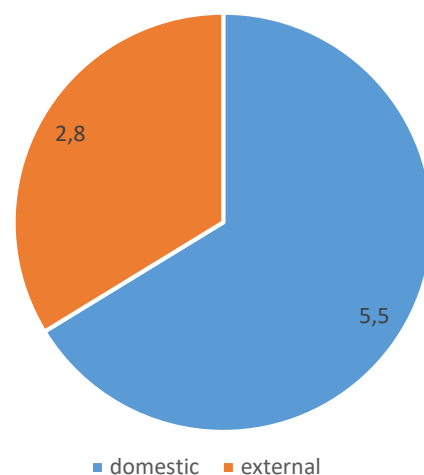
If we differentiate between domestic and external inflation, it is obvious that, as a result of the expansion of demand, the contribution of domestic goods and services to inflation was significantly greater (5.5 p.p.) than that of imported goods (2.8 p.p.) (Figure 2).

Figure 1. Dynamics of contributions to 12-month inflation (p.p.)



Source: EFSD estimates

Figure 2. Domestic and external inflation in 2022 (p.p.)



Source: EFSD estimates

During 2022, there was also inflationary pressure generated by the labour market, in particular due to high wage growth in the private sector (19%).

According to EFSD estimates, the effect of consumption by Russian citizens and the influx of Russian capital on RA economic growth is estimated at about 4.0 p.p. Additional consumption by Russian citizens pushed the RA inflation up by about 1–1.5 p.p.

In terms of supply

Despite some easing of the inflationary pressure from the external sector, the highly inflationary environment still persisted during 2022. Prices for imported food, whose share in the CPI basket was 14.8%, increased by 11.1% (a contribution of 1.6 p.p.).

Another important driver of inflation was changes in excise tax and customs duty rates. Due to the harmonisation of the common customs legislation in the EAEU countries launched in 2020, the rates of excise taxes and customs duties are raised annually. According to the EFSD Project Unit, the annual inflationary effect of changes in the excise tax is approximately 0.4–0.5p.p., and that of customs duties is about 0.3 p.p. (the estimates correspond to those of the Central Bank). As a result of changes in excise taxes, prices for alcoholic beverages and tobacco products increased by 8.9% in 2022 (a contribution of 0.34 p.p.).

Another driver of inflation in terms of supply was an increase in tariffs for some regulated services (a contribution of 0.8 p.p.). In Q1 2022, inflation expanded as a result of hikes in tariffs for water, electricity, and natural gas.

Thus, the growth of inflation by 8.3% in 2022 was driven by supply factors by about 3 p.p., and the remaining 5 p.p. were due to the expansion of domestic and external demand.

Table 1

Growth of consumer prices by product categories with the highest contribution to inflation growth			
Product category	<i>Weight (in %)</i>	12-month inflation (in %)	Contribution (in p.p.)
Bread and bakery products	8.1	14.1	1.1
Meat	9.0	12.3	1.1
Dairy products	4.2	16.6	0.7
Oils and fats	2.6	4.8	0.1
Chocolate	0.7	8.4	0.1
Coffee	1.4	11.9	0.1
Fruit	3.2	10.9	0.4
Alcoholic beverages and tobacco products	3.8	8.9	0.3
Clothes and footwear	2.1	7.2	0.2
Home appliances	0.6	8.8	0.1

Actual rent	1.0	63.0	0.6
Passenger air traffic	0.6	47.1	0.3
Restaurants and hotels	1.0	8.8	0.1
Banking and postal services	0.6	18.6	0.1
Regulated utility tariffs	15.5		0.8
- <i>Water supply</i>	1.6	10.0	0.1
- <i>Electric power</i>	5.0	7.6	0.4
- <i>Gas</i>	7.1	3.3	0.2
Fuel	6.9	2.6	0.3
Home care products and services	2.5	17.0	0.4
Miscellaneous products and services	6.4	12.8	0.8
Total	70	-	7.6