

Approved

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Opinion of the Central Bank of the Republic of Armenia on the Law of the Republic of Armenia "On the 2026 State Budget of the Republic of Armenia"¹

1. Process of execution process of the Law of the Republic of Armenia "On the 2025 State Budget of the Republic of Armenia"²

In 2025, the risks of economic growth slowdown in the global economy and the main partner countries of Armenia have persisted, bearing the continuous impact of geopolitical uncertainties and trade and economic tensions. At the same time, the mentioned global economic developments were accompanied by the risks of global inflation remaining at high levels.

Economic activity in Armenia has accelerated, especially starting from the second quarter of the year, to which the high growth of the construction and services sectors has continued to contribute significantly; meanwhile, industry has begun to recover slowly following a decline conditioned by certain one-time factors. Moreover, economic growth has continued to be concentrated mainly in sectors driven by increased demand, the growth of which has exceeded the impact of the gradual neutralization of certain short-term, non-structural growth factors. Consequently, economic activity for the first eight months of the year reached 7.1%, signaling positive momentum for the annual economic growth performance. As a result, according to the estimates of the Ministry of Finance of the RA, it is expected that under the conditions of the gradual neutralization of short-term, non-structural growth factors, Armenia's economic growth, after some adjustment, will stand at 5.2% for the year, ensuring the indicator outlined in the state budget program.

It should be noted that the high economic activity formed, under the aforementioned structural peculiarities, **still contains uncertainties regarding the stability of economic growth, the long-term outlook, as well as future trends in domestic demand.**

Since the beginning of 2025, 12-month inflation has exhibited accelerating trends, driven by inflation in seasonal food products as well as inflationary pressures transmitted from the global economy in recent months, particularly regarding imported food items. It should also be noted that a certain acceleration in services inflation has been observed since the start of the year, while inflation for non-tradable goods characterized by sticky prices, which primarily

¹ In the process of preparing the Opinion on the draft law on the state budget, the Central Bank of the RA is guided by the presentation of assessments under the principles of ensuring the sustainability of medium-term debt, the cyclical orientation and stance of the fiscal policy, contributing to long-term growth, and other principles of the budget program.

² The numerical data and assessments presented in this document are taken from the draft Law of the RA "On the 2026 State Budget of the Republic of Armenia."

describes price behavior conditioned by demand developments, has continued to form within the range of 2.0-2.5%. It is also noteworthy that during the year, inflationary expectations have also gradually stabilized around the 3% target level.

Guided by the principle of ensuring the objective of price stability and taking into account the existing risks and uncertainties, **at the beginning of the year, in February, the Central Bank of the RA reduced the policy rate by 0.25 percentage points, setting it at 6.75%, and subsequently left it unchanged. Moreover, from June 2023 to July 2025, the Central Bank reduced the refinancing rate by 3.5 percentage points.** In this context, the Central Bank of the RA monitors several scenarios, including, on one hand, risks regarding geopolitical and fiscal policies and the formation of excess demand in the domestic economy, and on the other hand, risks concerning the uneven weakening of certain sectors of the economy conditioned by the adjustment of external demand, the gradual adjustment of real estate prices, and the outlook for a global economic slowdown. Under the mentioned scenarios, the Central Bank of the RA is prepared to take equivalent actions to ensure the 3% inflation target and price stability over the medium-term horizon.

Higher-than-expected economic growth has also contributed to improved tax collection. Thus, **in the first eight months of 2025, an acceleration in the growth rate of the RA state budget revenues was recorded**, which, besides high economic growth, was also driven by the increase in tax administration efficiency, timing peculiarities of taxation in certain sectors of the economy (specifically, the construction sector), as well as legislative changes and the growth of tax bases. As a result of the first eight months of the year, the growth rate of the RA state budget tax revenues exceeded the growth indicator projected for the year and stood at 14.3%. Consequently, under the conditions of maintaining high economic growth rates, it is expected that in 2025, the tax-to-GDP ratio will increase by 1.0 percentage point, forming at a level slightly lower than the indicator projected by the 2025 budget. Thus, *it is estimated that in 2025 taxes will have a restraining effect on aggregate demand.*

Guided by the objective of implementing expenditures aimed at increasing economic potential, the execution of the RA state budget for 2025 has prioritized the implementation of expenditure measures aimed at supporting economic growth, strengthening economic and security infrastructure, capital expenditures, as well as social support measures. This has been reflected in the high 12.9% growth rate of the RA state budget expenditures as of the first eight months of the year, where current expenditures increased by 7.7% and capital expenditures by 39.3%. It should also be noted that the growth of current expenditures was primarily driven by the increase in social benefits and pensions, which hold a large weight. It is expected that the total state budget expenditures for 2025 will increase by approximately 2.2 percentage points relative to GDP, with current expenditures increasing by 0.9 percentage points and capital expenditures by 1.3 percentage points relative to GDP.

Thus, expenditure policy has remained consistent with the targeted direction in terms of supporting economic potential and current year economic growth, recording a high growth rate in capital expenditures. In this context, **from the perspective of the economy's**

medium-term potential, the consistent ensurance of the target level and efficiency of capital expenditures aimed at improving economic infrastructure is emphasized.

Consequently, ***expenditures in Armenia's 2025 state budget are expected to have a near-neutral, slightly expansionary impact on aggregate demand.***

Thus, under the conditions of a higher growth in revenues relative to expenditures, as well as the acceleration of the economic activity rate, the RA state budget deficit for January-August 2025 has significantly fallen short of the planned level, as well as the deficit formed during the same period of the previous year. Nevertheless, it is expected that **the state budget deficit will increase by 1.8 percentage points compared to the previous year, reaching approximately 5.5% of GDP.** In this context, it is assumed that under the ensurance of the designated deficit level, the burden of expenditure implementation will fall on the last few months of the year. Consequently, taking into account the stabilization of economic growth around its potential level, as well as the growth structure of state budget expenditures, ***the impact of the 2025 fiscal policy on aggregate demand will be near-neutral.*** It should be noted that, **considering the risks associated with budget revenue collection as well as potential risks in the area of expenditure execution, fiscal policy may have a more stimulatory effect in the short term, contributing to an increase in domestic consumption and demand.**

As a result of the stabilization of economic growth around its potential level and, correspondingly, the maintenance of a stable level of expenditures influencing aggregate demand in the economy, an increase of 2.7 percentage points in the RA Government debt-to-GDP ratio is expected in 2025, which was also somewhat mitigated by the appreciation of the Dram. Consequently, it is estimated **that the RA Government debt in GDP will form within the indicator projected by the 2025-2027 debt burden reduction program, remaining above the 50% level defined by the fiscal rules. In the absence of commensurate fiscal actions, the latter may contain certain risks from the perspective of ensuring debt and fiscal stability over the medium-term horizon.**

2. Opinion of the Central Bank of the Republic of Armenia on the Law of the Republic of Armenia "On the State Budget of the Republic of Armenia for 2026"

The fiscal policy outlined in the 2026 budget program reflects the objective of ensuring the growth of Armenia's competitiveness and the growth of GDP potential, as well as strengthening the economy's resilience through a substantial increase in the level of investment in economic and security infrastructure and human capital. Moreover, along with the gradual neutralization of the effects of short-term factors of high economic growth from previous years, ensuring stable economic growth near its potential level will significantly depend on the results of the Government's policies aimed at increasing productivity, promoting exports, and improving the investment environment.

In this context, taking into account the RA Government's objective to implement fiscal consolidation and to ensure capital expenditures at a level higher than historical averages, the continuous increase in the role of capital expenditures is of vital importance. This is emphasized especially from the perspective of the full and efficient implementation of programs aimed at strengthening economic and security infrastructure. Consequently, in 2026, **fiscal policy will be guided by the objective of ensuring 5.4% economic growth**, emphasizing fiscal consolidation and debt sustainability, as well as the maintenance and contribution to the growth of the high level of economic potential formed in recent years.

Nevertheless, under the conditions of the created geopolitical and economic uncertainties, significant external and internal risks exist from the perspective of the stability of factors determining economic potential and possible scenarios for the economic outlook. In this regard, it should be noted that the 2026 RA state budget program has considered the risks and uncertainties associated with possible deviations from the main assumptions and forecasts underlying it; scenario analyses have been conducted, and possible directions for adjusting budget flows and the fiscal policy framework in case of their emergence have been assessed. This is an important prerequisite from the perspective of fiscal policy risk management. At the same time, **taking into account the fact that risks and uncertainties regarding economic growth are high, from the perspective of effective risk management, the existence of strict restrictions on the use of the reserve fund is emphasized, aimed exclusively at meeting possible additional financial requirements arising from macroeconomic risks.**

As a result of the targeted economic growth, the expansion of the tax base resulting from legislative changes, and the tax policy measures implemented under the improvement of tax administration, **an increase of an additional 0.4 percentage points in the tax-to-GDP ratio compared to the expected indicator for the current year is programmed for 2026**, as a result of which taxes will constitute 24.9% of GDP. Moreover, the latter reflects a certain optimistic approach and signifies an exceeding of the tax-to-GDP indicators stipulated by the 2026-2028 Medium-Term Expenditure Framework. Consequently, it is estimated that **in 2026, RA state budget revenues will have a slight restraining effect on aggregate demand**. It is important to note that in the context of risks and uncertainties related to the economic growth outlook, **ensuring the continuity and efficiency of tax collection reforms in 2026 is key, while simultaneously emphasizing the formation of stable prerequisites for exports and long-term economic growth, public redistribution, and the strengthening of fiscal stability.**

In 2026, the state expenditure policy, emphasizing on one hand the implementation of the necessary consolidation, and on the other hand, objectives of increasing investment in human capital and stimulating the economy's potential, will continue targeting the reduction of state expenditures relative to GDP. It should be noted that in 2026 and over the medium-term period, **although the weight of capital expenditures relative to GDP decreases compared to the previous year, it stabilizes at a level higher than historical levels, driven especially by the objective of strengthening economic infrastructure.** As a result, owing to the 0.7 percentage point decrease in capital expenditures and the 0.1 percentage

point decrease in current expenditures compared to the expected indicators for 2025, **state expenditures relative to GDP will decrease by 0.8 percentage points, amounting to 30.4%**, having a restraining effect on aggregate demand. Moreover, in comparison with medium-term programs, the budget draft envisages a higher level of state expenditures relative to GDP, driven by the growth of current expenditures, while the capital expenditures-to-GDP ratio is consistent with the 2026-2028 MTEF, amounting to 5.9%. Nevertheless, regarding capital expenditures, the main emphasis is directed toward strengthening economic infrastructure, which will stimulate the economy's potential and productivity, creating foundations for the realization of the adopted economic development programs. It should also be noted that for the purpose of increasing the efficiency of expenditure programs, the introduction of a regular process for evaluating budget programs by the RA Government starting from 2026 will be of key importance from the perspective of realizing fiscal policy goals.

Thus, under the objective of ensuring fiscal consolidation, as a result of the targeted increase in taxes and the reduction of expenditures relative to GDP, **a 1.0 percentage point decrease in the budget deficit-to-GDP ratio is programmed, ensuring a level of 4.5% of GDP**. Consequently, **fiscal policy will have a mild restraining effect on aggregate demand, driven by restraining impulses from both revenues and expenditures**. Notably, the adoption of such a policy direction is aimed at curbing certain excess demand forming in the economy and ensuring a counter-cyclical position. At the same time, under a counter-cyclical fiscal policy, the targeted improvement in the structure of expenditures and the increase in efficiency will have a positive impact on economic potential, neutralizing the effect arising from the deficit adjustment. In this context, taking into account the objective of fiscal consolidation in the medium term, **the fulfillment of state expenditure policy targets and especially the ensurance of the planned high weights of state capital expenditures is of key importance. This will create a stable prerequisite for the growth of long-term economic potential and, consequently, for ensuring state debt sustainability in the long-run perspective.**

In 2026, the government **debt-to-GDP ratio is projected to increase by 2.8 percentage points compared to the relatively lower-than-planned expected level of the debt-to-GDP indicator for 2025, reaching 53.5% of GDP**. The latter will form at a level lower than projected for the medium term, yet above the 50% threshold defined by the fiscal rules. In the context of the programmed increase in RA Government debt and the aforementioned macroeconomic risks, the more efficient use of available resources and the development of capacities for managing potential risks are of vital importance, creating guarantees for ensuring fiscal stability in the long run. Notably, in this context, as a result of the Government's objective to reduce the budget deficit level and implement fiscal consolidation over the medium term, the debt growth rate will decrease, and the RA Government debt-to-GDP ratio will stabilize within the range of 54.6%. Moreover, the mobilization of funds from external sources, as well as the gradual increase in national currency debt and domestic debt, will continue in 2026 for the financing of the state budget deficit and especially capital expenditures. It should be noted that from the perspective of the

RA Government's adopted policy for ensuring debt sustainability, the implementation of state expenditures through own resources is emphasized, as well as the financing of the budget deficit in accordance with an adequate and efficient debt management strategy.

It should be emphasized that the ensurance and strengthening of macroeconomic and price stability in 2026 and over the medium-term horizon will continue to remain the primary target of fiscal and monetary policies, and the Central Bank of the Republic of Armenia will continue its consistent policy toward the regulation of inflation and inflationary expectations.

In conclusion, it is estimated that the fiscal policy outlined in the 2026 RA state budget draft will, on one hand, have a counter-cyclical impact under the conditions of forming excess demand, and on the other hand, create the necessary prerequisites for effective consolidation and the ensurance of fiscal stability in the medium term. Nevertheless, from the perspective of stimulating economic potential, the Government's consistency toward the objectives of increasing public investment and reducing the growth rate of current expenditures is emphasized. At the same time, tax reforms aimed at increasing the efficiency of tax collection will create a necessary prerequisite for ensuring fiscal policy flexibility in the long run.

It should also be emphasized that, amid geopolitical and macroeconomic uncertainties, consistent risk monitoring and the development of robust risk management capacities are crucial to mitigating negative impacts. These measures are key to ensuring macroeconomic stability and fiscal flexibility in the short and medium term, while safeguarding debt sustainability over the long-term horizon.