

Conclusion of the Central Bank of the Republic of Armenia Regarding the Draft Law of the Republic of Armenia «On the State Budget of the Republic of Armenia for 2027»¹

1. Implementation of the Law of the Republic of Armenia “On the State Budget of the Republic of Armenia for 2026”²

In 2026, economic growth and demand in the global economy and in the Republic of Armenia’s key partner countries weakened somewhat, while uncertainty surrounding the outlook increased, largely driven by the escalation of geopolitical conflicts and, in this context, disruptions to trade routes and the impact of high energy prices. At the same time, these developments have been accompanied by intensifying inflationary pressures. Against this backdrop, the central banks of a number of leading countries have continued to tighten monetary conditions.

Despite these developments, economic activity in Armenia remained high throughout 2026. During January-August, economic activity amounted to approximately 7.3% compared with the same period of the previous year. The construction and services sectors continued to make a significant contribution to the high level of economic activity, accompanied by an expansion in both domestic and external demand. However, according to estimates by the Ministry of Finance of the Republic of Armenia, the pace of economic growth is expected to moderate somewhat in the second half of the year, bringing growth to 5.6% in 2026, approximately 0.2 percentage points above the level projected in the 2026 state budget. *It should be noted that, given the structural peculiarities of the current growth, the high level of economic activity observed still entails significant uncertainties regarding the sustainability of economic growth and the medium-term outlook.*

During 2026, 12-month inflation accelerated, reaching levels somewhat above the target and standing at 4.4% in August. The expansion of the inflationary environment has been largely driven by inflationary pressures transmitted from the global economy, affecting both imported and domestically produced food products and, more recently, non-food goods and freight transport costs. On the other hand, restrictions on exports to the Russian Federation have had certain deflationary effects on the domestic market for specific goods. It is also

¹ In preparing its opinion on the draft state budget law, the Central Bank of Armenia assesses the budget program against the principles of medium-term debt sustainability, the cyclical direction and stance of fiscal policy, and the promotion of long-term economic growth, as well as takes into account other relevant considerations.

² The numerical data and estimates in this document are taken from the draft Law of the Republic of Armenia “On the 2027 State Budget of the Republic of Armenia”.

worth noting that services inflation has accelerated in recent months, pointing to conditions of strong demand in the economy.

Following the principle of ensuring price stability and the 3% inflation target, and taking into account existing risks and uncertainties, the **Central Bank of Armenia kept the policy rate unchanged at 6.5% during the first half of 2026, before raising it by 0.25 percentage points in September to 6.75%**. Against this backdrop, the Central Bank is monitoring various economic development scenarios involving, on the one hand, a further expansion of domestic and external demand, rising inflation expectations, and intensifying external inflationary pressures and, on the other hand, a slowdown in global economic growth, the emergence of deflationary pressures amid challenges in certain export markets, and a significant reduction in Armenia's country risk premium. The Central Bank of Armenia will continue to monitor developments under these scenarios and stands ready to take appropriate measures to ensure fulfilment of the 3% inflation target and maintain price stability over the medium term.

Higher-than-expected economic activity and inflation, tighter tax administration and improvements in its efficiency, as well as certain changes in tax policy, have contributed to strong tax collection performance in 2026. Thus, **during the first eight months of the year, tax revenues of the RA state budget amounted to approximately 14.5% compared with the same period of the previous year**. As a result, *the tax-to-GDP ratio is expected to increase by approximately 0.8 percentage points in 2026 compared with the previous year, reaching 24.8%*. Notably, this figure is nearly 0.3 percentage points above the 24.5% level projected in the 2027-2029 Medium-Term Expenditure Framework. It should be noted, however, that certain one-off factors not attributable to Armenia's economic growth will also contribute positively to the 0.8 percentage point increase in the tax-to-GDP ratio. In particular, contributions to the Comprehensive Health Insurance (CHI) program are estimated to account for approximately 0.3 percentage points, while payments related to royalties are expected to account for around 0.2 percentage points. It is therefore estimated that **in 2026 taxes will have a weak contractionary effect on aggregate demand, amounting to approximately 0.3 percentage points**. Notably, the current overperformance of tax revenues, including relative to revised projected targets, has significantly mitigated the risks associated with the widening budget deficit resulting from increases in pension and social expenditures, as well as the implementation of the Universal Health Coverage (UHC) program.

In view of the objective of implementing expenditures aimed at strengthening economic potential, the execution of the 2026 RA state budget prioritized measures to stimulate economic growth, strengthen economic, security and social infrastructure, and provide social support. **It is noteworthy that during January-August 2026, total state budget expenditures increased by 9.9%, reflecting a 17.8% increase in current expenditures and a 25.6% decline in capital expenditures**. In the meantime, both current and capital expenditures were under-executed relative to the projections. The under-execution of

current expenditures was primarily attributable to lower-than-expected interest payments, resulting from both a significant decline in the yield curve for dram-denominated bonds and lower-than-projected interest costs for servicing external debt. Meanwhile, social and healthcare expenditures have increased significantly, and risks remain regarding the potential over-execution of planned allocations for the universal health insurance program.

Total state budget expenditures as a share of GDP are projected to increase by approximately 0.8 percentage points in 2026 compared with 2025, reaching 29.9%. In particular, current expenditures are expected to increase by 1.4 percentage points of GDP, while capital expenditures are projected to decline by 0.6 percentage points. It should also be noted that the projected ratio of government expenditure to GDP is approximately 0.4 percentage points higher than the level envisaged in the 2027-2029 Medium-Term Expenditure Framework.

Thus, although the expenditure policy for 2026 is aimed at maintaining a high level of capital expenditure directed towards strengthening economic potential and developing infrastructure, the decline in capital expenditure and its continued under-execution during the first eight months of the year have somewhat limited the impact of expenditure policy in this regard.

In view of the aforementioned developments, Armenia's **2026 state budget expenditure is expected to have an expansionary effect on aggregate demand of approximately 0.7 percentage points.**

Supported by strong revenue collection and, notably, significant under-execution of capital expenditures, the state budget recorded a surplus of approximately AMD 18.0 billion during January-August 2026, compared with a deficit of around AMD 61.0 billion in the same period of the previous year. However, based on year-end projections and assuming improved execution of capital expenditures, the state budget deficit is expected to reach approximately 4.0% of GDP (AMD 504.2 billion), compared with the planned 4.5% and 3.7% in the previous year. **Consequently, taking into account the trajectory of tax revenues and the structure of expenditure growth, the impact of fiscal policy on aggregate demand in 2026 is assessed as mildly expansionary. At the same time, the projected expenditure execution profile implies that a significant portion of expenditure will be executed during the final months of the year, thereby somewhat intensifying short-term demand and inflationary pressures.**

On the back of high nominal economic growth, lower market interest rates, appreciation of the dram's nominal effective exchange rate, and other factors affecting debt dynamics, the RA government debt-to-GDP ratio is expected to decline by approximately 0.7 percentage points in 2026, from 47.2% in 2025 to 46.5%. As a result, the government debt-to-GDP ratio is expected to be approximately 2.2 percentage points below the level projected for 2026 in the 2027-2029 Medium-Term Expenditure Framework (MTEF), remaining below the

50% threshold established by the fiscal rules. **The projected decline in the government debt-to-GDP ratio is very important for further strengthening macroeconomic and debt sustainability and enhancing resilience to potential economic shocks.**

2. Conclusion of the Central Bank of the Republic of Armenia on the Draft Law of the Republic of Armenia “On the State Budget of the Republic of Armenia for 2027”

The fiscal policy outlined in the 2027 budget program aims to strengthen Armenia’s competitiveness and economic resilience, maintain high levels of investment in economic and security infrastructure, as well as in human and physical capital, and further expand economic potential through structural reforms. According to an assessment by the RA Government, the economy’s potential growth rate has increased to 5.0-5.5% in recent years. Nevertheless, it should be noted that, as the effects of certain short-term factors that previously contributed to high economic growth gradually phase out, sustaining robust economic growth will depend significantly on the effective implementation of policies aimed at increasing productivity, stimulating exports and private investment, and improving the investment climate. In this context, ensuring a gradual improvement in both the execution and efficiency of targeted high capital expenditures, amid planned fiscal consolidation, remains crucial. Thus, **in 2027, fiscal policy will be steered by the objective of achieving 5.8% economic growth, while balancing the continuation of fiscal consolidation and the strengthening of debt sustainability with the implementation of policies aimed at developing human capital and further expanding the economy’s potential.**

As a result of projected economic growth, improvements in tax administration, the reduction of the shadow economy, and the implementation of tax policy measures, a further increase in the tax-to-GDP ratio is projected for 2027, by nearly 0.6 percentage points compared with the level expected for 2026, bringing tax revenues to 25.4% of GDP. Note that this figure is approximately 0.4 percentage points above the level envisaged in the 2027-2029 Medium-Term Expenditure Framework. According to the RA government estimates, improvements in tax administration will contribute, on average, about 0.4 percentage points per year to the increase in the tax-to-GDP ratio between 2026 and 2029, while tax policy reforms will contribute around 0.1 percentage point.

Consequently, state budget revenues are expected to have a contractionary effect on aggregate demand in 2027. In the meanwhile, certain revenue sources, particularly royalties and health insurance contributions, will continue to make a significant contribution to the increase in the tax-to-GDP ratio in 2027, with their combined contribution amounting to nearly 0.7 percentage points. The increasing role of these non-structural factors poses certain risks to the medium-term sustainability of fiscal policy outcomes.

The state expenditure policy for 2027-2029 **highlights, on the one hand, the continuation of medium-term fiscal consolidation and, on the other hand, the objective of expanding the economy’s potential through investment in human and physical capital and the development of economic infrastructure. Over the medium term, a gradual**

reduction in the share of current expenditures is envisaged, alongside an increase in capital expenditures and their sustained allocation at levels significantly above historical averages. Compared with the projected figures for 2026, the current expenditure-to-GDP ratio is planned to decrease by a mere 0.1 percentage point, to 24.3% in 2027, while the capital expenditure-to-GDP ratio is projected to increase by approximately 0.1 percentage point, to 5.6%. Consequently, the total expenditure-to-GDP ratio is expected to remain at 29.9%. At the same time, compared with the 2027-2029 Medium-Term Expenditure Framework, the share of current expenditures in the draft budget is approximately 0.8 percentage points higher, even though nominal economic growth projections for both 2026 and 2027 have been revised upside, while the share of capital expenditures is about 0.1 percentage point lower. Notably, the increase in current expenditures is driven to a significant extent by higher spending on social benefits, pensions and healthcare, largely reflecting adjustments made in these areas during 2026.

With regard to capital expenditures, the primary focus is on the development of economic, educational and security infrastructure. This approach is aimed at increasing economic potential and productivity, thereby laying the groundwork for long-term economic growth. Under these circumstances, and particularly in light of the experience of previous years, ensuring the planned level and effective execution of capital expenditures is of critical importance. It is also worth noting that the continued implementation of the established regular process for evaluating budget programs, introduced to enhance their effectiveness, will play an important role in improving the efficiency of expenditure policy and achieving fiscal policy objectives.

As a result, within the framework of fiscal consolidation, **a budget deficit of 3.4% of GDP is projected for 2027, approximately 0.6 percentage points below the expected level for 2026 but around 0.1 percentage point above the level envisaged in the 2027-2029 Medium-Term Expenditure Framework.** Notably, the fiscal consolidation planned for 2027 will be driven primarily by a significant increase projected for tax revenues. Under these conditions, and assuming that economic growth remains slightly above its long-term sustainable level, fiscal policy is expected to have a certain contractionary effect on aggregate demand, reflecting the combination of a contractionary revenue-side impact and only a slightly expansionary expenditure-side impact. In this context, from the perspective of medium-term fiscal consolidation, it is important to maintain consistency in gradually reducing the share of current expenditures in GDP. At the same time, improving the expenditure structure and implementing effective investments over the medium term can help expand the economy's potential, thereby mitigating the short-term contractionary effects deriving from fiscal consolidation.

As a result, the government debt-to-GDP ratio is projected to increase by approximately 0.7 percentage points in 2027 compared with the 2026 forecast, reaching 47.2%, while remaining below the 50% threshold. Furthermore, in 2027, financing of the state budget deficit will continue to rely on both domestic and external

sources, while maintaining the benchmark of at least 40% domestic debt in the government debt structure and taking into account domestic market capacity and foreign-currency financing conditions. Given the projected increase in government debt and the aforementioned macroeconomic and fiscal risks, the efficient use of available resources and the strengthening of risk management capabilities remain crucial to ensuring long-term fiscal sustainability.

Maintaining and strengthening macroeconomic and price stability, it should be emphasized, will remain a primary objective of fiscal and monetary policy in 2027 and in the mid-term horizon.

Nevertheless, significant external and domestic risks to economic growth, tax revenues, public spending and financing conditions persist amid considerable geopolitical and economic uncertainty. In this context, it should be noted, the draft RA state budget for 2027 factors in the risks and uncertainties associated with potential deviations from its underlying assumptions and forecasts. Scenario analyses have been conducted, and potential adjustments to budgetary flows and the fiscal policy framework have been assessed in the event that these risks materialize.

To manage these risks, provision is made for establishing a reserve fund amounting to approximately 0.3-0.6% of GDP and maintaining a liquidity buffer of at least 1.0% of GDP in the Treasury Stabilization Account. Should risks materialize, additional tax administration measures may be implemented, while expenditure priorities and the scope of spending may be reviewed. In the event of significant pressure on fiscal stability, the medium-term fiscal framework would also be revised. These measures are essential for the effective management of fiscal risks.

Against this backdrop therefore, **strict adherence to clear restrictions on the use of reserve funds by directing them primarily towards meeting additional financing needs arising from pre-defined macroeconomic and other significant fiscal risks is important.**

Overall, the fiscal policy outlined in the draft RA state budget for 2027 is expected to continue the trajectory of medium-term fiscal consolidation and strengthen fiscal stability, while maintaining a moderately contractionary and counter-cyclical stance. However, from the perspective of expanding economic potential and ensuring medium-term fiscal stability, it is crucial for the Government to remain consistent in containing the growth of recurrent expenditure obligations and effectively executing the planned high level of capital expenditures. At the same time, the effective implementation of reforms in tax administration and tax policy is a vital prerequisite for establishing a steady tax revenue base and ensuring fiscal policy flexibility over the long term.

It should also be emphasized that, amid high geopolitical and macroeconomic uncertainty, continuous monitoring of risks and the strengthening of fiscal buffers and risk-response capacities are of particular importance. In this context, it is essential to highlight that, given the current favorable economic conditions and high level of demand, there is an opportunity to further expand fiscal space and build buffers, with a view to effectively absorbing shocks, ensuring macroeconomic stability, and maintaining fiscal flexibility over the medium term.