Central Bank
of Armenia

2024 Q1

Transparency Report

Published March 12, 2024

Minutes of the Central Bank of Armenia Board Meeting on the Refinancing Rate

March 12, 2024

Present at the meeting: Governor Martin Galstyan; Deputy Governors Armen Nurbekyan and Hovhannes Khachatryan; and Board Members Hasmik Ghahramanyan, Davit Nahapetyan, Artak Manukyan, Levon Sahakyan, and Narek Ghazaryan.

Assessment of Current and Underlying Economic Conditions

The meeting of the Board of the Central Bank of Armenia started with the Staff presentation of current and underlying global and domestic economic conditions. The presentation addressed developments in inflation, the external environment, and the real, fiscal, financial, and monetary sectors of the economy; touched upon the key risks and issues, as presented in various scenarios; and highlighted sources of policy-relevant uncertainty.

Discussions commenced with key narratives for the global economic environment. In the first quarter of 2024, economic activity among Armenia's main trading partners, has been mixed; however, the risks of weaker economic activity going forward are high. Given risks of deeper slowdown as well as sustained contractionary monetary policy in advanced economies, the overall inflationary environment in the world continued to soften significantly. This has been reflected in certain deflationary patterns in international commodity markets, with slowing global economic activity likely to continue to create a downward drag on prices. However, on this front, two important sources of risk were highlighted: first, continued geopolitical tensions in the Middle East continue to pose upward risk and volatility in oil prices and global supply chains; and second, concerns about slower growth in China and risks to financial stability could pose risks to global demand and exert meaningful downward pressure on commodity prices. Discussions also touched upon tight labor market conditions and continued consumption-driven demand in advanced economies, which continue to contribute to "sticky" prices remaining quite elevated. Considering these drivers, as well as messaging from monetary authorities, the central banks of key trading partner economies would be expected to maintain tight monetary policy stances in the near term. Against this context, Board members were in unison that inflationary effects on the Armenian economy coming from the global economy would likely continue to weaken in the near term.

The Board discussed current and underlying developments in the Armenian economy. Economic activity growth in Armenia remains at high levels thanks to continued strong growth in trade and construction, which continue to remain the major drivers of the economy (though the pace of overall growth has somewhat softened relative to the first half of the year). During the fourth quarter of 2023, and continuing into the first quarter of 2024, external demand pressures have softened, stemming from some cooling in tourism (evidenced by normalizing real expenditures per tourist and a slowdown in tourist inflows). At the same time, the Board emphasized the high level of uncertainty regarding domestic demand conditions. While private consumption has slowed, it was noted that risks exist for potential for growth in loans and reductions in savings to drive growth in private consumption going forward. Conversely, increases in private investment pointed to the potential for better supply conditions in the economy, and serves as a basis for perspectives that the output gap may be closing or already closed. Turning to the labor market, it was noted that while annual wage growth was lower than in previous quarters, it continued to remain quite robust and likely continued to apply upward pressure on inflation. On the other hand, it was noted that the growth in labor supply experienced in Q4 2023 (driven by the integration of forcibly displaced persons from Nagorno Karabakh in the domestic labor market, the arrival of migrant workers from India, and greater domestic labor force participation) could contribute to future softening in the labor market, though considerable uncertainty remained surrounding the magnitude of the existing labor supply expansion, the potential for these trends to continue (or accelerate or reverse), and their overall impacts on aggregate supply and demand.

The Board then turned to financial market developments in Armenia. Discussions began by addressing developments in the yield curve in the first months of 2024, when the long-term portion of the yield curve remained at meaningfully elevated levels since the last quarter of 2023. However, the Board noted that since the CBA's January policy decision, the long-term portion of the yield curve has again shifted back down, though the short-term portion of the curve remains elevated. Plausible explanations were discussed in the context of the uncertainty surrounding these shifts, which could reflect various factors, including higher inflation expectations or a reappraised country risk premium following the September events, as well as volatility in the term premium related to supply and demand shifts in the bond market. Further, it was observed that with domestic demand continuing to remain high, both consumer loans and mortgages continue to grow, while the banking system continues to maintain high liquidity and capital levels.

The Board proceeded to discussing inflation developments; it was noted that year-over-year CPI inflation stood at -1.7% in February 2024, marking the eleventh consecutive month that it has been below the CBA's medium-term target. These developments were attributed to the aforementioned weakened inflationary pressures coming from the external sector, the tight policy stance of the CBA, and the implications of the appreciated dram. 12-month core inflation was in negative territory as well, reaching -0.4%. Discussions turned to non-traded sticky price inflation, which had remained high throughout 2023, despite the abrupt slowdown in headline inflation during that period. The Board noted that NTSPI had also moderated meaningfully in recent months, standing at 3.0% Y-o-Y in January, while attention was also paid to the fact that inflation for services that are highly exposed to external demand have softened. Finally, the inflation expectations survey results show that household expectations of inflation in Q1 2024 appear to have softened, but still remain broadly elevated relative to pre-Covid levels, while household uncertainty about future inflation has declined meaningfully versus Q4 2023.

Deliberations around Key Risks, Uncertainties, and Scenarios

Following the discussion of current and underlying macroeconomic developments in the external and domestic sectors, the Board proceeded to addressing the broad spectrum of risks presented in terms of multiplicity of Scenarios, deliberating their implications for monetary policy, and making a decision on the policy rate.

To further facilitate the discussion, the staff presented two illustrative case scenarios. On the one hand, the Board discussed scenarios where possible underlying economic forces, including the potential for inflation expectations to prove to still be high as well as uncertainty around the country risk premium, would require a tighter policy stance to cool domestic demand, re-anchor inflation expectations, and meet the price stability objective.

On the other hand, the Board discussed scenarios where possible underlying economic developments, including a continued broad expansion of labor supply (including integration of forcibly displaced persons from Nagorno-Karabakh, inflow of migrant workers, and greater domestic labor force participation) and weakening demand conditions, generate excess supply conditions that contribute to inflation persistently remaining at low levels. This would imply a more rapid and sizable downward policy rate path to sustainably bring inflation to target over the medium term horizon.

Against the backdrop of the broader set of risks and these two illustrative scenarios, the Board members deliberated their views on the key sources and types of risks and uncertainty that were most relevant for making a prudent policy decision at this stage. All Board members emphasized potential risks of slowing global economic activity (including a "higher for longer" policy stance in the US, as well as risks of recession in the EU and China), with its implications on global demand and inflation. All Board members also emphasized the need to continue to monitor commodity markets, which, while trending downward, remain rife with risks in both directions. Upward risks to commodity prices stem from continued uncertainty about geopolitical tensions in the Red Sea and impacts on both oil prices and supply chains, while downward risks could emanate from China, ranging from soft deflationary effects if Chinese demand proves to be weak going forward, to more serious deflationary effects if the Chinese economy experiences a sufficiently large-scale contraction and financial crisis, given vulnerabilities in real estate and the financial sector. The Board was in unison that inflation and inflation expectations had somewhat subsided in Armenia as a result of implemented monetary policy and deflationary effects transmitted from the external sector. Several Board members, including Levon Sahakyan and Narek Ghazaryan, emphasized that annual CPI inflation of -1.7% in February meaningfully surprised on the downside. This echoed points made by Davit Nahapetyan, who argued that earlier risks of de-anchoring of inflation expectations had largely been put to rest. At the same time, Hovhannes Khachatryan and Levon Sahakyan highlighted the possibility of restricted demand conditions as key driving factor for decelerating inflation. On the other hand, Armen Nurbekyan emphasized that considerable uncertainty remains about how well-anchored inflation expectations are to the target, which may be contributing to some developments observed in financial markets. Further, while GDP growth registered a very high mark in Q4 2023, all the Board members, raised concerns that this recent growth was not broad-based and was concentrated in selected sectors, raising both near-term concerns as well as longer-term, structural risks related to potential output. While, Hovhannes Khachatryan, in particular, argued that amid these developments, the output gap is significantly negative. Others, including Martin Galstyan and Armen Nurbekyan, struck a softer note, arguing that some domestic and external demand pressures still persist, driving a slightly positive, though closing output gap. Turning to the labor market, many Board members, chief among them Martin Galstyan, Hovhannes Khachatryan, Hasmik Ghahramanyan, Artak Manukyan, Davit Nahapetyan, and Levon Sahakyan, noted that growth in labor supply coming from a number of sources could ease some of the inflationary pressures from the labor market and generate a slowdown in wage growth.

Summarizing their views, the Board agreed that the greatest policy imperative lies in accurately assessing which types of risks are most relevant and dangerous in terms of their scale and impact on the economy. One group of Board members (Martin Galstyan, Armen Nurbekyan, and Hasmik Ghahramanyan) placed greater emphasis on uncertainty regarding inflation expectations and the potential for a reappraised country risk premium; in this context, they argued against overemphasizing downside risks and believed the policy stance should continue to remain slightly restrictive and policy easing to follow a more conservative path Given his concerns about growing uncertainty about the neutral rate both globally and domestically; inflation expectations; and the country risk premium, Armen Nurbekyan argued that a strategically conservative approach would be most prudent. Hasmik Ghahramanyan argued that, from a least regrets perspective, the risks appear to be balanced from both a Case A and Case B perspective, but the greater potential impact of Case A-type risks, as well as concerns about the risk premium, necessitate a conservative approach. Martin Galstyan, meanwhile, took a similarly cautious stance, arguing that the output gap remained slightly positive, and that recent deflation was driven primarily by supply-side factors, putting to rest any dark corner risks of a demand or deflationary spiral. On the other hand, another group of Board members, including Hovhannes Khachatryan, Davit Nahapetyan, Artak Manukyan, Levon Sahakyan, and Narek Ghazaryan, placed greater emphasis on downside risks, arguing that a more aggressive loosening of the policy stance at this stage may be more appropriate. Hovhannes Khachatryan in particular argued that the output gap was already in negative territory, and that domestic demand conditions were not nearly robust enough to offset waning external demand, while sectoral risks in construction and information technology gave him cause for concern. Davit Nahapetyan, in prioritizing Case B-type issues, noted that the factors that previously drove growth and economic activity in the past two years were no longer as relevant, and the persistence of negative inflation should not be underemphasized. Echoing the latter point, both Narek Ghazaryan and Levon Sahakyan argued that February inflation surprised on the downside, putting to rest any lingering concerns about broad-based, underlying inflationary pressures in the domestic economy necessitating a quicker adjustment of still tighter policy stance. While also touching upon these points, Artak Manukyan made the case that non-traded sticky price inflation has largely adjusted to reflect the absence of generalized excess demand pressures and no longer pose a serious risk.

Policy Decision

In summary, balancing the aforementioned risks in both directions, the Board of the Central Bank of Armenia finds it appropriate to continue to gradually ease the policy stance. The Board will continue to monitor risk scenarios, and stands ready to take adequate actions to ensure that the price stability objective of 4 percent inflation over the medium-term horizon is met.

Central Bank
of Armenia

Transparency Report | **2024 Q1**