

THE CENTRAL BANK
OF THE
REPUBLIC OF ARMENIA

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Inflation Report

Monetary Policy Program, Q2, 2015



*Status Report on Implementation
of the Monetary Policy Program
Q1, 2015*

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Since January 2006, the Central Bank of Armenia has moved to a fully-fledged inflation targeting strategy, which highlights the importance of communicating of the Bank to the general public by publishing, inter alia, quarterly inflation reports. First section of the inflation report includes next quarter's monetary policy program that provides new forecasts of inflation and other macroeconomic indicators and main directions of the monetary policy in the forecast horizon. Second section includes status report on implementation of the monetary policy program of the previous quarter, which covers actual economic and monetary developments.

Publishing of inflation forecast and assumptions underlying it makes the monetary policy of the Bank more transparent, understandable and predictable, which considerably increases the public confidence in the Bank. The Bank believes that a clear and trusted monetary policy positively affects the anchoring of inflation expectations and maintaining financial stability in terms of cost reduction.

Starting from the second quarter of 2012, the Bank has been publishing forecasts of non-conditional inflation in a 3-year time horizon, in implementation of the inflation targeting strategy, whereby the monetary policy is steered to minimize any deviations of potential inflation from a 4 % target. Projections in this report are based on the factual information available by May 12, 2015, i.e. the day of setting of the refinancing rate, the results of a survey conducted by the Bank and the judgment made pursuant to the information on future macroeconomic developments.

All inflation reports which have been published to date are available on the Bank's website which also contains monetary policy-related publications.

1. EXECUTIVE SUMMARY

The Central Bank predicts that in the course of 2015 the 12-month inflation rate will be in the upper bound of the confidence band of 4%±1.5 pp; starting 2016, it will be going to stabilize around the target.

Economic growth for 2015 is forecast to be higher in comparison with the previous projection, which is determined by positive developments in economic activity in the first quarter. In 2016, economic growth rates will persist at the same level but then will speed up, gradually approaching the long-term equilibrium.

In the 1st quarter of 2015, economic growth will be in the range of 2.1%-2.5%.

The economic growth for 2015 has been revised upside relative to the former forecast to be in the range of 1.6%-2.6%.

According to the Central Bank forecasts, in the course of 2015 the 12-month inflation rate will be in the upper bound of the confidence band of 4%±1.5 pp; starting from 2016, it will stabilize around the target. Economic growth for 2015 is forecast to be higher relative to the previous projection, which is determined by positive developments in economic activity in the first quarter. In 2016, economic growth rates will remain the same but will speed up later, gradually approaching the long-term equilibrium.

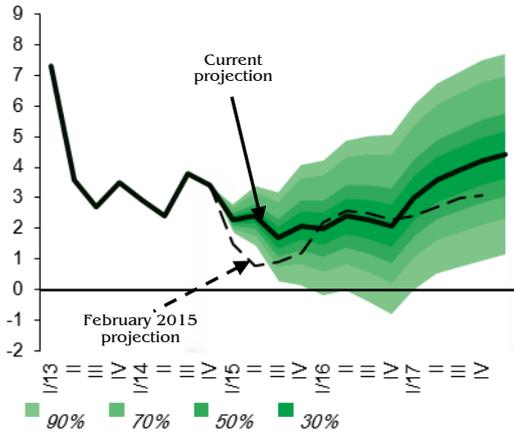
In the 1st quarter of 2015, the domestic demand grew somewhat relative to the projection attributable to lesser declined *private consumption*. However, *investment activity* has been consistent with an expected low level mainly due to weaker construction sector activity and slower growth rate in credit to enterprises. It is estimated that in the 1st quarter of 2015, compared to the same reference period last year, private consumption spending will decrease by 1.3% and private investment, by 7.4%. Lagged effect from implemented expansionary fiscal and monetary policies and expansionary impact of the fiscal policy implemented in 1st quarter of 2015 somehow offset the negative impact of these factors on the aggregate demand. Some growth in economic activity in terms of supply this quarter was due to higher-than-expected growth in agricultural output and lesser decline in construction. As a result, *the 1st quarter economic growth is estimated in the range of 2.1%-2.5%.*

In 2015, both private consumption and private investment will reduce by 2.5% and 8.0%, respectively, *according to the Central Bank forecasts*. The fiscal impulse (calculated in relation to the previous year) is estimated to be 2.0-2.5 expansionary during the year. Given that the information on the 1st quarter 2015 foreign trade indicators is not complete, forecasts of real growth of export and import of goods and services for 2015 remained unrevised. This means that the real growth of export of goods and services is expected within 7.0%-9.0% while the decline in import of goods and services in real terms in the range of 4.0%-6.0%. Moreover, about 25% net reduction in remittances of individuals in dollar terms is anticipated. This is, however, some improvement in relation to the former forecast, as the Russian ruble started appreciating at higher rates than expected.

As a result, *the 2015 economic growth has been revised upside relative to the former forecast to be in the range of 1.6%-2.6%*, which will be driven by further maintaining financial stability, loosening monetary conditions in the 1st quarter, more stimulating fiscal policy implementation and positive developments in agriculture.

In the forecast horizon, the 2016 economic growth rates will persist at the same level. Then the economic growth will speed up, owing to a bunch of programs the Government plans to carry out in the tradable sector and reflecting continued improvement in external economic environment, and approach its long-term

Real GDP cumulative growth projection probability distribution a for 3-year horizon



At the end of March, the 12-month inflation rate was 5.8%.

In the 1st quarter of 2015, the Central Bank loosened monetary conditions notably by gradually lowering the Lombard Repo Facility Rate from 20% to 12%.

In view of possible rise in electricity price in the upcoming period, the prediction is that the 12-month inflation rate would remain in the upper bound of the confidence band

equilibrium. In view of long-term economic growth equilibriums declining¹ amid growing uncertainties about further economic development in Armenia’s main trade partners and slowing foreign capital investment as well as still sluggish domestic economic activity, the *Armenian long-term economic growth equilibrium has been revised downside, ranging 4%-5%*.

Thus, *in the forecast horizon*, with stabilizing private demand and mostly a neutral impact of the fiscal policy, the *impact of the aggregate demand on domestic prices will be neutral*.

Economic activity in *Armenia’s main trade partners* further demonstrated slow-growth patterns over the 1st quarter of 2015, in which case the *external demand* remains at a low level. *International commodities and food product markets* continue observing deflationary developments, mainly driven by appreciating U.S. dollar as well as expectations of high crops.

In the forecast horizon, amid gradually accelerating global economy and rebounding growth in Armenia’s main trade partners, a steady price rise in international commodities and food products markets as well as relative stabilization of exchange rates and expectations of further appreciation will transmit positive effects onto the Armenian economy. Under these conditions, however, *significant inflationary pressures from the external sector are not likely*.

In the 1st quarter of 2015, *the 12-month inflation rate* behaved cumulatively, as was expected. As a result, at the end of March *the 12-month inflation rate was 5.8%*, staying closer to the upper bound of the confidence band.

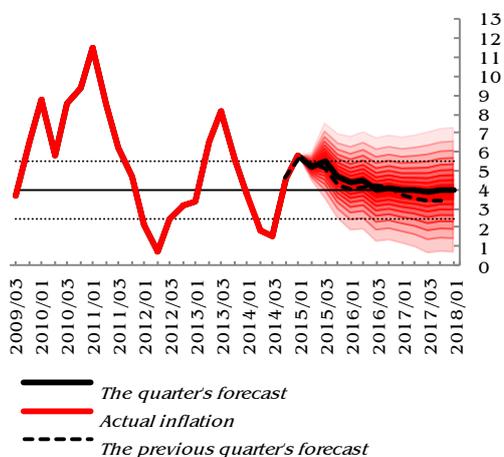
Despite high 12-month inflation rate, decisive actions of the Central Bank taken on in late 2014 helped to get inflationary expectations anchored as soon as the 1st quarter of 2015, which in turn contributed to the elimination of tension in the domestic financial and commodity markets. This prompted the Central Bank to *ease monetary conditions notably during the 1st quarter of 2015* by gradually lowering the *Lombard Repo Facility Rate from 20% to 12%*. However, in order to maintain Armenia’s monetary position in a long-term perspective amid investment risks and growing interest rate trends in developing countries, the Central Bank raised the Refinancing Rate to 10.5% in the 1st quarter of 2015. These actions helped the Lombard Repo Facility Rate to again uphold an accepted 1.5 percentage point spread from the Refinancing Rate and pushed short-term market rates down. *A zero or weak mechanism of reserve requirement for long-term funds attracted by banks became effective and some other macro-prudential measures* were taken on in the 1st quarter (see details in section “3.1.1 Actual inflation and fulfillment of the inflation target”).

In conclusion, the 1st quarter of 2015 saw generally an easing of monetary conditions.

In consideration of possible rise in electricity price in the upcoming period, the prediction is that the 12-month inflation rate would remain in the upper bound of the confidence band but would then reduce gradually fuelled by a greater seasonal drop in food prices owing to positive developments in agriculture as well as expected weak demand in both external and domestic sectors.

¹ See details in section 2.1 “External environment”.

Inflation (12-month) forecast probability distribution chart for a 3-year horizon



The Central Bank estimates that keeping the Refinancing Rate's current level in the 2nd quarter of 2015 would facilitate the 12-month inflation to stabilize, since 2016, around the target. Later, as economic developments unfold, the Central Bank will adjust its monetary policy directions, while fulfilling the inflation target in the medium-term perspective.

*Risks to inflation deviating from the projected value are estimated as **balanced** in both short and medium-term perspectives. **External sector risks** are primarily associated with global economic growth rates bouncing back as well as price developments in world commodity and food product markets. **Risks deriving from the domestic environment** are attributable to the pace at which the domestic demand would recover, the Government-led projects, economic effects from regional integration processes as well as the developments in agriculture sector which is largely reliant on weather conditions. At the same time, the lack of information about the size and timing of possible increase in electricity tariffs adds to the uncertainties over inflation developments. If such risks materialize, the Central Bank will react accordingly by maintaining the inflation target in the medium run.*

2. FORECAST, FORECAST CHANGES, RISKS

2.1. External environment²

In 2015, the global economy and main trade partners' economies will further see slow growth rates. This will be noticeable mostly in developing countries.

In the external sector, deflationary patterns will persist in the short run while weak inflationary trends will be observable in the forecast medium run horizon, as the global demand grows gradually.

In 2015, the global economy and economies in Armenia's main trade partner countries will further see slow growth rates. This will be noticeable mostly in developing countries, whereas some economic activity is anticipated on developed countries.

In the external sector, deflationary patterns will be persisting in the short run due to slower global economic growth, whereas weak inflationary trends will be observable in the forecast medium run horizon, as the global demand grows gradually.

In its *Global Economic Outlook* report, released in April 2015, the IMF revised long-term sustainable economic growth rates downside for both developed and developing countries due to the problem of aging of population and slower pace of capital growth. Based on the results of the analysis in the report, estimations of long-term sustainable economic growth in the U.S.A. and EU were lowered by about 0.5 percentage point.

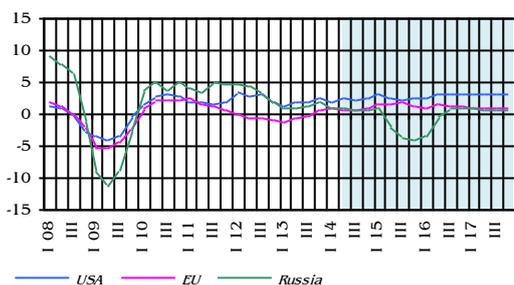
In early 2015, the **U.S.** economic growth slowed down. It is estimated at nearly 2.6%, which is predicted to accelerate in the forecast horizon to about 3.2% in 2017. Notwithstanding the inflation that was declining later the previous year, the U.S. Federal Reserve System is expected to raise the policy rates starting from the middle of 2015 as the economic activity and demand rebound.

In the **Eurozone**, the growth in 2015 is expected to somewhat accelerate after a slowdown in economic activity in 2014. A significant decline in oil prices, exchange rate depreciation and the European Central Bank's extensive asset purchase program will certainly contribute positively to the acceleration of economic growth. The latter will make up 1.5% in 2015 and stabilize around it in the forecast horizon. In the face of increasingly deflationary environment, the ECB will continue its low-interest-rates policy up until mid-2016. In the meanwhile, the asset purchases programs will continue by September 2016, resulting in a more expansionary monetary policy with the aim to handle inflation.

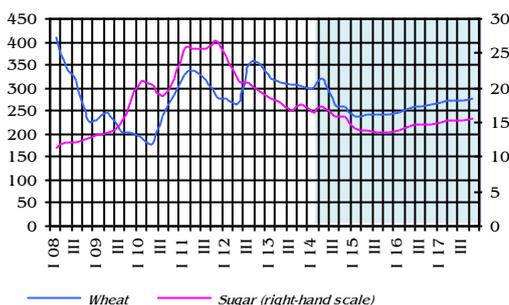
In **Russia**, substantially volatile patterns in economy observed in late 2014 and early 2015 make it to expect economic slowdown in 2015 by roughly 2.2% (later the year, the economic decline is predicted to even deepen to 4%). Recession in the economy will continue up until mid-2016, and some positive growth of about 0.7% will only be observable in the end of the forecast horizon. It is expected that the effects of reduced oil

² The forecasts of external sector were based on the information provided from international reputable analytical, research, ratings organizations and financial institutions as well as various news agencies worldwide (including the IMF, World Bank, The Economist, Economist Intelligence Unit, Global Insight, Financial Times, and so on).

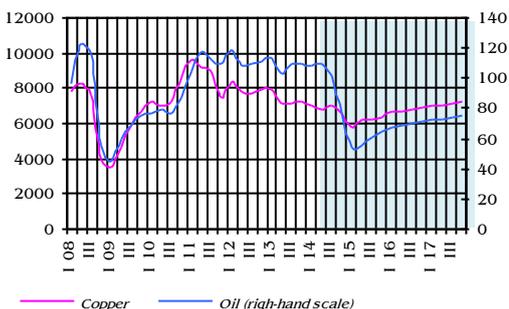
Economic growth in main trade partners (%)



Food products (USD)



Basic commodities (USD)



prices and economic sanctions, already visible in late 2014, would be even more pronounced this year and over 2016. With an anticipated decrease in demand during 2015, import substitution will however factor favorably into the economic growth, and this will somewhat alleviate the shock resulting from deteriorated terms of foreign trade. At the same time, exchange rate depreciation and trade restrictions will positively affect the output growth in some manufacturing areas, the improvement of the country's external position suffered from plunging oil prices, the economic growth recovery and the retaining of the rate of employment. High 12-month inflation rate, fuelled by steep depreciation of the ruble, will be persisting throughout 2015, which is predicted to reach 12% later the year. In the forecast horizon however, the exchange rate is predicted to somehow stabilize as oil prices are expected to grow and capital flows to rebound.

In addition, the IMF April 2015 report predicted a 3.5% growth of global economy for 2015 and 3.8% growth for 2016 (which is almost unchanged in comparison with the previous, i.e. the January, release of the report).

Relative to the previous year, the expected prospects for developed economies have improved, whereas economic growth in developing countries is expected to slow down.

With the global economy growing at a slow rate, deflation in **world commodity and food product** markets will continue up until mid-2015, yet some signs of recovery are anticipated in the forecast horizon as production and supply reduce to a certain extent driven by lower prices and the global demand rebounds slowly. In the meantime, individual commodity markets are predicted to develop under the influence of fundamental factors inherent in any such markets. Specifically, risks associated with energy price developments will be determined by geopolitical events, whereas prices of food products will depend on weather conditions.

Risks to the further pace of the global economy remain essential yet they have become more balanced relative to former prediction. Thus, the international prices of raw materials and food products staying at a low level will provide positive effects in terms of global demand. Risks to economic developments in Russia mostly relate to further and lasting recession associated with risks to even stricter economic sanctions and more capital outflow.

Downside risks to economic growth in the Eurozone are still noteworthy, which is due to a slowing pace of structural reforms and geopolitical developments in member states.

As the global economy rebounds and economic growth in Armenia's main trade partners gradually accelerates in the medium run, a steady price rise in international commodities and food products markets as well as trends of some appreciation and relative stabilization of exchange rates will transmit positive effects on to the Armenian economy.

**Developments in commodities markets in
the forecast horizon**

The OPEC April 2015 report of the oil market predicts that the global oil demand will grow in 2015 by 1.17 million b/d and consumption will reach 92.45 million b/d. In 2015, oil production outside OPEC is predicted to grow by 0.68 million b/d compared to the growth of 0.18 million b/d last year, while oil production by OPEC will grow by 0.19 million b/d against the growth of 0.18 million b/d the year before. Though oil prices are expected to remain low in the short run and capital investment in the oil industry is starting to slacken, the inflation environment will incur these effects only in the medium term perspective. At the same time, there were further uncertainties in oil product markets associated with oil producers' decisions about extraction volumes as well as geopolitical developments.

In base metals markets, prices are expected to grow unhurriedly amidst slowing of potential economic growth in China and a slow pace of global economic growth.

According to April estimates of the U.S. Department of Agriculture, in the 2014/2015 marketing year some 726.5 million tons of wheat crops is expected (the volume of crop has increased by about 9.7 million tons in comparison with the previous year). The wheat stock will amount to 199 million tons in 2015, which will represent roughly 11.0% (20.0 million tons) increase in relation to 2014. Positive developments with wheat production will be observed in all producer regions. In the short-term perspective, wheat prices will trend down due to a lag in demand in expectation of increased production volumes and deflationary patterns.

In the 2014/2015 marketing year, world production of rice will reach 474.6 million tons (about 2.28 million tons less compared to the previous year). According to the Food and Agriculture Organization data, the world rice stock will amount to 176 million tons in 2015, with a y/y decrease of 0.8%. Despite an expected reduction in rice production, the slowing of demand in the short run will result in the falling of the rice price.

Brazil, a leading sugar producer and exporter, expects high cane crops in 2015, which will lead to a short-term decrease in international sugar prices. The Brazilian real depreciating against the U.S. dollar will in turn contribute to the deflationary environment.

2.2. Aggregate supply and Aggregate demand

Aggregate supply

Economic growth forecasts for 2015 were revised slightly upside, driven mainly by loosened monetary conditions in the 1st quarter, more stimulating fiscal policy implementation and positive developments in agriculture. As a result, economic growth in 2015 is anticipated **in the range of 1.6%-2.6%**³. It should be noted however that slow global economic growth rates are maintained, Armenia's domestic demand is still sluggish and international ore and mineral prices persist at their low levels.

The 2015 economic growth is anticipated in the range of 1.6%-2.6%.

³ See the 30% range in the Real GDP Growth (Cumulative) Projection Probability Distribution Chart.

Starting from 2017, the economic growth is predicted to accelerate to be in a 3.5%-5% range in the end of the forecast horizon, which would be driven largely by the tradable sector.

Effective implementation of export- and investment-oriented program of the Government, improving external economic environment and structural reforms are among the key factors that will speed up the economic growth starting from 2017, amid a steady inflation environment. Based on the above mentioned developments, it is expected that ***economic growth would speed up to be within 3.5%-5% in the end of the forecast horizon***, which would be driven greatly by the tradable sector.

Given reduced long-term economic growth equilibriums⁴ amid growing uncertainties associated with economic developments in Armenia's main trade partners, anticipated slowing of foreign capital investment, and weak investment activity persisting in the domestic economy, ***Armenia's long-term economic growth equilibrium has been revised downside to 4%-5%***.

For ***Industry***, the 2015 forecasts of value added were revised slightly upside, with food processing growth rate adjusted as a result of positive developments in agriculture. Thus, in 2015 value added in industry is expected to grow in the range of 1.5%-2.5%. Exploiting Teghout mine and exploring new export markets will significantly contribute to the expected moderate growth in 2015.

In the ***forecast horizon***, the industry growth will speed up and ***stabilize within 3.5%-4.5%***. This will be underpinned by implementing a handful of investment projects and broadening export capacities as the Government carries out an export-oriented policy.

For ***Construction***, the forecasts of value added were also revised upside, mainly based on somewhat higher activity in the 1st quarter relative to the prediction. Anticipated shrinking in volumes of household funded construction will somehow be mitigated by construction activities for roads, irrigation, water supply and sewage systems, renewable energy and Yerevan underground modernization, which are planned to be carried out using funds of the central and local community budgets and of international organizations. As a result, value added is expected to decrease in 2015 in the range of 0.5%-1.5%.

In the ***forecast horizon***, the growth is expected to ***stabilize within 0%-2%*** as the supply and demand imbalance in construction phases out. The growth will be driven mainly by large construction projects designed for infrastructure improvement.

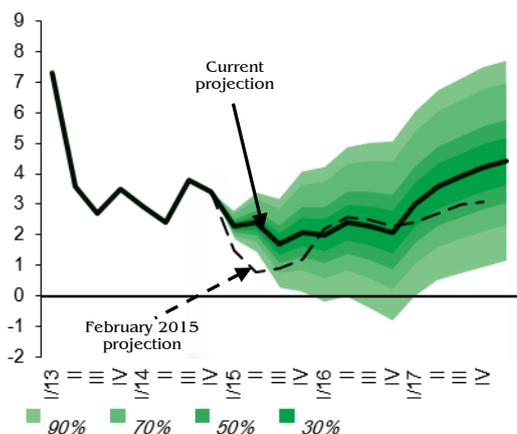
For ***Services***, the forecasts of value added were revised slightly downside, mostly due to factual negative developments in trade. As a result, real growth of value added in services in 2015 is predicted in the range of 0.6%-1.6%. Note that expected growth of the tourism industry could substantially contribute to an anticipated moderate growth during the year.

In the ***forecast horizon***, growth rates in services are expected to accelerate and ***stabilize within 4%-5%*** as the domestic demand recovers steadily and travel services grow.

For ***Agriculture***, the forecasts of value added were revised upside, primarily due to factual positive developments in the sector in the 1st quarter on the one hand and favorable weather on the other. As a result, the real growth of value added in the sector in 2015 is predicted in the range of 6.5%-7.5%.

⁴ See details in section 2.1 "External environment".

Real GDP cumulative growth projection probability distribution a for 3-year horizon



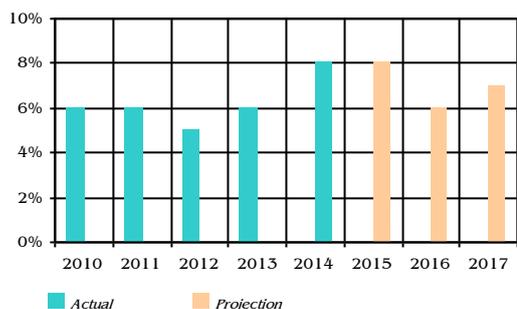
In the *forecast horizon, the growth in agriculture will stabilize within 5%-6%*. Relatively high growth rates in the medium run will be possible to maintain due to more house farming facilities, arable land, crops and cattle as a result of consistent complex measures which the Government has taken on lately.

In the forecast horizon, risks to the economic growth are dual sided and come in mostly balanced. In particular, they depend on how the global economy would develop further and what economic effects could be expectable from integration processes in the region, on the one hand, and on how investment activity in the tradable sector of the domestic economy would unfold, on the other.

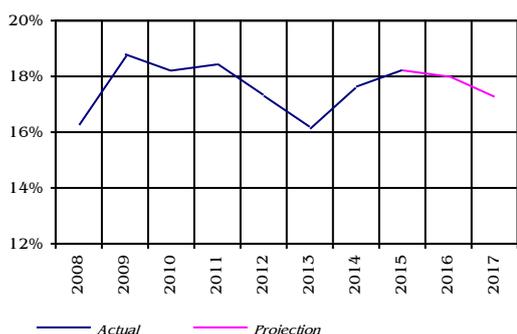
Real GDP Growth (Cumulative) Projection Probability Distribution				
Period	50% probability interval		90% probability interval	
	Min	Max	Min	Max
January-December 2015 / January-December 2014	1.6%	2.6%	-0.1%	4.1%
January-December 2016 / January-December 2015	1.4%	2.8%	-0.9%	5.1%
January-December 2017 / January-December 2016	3.4%	5%	-0.9%	7.5%

Average nominal wage is expected to grow by 8.3% in 2015, by 6.1% in 2016 and by about 6.5% in 2017.

Average nominal wage growth, y/y



Unemployment rate



Labor market:⁵ Forecasts of labor market indicators for 2015-2017 have improved relative to the previous forecasts, reflecting the adjustment in economic growth forecasts. Specifically, in the forecast horizon average wage is expected to have higher growth rates and the unemployment rate to be lower. Thus, average nominal wage is expected to **grow by 8.3% in 2015, by 6.1% in 2016 and by about 6.5% in 2017.**

On the back of wage increases in the public sector since July of 2014, average wage growth rates are expected to remain strong over the first half of 2015, making up 10.4%. The effect, however, will wane out in the second half of the year. Note that starting from the mid-2015, the minimum wage threshold will rise to AMD 55,000. As a result, the predicted average wage growth for 2015 is nearly 8.3%.

With an expected economic growth, stabilizing inflation rate and the Government policy further steered to minimum wage increases, the average nominal wage is predicted to grow by 6.0%-6.5% annually in the period 2016-2017.

The nominal wage increase of 8.1% in 2014 is higher than the average wage growth reported in recent years. The wage increase during the year was attributable to the minimum wage threshold increased up to AMD 50,000, the increase in wages in some undertakings in the private sector in the context of the funded pension reform and wage increases in the public sector during the second half of the year.

The wage growth expected in 2015 is consistent with the productivity growth projected for the year. **Thus, one may conclude that pressures from the labor market on the inflation are estimated neutral in the forecast horizon.**

⁵ The labor market data for the 1st quarter of 2015 are the Central Bank estimates which are based on the 4th quarter of 2014 data and actual January-February 2015 figures. The growth indicators presented in this sub-section are relative to the same reference period last year, unless otherwise specified.

The unemployment forecasts were revised somewhat downside relative to former forecasts. In 2015, the average unemployment rate is expected to amount to 18.2%. In anticipation of faster economic growth, a trend of steadily subduing unemployment rate will be observable in 2016-2017. In the forecast horizon however the unemployment rate will be above its equilibrium, reflecting a small negative GDP gap and minor deflationary pressures it will generate in the meantime.

Aggregate demand⁶

Driven by an anticipated decline in remittances from Russia, a main trading partner, and weak investment activity in the domestic economy, the private sector spending in Armenia is likely to reduce by 3.5% in 2015. However, anticipated slackening of private spending will diminish in 2015 relative to previous forecasts, which will be determined by an expansionary fiscal policy to be implemented this year.

A tight monetary policy in late 2014, carried out to maintain price and financial stability, was geared up for considerable easing of monetary conditions since the start of 2015. This will enable to mitigate the expected decline of the level of private spending in 2015.

In the period 2016-2017, the private spending will bounce back, growing at a moderate rate. The negative impact of private spending on economic growth during this period will alleviate owing to persisting effect from expansionary fiscal policy to be implemented in 2015 and a positive contribution from net exports.

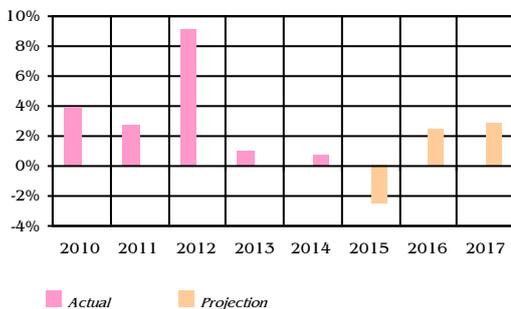
Although such a development with private spending will somewhat negatively affect the economic growth, it will however contribute to the long-term equilibrium and stability of the economy in future.

Estimates suggest that final consumption expenditures of households will reduce in 2015 by 2.5% in real terms resulting from considerable reduction in remittances from Russia and anticipated slowing of growth rates of credit to the economy. Note, however, that the shrinkage of private transfers is estimated to be smaller compared to former forecasts, which is attributable to higher economic activity to be seen in 2015, fiscal and monetary stimuli as well as much slower pace of decline in remittances.

The above factors, as well as current and expected sluggishness in investment activity will lead to almost 8% reduction in private investment in 2015, which is significantly lower compared to the previous forecasts. Expected decline in private investment in 2015 will be determined by reduced investment in companies engaged in construction and other non-tradable sectors of the economy, which will outweigh the investments in the tradable sector. The expected growth of investments in the tradable sector is due to increased profitability there as a result of the dram exchange rate depreciation in late 2014.

In 2015, final consumption expenditures by households will reduce by 2.5% and private investment, by 8%, in real terms.

Private consumption growth, y/y



⁶ The data of real growth of private consumption and investments for 2015-2017 are the Central Bank estimates. These actual figures are as of the 4th quarter 2014 published by the Republic of Armenia National Statistics Service. The real growth indicators represented in this sub-section are relative to the same reference period last year, unless otherwise specified.

In 2016-2017, private consumption is expected to grow by 2%-3% and private investment, by 3%-4%.

Private investment growth, y/y



The 2015 expansionary fiscal policy, considerable easing of monetary conditions in the forecast horizon, as well as improving external economic environment and Russia’s economic recovery, in particular, will cushion the decline in private consumption and investment in 2015 and even stimulate their growth in 2016-2017. As a result, the private consumption is expected to grow in 2016 and 2017 by 2.0%-2.5% and 2.5%-3%, respectively.

The private investment in 2016-2017 is expected to post a 3%-4% growth. There will be more investments owing to the ones expected in the tradable sectors of the economy, for which recent depreciation of the dram exchange rate and continued structural changes in the economy will be an important incentive. On the back of these developments, investment activity in the non-tradable sector is expected to recover in 2016-2017, although rather slowly than in the tradable sector.

In the forecast horizon, Armenia as a Eurasia Economic Community member will benefit from more private investment flowing into its economy as a result of implementation of a variety of projects to be carried out with EEC member countries and a free access to the EEC markets.

In view of the aforementioned developments with private consumption and investment, in 2015 the private sector expenditures will reduce by 3.5%. Starting from 2016, private spending will gradually recover and in the end of the forecast horizon will increase by 2.5%-3.0%. As a result, the private spending gap for the period 2015-2016 is estimated to be still negative, although the level of private spending is estimated to be higher in relation to former forecasts.

The expansionary fiscal policy to be implemented in the domestic economy, gradual easing of monetary policy, as well as acceleration of economic growth in Armenia’s main trading partners will gradually reduce the negative private spending gap and help these imbalances phase out in the end of the forecast horizon.

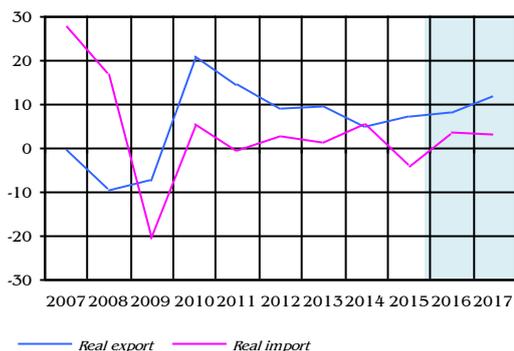
From the 1st quarter 2015 to the 2nd quarter 2016, the ***private spending will create some 2.0 pp - 2.3 pp of contractionary impact on the inflation***. In the period from the second half of 2016 up to the end of 2017, the private spending will leave no considerable impact on the inflation.

Current account

The information on foreign trade developments during the 1st quarter of 2015 is not complete due to shortage in compiling of trade indicators, which is why the export and import growth forecasts were left unrevised. Thus, according to the previous forecast, the real export growth of goods and services in 2015 will be in the range of 7.0%-9.0%, while the real decline in import of goods and services in the range of 4.0%-6.0%. On the part of trade of goods, revisions only relate to dollar values, which, according to the Central Bank, is attributable to improved terms of trade (estimations suggest that in 2015 average export prices will decline at a slower pace than average import prices).

In 2015, there will be somewhat a lower decline in remittances of individuals compared with the previous forecast, which is attributable to the Russian ruble with its higher-than expected rate of appreciation. As a result, the dollar value of

Real export and real import (goods and services), y/y, %



In 2015, the fiscal impulse is forecast to be 2-2.5 expansionary.

remittances of individuals is projected to reduce by about 25.0% against the previous decline of 30.0%.

On the back of these revisions, the Current Account Deficit-to-GDP ratio, which was 8.0% in 2014, will drop to stay within 6.0%-7.0% in 2015. It is noteworthy that the current account will improve mostly owing to the improvement of the balance of trade, in spite of negative developments with private transfers.

The current account position will continue improving in the medium-term perspective, and the Current Account Deficit-to-GDP ratio will reach a 5.0%-6.0% range.

The **fiscal policy's impact** on the aggregate demand for 2015 was assessed using the adjusted indicators of the Republic of Armenia Law on State Budget 2015. According to the assessment, the Tax-to-GDP ratio is expected to stay unchanged but the Expenditure-to-GDP ratio⁷ to somehow increase in relation to the preliminary indicators of 2014, with projected increase of expenditures owing to current expenses. As a result, the Deficit-to-GDP ratio in 2015 will be greater than 2.3% as provided for by the law.

In 2015, relative to 2014, the budget revenues are projected to leave a neutral impact and budget expenditures an expansionary impact on the aggregate demand. Meanwhile, expansionary effects are anticipated during all quarters of the year, and based on annual results the expansionary impact will amount to 2-2.5. It is worth mentioning that domestic economic developments will be largely determined by how the state budget will be performed.

The **projections of the fiscal policy in the forecast horizon** are based on underlying macroeconomic indicators in the Republic of Armenia Medium-Term Public Expenditures Program for 2016-2018. **In the medium run** the fiscal policy is steered to reduce the budget deficit. The fiscal policy's impact is estimated to be contractionary in 2016, neutral in 2017-2018, and generally **non-inflationary in the medium run**.

Medium-term fiscal policy impact assessment					
% in GDP	2014 ⁸	2015	2016	2017	2018
Budget revenues	24.3	24.2	24.6	25.0	24.9
Budget expenditures	26.4	27.9	27.4	27.3	26.8
Debt interest payment	1.4	1.5	1.9	1.9	1.9
Budget balance	-2.1	-3.7	-2.8	-2.3	-1.9
Primary balance*	-0.7	-2.2	-0.9	-0.4	-0.0
One-off flows**	-0.6	0.3	-0.7	-0.6	-0.5
Adjusted balance***	-0.1	-2.5	-0.2	0.2	0.4
Cyclical balance****	0.2	-0.2	-0.6	-0.2	-0.1
Cyclically adjusted primary balance (structural balance sheet)	-0.3	-2.3	0.4	0.4	0.5
Fiscal stance*****	0.7	2.0	-2.6	0.0	-0.1

* Budget balance less debt interest payments.
** Temporary or one-off budget entries. In this case net credit is considered; the sign "+-" means resources allocated and the sign "-+" means resources repaid.
*** Primary balance sheet adjusted by temporary or one-off entries.
**** Central Bank estimate: a part of the budget balance which depends directly on the business cycles. The latter's components depend on the GDP gap and revenues and expenditures elasticity coefficients on GDP gap.
***** Central Bank estimate: y/y change in the structural budget balance that reflects a discretionary nature of the fiscal policy (the positive sign denotes fiscal expansion and the negative sign denotes fiscal contraction).

⁷ The 2015 GDP is the estimation of the Central Bank.

⁸ The 2014 state budget indicators presented exclude records of off-budgetary funds.

To sum-up, from the 1st quarter of 2015 up to the 1st quarter of 2016 the combined impact of the fiscal policy, private demand and labor market on domestic prices will be deflationary, in the range of 0.4-0.5 pp, which will be determined primarily by deflationary impact of private spending. Also, given the 0.2-0.3 percentage point deflationary impact of net external demand, one may conclude that overall aggregate demand and labor market developments in the above-mentioned period will create an average 0.6-0.8 percentage point deflationary pressures in the consumer market.

Starting from the second half of 2016 up until the end of the forecast horizon, the impact of overall aggregate demand and labor market on the inflation is estimated to be neutral.

2.3. Inflation forecasts and monetary policy directions in 3-year forecast horizon

In the 1st quarter of 2015, global economic growth persisted at a slow pace while the world commodity and food product markets saw deflationary patterns.

In the 1st quarter of 2015, *global economic growth persisted at a slow pace*. This, coupled with increased supply factors and expectations in the commodity markets, as well as with the appreciation of the U.S. dollar, *has led to deflationary patterns in basic commodity and food product markets of the world*.

In the forecast horizon, *global economic growth will continue at a slow pace*, which will be observed mostly in developing countries, whereas developed countries will anticipate certain revival of economic activity. It is worth mentioning that in the time of geopolitical and domestic economic developments the Russian economic growth forecast has not changed significantly compared to the previous one. In particular, a 2.2% economic decline is expected in 2015, which will continue until mid-2016, gradually approaching the 0.7% level in the forecast horizon. In the meanwhile, external sector-driven uncertainties are still persisting although they have toned down. With the global economy growing slowly, *the external environment will remain deflationary in the short run but certain signs of recovery are expectable in the forecast horizon* due to some reduction in supply and gradual increase in global demand.

Economic growth had higher-than-expected growth rates in the 1st quarter of 2015 due to even more positive developments reported in agriculture and construction. The estimation is that the annual economic growth in the meantime will be *within 2.1%-2.5%*, with agriculture and services sectors remaining the main driving forces.

In the 1st quarter of 2015, economic growth rates were higher than expected; growth is estimated in the range of 2.1-2.5%.

At the time of significant economic slowdown in Russia when the ruble depreciated against the U.S. dollar, in the 1st quarter of 2015 *net inflow of private remittances and seasonal worker wages has reduced notably*, as was expected, resulting in a deep negative gap in remittances. The latter was concomitant with a decrease in private consumption expenditures during the quarter, which is however lower than estimated, owing to more stimulating fiscal policy as well as higher-than-predicted economic activity. In the 1st quarter of 2015, the investment climate was further weak due to persistently low activity in the construction industry.

Influenced by lagged effects from end-year exchange rate depreciation, the 12-month inflation rate somewhat expanded to approach the upper bound of the confidence band; in late March it was 5.8%

In the 1st quarter of 2015, the Central Bank loosened the monetary conditions remarkably by lowering the Lombard Repo Facility Rate from 20.0% to 12.0% as well as taking on some other macro-prudential measures.

The 2015 economic growth is forecast in the range of 1.6%-2.6%, with agriculture and services sectors to be the main drivers.

Economic growth will be in the range of 3.5%-5.0% at the end of the forecast horizon.

The above-mentioned factors pushed the domestic demand down in the 1st quarter of 2015, ***which contributed to shaping a negative GDP gap***. However, influenced by lagged effects from end-year exchange rate depreciation, ***the 12-month inflation rate somewhat accelerated***, as was expected (it approached the upper bound of the confidence band, ***amounting to 5.8% in late March***).

In the 1st quarter of 2015, the Central Bank loosened the monetary conditions remarkably after the situation in financial and commodity markets stabilized and inflation expectations diminished as a result of the Bank's action at the end of the year. Specifically, early in the year the Bank lowered the ***Lombard Repo Facility Rate from 20.0% to 12.0% and lifted the Refinancing Rate by 2.0 pp to 10.5%*** in response to investment risks and interest rate trends in developing countries in a long-term perspective. These actions helped the Lombard Repo Facility Rate to again uphold an accepted 1.5 percentage point spread from the Refinancing Rate and curtailed the spread between the policy rate and short-term market rates. ***Monetary conditions were loosened also in the context of other macro-prudential measures***. Specifically, ***a zero or weak mechanism of reserve requirement*** for long-term funds attracted by banks, made effective from the 1st quarter of 2015, somehow offset the effect of the reserve requirement mechanism that had been tightened at the end of the last year.

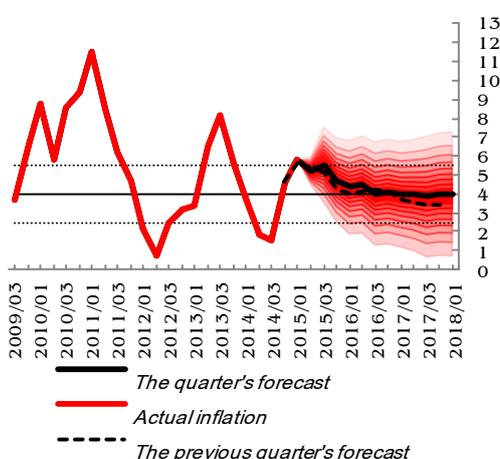
Regarding the Central Bank's macroeconomic forecasts, the 2015 economic growth forecasts have been revised somewhat upward in consideration of maintained financial stability, significantly loosened monetary policy conditions in the 1st quarter of 2015, fewer uncertainties in the external sector, a more-than-expected stimulating fiscal policy implementation and positive developments reported in agriculture. At the same time, in view of higher appreciation of the Russian ruble in comparison with the anticipation, the dollar value of private remittances is expected to decline at a slower rate. As a result, ***the 2015 economic growth is forecast in the range of 1.6%-2.6%***, with agriculture and services sectors to be the main drivers. Influenced by the aforementioned factors, the decline in private spending will be slower in 2015 while positive developments in construction will facilitate weak investment climate to decline lesser than anticipated.

In the forecast horizon, the 2016 economic growth rates will persist at the same level then will speed up, owing to a bunch of programs the Government programs to carry out in the tradable sector and continued improvement in external economic environment. The above developments will prompt the private spending to gradually rebound in the period 2016-2017. This, coupled with net export's positive contribution, will cause the negative GDP gap to shrink and finally phase out at the end of the forecast horizon. It is expected that ***the economic growth***, to be very much driven by the developments in the tradable sector, ***will be in the range of 3.5%-5.0% at the end of the forecast horizon***. Yet, economic growth projections in the forecast horizon will largely depend on the extent, course and efficiency of the Government's programs.

A possible increase in electricity price would keep the 12-month inflation rate around the upper bound of the confidence band over 2015.

The Central Bank estimates that keeping the Refinancing Rate at its current level in the 2nd quarter of 2015 would help the 12-month inflation rate stabilize, since 2016, around the target.

Inflation (12-month) forecast probability distribution chart for a 3-year horizon



As for inflation developments in 2015, a likely increase in electricity price would **keep the 12-month inflation rate around the upper bound of the confidence band**. Nevertheless, greater seasonal decline in food prices in anticipation of positive developments in agriculture as well as the expected weak demand in domestic and external economies might partly moderate the inflationary impact of the electricity price increase.

As a result, the Central Bank estimates that maintaining the Refinancing Rate at the current level in the 2nd quarter of 2015 would make it possible for the 12-month inflation rate to stabilize, since 2016, around the target. Later, as economic developments unfold, the Central Bank will adjust its monetary policy directions, while fulfilling the inflation target in the medium-term perspective.

Risks to inflation deviating from the projected value are estimated as **balanced** in both short and medium-term perspectives. **External sector risks** are primarily associated with global economic growth rates bouncing back as well as price developments in world commodity and food product markets. **Risks deriving from the domestic environment** are attributable to the pace at which the domestic demand would recover, the Government-led projects, economic effects from regional integration processes as well as the developments in agriculture sector which is largely reliant on weather conditions. At the same time, the lack of information about the size and timing of possible increase in electricity tariffs adds to the uncertainties with regard to inflation developments. If such risks materialize, the Central Bank will react accordingly by maintaining the inflation target in the medium run.

Period	Inflation forecast probability distribution chart				
	<1.0%	1.0-2.5%	2.5-5.5%	5.5-7.0%	>7.0%
Q2, 2015	0.0%	0.0%	8.0%	80.8%	11.2%
Q3	0.1%	2.4%	63.0%	30.8%	3.7%
Q4	1.1%	10.7%	73.2%	13.5%	1.6%
Q1, 2016	5.5%	21.9%	64.5%	7.3%	0.8%
Q2	4.1%	17.6%	65.6%	10.9%	1.8%
Q3	2.2%	11.2%	62.4%	18.8%	5.5%
Q4	3.9%	15.3%	62.8%	14.5%	3.5%
Q1, 2017	4.0%	15.2%	62.2%	14.8%	3.8%
Q2	5.0%	16.0%	59.8%	14.8%	4.4%
Q3	7.0%	17.1%	55.9%	14.6%	5.3%
Q4	8.0%	18.0%	55.0%	13.9%	5.0%
Q1, 2018	9.2%	18.9%	54.0%	13.1%	4.7%

In the **forecast horizon**, as the economic activity declines further, the forecasts of smaller demand for credit resources hence slower credit growth rates **will remain unchanged**. This will somewhat be compensated by various lending programs under a number of international financial institutions (World Bank, Asian Development Bank, KfW Bank, European Investment Bank) carried out through the Central Bank in cooperation with the Armenian Government, and by low-interest loan projects under a handful of social programs (Housing for Youth, the National Mortgage Company).

In a longer term, the Central Bank will look to the target level of the policy rate to adequately react to any shifts in liquidity to make sure money supply is consistent with demand.

3. ACTUAL DEVELOPMENTS IN Q1 2015

3.1. Inflation

3.1.1. Actual inflation and fulfillment of the inflation target

In the 1st quarter of 2015, inflation was 2.3%, with the 12-month inflation rate having amounted to 5.8%.

In the 1st quarter, the inflation environment expanded further



There was 2.3% inflation recorded in the 1st quarter of 2015, with the 12-month inflation rate having grown to a certain extent, as was expected, to 5.8%, i.e. closer to the upper bound of the confidence band of 4.0+/-1.5 pp. The quarter's inflation was mainly due to food and non-food price increases by 2.8% and 3.6%, respectively, with their total contribution of 2.1 pp to inflation. In particular, the increase in food prices was fuelled by seasonal increase in fruit, vegetable and potato prices, by 9.4% and 10.0% respectively (with their total contribution of 0.9 pp inflation). Also, there has been price inflation on bread products, meat products and pastry, making 0.4 pp of contribution to the inflation.

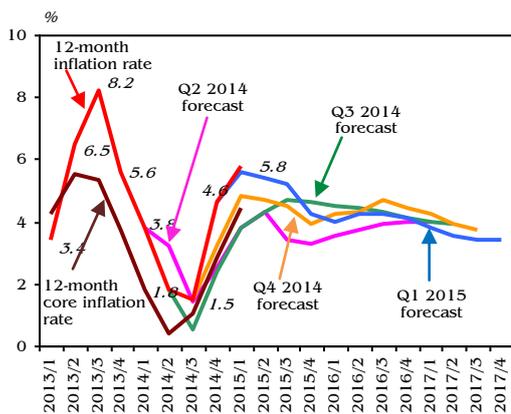
Non-food price inflation was driven primarily by increased prices of household appliances, footwear, clothing, knitwear and medicament, which was somewhat offset by 9.0% decline in gasoline and diesel prices. The growth of prices in rest and leisure (up by 17.9%) and medical services (up by 3.4%) also contributed to the quarter's inflation.

The 12-month inflation by commodity groups as most important contributors						
Commodity group	December 2014 (y/y)		March 2015 (y/y)		Q1 2015	
	Growth	Contribution	Growth	Contribution	Growth	Contribution
CPI	4.6		5.8		2.3	
Food products	6.3	3.4	6.8	3.3	2.8	1.4
Bread products	5.9	0.6	8.1	0.8	1.6	0.2
Dairy products	13.1	0.6	10.8	0.5	0.6	0.0
Meat products	3.3	0.3	7.6	0.7	1.3	0.1
Fruits	14.6	0.5	21.9	0.7	9.4	0.3
Vegetables and potato	7.9	0.5	-3.2	-0.2	10	0.6
Fats and oils	1.9	0.1	2.7	0.1	-3.4	-0.1
Egg	2.1	0.0	2.9	0.0	-0.5	0.0
Sugar	6.9	0.1	7.7	0.1	-0.02	0.0
Pastry	5.93	0.1	16.8	0.2	9.7	0.1
Non-food products	1.6	0.3	5.8	1.2	3.6	0.7
Services	3.0	0.9	3.7	1.1	0.8	0.2

In the 1st quarter of 2015, *core inflation was 1.1%*, with the 12-month rate having expanded by 1.6 pp to *4.4%* in late March.

In the previous year's short-term horizon, *in a time-span from the 2nd quarter of 2014 up to the 2nd quarter of 2015*, the Central Bank considered the inflation would further reduce to approach the lower bound of the confidence band in the 3rd quarter of 2014 as the impact of energy price increases had

The Central Bank forecasts that over the next two quarters the 12-month inflation rate will hover around the upper bound of the confidence band, then it will stabilize around the 4% target in the forecast horizon



phased out in July 2013. *In the 2nd quarter of 2014, the Central Bank was planning to continue easing the monetary conditions*, which, combined with the monetary policy carried out by that time and expansionary fiscal policy to be implemented during the year, had to lead to expanded aggregate demand and rebounded inflation rates, helping the inflation stabilize around its target in the forecast horizon.

Actual developments showed that over the 2nd and 3rd quarters of 2014 the 12-month inflation rate had declined faster than anticipated, reflecting weaker external and domestic demand. Based on the aforementioned, the Central Bank chose a down-trending path for the inflation for these quarters.

In the 2nd and 3rd quarters of 2014, there was 1.9% deflation against 0.3% inflation of the same reference period last year. Subdued gradually, the 12-month inflation rate reached 1.5% in late September 2014, stepping below the lower bound of the confidence band. The *12-month inflation further declined due to sluggish economic growth and a notable decrease in some food prices* amid a low level of investment and slowing private consumption growth rates. In the meantime though, the *12-month core inflation rate* had declined from 1.8% at the end of the 1st quarter to 1.0% at the end of the 3rd quarter of 2014.

Given persisting low inflation environment and in anticipation of non-inflationary pressures from the external and domestic sectors in the medium run, the Central Bank further loosened the monetary conditions: *in the period April-September 2014* the refinancing rate has reduced a total of 0.75 pp to 6.75% in late September.

The inflationary patterns varied dramatically in the 4th quarter of 2014 in the light of escalated geopolitical issues globally and, particularly, at the regional level. On the other hand, many developed and developing countries saw their currencies depreciating and inflation environment expanding further as the U.S. economic growth accelerated and the dollar strengthened. The effect of these events was observed in the domestic currency market in the first place, which reported a steep depreciation of the dram amidst notable reduction of foreign currency transfers from abroad and Russia, a main trade partner. This was immediately reflected on the commodity market, expanding the inflation environment and creating inflationary expectations. As a result, *the 12-month inflation rate, expected to amount to 3.2% late in the year, reached 4.6%, staying near to the confidence band.*

The Central Bank responded to the situation intensely: in late November the Bank raised the *Lombard Repo Facility Rate from 8.25 to 21.0%*, followed by a mid-December increase of the *Reserve Requirement Ratio for funds attracted in foreign currency from 12.0 to 24.0%*. The short-term dram market rates reacted to the Bank's tightening of financial conditions in the financial market by rising and staying around the Lombard Repo Facility Rate. This drove the *Lombard Repo Facility Rate to take the role of financial market's leading interest rate*. In the meantime, to moderate future inflationary pressures and have the inflationary expectations anchored around the target, in late December the Central Bank raised the Refinancing Rate by 1.75 pp.

Following these actions, the currency and product markets were able to see some signs of stabilization, which is why in late December the Central Bank lowered the **Reserve Requirement Ratio for funds attracted in foreign currency from 24.0 to 20.0% and the Lombard Repo Facility Rate from 21.0 to 20.0%.**

A strong response by the Central Bank later in 2014 secured anchoring of inflation expectations **in the 1st quarter of 2015**, which led to an easing of the tension in the domestic financial and commodity markets. In view of this development, the **Central Bank loosened the monetary conditions considerably in the 1st quarter of 2015 by gradually cutting the Lombard Repo Facility Rate from 20% to 12%.**

In the 1st quarter of 2015, the Central Bank lifted the Refinancing Rate to 10.5% with the aim to retain the monetary position of the Republic of Armenia over a longer run, reflecting upward trends of investment risk and interest rates in developing countries.

These actions helped the Lombard Repo Facility Rate to again uphold an accepted 1.5 percentage point spread from the Refinancing Rate and pushed short-term market rates down.

A zero or weak mechanism of reserve requirement, effective from the 1st quarter of 2015, means that the funds borrowed from international financial institutions as well as the 2-year and longer maturity funds borrowed through bonds issued by domestic banks will be subject to reservation at a zero or reduced rate. **Other macro-prudential measures** included mitigating the requirements to resident non-financial corporations and reducing risk weights ascribed to foreign currency loans to borrowers active in export businesses, if they have external credit rating.

It can be stated that the above measures taken on by the Central Bank were of expansionary nature in general.

The changes made will allow the effective rate of the reserve requirement to reduce in a short period of time while creating real incentives for banks to borrow long-term funds. This will expand lending opportunities in the framework of various programs of the World Bank, Asian Development Bank, KfW Bank, European Investment Bank, carried out through the Central Bank and the Armenian Government for a handful of social programs in the field of SME support, agriculture, renewable energy, housing, etc., thereby creating favorable conditions for a healthy growth of economic activity.

The Central Bank loosened the monetary conditions considerably in the 1st quarter of 2015; starting early the year, it gradually reduced the Lombard Repo Facility Rate from 20% to 12%.

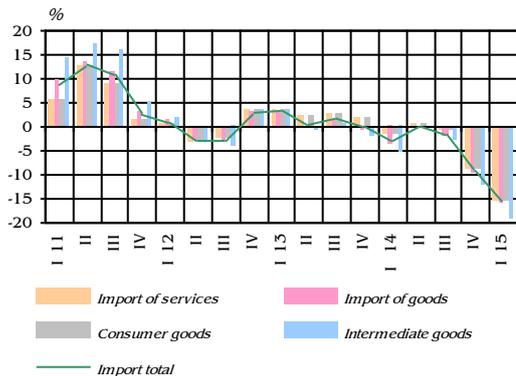
In the 1st quarter of 2015, the Central Bank actions helped the Lombard Repo Facility Rate to again uphold an accepted 1.5 percentage point spread from the Refinancing Rate thus restoring the latter's leading role in the financial market.

Loosened monetary conditions and other macro-prudential measures will facilitate lending, thereby creating favorable conditions for a sound economic activity.

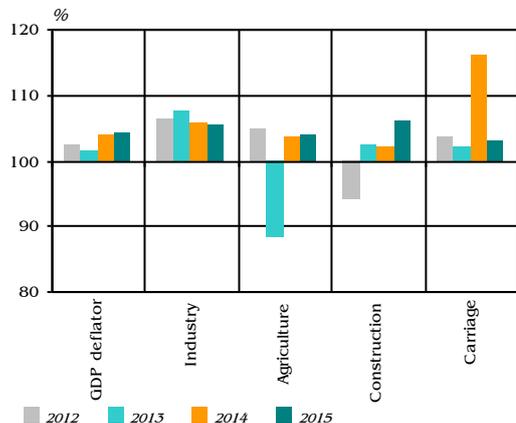
3.1.2. Import prices and producer prices

Import prices: in the 1st quarter of 2015, the dollar prices of import of goods and services fell even faster, making up 8.5% q/q, with y/y reduction of 15.7%. The decrement in dollar prices was attributable in general to the U.S. dollar having reported high appreciation rates at the end of 2014. Overall, the y/y decrement in dollar prices was driven by 12.0 pp drop in prices of goods and 3.7 pp falling in service prices (in the 1st quarter of 2015, the dollar prices of import of services and import of goods plunged by 9.1% q/q and 8.3% q/q, respectively).

In the 1st quarter, the dollar prices of import of goods and services declined rather quickly (y/y, %).



In the 1st quarter, the highest prices were reported in construction



Reduced prices of intermediate goods, including food products and raw materials, was the main contributor to the y/y falling in dollar prices of import of goods.

The falling in dollar prices of consumer goods was driven by y/y decrement in dollar prices in Russia, the European Union and Ukraine because of y/y/exchange rate depreciation there. As a result, consumer goods made 3.4 pp of negative contribution.

Producer prices⁹: in the 1st quarter of 2015, all sectors of the economy posted increased price indices, with the GDP deflator having reached y/y 104 in the period January-March, according to the Central Bank estimates.

Industry posted quarterly price increases of 5.4% y/y during the 1st quarter, owing to growths in processing industry (6.7%) and energy and gas production and distribution (8.3%). Note that a lower growth of the latter in comparison with previous periods is a result of an increased share of electricity (which is the lowest tariff¹⁰) used by the nuclear plant in the structure of electricity consumed by industrial enterprises.

Agriculture reported 3.7% y/y increase in prices¹¹ during the 1st quarter, fuelled by 5.3% y/y price increases in animal breeding. The 7.1% drop of prices in plant growing was due to decreased prices in groups "potato and gourds" (12%), and "grains" (6.5%), whereas price inflation in animal breeding was mainly attributable to the increases in milk and dairy products, egg and meat by 10.4%, 4.7% and 2.6%, respectively.

Construction reported 6.1% y/y price increases during the 1st quarter, determined by increased costs in construction works (4.8%), equipment & materials (2.7%) and other expenses (17.1%). Note that the inflation on other expenses is primarily due to a wage growth.

Carriage posted 2.9% y/y rise in tariffs during the 1st quarter, owing to increased tariffs for railroad transport (13%) and truck transportation (1.3%). Note that higher railroad tariffs are mainly attributable to the energy prices having risen since August 1, 2014.

3.1.3. Inflation and interest rate expectations

The Central Bank's Q1 2015 survey on financial sector and household expectations of selected macroeconomic indicators suggests that inflationary expectations for an upcoming one-year horizon have somewhat eased as the Bank succeeded in anchoring such expectations in the domestic financial market after a series of actions it took later in 2014 in response to geopolitical developments in the world and the region. Thus, most banks have their expectations of the 12-month inflation rate anchored around the 4.8% level against the 5.8% indicator reported in the previous survey and the households in the region of 3.7%, representing a downside adjustment relative to the previous indicator.

⁹ The price index change as of January-March 2015 is relative to the same reference period last year, unless otherwise specified.

¹⁰ Public Services Regulation Commission's Decision No. 232A, dated July 1, 2014, on "Electric Energy System Tariffs".

¹¹ Sales prices of producers of agricultural product are presented.

The results of the survey predict a certain rise in interest rates of dram deposits in a one-year horizon whereas interest rates of foreign currency deposits are expected to go a downward path, which is, again, explained by the end-year measures taken by the Central Bank. In the upcoming one-year horizon, interest rates of dram and foreign currency funds allocated by the financial sector are likely to increase, too.

3.2. Aggregate supply and Aggregate demand

3.2.1. Aggregate supply¹²

The *economic growth indicator* published by the National Statistics Service for 2014 was 2.7% y/y, in which case the January-December *growth* has been 3.4% y/y, consistent with the economic growth indicator as outlined in previous two forecasts of the Central Bank.

In the 1st quarter of 2015, the economic activity indicator was 2.5% y/y, representing a slight increase against expectations as a result of higher-than expected output growth in agriculture and construction sectors.

In the 1st quarter of 2015, the economic growth is estimated to be in the range of 2.1%-2.5%¹³.

Given an increased output of 2% y/y reported in *Industry* in the 1st quarter of 2015, the growth of value added is estimated in the range of 0.5%-1.0% y/y, mainly due to increased production in ore mining (28%), metallurgy (3.5%), tobacco production (48.3%), pharmaceuticals (46.5%), production of building materials (8.3%), and water supply (8.9%). High growth in ore mining is determined by the exploiting of Teghout mine.

Based on an actually increased output of 0.8% y/y recorded in *Construction* for the period January-March 2015, the growth of value added is estimated within 0-0.5%. Exclusive of reduced volumes of construction financed by households (9.9%), organizations (0.7%) and local community budgets (28.2%), all other sources of construction financing posted growths as follows: state budget (12.3%), international credit (57.1%), and humanitarian aid (8.6%).

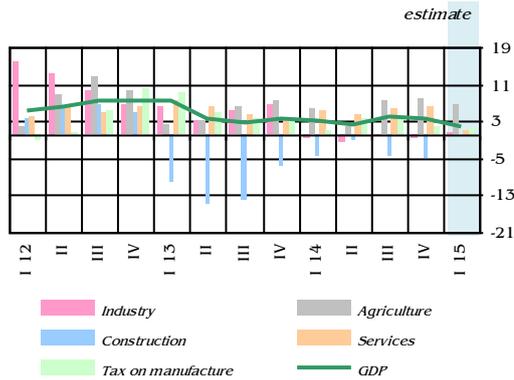
In *Services*, the growth of value added in the 1st quarter of 2015 is estimated in the range of 0.7%-1.2% y/y, attributable to the volumes of services rendered and trade turnover having reduced by 3.9% and 6.3%, respectively. Note that the increase in the volume of services rendered was driven largely by growth reported in banking services (20.9%), events, leisure and rest (88.3%), information technologies (8.3%), hotel and accommodation (7.4%), and entrepreneurship (0.6%). The

¹² The indicators of real growth of value added in sectors of the economy for January-March 2015 y/y are the Central Bank forecasts whereas the indicators of sub-sectors represent y/y growth rates in output volumes for January-March 2015, unless otherwise specified.

¹³ See the 50% range in the Real GDP Growth (Cumulative) Projection Probability Distribution Chart.

In the 1st quarter of 2015, the economic growth is estimated to be within 2.1%-2.5%.

Actual real GDP and economic sector cumulative growth rates, y/y, %



In the 1st quarter of 2015, private consumption will slow down by 1.3% and private investment, by 7.4%.

decline in trade was attributable to the turnover in retail, wholesale and passenger car trade having reduced by 6.4%, 5.1% and 16.1%, respectively, due to real disposable household income reduced largely as a result of an abruptly narrowed net inflow of private transfers.

In **Agriculture**, the growth of value added for the 1st quarter of 2015 is estimated in the range of 6.4%-6.9% y/y, fostered by increased outputs in animal breeding, plant growing and fishing by 3.5%, 28.9% and 23.1%, respectively. Reported increases in milk production and slaughtered animal and poultry production by 5% and 4.5%, respectively, contributed to the overall growth in animal breeding. Similarly, as much as a 2.3-fold increase in the production of vegetables contributed positively to plant growing.

3.2.2. Aggregate demand¹⁴

In the 1st quarter of 2015, the decline in private spending is estimated to be slower compared with forecasts and amounts to 1.3%. The revision is based on the lagged effect of expansionary monetary and fiscal policies carried out in 2014 as well as a more stimulating fiscal policy the Government implemented in the reporting period.

Reduced private remittances from Russia have notably diminished the households' disposable income, which, in turn, led to the shrinkage of private spending in the 1st quarter of 2015. Nonetheless, the first quarter contraction of private consumption was mitigated by the above-mentioned factors.

The results of the Central Bank surveys¹⁵ as well as trade turnover indices, as calculated by the National Statistics Service, also point to the contracted private consumption. Thus, in the 1st quarter of 2015 the Consumer Confidence Index was 41.4 – below its stability range – reflecting a declined consumer spending. In the first quarter, compared to the same reference period last year, the trade has shrunk by 6.3%, with the decline reported in wholesale and retail trade as well as motor vehicle trade.

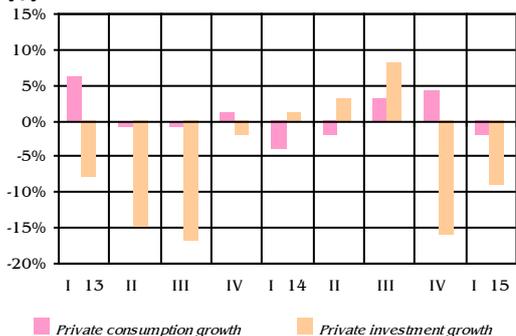
In the 1st quarter of 2015, the investment climate in the economy was weaker, just in line with anticipation, with an estimated 7.4% decline in the private investment in relation to the same reference period last year. The decline is determined by weak activity in construction, slower growth rates in company lending as well as a sluggish business environment in general.

The results of the Central Bank's investment survey on Armenian companies point to the decline in investment in t period under review. Thus, only 16% of the companies surveyed invested during the 1st quarter of 2015, which is 2 pp smaller than the indicator reported in the same reference period last year.

¹⁴ The private spending, private consumption and private investment data for the 1st quarter 2015 are the Central Bank estimates based on the actual 4th quarter 2014 data. Growth estimates in this sub-section are relative to the same reference period last year, unless otherwise specified.

¹⁵ See <https://www.cba.am/am/SitePages/statsscci.aspx>.

Private consumption and investment growth, y/y



With private consumption and investment developments described above, private spending contracted by 2.1% in the 1st quarter, which, coupled with a 2.2% increase in public expenditures, pushed the domestic demand down by 1.4%.

In the 1st quarter of 2015, the private spending gap is estimated negative, and it left **1.0 pp - 1.2 pp of contractionary impact** on the inflation.

The information on foreign trade developments during the 1st quarter of 2015 is not complete due to shortage in compiling of trade indicators.

In the 1st quarter of 2015, the net inflow of non-commercial remittances of individuals via the banking system slowed down by as much as 48.0% against the same reference period last year due to an abrupt depreciation of the Russian ruble against the U.S. dollar amid unfavorable developments in the Russian economy.

3.2.3. Labor market¹⁶

In the 1st quarter of 2015, the **average nominal wage growth rate** run slightly above former forecasts of the Central Bank, amounting to 10.6%. In the period under review, the growth rate in wages of public sector has been slightly faster than the wage growth in the private sector.

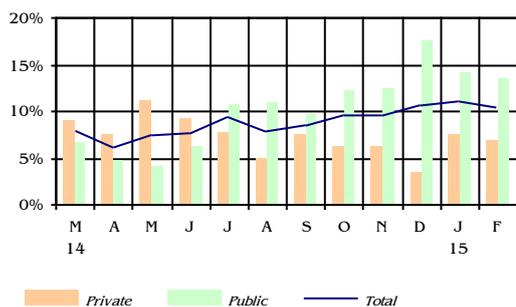
The wage increase in some areas of the public sector since July of 2014 has pushed the average public sector wage up to persist above the post-crisis level over the second half of 2014 and the 1st quarter of 2015. As a result, the average annual wage growth in the public sector in the 1st quarter was 13.7%.

In the 1st quarter of 2015, the average nominal wage growth rate in the private sector was 7.1%, somewhat slower than the wage growth of 7.4% recorded in the previous year, due to a relatively weak economic activity.

A sluggish economic activity recorded in the 4th quarter of 2014 and the 1st quarter of 2015 dragged the demand for labor market behind the supply for that market. This trend has been observable since the 1st quarter and grown deeper later in 2014 and the 1st quarter of 2015. As a result, in the 1st quarter of 2015, relative to the same reference period last year, the **unemployment rate** has grown by 1.4 pp to 19.2%. Compared to previous forecasts, the unemployment rate is somewhat lower in the 1st quarter as the economic activity is slightly higher from the expectations.

In the period under review, the wage growth has been in line with the productivity indicator, so the labor market's impact on the inflation during the 1st quarter of 2015 is estimated neutral.

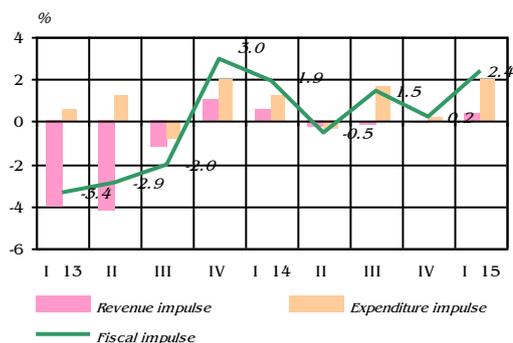
Nominal wage growth, y/y



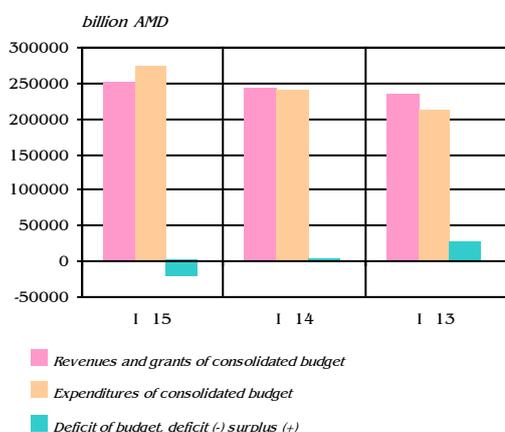
¹⁶ The labor market data for the 1st quarter of 2015 are the Central Bank estimates which are based on the 4th quarter of 2014 data and actual January-February 2015 figures. The growth indicators represented in this sub-section are relative to the same reference period last year, unless otherwise specified.

3.2.4. Fiscal policy¹⁷

In the 1st quarter, the fiscal policy's impact is expansionary due to expansionary effect of expenditures

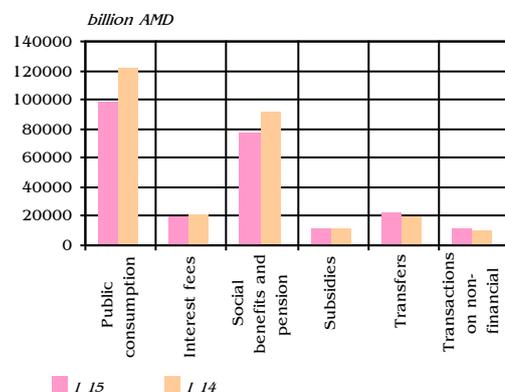


Consolidated budget indicators



In the 1st quarter of 2015, the fiscal policy's impact on aggregate demand was 2.4 expansionary.

In the 1st quarter, budget expenditures posted an increase in current expenditures



In the 1st quarter of 2015, the State Budget performed with revenues collected in proportion to quarterly projections and resources saved on certain expenditure items. The fiscal sector's impact on aggregate demand was slightly more than projected, making up 2.4 expansionary. The revenue impulse was 0.4 expansionary and the expenditure impulse, 2.0 expansionary.

In the period under review, relative to the same reference period last year, revenues of the consolidated budget have grown by 3.5% mainly owing to tax receipts. Compared to the 1st quarter of 2014, tax revenue and state duty have grown by 3.8% largely due to income tax and customs duty. As a result, the state budget over-performed the quarterly projection by 0.3% for tax and state duty. In the 1st quarter of 2015, relative to the same reference period last year, indirect taxes and direct taxes have grown by 3.5% and 4.3% but other tax revenues decreased by 2.7%, respectively, in the tax and duty portfolio of the consolidated budget. Moreover, the share of indirect taxes and direct taxes has grown by 0.1 pp and 0.4 pp to 52.8% and 39.4% but the share of other taxes reduced by 0.4 pp to 7.8%, respectively.

Other revenues posted a 40.1% increase in comparison with the same reference period last year thus outstripping the quarterly projection.

In the 1st quarter of 2015, actual expenditures amounted to 89.9% of the program specified for the quarter. However, compared to the same reference period last year, consolidated budget posted a 14.2% growth of expenditures mainly due to current expenditures. In the current expenditures structure, **public consumption** has grown by 24.4% compared to the same reference period last year. The **item "transactions with non-financial assets"** posted a 7.5% decrease due to reduced spending under both foreign-funded and domestic projects.

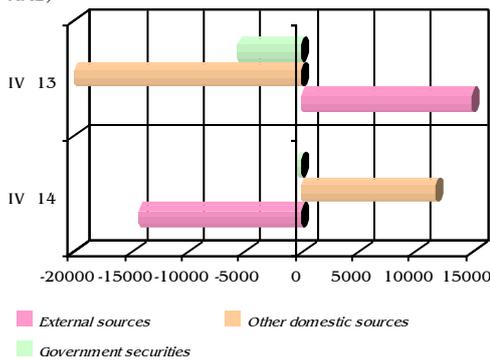
With revenues and expenditures figures shown above, the state budget reported a deficit of AMD 22.2 billion for the 1st quarter of 2015 instead of AMD 51.3 billion projected for the quarter under an adjusted plan. The deficit has been fully financed by external sources.

The placement of foreign currency government bonds brought in AMD 229.9 billion worth of proceeds for the state budget in the 1st quarter of 2015, of which AMD 94.2 billion was spent to repurchase the foreign currency government bonds issued back in 2013. The said placement and repurchase of government bonds have generated free domestic resources.

In the 1st quarter of 2015, the fiscal policy had an expansionary impact on aggregate demand due primarily to increased costs.

¹⁷ The review of the fiscal sector was done using the preliminary actual consolidated budget indicators prepared on the basis of the preliminary actual indicators of the 1st quarter of 2015 (PIU funds included), excluding off-budgetary funds. The impact of revenues was calculated in respect of the nominal GDP indicator while the impact of expenditures, in respect of the estimated economic potential.

The 1st quarter saw a budget deficit, unlike first quarters of the last two years (billion AMD)



Summary: reduced private transfers from Russia as well as sluggish investment activity in the domestic economy pushed private spending down in the 1st quarter of 2015. However, the contraction of expenditures in private sector has diminished owing to lagged impact of the expansionary monetary and fiscal policies implemented in the course of 2014 and, particularly, new fiscal and monetary incentives provided to the domestic economy in the 1st quarter of 2015, which, in turn, mitigated the domestic economic slowdown and the deflationary environment.

In the 1st quarter of 2015, the private spending gap is estimated to be negative. Given also the behavior of the labor market and public expenditures, it is estimated that the above factors combined created 0.4 pp - 0.5 pp of deflationary pressures in the consumer market in the 1st quarter of 2015.

3.3. Money and financial market developments

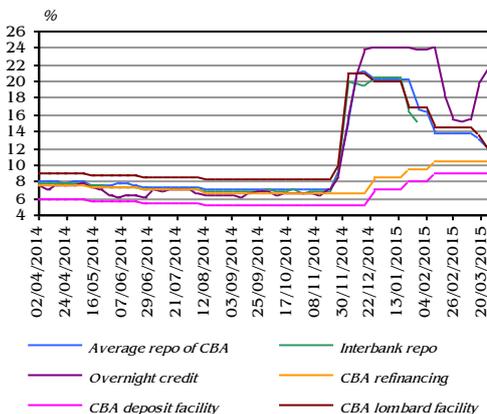
3.3.1. Financial market, money and credit

In pursuit of its statements made with the aim to ease the tension and stabilize the situation in the domestic financial market resulted from the events in late 2014, the Central Bank looked to change the interest rates more often during the 1st quarter of 2015. **The financial market saw at the time high interest rates closer to the Lombard Repo Facility Rate of the Central Bank.** In view of achieving lower interest rates along with financial market stabilization, the Central Bank gradually reduced the Lombard Repo Facility Rate from 20% to 12% during the 1st quarter of 2015. However, driven by investment risks and growing interest rate trends in developing countries, the Central Bank raised the Refinancing Rate in January and February each time by 1 pp to 10.5%. This action helped the Lombard Repo Facility Rate to again uphold an accepted 1.5 percentage point spread from the Refinancing Rate and reduce the spread between the policy rate and short-term market rates **in order to restore the leading role of the Refinancing Rate in the market** thus contributing to the stabilization of the financial market and fulfillment of the inflation target in the medium run.

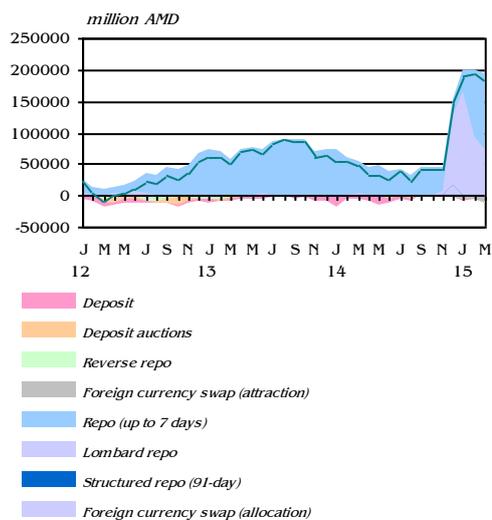
The actions successfully taken by the Central Bank during the quarter to weather the tension spilled over from the outside world in November-December 2014 brought about reduced short-term interest rates, on the one hand, and relatively a stable domestic exchange rate behavior, on the other.

In the 1st quarter of 2015, the 7-day Repo Rate, the main policy instrument of the Central Bank, floated around the Lombard Repo Facility Rate of the Central Bank. As a result, the average March rate has reduced by 7.4 pp against December and amounted to 13.16%.

In the 1st quarter, short-term interest rates came in around lombard repo facility rate of the Central Bank



Operations carried out by the Central Bank (average monthly volume)

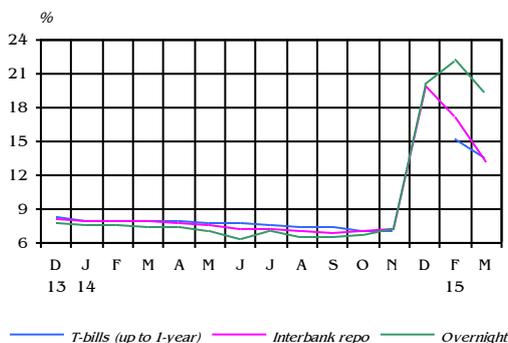


Operations carried out by the Central Bank (average value)						
Period	Repo (up to 7 days)		Funds attracted		Lombard repo	
	Value (million AMD)	Weighted average %	Value (million AMD)	Weighted average %	Value (million AMD)	Weighted average %
Q1 2013	63652.16	8.09	2518.46	6.50	14.53	9.50
Q2	71467.51	8.19	2712.31	6.50	45.74	9.50
Q3	86238.94	8.42	2712.31	6.75	20.30	9.50
Q4	76070.53	8.31	6035.38	6.71	7.69	10.0
Q1 2014	58769.52	7.80	8230.77	6.17	297.76	9.05
Q2	41619.24	7.79	9908.46	5.88	41.38	8.75
Q3	37331.05	7.16	3270.00	5.47	16.08	8.43
Q4	34048.94	10.60	1765.67	5.25	41550.14	19.69
Q1 2015	95454.55	14.25	63.75	8.04	104521.49	16.27

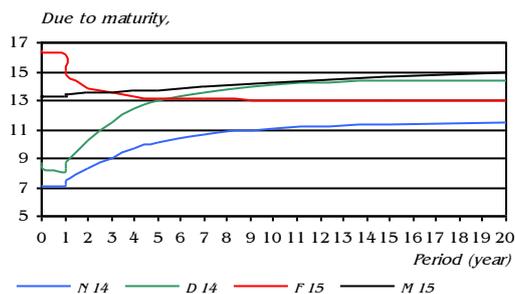
The situation in the financial market in the 1st quarter of 2015 was consistent with the policy of the Central Bank. There were only few transactions executed in the interbank market at the time, and it was difficult for the Central Bank to identify the short-term interest rate. However, the volume of transactions in the interbank repo market was maintained, and gradual lowering of interest rate of the Lombard Repo Facility by the Central Bank prompted a phase by phase reduction of interest rates in the interbank market. The average monthly rate decline in March was nearly 7 pp against December.

Box 2

Short-term interest rates during the 1st quarter



In the T-bills market in the 1st quarter, interest rates rose



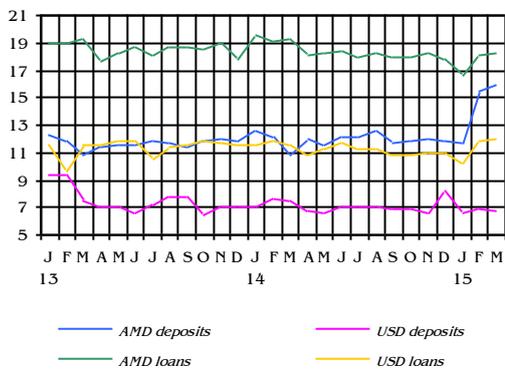
Government securities market

The situation in the financial market certainly affected the government bonds' market. The average quarterly yield of short-term T-bills has grown by 7.6 pp to 14.7% in relation to the previous quarter and the March yield of mid-term notes and long-term bonds has increased by about 2.0 pp against the December yield.

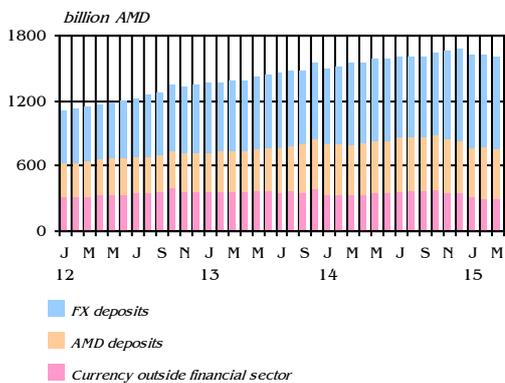
The financial market turmoil in November-December 2014 did not have a significant impact on the secondary market of government bonds on the market perhaps due to the lack of transactions in the market. Though in December, compared to November, the yield curve rose by around 2.0 pp the entire length, it did not, however, reflect the developments in the financial markets. The situation changed in January and February when the curve came in inverted as a result of new issues of short-term bonds, reflecting market participants' high risks to the current uncertainties in the short term segment. Along with stabilizing financial market, the situation normalized in the bonds market, as in the end of the quarter the yield curve got back to its original shape of upslope. In late March, compared to December, the total yield curve indicator has grown: the long-term interest rate reached 14.9%, up by 0.5 pp, while the long-term and short-term interest rates spread narrowed in March by 4.0 pp to 1.6 pp.

In the 4th quarter of 2014, the interest rate rise in the financial market also meant an increase in interest rates of funds attracted by banks. It was only observed in respect of dram deposits (mainly with short-term maturities, while the reserve requirement ratio for funds attracted in foreign currency, increased in December, has led to a contracted volume of foreign currency deposits and lower interest rates of such deposits. In March, the average monthly dram deposit rate was 15.9%, up by 4.0 pp against December, with the average quarterly indicator having grown by 2.5 pp to 14.4% relative to the previous quarter. The average foreign currency deposit rate was 6.7%, down by 1.5 pp against December, with the average quarterly interest rate having fallen by 0.4 pp to 6.8% compared to the previous quarter.

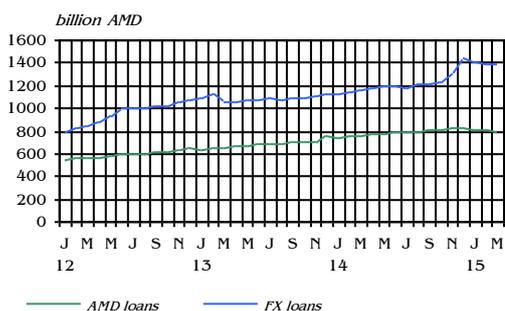
Interest rates of funds in domestic currency and foreign currency



In the 1st quarter, deposits in both foreign currency and domestic currency posted a decrement



In the 1st quarter, foreign currency loans again outnumbered in total lending portfolio



The uncertainties in the financial market in December 2014 left their mark on the volume of funds attracted during the 1st quarter of 2015. The volume of funds attracted in both Armenian dram and foreign currency has shrunk. The contraction was remarkable for both demand and time deposits attracted from enterprises. During the quarter, deposits in Armenian dram decreased by 2.0% and foreign currency deposits, by 1.3%.

The dram lending rates were relatively stable during the quarter. The interest rates even posted a slight decline in some cases. The average quarterly dram lending rate has dipped by 0.3 pp in relation to the previous quarter to 17.7%. The trend of decline was observable in interest rates of more than 1-year loans to individuals and companies: the average figure for the quarter dipped by 0.9 pp.

In the 1st quarter of 2015, foreign currency lending rates did not report a notable change.

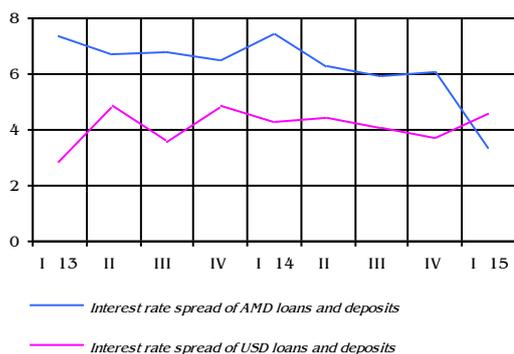
The slowing economic growth, reduced household savings, and expensive financing all have influenced the lending volumes. This is evidenced by the Central Bank's survey on terms of lending by Armenian banks and credit organizations. During the quarter, at the time of structural changes in the economy, banks reassessed their risks, adjusted their credit policies in order to maintain the quality of the loan portfolio.

Box 3

The results of Q1 2015 survey on terms of lending by Armenian banks and credit organizations suggest that the terms of lending came in much tightened during the quarter. This was anticipated basing upon the results of the previous survey. The main factors in support of the tightening included slowing of the economic activity and borrower creditworthiness.

The demand for all loan products is expected to grow during the 2nd quarter, and the measures which the Central Bank takes in favor of target lending will, most likely, prevent further tightening of the terms of lending.

In the 1st quarter, the spread of interest rates of dram loans and deposits narrowed



The spread of interest rates of loans and deposits in local currency narrowed during the 1st quarter of 2015. The average quarterly indicator has reduced by 2.7 pp compared to the previous quarter to 3.3 pp; in March the spread was 2.3 pp having narrowed by 3.6 pp relative to December.

On the contrary, the spread of interest rates of loans and deposits in foreign currency has grown. The average quarterly indicator has increased by 0.9 pp compared with the previous quarter to 4.6 pp.

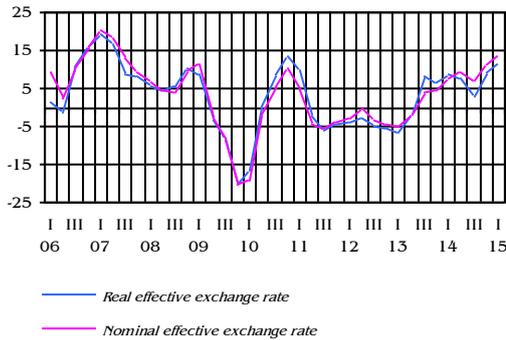
In the 1st quarter of 2015, the indicator of dollarization (the Foreign Currency Deposits-to-Broad Money ratio) posted a 1.6 pp increase in relation to the previous quarter.

Monetary indicators	March 14, 12-month growth	June 14, 12-month growth	September 14, 12-month growth	December 14, 12-month growth	March 15, 12-month growth
Broad money (%)	12.84	14.78	9.64	8.34	4.1
Dram broad money (%)	10.92	14.26	14.15	-3.51	-4.4
Base money (%)	20.84	8.21	-0.52	-0.15	1.61
Dram base money (%)	1.67	4.49	0.63	15.53	19.6
Currency (%)	-4.49	-1.19	1.44	-9.39	-9.8
Deposits in local currency (%)	25.27	28.59	25.31	1.37	-0.5
Deposits in foreign currency (%)	14.95	15.36	4.71	22.74	13.0
Dollarization (percentage point)	0.89	0.24	-2.15	6.0	4.2
Money multiplier (percentage point)	-0.14	0.13	0.21	0.15	0.0
Dram multiplier (percentage point)	0.12	0.12	0.17	-0.22	-0.28

3.3.2. Exchange rate

In the 1st quarter of 2015, the trade partners' average nominal weighted exchange rate kept on depreciating against the US dollar. It amounted to 14.6% q/q. Though stepping a path of appreciation during the 1st quarter of 2015, the average nominal exchange rate of the Russian ruble is still above its average 4th quarter 2014 level. As a result, the bulk of trade partners' average nominal weighted exchange rate depreciation, making up as much as 6.2 pp, was due to the ruble behavior. At the same time, high depreciation of the euro and hryvnia had, respectively, 3.1 and 3.0 pp contribution. In the 1st quarter of 2015, the average nominal exchange rate depreciation of the Armenian dram was 9.9% q/q as a result of external equilibrium sustained under currency depreciation pressures in trade partner countries. Meanwhile, the Central Bank has injected around USD 149.6 million in the currency market, primarily at the beginning of the year, in order to neutralize expectations in the currency market and maintain overall financial stability.

In the 1st quarter, real effective exchange rate appreciated y/y, (%)

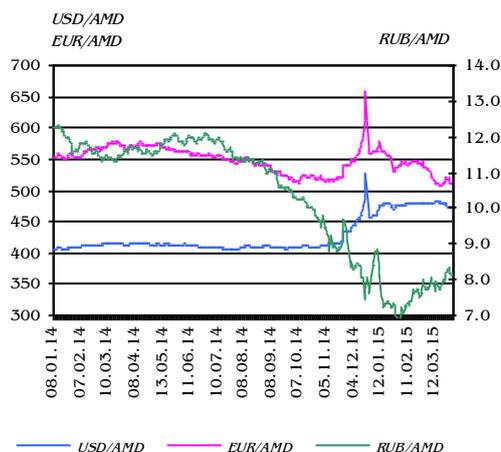


Influenced by dramatic currency depreciation in trade partners, the nominal effective exchange rate of the Armenian dram posted 3.5% appreciation q/q and the real effective exchange rate¹⁸, 5.6% appreciation q/q during the 1st quarter of 2015. The 11.6% y/y appreciation of the real effective exchange rate was attributable to the average nominal weighted exchange rate highly depreciated in trade partner countries since the end of the previous year.

y/y growth, %	Q1, 2013	Q2	Q3	Q4	Q1, 2014	Q2	Q3	Q4	Q1, 2015
Real effective exchange rate (+ means appreciation)	-6.4	-1.6	7.9	6.8	8.5	7.8	3.1	9.2	11.6
Average inflation in Armenia	3.0	5.2	8.7	6.4	4.6	3.3	1.0	3.2	5.2
AMD/USD average nominal exchange rate (+ means appreciation)	-5.1	-3.3	0.5	0.2	-0.4	0.5	0.0	-5.7	-13.9
Average weighted inflation in trade partner countries	4.5	4.4	4.3	4.0	3.7	4.4	4.6	5.1	6.7
Trade partners' average weighted nominal exchange rate (+ means appreciation versus dollar)	-0.4	-1.1	-3.2	-4.3	-8.0	-8.6	-7.0	-18.5	-32.1

Real exchange rate appreciation = Inflation in Armenia + Nominal exchange rate appreciation – Trade partners' average weighted inflation – Trade partners' average nominal weighted exchange rate appreciation.

Armenian dram exchange rate versus US dollar, Euro and Russian ruble



Foreign exchange market

Box 4

As of end Q1 2015, the average market exchange rate of AMD/USD was 471.13, having appreciated by 0.82% relative to the end of the previous quarter.

The table shows the Armenian dram's behavior versus the U.S. dollar, Euro and Russian ruble during the 1st quarter of 2015:

The Armenian dram's exchange rate, q/q			
Currency pair	Exchange rate as of 30.12.2014 (AMD)	Exchange rate as of 31.03.2015 (AMD)	% (appreciation "+", depreciation "-")
USD/AMD	474.97	471.13	+0.82
EUR/AMD	577.47	505.29	+14.28
RUB/AMD	8.15	8.13	+0.25
The Armenian dram's average exchange rate, y/y			
Currency pair	Average exchange rate, Q1, 2014	Average exchange rate, Q1, 2015	% (appreciation "+", depreciation "-")
USD/AMD	411.05	477.26	-13.87
EUR/AMD	562.97	538.40	+4.56
RUB/AMD	11.72	7.61	+54.01

¹⁸ The 1st quarter 2015 indicator of the real exchange rate is the Central Bank estimate.

The aggregate volume of U.S. dollar/Armenian dram transactions in the foreign exchange market during the 1st quarter of 2015 amounted to USD 2.45 billion, which represents an 11.55% decrease in relation to USD 2.77 billion reported in the same reference period last year.

The aggregate volume of Euro/Armenian dram transactions carried out during the quarter reached EUR 199.42 million against EUR 192.7 million recorded in the 1st quarter of 2014.

The aggregate volume of Russian ruble/Armenian dram transactions in the 1st quarter of 2015 totaled RUB 9.6 billion, which represents a 5.5% growth y/y compared to RUB 9.1 billion recorded in the 1st quarter of 2014.

3.4. Balance of payments¹⁹

The information on developments in foreign trade during the 1st quarter of 2015 is not complete due to shortage in compiling of trade indicators, and export and import figures by commodity group are not presented in the report, as a result. The overall export and import figures are the forecasts set out in the previous quarter's program, adjusted to actual developments in dollar prices of export and import.

In the 1st quarter of 2015, the declining rates in remittances of individuals remained high, since the Russian ruble further felt the effect of steep exchange rate depreciation against the U.S. dollar, compared to the same reference period last year, in the course of adverse developments in the Russian economy. The current account deficit reduction on the back of the aforementioned developments and forecasts was mainly attributable to the narrowed trade balance deficit. The 1st quarter also saw the placement of Eurobonds by the Armenian Government, resulting in a large net inflow of funds through the Capital and Financial Account. Net foreign assets of the Central Bank have grown as a result of the balance of payment developments.

3.4.1. Current account

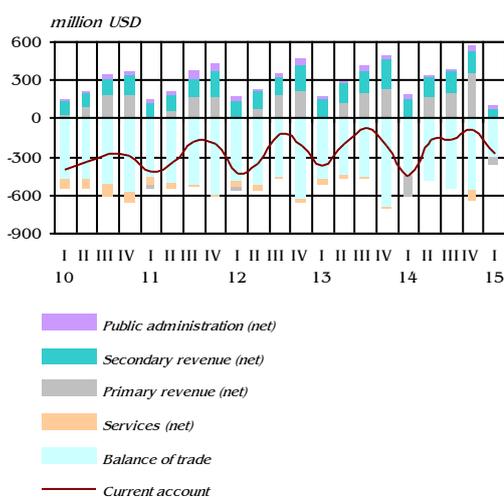
In the 1st quarter of 2015, relative to the same reference period last year, the current account deficit has reduced by USD 175.5 million to USD 271.5 million, which was determined by a large one-off transaction in the item "Income on investment" carried out during the 1st quarter of the previous year.

According to the 1st quarter 2015 forecasts, the export of goods has decreased by 11.2% y/y and the import of goods, by 22.6% y/y, reflecting a notable drop in export and import prices²⁰.

¹⁹ The 1st quarter 2015 indicators are the Central Bank forecasts and estimates.

²⁰ The dollar prices of export and import reported considerable decrement in the 1st quarter of 2015, according to the Central Bank estimates.

In the 1st quarter, current account deficit narrowed, y/y

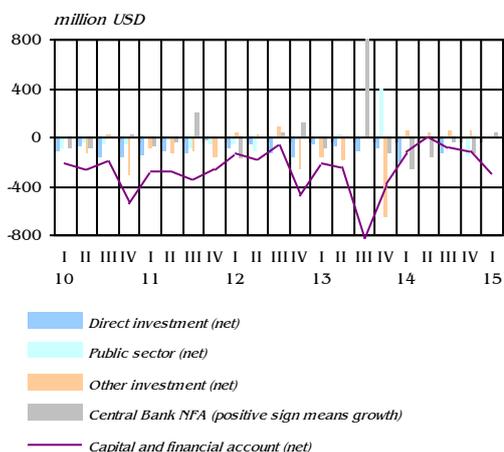


In the 1st quarter of 2015, relative to the same reference period last year, the negative balance of services has shrunk to USD 3.9 million. This was mainly attributable to a contracted negative balance of travel. As a result, the 1st quarter saw an estimated 6.2% y/y and 8.6% y/y decreases in the export and import of services, respectively.

In the 1st quarter of 2015, the declining rates in remittances of individuals²¹ persisted at an elevated level, which was determined by high exchange rate depreciation of the Russian ruble versus the U.S. dollar, relative to the same reference period last year, amid adverse developments in the Russian economy. The net inflow of funds through item “Compensation of employees” posted a 48.0% y/y decrease to USD 72.0 million, which stands below the figure of net outflow through item “Income on investment”. As a result, item “Primary income” posted net outflow of USD 52.4 million. The net inflow of private transfers has reduced by 50.9% y/y to USD 135.5 million.

In the 1st quarter, the capital and financial account posted an increased net inflow of funds

(+ net credit, - net borrowing)



3.4.2. Capital and financial account²²

The 1st quarter of 2015 reported net inflow of funds amounting to USD 306.6 million through the Capital and Financial Account, which was mainly determined by the placement of Eurobonds by the Armenian Government. The current account deficit was financed through portfolio investment (placement of Eurobonds) and funds attracted by other private sector (excluding banks). As a result of the balance of payment developments, net foreign assets of the Central Bank have grown by USD 35.1 million.

In the 1st quarter of 2015, capital transfers reduced to USD 8.4 million in comparison with USD 11.0 million reported for the 1st quarter of 2014.

During the reporting quarter, net inflow of foreign direct investment totaled USD 13.6 million. Net inflow of public loans (excluding Eurobonds) amounted to USD 13.1 million against net outflow of USD 7.3 million reported for the same reference period last year.

Net foreign assets of the private sector have reduced by USD 2.9 million as opposed to an increase of USD 48.2 million posted during the 1st quarter of the previous year. Net foreign assets of commercial banks have grown by USD 136.6 million in contrast to other private sector’s net foreign assets having decreased by USD 139.6 million.

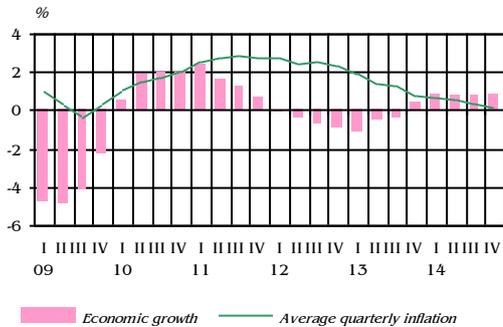
²¹ The 1st quarter of 2015 saw as much as 48.0% y/y reduction in net inflow of non-commercial transfers of individuals via the banking system.

²² The 1st quarter 2015 capital and financial account figures are the Central Bank forecasts and estimates.

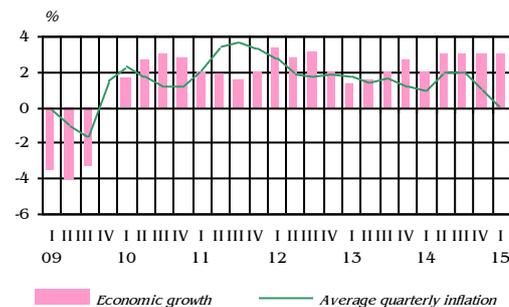
3.5. External environment

A slow growth of economic activity was observable in Armenia's main trade partner countries during the 1st quarter of 2015, too.

In Eurozone, inflation subdued in the 1st quarter



Deflation was recorded in the USA in the 1st quarter



According to preliminary estimates of the U.S. Department of Commerce Bureau of Economic Analyses, ***in the United States of America in the 1st quarter of 2014*** the annualized economic growth was 0.2% q/q instead of the previous quarter's 2.2% growth (3.0% y/y economic growth was recorded in the 1st quarter). The slowing of the growth in the 1st quarter was mainly driven by reduced private spending, slowed down exports, investment and public expenditures. These were only partly offset by slowing imports and added private investment in inventories.

There was average quarterly deflation of 0.06% y/y in the U.S.A during the 1st quarter of 2015 against 1.2% inflation recorded in the previous quarter. The inflation rate persisted below its target due in part to decreased prices of oil products and imported non-oil products. In the 1st quarter of 2015, the U.S. Fed kept the policy rates in the range of 0%-0.25%.

In Eurozone in the 1st quarter of 2015, there was 1.0% economic growth relative to the same reference period last year, according to preliminary estimates provided by the Eurostat. The reporting quarter also saw an average 0.3% deflation y/y against 0.2% inflation recorded in the previous quarter.

In the 1st quarter of 2015, the European Central Bank kept the policy rate at 0.05% and the deposit facility rate at 0.2% levels. In addition to the program for buying asset-backed securities and covered bonds launched in late 2014, the ECB started another program in early 2015 aimed at buying sovereign bonds, with a total monthly purchase volume reaching EUR 60 billion.

In the currency market in the 1st quarter of 2015, Euro depreciated versus the U.S. dollar by 9.8% (y/y depreciation was 17.8%), with the average dollar exchange rate reaching 1.126 for one Euro.

In Russia in the 1st quarter of 2015, the economy posted 1.9% decline y/y, according to the preliminary estimates of the Russia State Statistics Service. This was the first decline after 2009, which was driven by the effect of plunged oil price and applied sanctions. However, based on annual results, positive developments were reported in processing industry and construction, with 2.1% and 1.1% growths reported there, whereas agriculture posted a 5.7% decline. In the time of slackened economic activity, consumption growth rates slowed down to 1.3% compared to the previous 1st quarter's 1.5% growth and aggregate investment reduced further, amounting to 6.0% against the previous quarter's 2.8% decline.

Consumer Price Index in Russia posted an average 16.2% y/y growth (compared to a 9.6% growth last quarter) on the back of as much as 43.8% y/y depreciation of the ruble in the 1st quarter of 2015. In view of fewer risks to inflation yet persisting risks to a significant slowdown in economic growth, the Central Bank of Russia cut the policy rate to 14.0% in the 1st quarter of 2015 from 17.0% in the end of the previous quarter.

In the 1st quarter of 2015, the *price of Brent crude* at Intercontinental Exchange plunged by as much as 25.6% against the previous quarter to roughly USD 54.0 a barrel (with 49.5% y/y decrease), amidst increased U.S. extraction volumes and relevant anticipations in the financial markets.

In the 1st quarter of 2015, the *price of copper* at the London Metal Exchange fell by 11.7% (with 17.1% decline y/y) to USD 5801 per ton on average. The drop in the price was explained by the slowing of demand in China, on the one hand, and the effects of appreciating U.S. dollar, on the other.

In the 1st quarter of 2015, export price of *hard red wheat* dropped by 7.4% q/q to USD 6.5 a bushel (with 19.6% decline y/y), according to the U.S. Department of Agriculture data. The price fell during the quarter in anticipation of abundant crops this year.

In the 1st quarter of 2015, the price index of *unprocessed sugar* at the New York Board-Intercontinental Exchange reported a 10.4% fall (with 13.9% decline y/y), mostly attributable to anticipated abundant crops in Brazil, the main producer of this commodity, and the Brazilian real's depreciation against the U.S. dollar.

In the 1st quarter of 2015, the price of *rice* at the Chicago Board of Trade fell by 12.0% to USD 10.9 per U.S. hundredweight (45.4 kg) (with 29.2% decline y/y) in spite of a certain reduction in the production volumes. The reduced price was driven by the slowing demand.

Substantial deflationary patterns were observable in world commodity and food product markets during the 1st quarter of 2015 primarily driven by sluggish global demand, appreciating U.S. dollar and anticipations for abundant harvest.

There were further deflationary trends observable in world commodity and food product markets during the 1st quarter of 2015, primarily attributable to a low level of global demand, appreciating U.S. dollar as well as world food markets' anticipations for heavy crops.

4. CONCLUSION

In the *external sector* in the 1st quarter of 2015, the *external demand* remained sluggish while deflationary patterns were observable in *basic commodity and food product markets of the world*. In the *forecast horizon*, *considerable inflationary pressures* from the external environment *are not likely*.

In the 1st quarter of 2015, the *economic activity* accelerated to some extent owing to more-than-expected growth in agricultural output and a lesser decline in construction. Under this circumstance, the *economic growth* in the 1st quarter of 2015 is estimated in the range of *2.1%-2.5%*.

In the forecast horizon, the economic growth rates will persist at the same level, and then the growth will gradually approach its long-term equilibrium, determined by a bunch of programs the Government plans to carry out in the tradable sector and continued improvement in external economic environment. *In the forecast horizon*, the *impact of the domestic economy on aggregate demand will be non-inflationary* as a result of stabilizing private demand as well as mostly a neutral impact of the fiscal policy.

In the 1st quarter of 2015, *the 12-month inflation rate* behaved cumulatively; at the end of March *the 12-month inflation rate was 5.8%*, staying around the upper bound of the confidence band.

In the forecast horizon, *the 12-month inflation rate* will stabilize around the 4% target. The probable rise in electricity price in the upcoming period will prompt *the 12-month inflation rate to remain around the upper bound of the confidence band in the course of 2015*. Then it will reduce gradually fuelled by a greater seasonal drop in food prices owing to positive developments in agriculture as well as expected weak demand in both external and domestic sectors.

The Central Bank estimates that keeping the Refinancing Rate's current level in the 2nd quarter of 2015 would facilitate the 12-month inflation to stabilize around the target since 2016. Later, as economic developments unfold, the Central Bank will adjust its monetary policy directions, while fulfilling the inflation target in the medium-term perspective.

Risks to inflation deviating from the projected value are estimated as *balanced* in both short and medium-term perspectives. *External sector risks* are primarily associated with global economic growth rates bouncing back as well as price developments in world commodity and food product markets. *Risks deriving from the domestic environment* are attributable to the pace at which the domestic demand would recover, the Government-led projects, economic effects from regional integration processes as well as the developments in agriculture sector which is largely reliant on weather conditions. At the same time, the lack of information about the size and timing of possible increase in electricity tariffs adds to the uncertainties over inflation developments. If such risks materialize, the Central Bank will react accordingly by maintaining the inflation target in the medium run.

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