



SUMMARY:

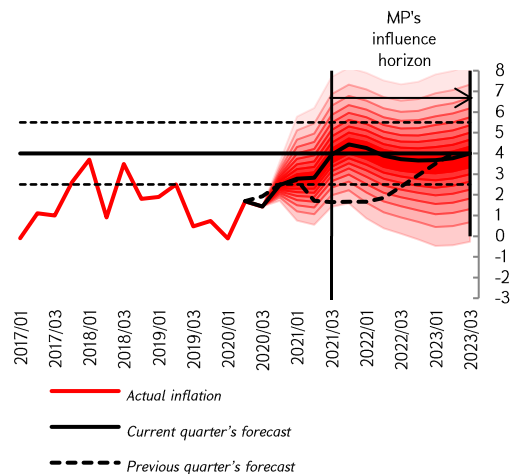
Armenia's macroeconomic environment in the fourth quarter of 2020 shaped as the new wave of coronavirus pandemic broke out all over the world, including Armenia. In addition, important influence came from the martial law declared in Armenia due to the large-scale offensive unleashed by Azerbaijan on September 27th along the entire line of contact with the Artsakh Republic. These factors are estimated to have added to uncertainties about the economic outlook, which will have a significant drag on the recovery to economic activity and aggregate demand in both the outside world and Armenia. At the same time, in light of positive expectations for the use of vaccines in different countries starting from 2021, there is an increase in prices in international commodity markets, which creates some inflationary pressures on domestic prices.

According to the baseline scenario of the Central Bank of Armenia, inflation will keep on increasing in the forthcoming quarters, yet inflationary environment will run below the target, under which the CBA will continue maintaining the monetary policy stance expansionary, while projecting a gradual phase-out in the medium term.

With such monetary policy stance and in view of expected economic developments, the 12-month inflation will approach the 4.0% target in the near future and stabilize around it in the medium term. This will be determined by external inflationary trends, the actual depreciation of the exchange rate and some acceleration of inflation expectations along with still a weak private demand amid existing high uncertainties. The stimulative monetary and fiscal policies will also contribute to the above trends. Taking into account some acceleration of inflation on the back of inflationary effects expected from the external sector and actual depreciation of currency exchange rate, as well as the increase in the country's risk premium, the **CBA decided to raise the refinancing rate**

Chart 1

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



by 1.0 percentage point, still keeping the monetary policy stance expansionary. It was estimated that in case of expected economic developments, a gradual reduction of the expansionary monetary policy stance would be required to ensure that inflation stabilizes around the target in the medium term.

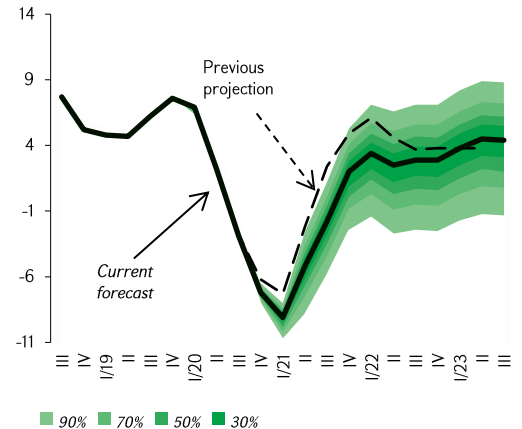
According to the CBA baseline short-term scenario, with a new wave of pandemic, declared martial law and growing uncertainties about economic outlook in the fourth quarter, the 2020 economic growth will float in the negative territory, and in the medium run it will gradually recover, stabilizing around its long-term equilibrium, which is currently estimated to be lower.

The 2020 economic decline will be determined mainly by a considerable reduction in output in services, which will be accompanied also by persistently weak private demand. The stimulative monetary and fiscal policies and gradual elimination of negative demand factors will greatly facilitate the recovery of economic growth in the medium term.

In the forecast horizon, risks of inflation deviating from the projection path are on the upside in the short run, while downside risks to projected economic growth path prevail. As healthcare, political and economic uncertainties remain high, the Central Bank of Armenia is monitoring the developments and stands ready to respond accordingly should such risks emerge, in order to ensure price stability in the medium run.

Chart 2

Real GDP (cumulative)¹ growth projection probability distribution for 3-year horizon



Source: RA Statistics Committee, CBA forecast

¹ The growth rate of each quarter is calculated as the cumulative growth rate for the last four quarters.