

Inflation Target in Armenia

2024-10-22

Central Bank of Armenia

Inflation Target in Armenia

H. Avetisyan, H. Igityan, A. Papikyan

October 2024

EXECUTIVE SUMMARY

As enshrined in the Constitution and “The Law of the Republic of Armenia on the Central Bank of Armenia,” the primary objectives of the Central Bank of Armenia are to ensure price stability and financial stability. The mission of the CBA, as an accountable public sector institution, is to improve the welfare of our nation by realizing these main objectives of ensuring price and financial stability.

To achieve the price stability objective, the Central Bank of Armenia chooses an appropriate monetary strategy and implements monetary policy. Prudent policy aimed at ensuring low and stable inflation provides a credible nominal anchor for the economy and thereby anchors inflation expectations, helps to avoid inefficient boom-bust cycles, stimulates investment, supports the economic development of the country, and improves living standards over time.

In order to define and achieve its price stability mandate, the Central Bank of Armenia is guided in the medium term by the inflation target which is consistent with this mandate. Importantly, defining and achieving price stability is not only about setting an inflation target. Rather, ensuring price stability is a dynamic process that—in addition to having a well-defined and appropriate target—requires a comprehensive, forward-looking monetary policy framework and robust toolkit; the highest standards of transparency, communication and accountability; and an effective transmission mechanism. Guided by this comprehensive approach, the Board of the Central Bank of Armenia reaffirms its commitment to price stability in its “Statement of Long-Run Monetary Policy Objectives” (see Box 1), which is approved and published in the first Monetary Policy Report at the

beginning of each year.

A reliable and clearly communicated inflation target is an important benchmark for businesses in decisionmaking, setting contracts, and forming inflation expectations. At the same time, the selection of the inflation target should reflect the specific characteristics of the RA economy, and take into account issues associated with accurately measuring inflation. Over time, the Central Bank may consider it necessary and appropriate to revise the inflation target to best reflect the long-term structural characteristics of the economy, its driving forces, and the vision for the country's future economic development and improvement of the country's wellbeing.

Modern economic literature asserts that an inflation target of zero is the best and most optimal mediumterm inflation target that is consistent with price stability. However, the literature also identifies a number of arguments that can explain why a low positive target is chosen in practice. These include factors relating to the zero lower bound of the nominal interest rate, downward rigidities for prices of factors of production (especially wages), and statistical errors in calculating inflation. Taking these factors into account, a low, positive inflation target is considered an acceptable and optimal solution.

In 2005, the Central Bank of Armenia published a "Rationale for the Adoption of Inflation Targeting Strategy by the Central Bank of the Republic of Armenia," in which a maximum level of 3% was set as a long-term inflation target. The Central Bank of Armenia officially implemented this inflation targeting strategy from January 1, 2006. Some months after the adoption of the inflation targeting strategy and based on developments in the global and domestic economies, a medium-term target index was set at 4% inflation with a tolerance range of ± 1.5 percentage points, while maintaining the long-term inflation target of 3%.

Since the adoption of the inflation targeting strategy in 2006, the Central Bank has consistently achieved the proposed 4% inflation target. As such, between 2006 and 2024, the average year-over-year rate in Armenia has stood at approximately 4.0%. This is the most important indicator of the success and effectiveness of the CBA's monetary policy. However, it is important to note that this has not fully translated to the public perceiving price stability, as during various regional and internal shocks, the Armenian economy often faced risks of inflation and deanchored inflation expectations. The prevalence of similar situations over the course of Armenia's monetary policy history may offer signals that the 4% target may currently not be consistent with the definition of true price stability, or that maintaining price stability in line with a 4% target may come at the expense of significant social costs.

Since the introduction of inflation targeting by the Central Bank of Armenia in 2006 and the establishment of a 4% inflation target, the CBA Armenia has made significant investments in developing the Forecasting and Policy Analysis System (FPAS) for monetary policy. Investments in the FPAS over time have laid a solid foundation for implementing wide-ranging reforms in this direction in the present period. In the context of variegated challenges, soberly assessing the limitations arising from the existing system, and clearly understanding the issues facing the Armenian economy, the CBA has always shown its readiness to implement new and appropriate reforms. Against this background, in 2024, the Central Bank of Armenia officially introduced an innovative and progressive approach to monetary policy aimed at prudently managing risks and uncertainties.

Since the independence of the Republic of Armenia, the country's economy and economic situation have improved significantly, becoming more robust, diversified, and globally interconnected. Parallel to this economic growth and development, the central bank's framework and strategy for price stability and monetary policy have also undergone fundamental changes and developed in several stages, providing a stronger and more robust foundation for prudently managing a growing layering of risks and uncertainties. In recent years, the Armenian economy has benefitted from consistent structural and institutional improvements, while the financial system has made significant strides in becoming more developed and robust, whether in terms of its depth, diversity of sectors, or significant expansion of its toolkit. It is also worth mentioning that with the successes achieved in the fields of monetary and macroeconomic policy as well as in developing robust policymaking frameworks, Armenia is currently "classified" by international experts and investors as a country with a leading monetary policy framework. Therefore, setting a lower and consistent inflation target is also an important factor from the perspective of Armenia's international reputation and rating.

Considering the above, recent developments and achievements in Armenia's economy and monetary policymaking framework provide a solid foundation for the Central Bank of Armenia to continue working to strengthen public confidence in monetary policy, develop the monetary policy framework, and implement large-scale, long-term reforms. This includes setting a lower inflation target that is consistent and compatible with the perception of true price stability and the current structure of the financial and economic system.

[Inflation Target in Armenia](#)

