

Inflation report 2022/1 (Monetary Policy Program Q1, 2022, Status report on implementation of the Monetary Policy Program, Q4, 2021)

2022-03-28

Executive summary

At the beginning of 2022, both the global economy and the Armenian economy experienced a rapid recovery of economic activity, and 12-month inflation in Armenia was declining at a faster pace than expected. The escalation of the Russian-Ukrainian military-political conflict and sanctions imposed on the Russian Federation have created unprecedented uncertainties in terms of both global and regional economic developments. Amid significant uncertainties and complex risks, the Central Bank of Armenia developed several scenarios for the development of the situation, one of which underpins the current monetary policy program.

According to this scenario, as a result of the Russian-Ukrainian military-political conflict and the application of severe sanctions against Russia, a significant slowdown in economic growth, and in the case of Russia, an economic downturn, is expected this year. At the same time, supply chain disruptions and current uncertainty incited a significant expansion of inflationary environment in various global commodity markets, including energy and food, and inflation expectations have amplified.

These developments, in particular the sanctions imposed on Russia, will strongly affect the Armenian economy, mainly by way of industrial decline and shrinking remittances. The negative impact of the latter on the gross demand will be partially offset by the expected recovery in the sphere of tourism due to the significant growth of tourists visiting Armenia, mainly from Russia. On the other hand, a number of goods imported from international commodity markets convey a strong inflationary effect to domestic prices, which in turn is reflected in the increased inflation expectations and risks.

According to the scenario designed by the Central Bank of Armenia, in view of the above-mentioned factors, a high inflationary environment is expected in the coming quarters. In such circumstances, given the significant increase in the country's risk premium and rising inflation expectations, the Central Bank has already raised the policy rate through a relatively large step. Along with previous policy rate hikes, this will lead to a gradual

decline in 12-month inflation under the expected macroeconomic developments and stabilization around the target 4% in the medium term.

According to this scenario of the Central Bank's short-term projections, in case of a negative impact of the economic sanctions imposed on Russia, which is the main partner of the Republic of Armenia, the Armenian economic growth forecast in 2022 has been significantly lowered. In the medium term, economic growth will also be lower than previously expected. Economic growth will remain low until the end of the year, then it gradually will accelerate and stabilize around a long-term equilibrium level.

The revision of economic growth forecast for 2022 is largely conditioned by the expected decline in industry, as well as the slowdown in growth in construction and services. At the same time, aggregate demand will be negatively impacted by weakening external demand and a significant reduction in remittances, while tourism is expected to have a positive contribution. The slowdown of economic growth in the medium term will result from the expected frail investment climate, which in turn will lead to a slower recovery in productivity.

The risks of inflation and economic growth deviating from the predicted trajectory in the forecast horizon are balanced (see the details in Subsection 2.2.4 “Key Assumptions and Risks”). Amid the current geopolitical developments and high uncertainty, the Central Bank is reviewing various scenarios and monitoring changes in the macroeconomic situation on a daily basis, and in case of any emergence of risks, stands ready to respond accordingly, ensuring the fulfilment of the price stability objective in the medium term.

[Inflation report \(Monetary Policy Program Q1, 2022, Status report on implementation of the Monetary Policy Program, Q4, 2021\)](#)

[Graphs and tables Q1, 2022](#)