

Inflation report 2021/1 (Monetary Policy Program Q1 2021, Status report on Implementation of the Monetary Policy Program Q4 2020)

2021-03-30

Executive summary

Amid the continuing spread of the coronavirus worldwide, the state of martial law declared in Armenia since the end of last year, and the resulting uncertainty over the economic outlook, Armenia at the beginning of 2021, continues to experience low economic activity and a weak demand environment. Meanwhile, a sizable surge in inflation and inflation expectations was observed. It is estimated that the inflationary trends were mainly due to supply factors, including inflationary effects transmitted from international commodity markets, as well as depreciation of the dram.

According to the baseline scenario of the Central Bank of Armenia, in the coming quarters 12-month inflation will remain at a high level. This will be mainly due to short-term supply factors, the impact of which will be gradually offset by the downward adjustment of inflation in the medium term. Given the short-term nature of inflation factors, monetary policy of the Central Bank in the near future will be aimed at neutralizing any risk of the acceleration of inflation expectations, without harm, as much as possible, to recovery of domestic demand.

In the light of the implemented monetary policy and anticipated economic developments, 12-month inflation will still be persisting at a high level, while in the medium-term it will decline in the weak demand environment, stabilizing around the target of 4.0%. Given the projected path of inflation and continuing sluggish demand, as well as the important role of previous tightening of monetary conditions under the principle of future-oriented monetary policy in terms of curbing inflation and inflation expectations (refinancing rate increase in December 2020 and February 2021 by a total of 1.25 percentage point), the Central Bank decided to leave the refinancing rate unchanged.

According to the Central Bank's short-term forecast scenario, the annual economic growth forecast for the beginning of 2021 amid a new wave of the pandemic, the ongoing martial law and uncertainty over the economic outlook has been revised slightly downwards compared to the previous one. In the medium term, economic growth will recover

somewhat, but only at the end of the horizon will it approach the estimated long-term equilibrium because of the expected low growth trends in productivity and investment.

Economic growth in 2021 will be mainly driven by growth in output from the construction and agriculture sectors, accompanied by some recovery in private spending growth, while domestic demand will remain weak due to low private consumption. Against the background of the gradual contraction of fiscal policy in the medium term, the expansionary monetary policy combined with gradual neutralization of the negative factors of demand will greatly contribute to the recovery of economic growth.

Risks of deviation from the forecast inflation and economic growth in the forecast horizon are balanced (see subsection “2.2.4 Main Assumptions and Risks”). The Central Bank monitors macroeconomic developments and in case of any emergence of risks the CBA stands ready to respond accordingly, ensuring the fulfilment of the price stability objective in the medium term.

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[Graphs and tables Q1, 2021](#)