

Inflation report 2017/2 (Monetary Policy Program Q2, 2017. Status report on implementation of the Monetary Policy Program Q1, 2017)

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Executive summary

The economic activity in the first quarter of 2017 has been strong enough compared with the forecasts, primarily due to higher output in industry and services sectors. Consequently, the Central Bank of the Republic of Armenia (“the Central Bank”) has revised the 2017 economic growth forecast upside. In the forecast horizon the economic growth will accelerate, gradually approaching the long-term equilibrium. In the first quarter of 2017 the deflationary environment largely phased out, and the 12-month inflation rate stood at -0.1% in late March but continued increasing up to 1.2% in April. Up until the yearend the inflation will continue to expand, shaping within the lower bound of the confidence band, and in the forecast horizon it is expected to stabilize around the target.

The economic activity in the first quarter of 2017 significantly exceeded the Central Bank’s predictions as it amounted to 6.6%, in which case the first quarter’s economic growth was revised upside, in the 5.0-5.4% range. Expansionary monetary and fiscal policies implemented by the Central Bank and the Government of Armenia in 2015-2016 have contributed to the recovery of domestic demand, which resulted in revised private consumption and private investment figures, amounting to 5.0% and 3.7% in real terms (3.0 and 2.0 percentage points higher than previous forecast, accordingly). It should be noted that domestic demand was recovering at a faster pace. In the first quarter of 2017 the net real export indicator declined in the light of high real growth in import of goods and services and is an estimated 11.5%, whereas real export of goods and services grew by 1.5%.

In the first quarter of 2017 the deflationary environment almost phased out, while the 12-month inflation rate stood at -0.1% in late March and it rose up to 1.2% in April. Because inflation was likely to follow somewhat a slower path to target in consideration of lower prices expected for some non-food products compared with the previous forecast as well as reduced gas and electricity tariffs since January and February, accordingly, the Central Bank lowered the refinancing rate by 0.25 pp in February to 6.0% but left it unchanged in

March, since some inflationary risks were beginning to materialize (see details in section “3.1.1. Actual inflation and fulfillment of the inflation target”).

According to the Central Bank forecasts, no significant changes are forecast for global economic growth rates and developments in international commodity markets. However, indicators of remittances of individuals were adjusted upward owing to continued recovery of the Russian economy and revision of the ruble appreciation. In this circumstance, minor inflationary pressures from the external environment are likely.

The Central Bank’s estimates of the 2017 economic growth rates were revised upside mostly thanks to much higher economic activity registered in the first quarter of 2017 and materialization of some of the risks to growth outlined in the previous monetary policy program. As a result, the 2017 economic growth is expected within 3.3-4.8%, and the increase is driven solely by domestic demand. What is more, such high growth will offset in part the effect of decline in external demand because of deteriorated net exports. In the structure of domestic demand, private consumption is forecast to grow by 4.3%, private investment, by 6.0%, as well as export and import of goods and services in real terms, within 3.0-5.0% and 4.0-6.0%, respectively. In the meantime, the fiscal policy is predicted to leave a 3.0 pp contractionary impact on aggregate demand during the year, compared to last year (former forecast remained unchanged). This, however, will be adjusted, depending on the pace of implementation of fiscal policy. From the supply perspective, the growth in industry and agriculture will contribute to the economic growth on the whole. The medium-term forecasts have not been revised; the economic growth will be in the range of 2.7-4.5% in 2018, and 3.1-5.2% in 2019. However, if current high rates of economic growth are maintained, the medium-term forecasts will be revised upward, too.

Thus, in the forecast horizon up to the second quarter of 2018, the domestic demand’s deflationary impact on domestic prices will gradually weaken. Then, up until the end of the forecast horizon, it will turn into that of inflationary, which is in line with the forecast of the previous program.

According to the Central Bank forecasts, the inflation indicator forecast for end-2017 was revised upside driven by higher-than-expected prices of seasonal products on the one hand and in anticipation of faster recovering prices of non-food products and services during 2017 amid accelerating pace of recovery in aggregate demand on the other. The Central Bank estimates that by the end of the year the 12-month inflation rate will be within the lower bound of the confidence band and in the rest of forecast horizon it will gradually stabilize around the 4% target.

Given the assessment that current monetary conditions are still stimulating and facilitate the recovery of aggregate demand and help the inflation stabilize around the target, the Central Bank considers it appropriate to leave monetary conditions unchanged in the second quarter of 2017.

Risks that inflation will deviate from the projected value are generally balanced in both short and medium-term perspectives. Risks deriving from external and domestic sectors amid gradually rebounding global economy and the aforementioned developments in the domestic sector are generally estimated as balanced as well. If these risks materialize, the Central Bank will react accordingly by maintaining the inflation target in the medium run.

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