

Inflation report 2017/3 (Monetary Policy Program Q3, 2017. Status report on implementation of the Monetary Policy Program Q2, 2017)

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Executive summary

According to the Q3, 2017 Monetary Policy Program of the Central Bank of Armenia (“the Central Bank”), up until the end of 2017 the inflation will continue expanding, shaping within the confidence band; in the forecast horizon it will stabilize around the 4% target.

Positive developments in the macroeconomic environment expected in the short run will primarily contribute to the recovery of the 12-month inflation rate, owing to relatively high activity observed in both the external and domestic economies since the beginning of the year. At the same time, it is estimated that the impact of expansionary monetary policy on inflation will still be noticeable. Macroeconomic developments of the second quarter have been mostly in line with the baseline scenario, so the Central Bank decided to leave the monetary conditions unchanged; this corresponded to the impulses the Central Bank’s Board previously gave to the financial market that should the expected macroeconomic developments unfold the policy rate would remain unchanged for some time. The Central Bank estimates that monetary conditions will further be expansionary in the foreseeable future, under which circumstance the GDP gap will run slightly positive in the medium run, making sure the inflation stabilizes around the target in the forecast horizon.

In view of registered high economic activity in the first half of the year, the Central Bank has revised the 2017 economic growth forecast upside. In the forecast horizon the economic growth rates will accelerate, gradually approaching the long-term equilibrium.

Economic growth is recovering primarily by supply factors, owing to increased productivity in industry and service sectors, in particular. Rebounding of aggregate demand is underpinned by both continuous recovery of external demand and positive behavior of domestic demand, which, under a contractionary fiscal policy, is fully driven by expansionary monetary policy implementation. In the structure of domestic demand, private investment also increases; this may positively contribute to the GDP growth potential in future.

Economic growth in the medium-term will strive for its long-term potential, staying within a 4-5% range. In the meanwhile, the tradable sector of the economy will remain the key driver to economic growth, which will be fueled by persistent productivity growth rates and Armenia's competitiveness in an inflation environment much lower than in trade partner countries.

In the forecast horizon risks to the implementation of monetary policy program are balanced and largely depend on how fast the global and domestic demand will recover. In the short-term, inflation risks may also show up as a result of volatile prices of domestic agricultural products and raw materials in international markets, as well as because of geopolitical developments and economic expectations thereon. If these risks materialize, the Central Bank will react accordingly by maintaining the inflation target in the medium run.

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