

Inflation report 2014/2 (Monetary Policy Program Q2 2014, Status report on Implementation of the Monetary Policy Program Q1 2014)

2014-05-20

Executive summary

The Central Bank forecasts suggest the 12-month inflation will keep on reducing to the lower bound of the confidence band in Q3, 2014 but will come closer to the target in Q2, 2015 and stay around in the rest part of forecast horizon. The economic growth will speed up in 2014-2015 and stabilize around its potential in the rest part of forecast horizon.

In Q1, 2014, the economic environment remained sluggish due to the slow pace with which construction was recovering as well as modest growth of industrial output. Slow private consumption growth rates and weak investment activity observable since the previous year also contributed to such an environment: in Q1, 2014 private consumption growth is estimated 1.8% y/y, while private investment has declined by 4.5% y/y. As a result, it is expected that economic growth in the first quarter would range 3.2-3.5% y/y.

According to short-term forecasts, private consumption growth rates will accelerate, with a stable investment environment; so in 2014, private consumption will grow by 4.6% and private investment will persist almost at the same level. In anticipation of expansionary fiscal policy during the year, the fiscal impulse will leave some 0.7 pp of expansionary impact. Based on the 2014 results, the real growth of export of goods and services will be in the range of 5.5-7.5%, the real growth of import within 1.5-3.5% and the growth rate of remittances of individuals within 4.5-6.5%. As a result, economic growth in 2014 is estimated in the range 4.1-4.8%, due mainly to good performance in the agriculture and service sectors (a total contribution of 3.0 pp),

In the forecast horizon the economic growth will stabilize around its potential, reflecting steady private consumption growth rates and slowly rebounding private investment. Thus, in the forecast horizon, stabilizing private demand as well as neutral impact of the fiscal policy is expected to create non-inflationary effect on domestic demand.

In Q1, 2014, external demand remained sluggish: Armenia's main trade partners, other than the Euro-area, reported trends of slowing economic activity. In such a situation,

deflationary patterns prevailed in international markets of basic commodities and food products.

In the forecast horizon, a slow pace of recovery in global economic growth rates is anticipated, under which conditions notable inflationary pressures are not likely to come from international markets of basic commodities and food products.

In Q1, 2014, the 12-month inflation trended down – from 5.6% in late 2013 to 3.8% in end-March 2014, approaching the upper bound of the band. In the first quarter, core inflation also demonstrated a downward trend, with its 12-month indicator dropped to 1.8% in end-March from 3.7% reported in early of the year.

In Q1, 2014, the Central Bank further eased the monetary conditions by cutting the refinancing rate further (0.25 pp) to 7.5% in end-March (see details in section 3.1.1 Actual inflation and attainment of target). The dram reserve requirement ratio, lowered from 4% to 2% since February 2014, was another step of easing.

In 2014, inflation will continue to decline at a rate faster than expected, according to the Central Bank projections, and in the third quarter it will be closer to the lower bound of the band as the effect of energy prices risen in July of 2013 phases out. In Q2, 2014, the Central Bank will further loosen the monetary conditions. This, coupled with the easing of monetary conditions to date and an expansionary fiscal policy anticipated during the year, will stimulate aggregate demand and push inflation rates to rebound. As a result, the economic activity will somewhat revive whilst facilitating the inflation to stabilize around its target over the forecast horizon.

According to the Central Bank estimation, the 12-month inflation in 2014 will be within 2.5-5.5%.

Risks to inflation deviating from the projected value are estimated as balanced in both short and medium-term perspectives. The primary risks are associated with the development perspectives in emerging economies and domestic demand. If such risks materialize, the Central Bank will react accordingly by maintaining the inflation target in the medium run.

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