

Inflation report 2012/3 (Monetary Policy Program Q3, 2012. Status report on Implementation of the Monetary Policy Program Q2, 2012)

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Executive summary

There was 3.1 percent of deflation recorded in the second quarter of 2012 compared to that of 1.6 percent in the previous reference period, and the 12-month inflation further subsided to 0.7 percent at the end of June. A low 12-month inflation indicator has been totally due to 0.9 percent decline in food prices whereas non-food prices and service tariffs have posted increases as expected, by 3.9 percent and 1.9 percent, respectively. In the forecast horizon the developments in world economy and domestic economy mark some expanding of the inflation environment. In the upcoming period of time the 12-month inflation will go up, reaching a lower border of the confidence band at the end of the year. Then, in the forecast horizon, it will be managed primarily around a 4 percent target level.

In the first quarter of 2012 economic growth was 4.7 percent. The Economic Activity Indicator for the second quarter of 2012 released by the National Statistics Service of Armenia points to an enlivened economic activity, which is a result of increased output volumes in industry, agriculture and services. According to a baseline scenario, there is much probability that economic growth in 2012 will be in the range 5.6-6.7 percent, attributable to expected faster recovering of external and domestic demand in the light of optimistic domestic economic growth outlook. Economic growth will continue to be driven mostly by increased value added in services, industry and agriculture: in 2012 these will amount to roughly 5 percent 9.5 percent and 7.5 percent, respectively. The outlined trends of economic growth will persist over forecast horizon while economic growth will stabilize within the 4-5 percent interval.

In the labor market in the second quarter of 2012, average nominal wage grew by 6.0 percent and official unemployment reduced by 0.3 pp to 18.9 percent, according to the Central Bank estimates. In the light of expected economic activity, in 2012 the labor market will anticipate 6.2 percent growth of average nominal wages and 0.3 pp reduction of unemployment. Given the baseline scenario-developments with economic growth persist, such growth rates of average nominal wages and reduction of unemployment will

continue in the forecast horizon, too. Material imbalances affecting the inflation in the labor market are not anticipated, either.

Real growth of private spending in the second quarter of 2012 was 3.5 percent, according to the Central Bank estimates, whereas private investment has contracted by 11.5 percent. In the second half of the year growth rates of private spending is expected to remain relatively strong (7.1 percent) while private investment is anticipated to recover slowly (4.1 percent) after the first half's decline. In the private sector, total expenditures will grow by 6.4 percent. There is anticipation that in the forecast horizon high growth rates in private consumption will be adjusted downside to carry on with somewhat a slower and steadier pattern. Growth rates in private investment will bounce back, contributing to added private spending and sustainable economic growth.

In the second quarter of 2012 the impact of fiscal policy on aggregate demand was neutral, according to the fiscal impulse indicator, which was determined by expansionary impact of revenues (1.25 pp) and contractionary influence of expenditures (1.1 pp). For 2012, the fiscal impulse was estimated to be 1.1 pp contractionary according to the baseline scenario, attributable to restrictive influence of both revenues and expenditures. In the forecast horizon the fiscal policy will be steered to an effective debt management and maintaining the debt/GDP ratio up to a 3 percent level, under which circumstance the impact of fiscal policy in forecast horizon is estimated to be non-inflationary.

In the second quarter of 2012, relative to the previous reference period, the deficit of current account has improved in the light of developments in world economy and domestic economy. The dollar value of export of goods was nearly the same as in the second quarter of the previous year while that of import of goods amounted to 3.8 percent y-o-y. Growth rates in remittances of individuals somewhat slowed down due to slackened economic growth rates in Russia. Over 2012 current account will keep on improving and the current account/GDP ratio will be in the region 10-12 percent, which will be determined by higher growth rates of imports in real terms and reduced export prices. In 2012 the dollar value of export of goods and services is expected to increase by 6-8 percent, and that of import, by 5-7 percent. The growth of net inflow of noncommercial transfers of individuals will be in the range of 10-12 percent in 2012.

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