

Inflation report 2012/4 (Monetary Policy Program Q4, 2012. Status report on Implementation of the Monetary Policy Program Q3, 2012)

2012-11-08

Executive summary

There was 1.1 percent of deflation recorded in the third quarter of 2012 compared to that of 2.8 percent in the same period of the previous year, and the 12-month inflation ascended earlier the third quarter after continued subsidence in the course of the first half of the year and reached 2.5 percent in end-September. The 12-month inflation indicator has been totally due to 1.8 percent increase in food prices (with 0.96 pp of contribution to headline inflation) and 5.7 percent and 2.1 percent rises y-o-y in non-food prices and service tariffs (with 1.55 pp of contribution to headline inflation). 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 3.4 percent. Then, in the forecast horizon, it will be managed primarily around a 4 percent target level.

In the second quarter of 2012 economic growth was 6.6 percent y-o-y, with the January-June growth having reached 6.2 percent. The Economic Activity Indicator for the third quarter of 2012 as 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 high probability that economic growth in 2012 will be in the range 7-7.4 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 end-2012 these will amount to roughly 6 percent, 9.5 percent and 11 percent, respectively. The outlined trends of economic growth will persist over forecast horizon while economic growth will stabilize within the 5-6 percent interval.

In the labor market in 2012 the growth of average nominal wage will be 5.7 percent and official unemployment will reduce by 1.2 pp to 17.2 percent, according to the Central Bank estimates. 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.

With private consumption and private investment growing by 8 percent and 4.8 percent, respectively, private spending will grow by 7.2 percent in 2012 and bring in some inflationary pressures in the consumer market in the second half of the year, according to the Central Bank estimates. Growth rates in private consumption and private investment for 2013 were revised upside against previous forecasts and are predicted to reach 4 percent and 5.5 percent, respectively. Whereas private spending will grow by 4.4 percent while its deceleration will loosen the inflationary impact. There is anticipation that in the forecast horizon private consumption will grow at somewhat a slower but steadier pace compared with high growth rates observed in 2012. Private investment will continue rebounding after the slump in the first half of 2012 and will grow in a stable pattern in the medium run, contributing to sustainable economic growth and not creating inflationary pressures.

In the third quarter of 2012 the impact of fiscal policy on aggregate demand was contractionary according to the fiscal impulse indicator. This is within the Central Bank projection and determined by contractionary influence of revenues (0.57 pp) and of expenditures (0.51 pp). For 2012, the fiscal impulse was estimated 1.1 pp contractionary according to the baseline scenario, attributable to savings on government expenditures. In 2013 the fiscal policy's impact on aggregate demand is predicted to be neutral, which will be driven by restrictive influence of revenues and that much expansionary impact of 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 is estimated to be noninflationary.

In end-2012 the deficit of current account to GDP ratio will be around 9 percent compared with 10.9 percent recorded in the previous year. In the third quarter of 2012 the ratio is estimated to drop by 1.5 pp.

With slower rates of recovering of world economy and persisting high growth rates reported in domestic economy, the deficit of current account in the third quarter of 2012 has shrunk in relation to the third quarter of the previous year. With export prices reducing, the dollar value of both export and import of goods has decreased by 5.3 percent and 8.7 percent, respectively, in relation to the same period of the previous year. In the third quarter growth rates in remittances of individuals persisted chiefly determined by economic developments in Russia.

In 2013 the dollar value of export of goods and services is expected to increase by 4-6 percent, and that of import, by 3-5 percent. The growth of net inflow of non-commercial transfers of individuals will be in the range of 8-10 percent as Russia's economic growth forecast for 2013 is revised down. Current account will keep on improving in forecast horizon and is predicted to be within a 6-8 percent interval, a more favorable position relative to the previous program.

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