

The Monetary Policy Program of the Republic of Armenia 2004

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2004 THE STRUCTURE OF THE MONETARY POLICY PROGRAM

The Monetary Policy Program 2004 of the Republic of Armenia comprises the development of the economy in the medium term. This includes retaining sustainable economic development and low inflation, further improvement of balance of payments, and enlargement of the financial sector by ensuring stability in the sector. The Program is built commensurate with the provisions of Armenian Law on Central Bank.

It presents the directions of the 2004 policy implementation and forecasts the indicators in line with forecasts of all the sectors of the economy (Annex 2). The macroeconomic developments in all the sectors of the economy in 2003 are emphasized in the Program as a precondition for the forecast of the macroeconomic environment for 2004.

The section Introduction provides the basic principles of the macroeconomic model underlying the forecast of the macroeconomic indicators. It refers to the features of macroeconomic environment of 2004, which would be considered important in implementing the monetary policy.

The section Macroeconomic Developments in the Republic of Armenia contains the factors determining the developments of aggregate supply and aggregate demand. Indicators of economic growth, inflation and Gross Domestic Product (GDP) deflator are summed up by comparing the real growth and price changes. There is a detailed account of how the private sector and other branches of the economy develop combined with the behavior of the private consumption and capital investment in aggregate demand.

The section Fiscal Policy provides an analysis of the revenue and expenditure policy of the state budget and size of the deficit and structure of financing sources, based on the viewpoint of the impact of the fiscal policy on aggregate demand, and the coordination of the two policies with the monetary policy.

The section External Sector contains the development of current account components and capital and financial accounts from the viewpoint of the impact and dependence on

aggregate demand. The section covers the issue of sustainability of external debt of Armenia while describing how certain debt sustainability indicators behave. The section refers also to Armenian dram's real effective exchange rate and the factors responsible for its changes.

The section Inflation surveys the impact of certain sectors of the economy on consumer price index for 2003 while commenting on the impact of wheat price growth in international markets on inflation (as high as 8.6 % in Armenia). The principles of monetary policy 5 implementation in this context are set forth. The reality of maintaining up to 3 % inflation in 2004 is also commented on in view of the impact of certain sectors of the economy and monetary aggregates.

The section Monetary Policy has two parts: i) Directions and Trends of the Monetary Policy in 2003 and ii) Issues and Directions of Monetary Policy in 2004. The first part describes behavior of the programmed and actual levels of demand and supply for money in 2003. This will cover the impact of changes in economic activity throughout the year, as reflected in the development of demand for various monetary aggregates and their components. The process of money supply change is commented on in view of both commercial bank lending to the economy and accumulation of net foreign assets, and operations carried out by the Central Bank. The pace of monetary policy is provided here more circumstantially, depending on variable patterns of economic activity, inflation and the coordination of monetary and fiscal policies.

The second part provides forecasts for money demand for 2004 by individual aggregates, based on expected developments in overall macroeconomic environment and growing financial intermediation. Consistent with forecasted demand for money, the provision of money supply is also commented on in view of commercial bank lending to the economy and proportional accumulation of net foreign assets. The assets side of monetary policy is reviewed pointing out the use of various policy instruments with directions based on expected operations of commercial banks and fiscal policy indicators projected for 2004.

The next section deals with the risks in implementing the monetary policy program. It provides all potential divergences in all the sectors of the economy from what has been forecasted for 2004. Such divergences are treated as risks in retaining the defined levels of inflation and monetary aggregates. Revision of the program levels of monetary aggregates is another issue for review, which implies that such a need would arise if the economic growth indicator deviates considerably from the program. The section Development of the Banking System covers the basic banking system indicators that help estimate the levels of development of the banking sector and maintenance of financial

stability. This section presents those institutional measures of the Central Bank that will play an important role in developing the banking system.

The section Development of Payments and Settlements Relations provides an account of actions and identifies areas to further stimulate development of the sector. 6 Forecasts of basic macroeconomic indicators for all sectors of economy for 2004, and the methods of forecasting, are provided in the program as Annexes.

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