

The Monetary Policy Program of the Republic of Armenia 2003

2003-01-27

2003 Introduction

The Monetary Policy Program for 2003 is based on the directions of the medium-term economic developments, which include preserving achieved levels of economic growth and inflation; macroeconomic and financial stability; and continuous improvement of the balance of payments. The program is designed in accordance with the requirements of Armenian Law on “The Central Bank”. The program presents an analysis of developments in all sectors of the economy in 2002 under the macroeconomic environment, and provides forecasts for 2003 with a detailed account of the course, objectives and trends of the monetary policy (Annex 2). The macroeconomic environment for implementation of the monetary policy in 2003 would broadly have the same patterns as were in 2002, owing to a considerable financial inflow expectable for 2003, too. The developments that are expected in the financial sector might be considered particular for 2003. The deposit insurance system, further remedies in the banking sector and existing preconditions for creation and development of non-bank financial institutions would serve an essential stimulus for more extensive financial intermediation.

The first section of the program “The Macroeconomic Developments in the Republic of Armenia” describes the factors determining the developments of the aggregate supply and the aggregate demand in 2002. The section marks an intensive real growth rate of the aggregate supply in 2002 owing to the industry and the construction, and the sequential trends in the course of the next year. The forecasts relative to the other branches of the economy also witness that the real growth of the aggregate supply would behave stably. The aggregate demand would have moderate rates of growth. The main factors stimulating such growth, as were in 2002 too, include the disbursement of the grant of the Lincy Foundation and of the external funds for the budget deficit financing. The private consumption as a basic component to the aggregate demand would remain in lower growth rates in respect of the income growth. This is viewed as a result of incremental growth of savings in the economy and still high inequality of incomes. The section also presents the GDP branch and expenditures deflators and the GDP deflator assessed by comparison of the above two deflators.

The second section “The Fiscal Policy” opens with a notice to the course of the fiscal policy

of 2002 marking the more robust collection of taxes compared with the previous years, and the execution of the annual program. The section then introduces the issues that have complicated the handling of the aggregate demand and the coordination with the monetary policy pointing out a still low level of taxes in the GDP, a heavily disproportionate collection of taxes in each month and the delays in disbursements of external funds for the budget deficit financing. With respect to the program indicators of the budget for 2003, the section provides that the net influence of the expenditures and incomes on the program level of the aggregate demand would be somewhat expansionary, while the indicator of the primary deficit in the GDP would make the share of the external debt in the GDP to remain on the 2002 level.

The third section "The External Sector" reviews the expected trends for the current account components of the balance of payments and for the deficit, the autonomous sources of its financing, and the change in international reserves due to implementation of the monetary policy. It is predicted that the share of the current account deficit in the GDP (including the official transfers) would slightly shrink against 2002 mostly due to outstripping growth rates of the exports compared to those of imports. The section also provides forecasts on the real effective exchange rate, the terms of trade and the import and export prices for 2003.

The fourth section "The Inflation" points out the basic factors that entailed 2.0% inflation given the high growth rates of incomes and a more expansive monetary policy conducted by the Central Bank in 2002. The calculation for 2003 provides that the difference between the salary and productivity, the change in the import prices and the share of indirect taxes in the GDP would probably affect the consumer price index. Similarly, the likely impact of such factors on the consumer prices was calculated for 2003. In view of this and the importance of low inflation, the joint economic program has defined a desired level of inflation of up to 3% for 2003. The fifth section "The Directions and Trends of the Monetary Policy in 2002" describes behavior of the economic growth and inflation throughout the year and the money demand patterns, and the issues of the money supply regulation determined by financial flows.

The growth trends for the monetary aggregates are commented according to individual components whose behavior indicates a deeper financial intermediation. The growth rates of dram deposits were far high in comparison with the years before. The description of behavior of the monetary aggregates considered incidence of the data of only 22 banks since January, 2002, as the indicators of 6 banks, where the Central Bank has assigned temporary administration, were removed from calculation of the monetary indicators. The conducted monetary policy, which was targeted to preserve an annual inflation indicator,

is assessed as sufficiently expansionary, and the decrementing annual index of the monetary terms is an evidence of this. The section provides evaluation of the monetary and fiscal policy coordination (which has not been impressive in terms of improved efficiency) especially in respect of smooth handling of the current liquidity of the banking system and the aggregate demand. This is broadly determined by severely disproportional tax collection and a huge amount of accumulations in the Unified Treasury Account over the months.

The sixth section "The Main Issues and Directions of the Monetary Policy in 2003" provides monetary indicators forecasts for 2003 based on the expected developments in the overall macroeconomic environment, medium term economic development trends and setting the inflation up to a 3% target. Despite the projected slow rates of growth even compared to the end of 2002, the average annual growth rates of the monetary aggregates would further outpace the growth rates of the nominal GDP. This is attributable first of all to a steep increase of the money supply as huge budgetary foreign currency flows were converted at the Central Bank at the end of 2002. The money multiplier and the dram multiplier would increase given the predicted continuous growth of foreign currency and the dram denominated deposits and the reserve requirement to be lowered from July of 2003. Consequently, the average annual growth rate of the monetary base would lose to growth rates of the broad money and the dram broad money, but would exceed the growth rate of the nominal GDP.

Considering the large-scale growth of the monetary base at the end of 2002 and the financial influx expected in 2003, the monetary policy would increasingly use absorbing instruments. The program underlines the importance of an improved efficiency of coordination with the fiscal policy to moderate liquidity fluctuations in the banking system and handle the overall demand more smoothly. The overall interest rates, and the difference between interest rates on loans and deposits are predicted to decline as the projected monetary aggregates grow and the loan portfolio of the banking system improves by quality. Surely, the execution of the program of the monetary policy includes risks relating to potential divergences that are likely to arise out of individual sectors of the economy. The seventh section "The Risks in Execution of the Monetary Policy Program" refers in detail to such risks. The section addresses the possible approaches to revise the program should risks occur, or arise a need to neutralize them, and ensure a target indicator of inflation.

The eighth section "The Development of the Banking System" provides that the banking system has entered a new, rehabilitation phase as the Central Bank started to remove inefficiencies of weak and insolvent banks and endorse a handful of legislative and

regulatory papers to further enhance the rehabilitation process. Creation of a deposit guarantee scheme, a credit registry and credit institutions, as stipulated in the law, comes as part of the regulations. The execution of the program of such remedies and reforms in the banking sector with a time span of up to the year 2005 would presume a stronger and sounder banking system with continuous growth of its profitability and financial intermediation.

The ninth section, the last one, “The Development of the Payments and Settlements Relations” introduces the complex measures to further develop the banking system, enlarge the scope of financial and banking services and improve the quality of such services. To encourage non-cash circulation, use of plastic cards as a means of payment is intended to enlarge not only at commercial and retail outlets but also in payments for public utility services. The Central Bank would continue work to improve the payment and settlement systems operations and further regulate the sphere.

[The Monetary Policy Program of the Republic of Armenia 2003](#)