

Inflation report 2023/2 (Monetary Policy Program Q2, 2023, Status report on implementation of the Monetary Policy Program, Q1, 2023)

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EXECUTIVE SUMMARY

In the second quarter of 2023, the economic growth rates in the main partner countries to Armenia are still sluggish, which is accompanied by continuous easing of the inflation environment. Nevertheless, in all partner countries, as inflationary pressures derived from labor markets linger, the prices of goods and services that stand out with “sticky” prices still remain high. The central banks of those countries will therefore carry on tightening monetary conditions in the near future. As a result, global demand will continue to weaken, contributing to lower prices in international commodity markets.

The trends of high economic activity in Armenia are persisting, which is primarily sustained by the positive developments in the construction sector and strong external demand in the services sector. At the same time, continued weakening of the inflationary effects spilling over to the Armenian economy from the world economy, the contractionary monetary policy implemented by the Central Bank of Armenia and the dram appreciation all have resulted in a notable drop in prices of imported food products, which has in turn facilitated a rapid easing of the overall inflation environment. However, determined by high demand and inflation expectations, the inflation of services and some product groups is being adjusted more slowly.

In general, with uncertainties carrying on, the Central Bank of Armenia is striving to reduce the possible risks that arise therefrom by building and discussing different scenarios for the situation development, the one of which is outlined in this monetary policy program.

In the second quarter of 2023, the 12-month inflation declined sharply to 1.3% as of end-May. According to the scenario presented by the Central Bank of Armenia, a certain decrease in the 12-month inflation is expected in the near future, with high demand and inflation expectations persisting in the economy, in which case wages and inflation of a number of services and goods standing out with “most sticky prices” are still at high levels. Based on the above, the Central Bank of Armenia considered it appropriate to loosen the monetary conditions in a relatively small step at this stage, while further committed to eventual controlling of inflation.

In view of the monetary policy implementation and expected macroeconomic developments, the 12-month inflation will remain below the target value in the near

future, then will Chart 1 Inflation (12-month) scenario probability distribution for a 3-year policy horizon Source: Armenia Statistics Committee, Central Bank of Armenia scenario -1
0 1 2 3 4 5 6 7 8 9 10 11 2020/01 2020/03 2021/01 2021/03 2022/01 2022/03 2023/01 2023/03 2024/01 2024/03 2025/01 2025/03 2026/01 Actual inflation Current quarter's scenario Previous quarter's scenario MP's influence horizon 6 gradually increase and stabilize around the 4% target in the medium term.

According to the scenario presented by the Central Bank of Armenia, high economic activity will be sustained in the near future, whereas the growth in 2023 is expected to be higher relative to the one outlined in the previous program’s scenario.

In the mid-term horizon, as the demand side factors and positive GDP gap seek adjustment, the growth will gradually slow down and stabilize around its long-term sustainable rate of 4.5%.

In the 3-year policy horizon of the outlined scenario, the probability risks of inflation and economic growth deviating from the projection paths are mostly balanced (see subsection 2.2.3). In the case of risks emerging in any direction, the Board of the Central Bank of Armenia will adequately respond and ensure the fulfilment of the price stability objective.