

(2024/1) 2024 Q1 Monetary Policy Report Monetary Policy Program

2024-03-12

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Summary of Economic Conditions

Global Economy - In 2023H2, economic activity among Armenia's main trading partners, has been mixed; however, the risks of weaker economic activity going forward are high. The US and Russia both continue to experience high rates of growth, despite continued contractionary monetary policy. On the other hand, the Eurozone is on the precipice of a recession, while sluggish growth in China has again raised questions about the stability of its financial system and remains a key concern for a much weaker global economic outlook. Heightened geopolitical tensions in the Middle East continue to pose risks to oil prices and supply chains.

While the overall inflationary environment in the world continued to soften, strong labor markets across many countries have helped sustain demand, and the domestically driven sticky prices of goods and services in key trading partner countries remain elevated. In such a situation, the key trading partner country central banks would be expected continue to pursue relatively contractionary monetary policy in the near future, until progress on this front is realized. As a result, deflationary effects from the external environment would likely persist in a high-interest rate environment.

Domestic Demand Conditions The growth rate of economic activity in Armenia remained robust in Q4 2023, standing at 7.8% Y-o-Y, well above estimates of long-run sustainable growth of approximately 5%. Growth continues to be driven by strong activity in the trade and construction sectors. Similar trends were observed in January 2024, with the Y-o-Y economic activity index comprising 10.7%. However, the structure of growth and concentration in some subsectors serves as a source of uncertainty relating to the sustainability of growth. Moreover, growth in private consumption has slowed, though risks for future growth exist given accumulated savings and the potential for future credit expansion. Despite uncertainty, there appear to be somewhat fewer imbalances between aggregate demand and supply in the economy than in recent quarters.

Labor Market & Inflation In the context of continued strong growth and demand, pressures in the labor market continue to persist despite some softening. Relative to prior quarters, the labor market has softened somewhat, with private wage growth standing at 7.9% y/y in Q4 2023 and 6.0% y/y in January 2024 due to increases in labor supply. The potential

for labor supply to increase further, due to a combination of migrant workers to Armenia and the integration of forcibly displaced Armenians from Nagorno-Karabakh into the labor market, could help ease labor market conditions, potentially moderating inflationary pressures in the medium to long term. The inflationary environment continued to soften, primarily driven by weakened pressures coming from the external sector and the impacts of the CBA's policy stance over the past several quarters. Overall CPI inflation has remained below target since

April 2023, registering -1.7% Y-o-Y in February 2024. . Non-Traded Sticky Price Inflation, which captures domestically driven demand dynamics, remained relatively stable in January 2024, at 3.0% Y-o-Y, continuing along its gradual downward path. At the same time, inflation for services that are highly exposed to external demand have softened.

Monetary Policy The illustrative Case A scenario in the MPR, where the policy rate path would need to be higher than market expectations, is represented by a scenario motivated by the risk of higher and entrenched inflation expectations that might be masked by lower inflation, while could pose serious risk to price stability for the medium term. In such a scenario, lower real interest rates would reduce incentives to save and boost consumption, adding to existing demand pressures. This could result in a rapid acceleration of inflation, as current exogenous deflationary forces gradually fade away. In such a scenario, a tighter policy stance relative to current market expectations would be needed to anchor inflation expectations to the target and guarantee the price stability objective. The illustrative Case B scenario in the MPR, where the policy rate path would need to be lower than market expectations, is represented by a scenario in which the labor market experiences a broad expansion that generates excess supply conditions. This scenario presumes that labor supply trends noted in during 2023, including the gradual integration of forcibly displaced persons from Nagorno-Karabakh, migrant workers from India, and greater labor force participation, would continue at an accelerated pace. This would have the effect of raising labor supply, increasing potential output, and reducing pressures on wage growth, leading to excessive deflationary forces. Given this type of scenario, the policy rate would need to follow a more rapid and aggressive downward path than what is currently priced in markets in order to sustainably bring inflation back to target in the medium-term horizon.

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[Graphs and tables Q1, 2024](#)