

THE CENTRAL BANK OF
THE REPUBLIC OF ARMENIA

*Approved under the Central Bank
Board Resolution No. 89A, dated May 29, 2018*

Inflation Report

Monetary Policy Program, Q2, 2018



*Status Report on Implementation of the Monetary
Policy Program, Q1, 2018*

The inflation targeting strategy of the Central Bank of Armenia highlights the importance of communicating of the Bank to the general public by publishing, inter alia, quarterly inflation reports.

The first section of the inflation report includes the Monetary Policy Program that provides main directions of the monetary policy in the forecast horizon as well as forecasts of inflation and other macroeconomic indicators. These forecasts are based on the Bank's assessment of the current situation and future assumptions by the Bank, which also include the impact of the Bank operations.

The second section includes status report on implementation of the monetary policy program of the previous quarter, which presents the results of monetary policy implementation and covers the actual developments in the domestic economy.

Publishing of inflation forecast and assumptions underlying it makes the monetary policy of the Bank more transparent, understandable and predictable, which considerably increases the public confidence in the Bank. The Bank believes that a clear and trusted monetary policy positively affects the anchoring of inflation expectations and maintaining financial stability in terms of cost reduction.

According to the rule of monetary policy, the policy is aimed at minimizing the deviations between the 4% target and the inflation forecasts. The path to inflation rate shaped as a result of projected policy directions is published as a forecast probability distribution chart for the 12-quarter time horizon.

Projections in this report are based on the actual information available by May 15, 2018, i.e. the day on which the refinancing rate was set, the results of a survey conducted by the Bank and the judgment made pursuant to the information on future developments of the macroeconomic environment.

All inflation reports which have been published to date are available on the Bank's website which also contains all press-releases and other monetary policy-related publications.

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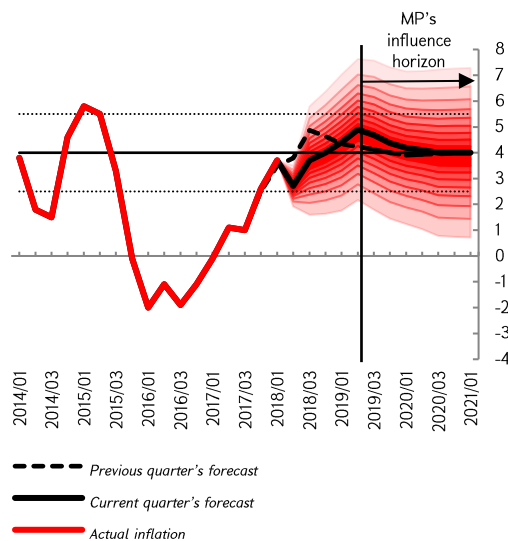
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1. EXECUTIVE SUMMARY

Inflation slowed down to a certain extent during the quarter, which was driven by the fall in prices of seasonal products. However, inflation will continue expanding over 2018, fluctuating within the confidence band; in the forecast horizon it will stabilize around the target.

Chart 1

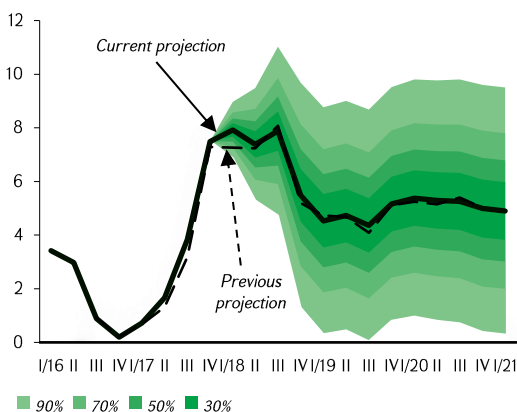
Inflation (12-month) forecast probability distribution chart for 3-year horizon



High economic activity was still persisting over the first quarter of 2018, which will gradually eliminate starting from the second quarter, approaching its long-term equilibrium.

Chart 2

Real GDP (cumulative) growth projection probability distribution chart for 3-year horizon



Inflation slowed down to a certain extent in the first quarter of 2018, driven by the fall in prices of seasonal products. However, under current monetary policy, inflation will continue expanding over 2018, fluctuating within the confidence band; in the forecast horizon it will stabilize around the target.

Positive developments in the macroeconomic environment expected in the short run will largely facilitate the fulfilment of the 12-month inflation target, owing to persisting influence of expansionary monetary policy and continued recovery in demand in the external environment. Actual developments over the past period of 2018 show that the 12-month inflation rate continued increasing in the first quarter, but declined in the second quarter due to the fall in prices of seasonal agricultural products. The estimation is that this has been a seasonality shift and will be restored in the upcoming quarters. In view of the need to strengthen the domestic demand recovery and evaluating that short-term inflation expectations of households have generally stabilized and no additional inflation developments are expected under the current conditions, the **Board of the Central Bank decided to keep the refinancing rate unchanged, leaving the monetary policy direction expansionary.**

However, in the light of predicted macroeconomic developments, **expansionary monetary conditions to phase out gradually will be needed** in the medium run, in fulfilment of the inflation target.

High economic activity was still persisting over the first quarter of 2018, which will gradually eliminate starting from the second quarter, approaching its long-term equilibrium.

According to the baseline scenario, mid-term economic growth trends are largely determined by the economy's fundamentals, as well as the implementation of investment programs, the pace of Government-led structural reforms, and by anticipated potential of economic growth in partner countries. It should be noted that the political events in Armenia resulted in a very short-term slowing in growth rates of domestic demand and economic activity in the second quarter, but they will not affect macroeconomic developments in the mid-term perspective.

In the short run, risks to inflation and economic growth are mainly dual-sided, and are determined by possible developments in the agricultural sector.

In the medium run, risks to inflation and economic growth are estimated to be balanced, in which circumstance the 12-month inflation rate is within the confidence band.

If the aforementioned risks materialize, the Central Bank will react by adjusting its monetary conditions accordingly.

¹ The growth rate of each quarter is calculated as the cumulative growth rate for the last four quarters.

2. FORECAST, FORECAST CHANGES AND RISKS

2.1. External environment

The strengthening of the global economy continued in the first quarter of 2018, and this tendency is predicted to carry on throughout the year. As for principal trade partners to Armenia, strong growth rates are expected to persist in the USA and Eurozone, while recovery will be observable in Russia after the previous quarter's slowing in economic growth.

Relatively high prices will be maintained in world commodity markets over 2018 owing to both demand and supply factors: although acceleration in global economic growth has bolstered the increase in demand, some raw materials have been affected by limited supply volumes. Weak inflation developments will still be observable in food product markets.

Economic developments in the external sector: According to preliminary estimates of the Bureau of Economic Analysis of the U.S. Department of Commerce, economic growth in the **United States** in the first quarter of 2018 was 2.9% y/y, with average economic growth projected at 2.6% for 2018 owing to robust external demand and anticipated effect from a change in the fiscal policy adopted later in 2017. In the first quarter of 2018 the unemployment rate persisted at a low level, 4.1%.

According to preliminary estimates provided by the Eurostat, economic growth in the **Eurozone** in the first quarter of 2018 amounted to 2.5% y/y; that much is predicted for the entire year, which will be driven by high domestic demand, expansionary monetary policy, recovering global economy and favorable conditions in the labor market, where the unemployment rate has further dropped to 8.5% in March of 2018.

According to preliminary estimates provided by State Statistics Service of the **Russian Federation**, economic growth in the first quarter of 2018 was 1.3% y/y against the previous quarter's respective indicator of 0.9%. The 2018 economic growth is forecast to reach 1.8%, which will further be driven by a growth of domestic demand and recovering investments. With such economic activity, some decline in the unemployment rate continued over the first quarter of 2018.

Price and financial developments in the external sector: In the first quarter of 2018 external factors unfolded mostly in line with the previous forecast, with the only exception of food prices, the current and projected levels of which are somewhat below the forecast.

In the first quarter of 2018, the strengthening of the global economy continued and this tendency is predicted to carry on throughout the year.

Relatively high prices will be maintained in world commodity markets over 2018 owing to both demand and supply factors: although acceleration in global economic growth has bolstered the increase in demand, some raw materials have been affected by limited supply volumes. Weak inflation developments will still be observable in food product markets.

Chart 3

Economic growth in trade partner countries, %

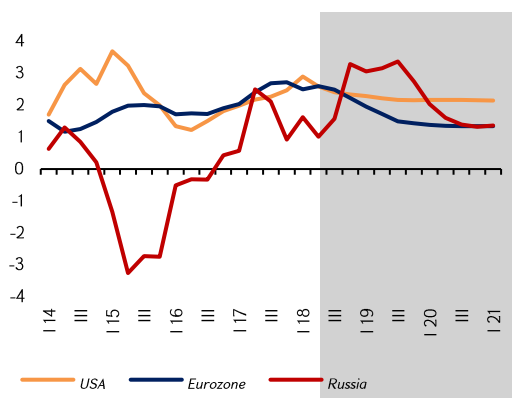
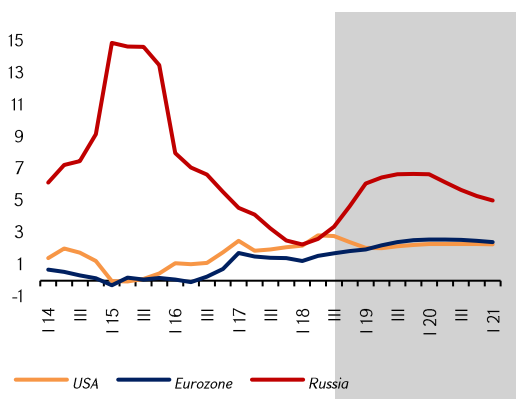


Chart 4

Inflation in trade partner countries, %



In the United States in the first quarter of 2018, compared to the previous quarter, the average quarterly inflation kept on accelerating: it amounted to 2.2%, running slightly above its long-term target. In view of such economic and price developments, in the first quarter the US Federal Reserve System adjusted the policy rate upside, as was expected, by 0.25 pp, setting it in the range of 1.5 to 1.75%. Predictions suggest that the US inflation in 2018 will run slightly above its target, in which case, taking into account the economic developments described above, the FRS will further pursue a gradually tightening monetary policy. Note that the risk to capital outflows from emerging economies and subsequent volatilities in the financial markets will persist in the event the long-term interest rates of US Treasury bonds rise in the market.

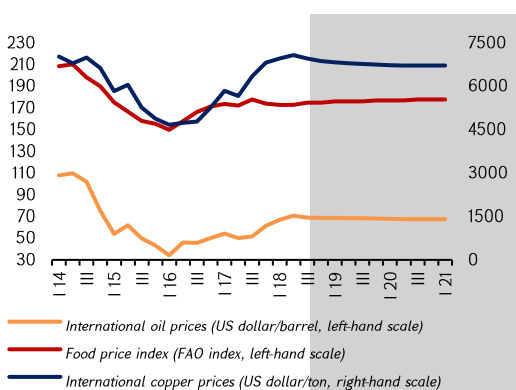
In the first quarter of 2018, the average quarterly inflation in the Eurozone somehow slowed down to 1.3%, still running below its target. It is expected to reach its target only in the medium run. Under such economic conditions, the European Central Bank will further conduct a low interest rate policy, while the asset purchases program on a EUR 30 billion-a-month scale will continue up until the end of 2018.

The average quarterly inflation in the **Russian Federation** continued a path to decline: in the first quarter of 2018 it dropped to 2.3%, still below its target of 4%. The decline in food and non-food prices has been the main contribution to the decrease in inflation. In the first quarter of 2018, therefore, the Central Bank of Russia lowered the policy rate by another 0.5 pp to 7.25%. Although inflation is below the target, it is expected that the CBR will nevertheless pursue a moderately tight policy aimed at reducing inflation expectations and anchoring the inflation around the target.

Depreciation of the US dollar continued over the first quarter of 2018, as it was the case in the previous quarter. Specifically, in the first quarter, the euro exchange rate versus the US dollar appreciated by 15.0% y/y to 1.23 dollars per euro. Such tendency in the exchange rate reflects both the expectations about future monetary policy in the Eurozone and USA and anticipated budget deficit growth as a result of the US tax reduction program. It should be mentioned, however, that the euro/US dollar exchange rate depreciation is anticipated in the short run due to a low performance of economic indicators in the Eurozone as well as political developments in March-April. In the first quarter of 2018 the Russian ruble appreciated by 3.5% y/y to an average RUB 56.8 per dollar. Nevertheless, the ruble depreciated against the US dollar in April, due to new US sanctions against Russia, which is expected to persist over a short run in spite of high international oil prices.

Chart 5

International prices of raw materials and food products



The rise in prices in commodity markets, a trend coming from previous quarters, continued during the first quarter of 2018. The expectation for the forecast horizon is that the commodity prices will remain elevated. Specifically, the rise in international oil prices observable in the previous year and in early 2018 will, according to

forecasts, continue in the short run as well, due to the resumption of US sanctions against Iran as well as reduced US oil inventories. The rise in international copper prices in the first quarter of 2018 was driven by robust demand, yet, in the medium-term, a slight retreat from currently high levels is anticipated.

In the world food product markets in the first quarter of 2018, the price growth rates somewhat decelerated. In particular, the decrease in prices for sugar and meat products has resulted in slower growing food prices, although the dairy product and wheat prices have risen. In 2018, however, international food prices are expected to grow at a faster rate.

2.2. Forecasts

2.2.1. Inflation and monetary policy

Driven by falling prices of seasonal products, inflation slowed down to some extent in the first quarter of 2018. However, given the current monetary policy conditions, it will continue expanding in 2018, staying within the confidence band, and will stabilize around the target in the forecast horizon.

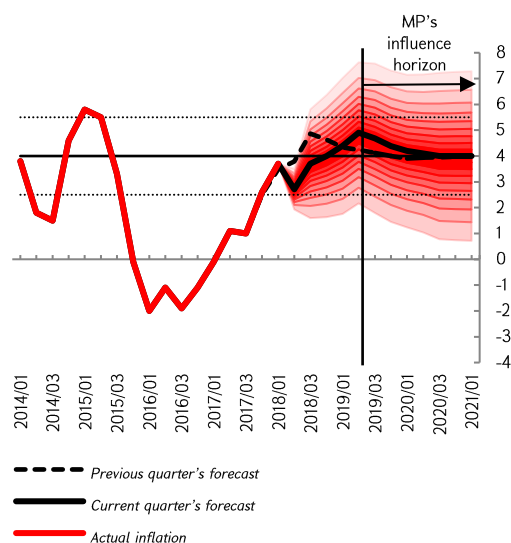
Driven by falling prices of seasonal products, inflation slowed down to some extent in the first quarter of 2018. However, given the current monetary policy conditions, it will continue expanding in 2018, staying within the confidence band, and will stabilize around the target in the forecast horizon.

In the first quarter of 2018, core inflation rate kept on increasing, yet it is expected to stabilize amid a certain slowing of demand. At the same time, with notably decreased prices of seasonal agricultural products, headline inflation will decline in the second quarter. The estimation is that the aforementioned price decline greatly owes to a seasonality shift in production, so the price increase is thought to recover in the upcoming quarters.

The Central Bank estimates suggest that high economic activity observable earlier the year are largely driven by increased productivity in industry, services and construction. On the other hand, despite signs of slowing demand at the start of the year, the expansionary monetary environment continues to positively contribute to the demand. As a result, the GDP gap is estimated positive in the first quarter of 2018. At the same time, political processes in the country are expected to be reflected in both the supply and demand developments in the second quarter, leaving generally a neutral impact on GDP gap and inflation. In the outcome, as expansionary monetary conditions gradually eliminate and in an almost neutral fiscal policy environment, the positive GDP gap will reduce and phase out in the medium-term perspective, helping the inflation stabilize around the target. In view of current inflation developments, it is estimated that short-term inflation expectations of households have stabilized on the whole. ***Moreover, additional inflation developments in the current situation are not***

Chart 6

Inflation (12-month) forecast probability distribution chart for 3-year horizon



likely, so the Board of the Central Bank believes that the policy rate should be left unchanged.

The demand- and inflation-related risks are projected balanced, and if such risks materialize, the Central Bank will react by adjusting the monetary conditions accordingly.

Table 1

Period	Inflation interval forecast probability distribution				
	<1.0%	1.0-2.5%	2.5-5.5%	5.5-7.0%	>7.0%
Q2, 2018	0.0%	0.3%	99.6%	0.1%	0.0%
Q3	0.2%	6.8%	73.5%	16.0%	3.6%
Q4	0.0%	1.2%	52.1%	30.2%	16.5%
Q1, 2019	0.1%	2.9%	54.0%	26.5%	16.5%
Q2	0.5%	6.2%	59.9%	22.7%	10.8%
Q3	1.5%	10.0%	61.6%	19.6%	7.2%
Q4	2.2%	11.9%	62.0%	17.9%	6.0%
Q1, 2020	3.1%	13.8%	62.0%	16.2%	4.9%
Q2	4.0%	15.2%	60.4%	15.5%	5.0%
Q3	4.6%	15.1%	57.8%	16.2%	6.3%
Q4	4.6%	15.0%	57.3%	16.4%	6.6%
Q1, 2021	4.7%	14.9%	56.8%	16.7%	7.0%

2.2.2. Economic activity ²

Aggregate demand: High economic activity still persisted over the first quarter of 2018; starting from the second quarter, it will gradually defuse to approach its potential level. The 2018 economic growth is largely attributable to the expansionary monetary policy implementation by the Central Bank, growth of lending to the economy, high investment activity as well as increased external demand.

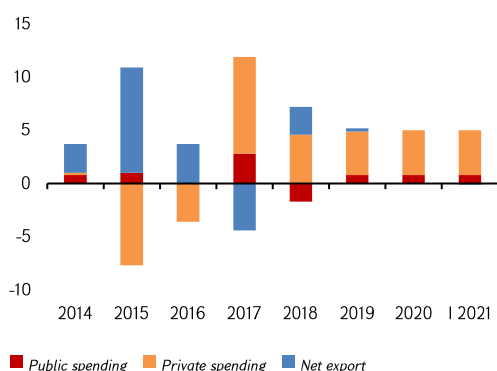
In light of the aforementioned developments, economic growth in 2018 is expected in the range of **4.5-6.5%**. The 3.7% growth in private consumption and 9.5% growth in investment will make a 4.6 pp contribution to the growth, whereas public spending will leave a 1.7 pp negative impact on the growth. Net exports will make a 2.6 pp positive contribution to the 2018 economic growth.

In the medium run, economic growth developments are largely determined by the economy's fundamentals, as well as investment activity in the period 2017-2018. Thus, the 2019 economic growth is estimated in the range of **4.1-6.2%** and that of 2020 in the range of **3.9-6.1%**. These mid-term growths will be determined by implementation of investment programs, the pace of Government-led structural reforms, and anticipated potential of economic growth in partner countries.

The economic growth in 2018 is expected in the range of 4.5-6.5%.

Chart 7

Demand components contributing to the growth (percentage point)



² For a detailed account of economic growth forecasts, see the "GDP Projection Probability Distribution", chart 18, table 2.

External demand: Sustainable global economic growth, persistently high growth of travel to Armenia, the Government-led export promotion policy all positively contributed to the domestic economic growth in the first quarter of 2018. However, contribution of net export to economic growth is estimated negative as the growth in consumption and investment in the domestic economy has been concurrent with a significant increase in import volumes.

The real growth of export of goods and services has been revised upside for the next quarters of 2018 in view of predictions for sustainable revenue growth in principal partner countries on the one hand and maintaining a stable growth rate of the tradable sector in the domestic economy on the other. As a result, the real growth of export of goods and services in 2018 is forecast in the range of 11.0-13.0%. With domestic demand demonstrating as high growth rates as currently, the real growth of import of goods and services will be higher than predicted previously, in which case the growth will be in the range of 5.0-7.0%³. As a result of these forecasts, net export's first quarter negative contribution to the real GDP will neutralize over the next quarters.

Remittances of individuals exceeded expectations in the first quarter of 2018. Nevertheless, for the following quarters the growth rates in the remittances have been revised somewhat downside, compared to the previous forecast, which is in line with adjusted forecasts of the ruble depreciation and expected economic developments in Russia. As a result, the growth of individuals' remittances will be in the range of 7.0-9.0%, inclusive of the first quarter's high growth.

As a result of the aforementioned developments, the current account deficit-to-GDP ratio will increase against the previous forecast and will eventually stabilize in the range of 3.0-4.0%, a mid-term equilibrium.

Fiscal policy: In the first quarter of 2018 actual developments in the fiscal sector deviated from the projections outlined in the Q1, 2018 Monetary Policy Program. The fiscal policy's impact on aggregate demand was 1.0 pp contractionary, instead of projected 2.2 pp expansionary. The deviation occurred as expenditures reported greater contractionary impact and revenues smaller expansionary impact.

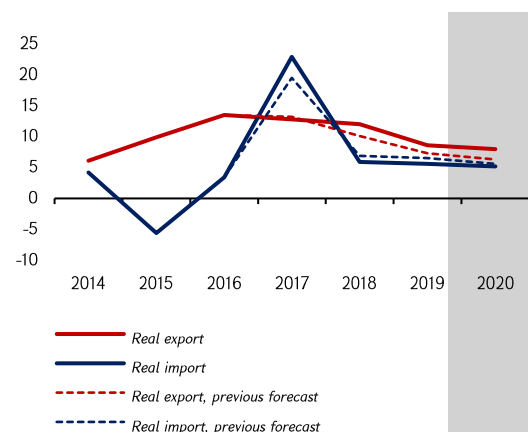
The **fiscal policy's impact on aggregate demand** for 2018 has been estimated using the revenues and expenditures indicators set out in the Republic of Armenia Law on "State Budget 2018" and adjusted⁴ under specific Government of Armenia resolutions.

³ If the impact of a one-off transaction related to the 2017 budget was excluded, the real growth of import of goods and services for 2018 would amount to 8.0-10.0%, instead of the previous forecast of 6.0-8.0%.

⁴ The indicators set out in the Republic of Armenia laws on the state budget have to be adjusted under separate Government of Armenia resolutions during the year, for which the Government of Armenia has a relevant mandate; these resolutions are published on <https://www.e-gov.am>.

Chart 8

Changes in real export and import of goods and services in the medium term, %



The fiscal impulse for 2018 is calculated to be 0.2 pp expansionary.

Chart 9

Nominal wage growth in private sector, y/y, %

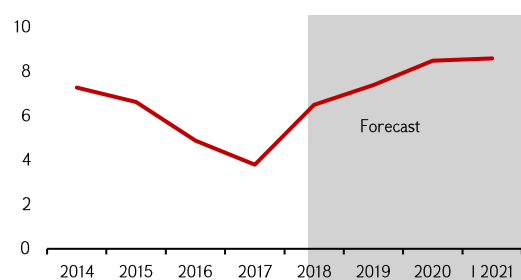
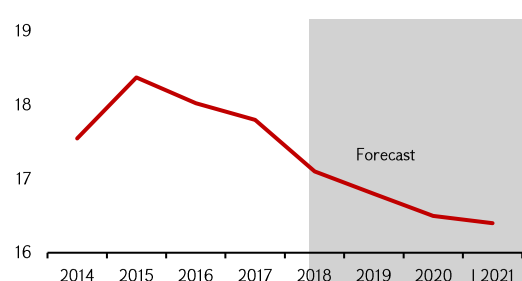


Chart 10

Unemployment rate, %



Relative to the previous MP program, the state budget revenue forecasts did not change and are in line with quarterly revenue plans. However, due to the upside adjustment of the nominal GDP estimate, the share of deficit in GDP has changed and it will make up 2.0%, instead of 2.7% as defined under law, according to the Central Bank estimation. As a result, the fiscal impulse for 2018 is calculated to be 0.2 pp expansionary.

In the period 2019-2020 the fiscal policy is thought to have a neutral impact, but this will mainly be conditioned by which policy of revenue collection and expenditures will be carried out in future.

Labor market⁵: In 2018 the **private sector's** nominal wage⁶ growth rate will accelerate to 6.5%. In the medium term, the growth of nominal wage in the private sector will be determined by fundamental economic growth and inflation developments. In 2019 the private sector's nominal wage is predicted to increase by about 7.5%, and at the end of forecast horizon it will stabilize around 8.5%.

In the context of developments described above, the unemployment rate in 2018 is expected to reach 17.1%. In the medium term, the unemployment rate will decline by about 0.3 pp annually, approaching its mid-term equilibrium at the end of the forecast horizon.

In 2018, the growth of firms' unit labor costs will enter a positive territory and at the end of forecast horizon it will stabilize around its fundamental value, i.e. the 4% inflation target.

Chart 11

Unit labor costs growth, y/y, %

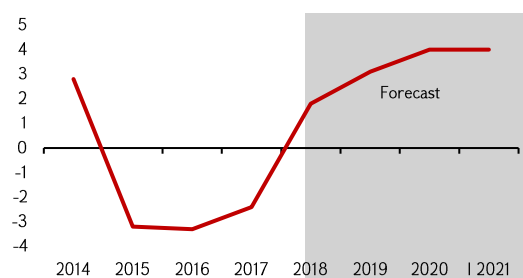


Chart 12

The US economic growth forecasts, %

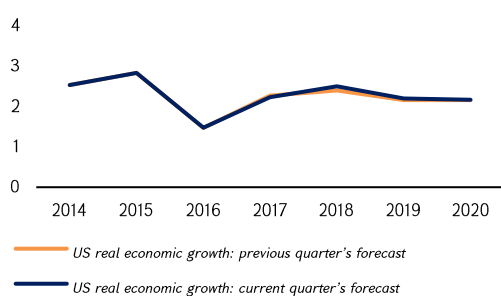
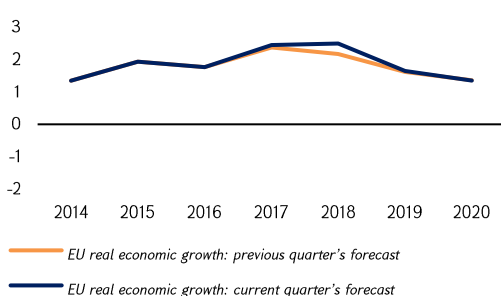


Chart 13

The EU economic growth forecasts, %



2.2.3. Comparison with the previous forecast

Trade partners' short-term economic growth indicators were adjusted upward against the previous forecast.

The US economic growth forecasts for 2018 were slightly revised upward, driven by persistently high economic growth indicators reported in previous quarters, an anticipated positive impact of tax reforms, as well as the first quarter's actual economic growth rate which has been higher than the previous forecast. The 2018 upward revision of economic growth forecasts in Eurozone owed to expected growth of external demand amid accelerating global economic growth

⁵ The labor market data for 2018-2021 are the Central Bank projections which are based on the fourth quarter of 2017 data and actual January-February 2018 figures. The growth indicators presented in this sub-section are relative to the same reference period last year, unless otherwise specified.

⁶ Starting from January 2018, the National Statistics Service of Armenia began publishing the nominal wage, using data of commercial undertakings with 1 or more employees. Previously, the NSSA published data of commercial undertakings with more than 50 employees. Because the 2017 figures on average monthly wage of commercial undertakings with 1 or more employees are not available for now, the Central Bank will, for its predictions, look to previous methodology of calculating the average salary, in order to maintain comparability. Starting from 2019, the Central Bank will forecast the average nominal wage of commercial undertakings with 1 or more employees in the private sector.

rates, as well as higher-than-predicted economic growth reported in previous quarters. In Russia, a different economic growth rate in relation to the previous period is partly due to the revision of the historical series, while the mid-term change, as compared with the previous one, is attributable to faster recovery of domestic demand in the medium run and revised international oil prices.

In the world's commodity markets, inflationary patterns are anticipated, as was outlined in previous forecast; in food product markets in the forecast horizon, prices will shape at the levels somewhat lower than forecasted previously.

In the world's food product markets, the prices are expected to increase by the speed as predicted previously, but they will shape at lower levels as the actual first quarter 2018 indicator has been lower from the forecast. In the medium run the prices will behave in line with the previous forecast.

Relative to previous forecasts, international oil prices will rest on somewhat a higher level. This will be driven by possible reduction in the supply as a result of the US sanctions on Iran, on the one hand, and as the world oil demand continues rebounding, on the other.

International copper prices will shape at the levels close to the ones outlined in the previous forecast, as changes in the structure of supply and demand in the world copper market are negligible compared to previous expectations.

In 2018 Armenia's economic growth rate was revised slightly upside relative to previous forecasts, but it did not change substantially along the path of forecast horizon.

Year 2018 began with higher economic activity (see section III. 2. 3) than expected previously, under which circumstance the 2018 economic growth forecasts were slightly revised upside, while the GDP developments anticipated in the medium-term did not change notably. Consistent with previous estimations, the industry and service sectors will remain the key drivers to economic growth both over 2018 and the forecast horizon, and the agricultural and construction sectors will make relatively small contribution to the growth.

There is expectation that the positive GDP gap will close in the short run, and in the forecast horizon it will approach its potential value.

Chart 14

Russia economic growth forecasts, %

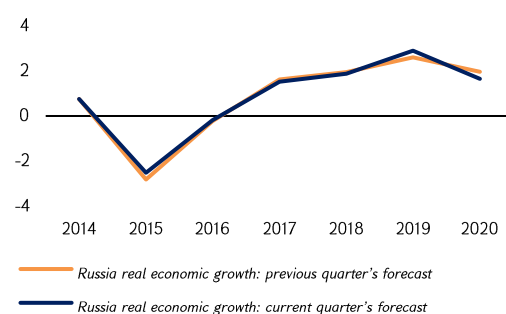


Chart 15

International food price forecasts

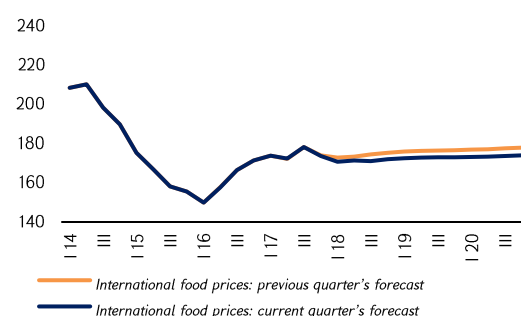


Chart 16

International oil price forecasts

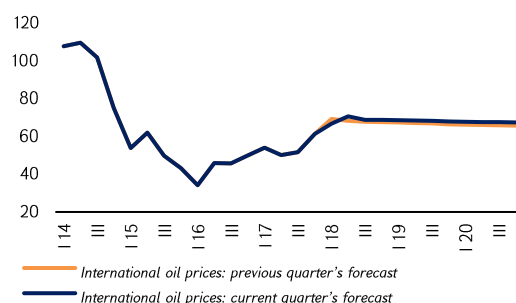


Chart 17

International copper price forecasts

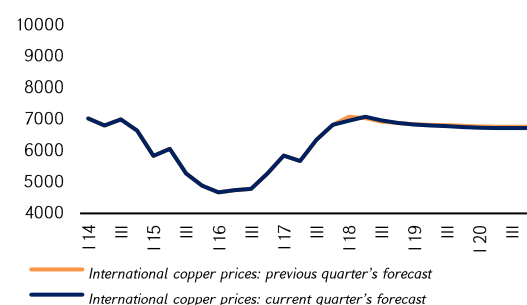


Table 2

Real GDP (cumulative) growth projection probability distribution		
Period	30% probability interval	90% probability interval
January-December 2018 / January-December 2017	4.50 – 6.50	1.30 – 9.70
January-December 2019 / January-December 2018	4.10 – 6.20	0.80 – 9.50
January-December 2020 / January-December 2019	3.90 – 6.10	0.40 – 9.60
January-December 2021 / January-December 2020	3.80 – 6.00	0.30 – 9.50

Chart 18

Real GDP (cumulative)¹ growth projection probability distribution chart for 3-year horizon

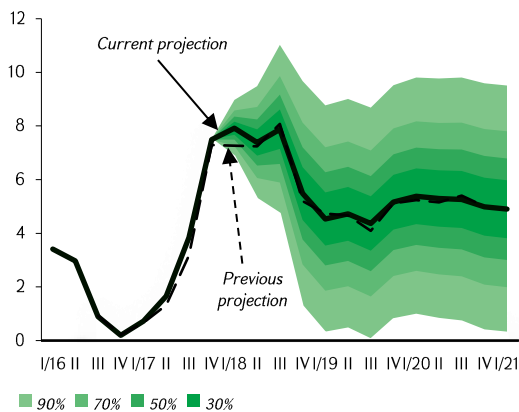


Chart 19

Mid-term current account / GDP forecasts, %

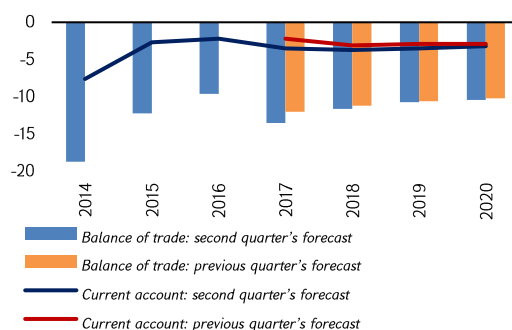


Chart 20

Fiscal impulse forecasts (percentage point)

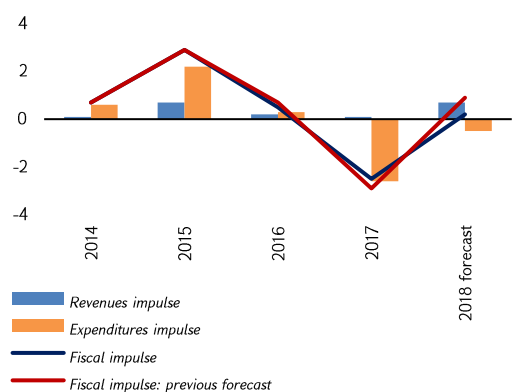
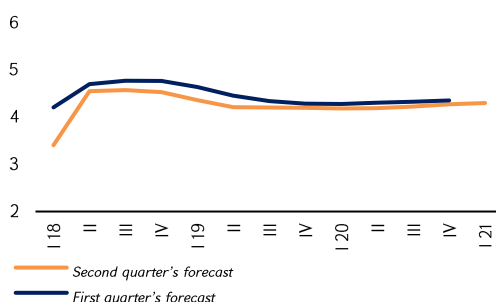


Chart 21

Short-term core inflation expectations estimated by Quarterly Projection Model



In 2018, the current account deficit-to-GDP ratio will run above the previous forecast due to an upside revision of the GDP growth. At the end of mid-term horizon, the current account deficit will be within the value forecasted for the previous quarter.

Compared to the previous forecast, the 2018 fiscal sector's impact has reduced to an estimated 0.2 pp expansionary from 0.9 pp expansionary. This is attributable to both increased revenues in anticipation of higher economic growth for the year and reduced expenditures amid certain savings.

According to the current forecast, in the short run the inflation will run below the previous forecasts due to a lower demand and notably fallen prices of seasonal agricultural products. As the latter phases out, the 12-month inflation rate will somewhat accelerate, stabilizing around the target in the medium-term perspective.

The forecast of a relatively weak inflation in the short term is attributable to seasonal product prices which suffered a substantial decline explained by a certain shift in the seasonality structure. Consequently, the upcoming quarters will see certain weakening of the seasonality, giving agricultural product prices and headline inflation a room for recovery while helping the 12-month inflation rate to run above the previous forecast. In the forecast horizon however, core inflation will be lower than envisaged by the previous scenario, due to a relatively sluggish aggregate demand. Nevertheless, the fulfillment of the inflation target in the medium term will require that an expansionary monetary environment phase out gradually in order to buffer the impact of a still robust demand (see the Inflation Forecasts Probability Distribution Chart).

Short-term inflation expectations will shape at a lower level than outlined in previous forecasts and will virtually be driven by how core inflation developments unfold.

2.2.4. Main assumptions and risks

This section contains the main assumptions underlying the Monetary Policy Program for the second quarter of 2018 and the risks to implementation of the program, which derive from the external sector developments, the fiscal policy, basic trends and short-term forecasts.

1. High economic activity indicators in the first quarter of 2018 are largely driven by a strong productivity growth rate, under which circumstance the positive GDP gap is estimated to be less positive in relation to the previous one.
2. The real equilibrium exchange rate seems to have followed a slightly more appreciation path over the past 2-3 years relative to the previous estimate. This revision is driven by the exclusion of

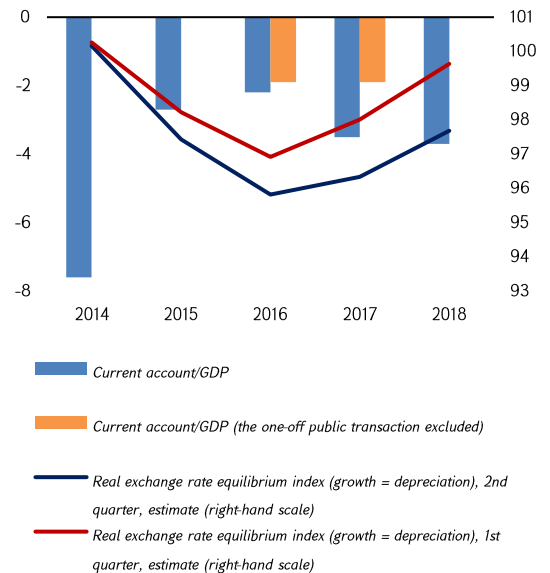
the impact of a one-off transaction related to the budget on current account developments, which points to the fact that net exports have had a greater positive contribution to the economic growth. As a result, in the context of using monetary policy instruments to bolster current aggregate demand, the impact of the exchange rate channel has been revised somehow upside, whereas the impact of the interest rate channel, downside.

3. The interest rates of mid-term Eurobonds issued by the Government of Armenia point to a certain increase in the risk premium for the current quarter, which is chiefly concomitant with recent trends in emerging economies, since assets in such countries get revalued in world capital markets on the brink of an expected rise in interest rates by the US Federal Reserve System.
4. The domestic political events had an impact on economic growth during the second quarter of 2018 only, reflecting a slight contraction in supply and demand, but they did not affect the GDP gap and inflation. At the same time, the impact of political events in April-May on the financial market is thought to have been effectively absorbed thanks to adequate action by the Central Bank. Yet, the impact of political events on the economic growth in the medium run is uncertain and depends on factors, such as:
 - a. the pace by which performance of the budget will go and the change in the ways expenditures will be made and revenues collected,
 - b. the pace by which structural reforms will be pushed ahead and the extent of their influence,
 - c. the change in investment flows and directions.

All these factors are expressed to a greater extent of uncertainty in the GDP Projection Probability Distribution Chart (see chart 18, table 2).

Chart 22

Interpretation of the current account and revaluation of the real exchange rate equilibrium



Box 1:

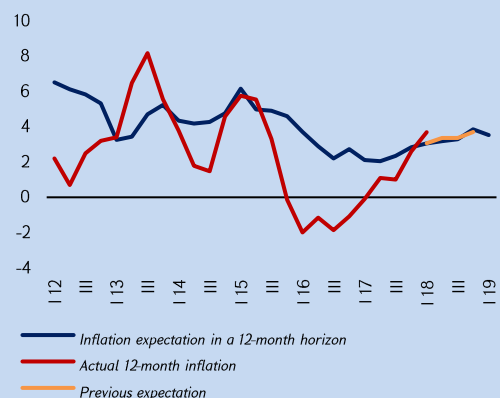
The results of survey on expectations by the households and the financial system

The inflation expectations have generally stabilized, according to the results of the Q1, 2018 survey on selected macroeconomic indicators, conducted by the Central Bank with the households as well as companies in the financial sector. Thus, the share of those households expecting a very high inflation rate has almost halved, while there has been a 4 percentage point increase in expectations for stable inflation expectations.

The **average level of inflation expectations of the financial system** in the upcoming one-year horizon is **3.5%** against that of **3.4%**, as provided in the previous survey.

Chart 23

Average level of financial system's inflation expectations, %



Forecast assumptions and risks

Table 3:

Main judgments and assumptions	
Main judgments and assumptions	Possible developments in case this assumption proves to be correct
In the external sector, economic activity keeps on recovering at steady rates, and prices grow at faster rates	- As economy continues to rebound, demand will keep on recovering in trade partner countries. In this case, developing countries are expected to gradually tighten their monetary policy conditions. - In spite of expected high oil prices, the Russian ruble depreciated as a result of the US sanctions imposed on Russia may contribute to the acceleration of inflation, in which circumstance a more cautious approach to lowering policy rates are likely. - As supply volumes are possible to contract, increased prices on raw materials will keep high.
Armenia's real exchange rate equilibrium revalues	In recent years, the real exchange rate equilibrium has demonstrated slightly more appreciation patterns, compared to previous estimates.
Armenia's risk premium grows	In the second quarter of 2018, the spread of interest rates of 10-year Eurobonds issued by the Armenian Government will increase by 70 basis points, relative to the similar maturity-US assets, compared to the previous quarter, amounting nearly to 3%. Armenia's risk premium is also assessed accordingly.
The effects of political events in April and May of 2018	- Direct and indirect effects of political events on economic growth showed up during the second quarter of 2018 only. - No impact on the GDP gap and inflation. - The impacts on the financial market have been effectively absorbed by adequate action of the Central Bank.
Fiscal policy conditions	The fiscal sector's impact on aggregate demand is small, an estimated 0.2 pp expansionary, in 2018.
Action to tackle the growth of GDP potential	Growth of GDP potential will show up mainly in continuous growth of private investment in the tradable sector by increasing output capacities for both goods and services, ensuring an annual growth of 4.5-5.0%.

In the short run, the risks to inflation and economic growth forecasts are generally dual-sided, depending on the developments in the agricultural sector.

In the medium run, the risks to inflation are currently assessed as balanced, as the 12-month inflation rate is within the confidence band (see the Inflation Forecasts Probability Distribution Chart).

This is determined by a bunch of key factors and developments taking place in relevant sectors of the economy.

First group factors are pertinent to the acceleration of economic recovery in the external environment and its impact spillover to the Armenian economy. Specifically, the following key factors can be highlighted:

- Quicker recovery of external demand and inflationary risks resulting therefrom, including faster-than-expected rise in international prices in raw materials and food product markets.
- Risks to capital outflow from developing countries if developed countries attempt further tightening of their monetary policy conditions.

Risks of domestic economic development are currently assessed as balanced.

As indicated in the previous monetary policy program of the Central Bank, there might be risks to domestic demand with high growth rates persisting in the medium run. Now these risks have largely eliminated, and the risks to the domestic demand growth along the forecast horizon are more balanced.

In the context of how the fiscal policy will pace further, there have been some more uncertainties as to which influence revenue collection and expenditures policy, contraction of shadow economy will make on the demand and inflation.

In the forecast horizon, the risks to economic growth are dual-sided. However, the extent of uncertainty arising from these risks is greater than described in previous predictions.

In addition to the above medium-term cyclical risks to inflation and economic growth, more mid-term risks associated with economic growth potential include:

- further pace of structural reforms and the extent of their impact on investments,
- uncertainties related to further exploring new export markets and creating new products by businesses.

3. ACTUAL DEVELOPMENTS IN Q1, 2018

3.1. Inflation

3.1.1. Fulfilment of the inflation target

For the previous one-year horizon, which comprises a period from the second quarter of 2017 to the second quarter of 2018, the Q2, 2017 Monetary Policy Program provided for an inflation environment that would continue to expand in line with anticipated macroeconomic developments. According to current estimates, the policy rate of the Central Bank was still expansionary, facilitating aggregate demand to recover while helping the inflation return to the target. In this situation, as well as taking into account the impact of the Government's 2017 contractionary fiscal policy on domestic demand, **leaving the monetary conditions unchanged in the second quarter of 2017 was still reasonable.** The estimation was that such a policy would push the 12-month inflation rate into the lower part of the confidence band at the end of the year and help it gradually stabilize around the 4% target in the forecast horizon.

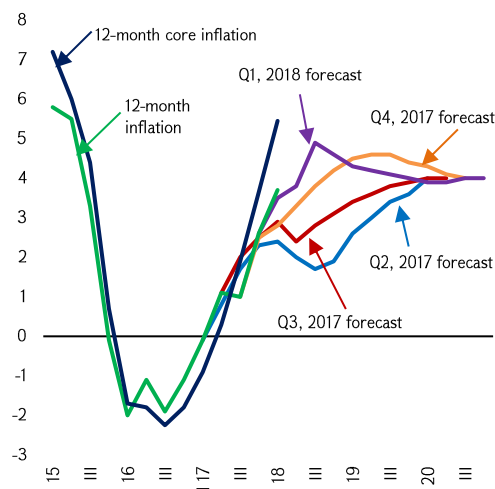
According to the actual second quarter 2017 results, the 12-month inflation rate has increased, as was expected, **entering the positive territory since April; it was 1.2% at the end of April.** In the third quarter, the 12-month growth rates in fruit and vegetable prices slowed down; this has halted the recovering of inflation which averaged 1.0%. Nonetheless, the Central Bank saw the slowing of growth rates in seasonal prices of agricultural products a temporary phenomenon, anticipating that such growth rates would accelerate and certain inflation risks accumulate up until the end of the year. The anticipation materialized in the fourth quarter when headline inflation expanded notably to 2.6% in the yearend. At the same time, relatively high inflation observed during the quarter was largely attributable to inflation expectations that were growing even faster with the population due to increased prices for some products in food markets in the world. During the year, incurring the impact of the expansionary monetary policy, core inflation took gradually increasing patterns. Thus, starting from the second quarter, the 12-month core inflation has entered a positive territory and increased by 4.6 pp by the end of the year, making up 3.7% at the end of December. As for a slower pace of headline inflation relative to that of core inflation, the impact of expansionary monetary policy has been somewhat absorbed by a sluggish growth in prices of agricultural products.

In the first quarter of 2018 too, the 12-month inflation rate increased, in line with expectations, amounting to 3.7% at the end of March, primarily driven by the rise in food product prices.

In view of the macroeconomic situation and inflationary developments mentioned above, the Central Bank had left the monetary conditions unchanged for the previous one-year period, **keeping the refinancing rate at 6%.** The monetary policy conducted

Chart 24

According to the Central Bank forecasts, inflation will fluctuate within the confidence band in the forecast horizon



previously, the Central Bank reckoned, has proved rather expansionary for the inflation to recover and would still carry its impact on. Moreover, as the inflation environment somewhat expanded and inflation expectations grew, this also justified the need to ensure sustained recovery of demand. At the end of the year, the Central Bank signaled the financial market **that expansionary monetary conditions would need to phase out gradually** amid the developments predicted. Influenced by such a monetary policy, the 12-month inflation rate will somehow grow; in the forecast horizon it will be staying within the confidence band and stabilizing around the target.

3.1.2. Prices

Consumer prices: There was **2.5% inflation** recorded in the first quarter of 2018, largely driven by 15.5% increase in seasonally-sensitive food prices, which has been mostly attributable to price rise in groups **Fruit** (16.71%) and **Vegetable and Potato** (20.27%), with their combined contribution to the quarter's inflation reaching 1.6 pp.

Meanwhile, core inflation rate has decelerated to 1.4% from the previous quarter's 1.8%, driven by increased prices in groups **Meat products, Fish, Dairy products, Fuel, and Medicine** by 2.85%, 2.9%, 0.67%, 10.6% and 2.0%, respectively (combined contribution to the quarter's inflation: about 2.5 pp). On the contrary, price inflation in groups **Clothes** and **Footwear** amounted to -3.0% and -6.0%, reducing the overall positive dynamics of inflation by around 0.2 pp.

With the developments mentioned above, the 12-month inflation rate amounted to 3.7% in March of 2018 instead of predicted 3.5%.

There was 2.5% inflation recorded in the first quarter of 2018, which was considerably fostered by 15.5% increase in seasonally-sensitive food prices.

Chart 25

In the first quarter of 2018 inflation accelerated

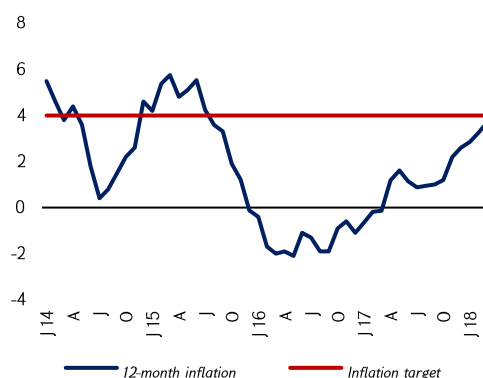


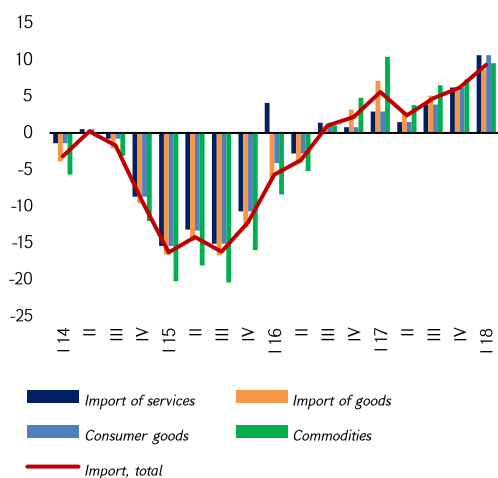
Table 4

Price inflation by commodity item as key contributors ⁷						
Commodity item	December, 2017 (y/y)		March, 2018 (y/y)		Q1, 2018	
	growth	contribution	growth	contribution	growth	contribution
CPI	2.6		3.7		2.5	
Food products	5.2	2.4	4.6	2.1	4.0	1.8
Bread products	-1.1	-0.1	-0.97	-0.09	-0.26	-0.02
Meat products	11.1	1.0	14.65	1.42	2.85	0.28
Dairy products	5.3	0.2	6.68	0.30	0.67	0.03
Oils and fats	13.3	0.4	17.15	0.52		0.00
Fruit	0.8	0.0	6.38	0.18	16.71	0.46
Vegetable and Potato	8.2	0.4	0.00	0.00	20.27	1.13
Fish	24.8	0.2	12.66	0.10	2.90	0.02
Egg	10.2	0.1	-0.34	0.00	-10.05	-0.14
Sugar	-6.0	-0.1	-9.26	-0.07	-0.83	-0.01
Non-food products	1.6	0.3	5.0	1.1	1.9	0.4
Services	-0.5	-0.2	1.8	0.6	0.8	0.3

⁷ In the table the y/y data of structural elements of food products are calculated by the Central Bank on the basis of the National Statistics Service of Armenia data.

Chart 26

In the first quarter of 2018 the growth of dollar prices of import of goods and services speeded up, y/y, %



According to the data issued by the National Statistics Service of Armenia, there was 0.3% deflation in April of 2018, mainly due to decreased prices in groups **Vegetable** and **Potato** (5.3%), **Egg** (11.9%), **Bread products** (0.3%), **Meat products** (0.2%), **Dairy products** (0.6%), and **Fuel** (0.4%), with their combined contribution to inflation reaching -0.5 pp.

Import prices: The dollar prices of import of goods and services to Armenia grew faster during the first quarter of 2018, posting an average 3.9% increase q/q, and the growth against the same quarter of the previous year amounted to 9.3%. The growth rates have accelerated mainly due to the growth of intermediate consumption goods and especially oil prices.

The rise in dollar prices of import of consumer goods in the first quarter of 2018 has been driven mainly by increased dollar prices in the European Union and China, reflecting appreciation of their exchange rates against the US dollar. The total contribution of consumer goods to the y/y rise in dollar prices of overall imports amounted to 1.8 pp.

3.2. Economic developments

3.2.1. Economy position

In the period under review, the GDP gap estimations have reduced. The expansionary monetary policy the Central Bank has been implementing since 2016, the growth in external demand, money transfers and lending all have contributed to the notable reduction in the GDP gap and, starting from the end-2017, facilitated the shaping of the positive gap. In the first quarter of 2018, high rates of economic growth were largely due to productivity growth (see section 3.2.4), in which circumstance the positive GDP gap has declined and is estimated to be about 1%, softening the inflationary pressures in the consumer market. The slowdown in domestic demand in the first quarter of 2018 (see section 3.2.2) as well as stabilized core inflation rate in March-April (see section 2.2.1) also point to the contracted GDP gap. It is expected that this positive gap – a fallout of a restored demand after reported contraction in previous years – will eliminate in the course of the next quarters.

3.2.2. The expenditures aspect of the economy

In the private sector in the first quarter of 2018, the growth rate of demand remained high enough. With an anticipated 9.5% economic growth, private spending is expected to grow by 7.9% in the first quarter of 2018, which is nearly 3 pp higher than previous predictions by the Central Bank.

The 7.9% growth of private spending in the first quarter of 2018 is a result of increased private consumption (4.7%) and private investment (35%). The strong private spending growth owed to an expansionary monetary policy carried out by the Central Bank, high lending growth rates and grown remittances from abroad. The growth rate of private consumption has slightly decreased in comparison with the relevant 2017 indicator, and the 3.7% slowing in retail trade turnover in the first quarter is indicative of the above deceleration. In the period under review, private consumption was still higher than its equilibrium. An estimated high growth in investments in the private sector has been also attributable to strong growth in the construction sector and almost a twice as much increase of investment goods imported during the quarter.

The pace of growth of private spending in the first quarter of 2018 is still above its equilibrium, which has been the case since 2017. The first quarter 2018 growth rate of private spending has slowed down relative to that of the fourth quarter 2017. As a result, although the gap in private spending has narrowed over the reporting period, it is still running positive, which brought about minor inflationary pressures during the quarter.

In the first quarter of 2018, according to the Central Bank estimates, net real export affected the GDP growth negatively as a result of faster growth of real import over export. It should be noted that while the real growth of export of goods and services reached 17.0%, the real growth of import exceeded the expectations sizably, amounting to 21.4%⁸ over the quarter.

In the first quarter of 2018, the growth rates in dollar value of net remittances of individuals (seasonal workers' income and personal transfers inclusive) accelerated to an estimated 15.3% y/y, as the Russian economy reported positive developments and the ruble exchange rate appreciated versus the US dollar.

According to Q1, 2018 estimates, the impact of net external demand on real GDP is negative, as real import of goods and services has been faster compared to that of export of goods and services, which was attributable to the domestic demand having grown quicker than anticipated. It should be noted that most growth of domestic demand was reflected in the growth of import of investment goods. In addition to other factors, the domestic demand has been fuelled by high growth of remittances of individuals. The increase in private money transfers notwithstanding, in the first quarter of 2018 the current account deficit-to-GDP ratio rose by about 4 pp as a result of increased trade balance deficit and net factor income balance estimations.

Chart 27

Structure of private spending, y/y, %

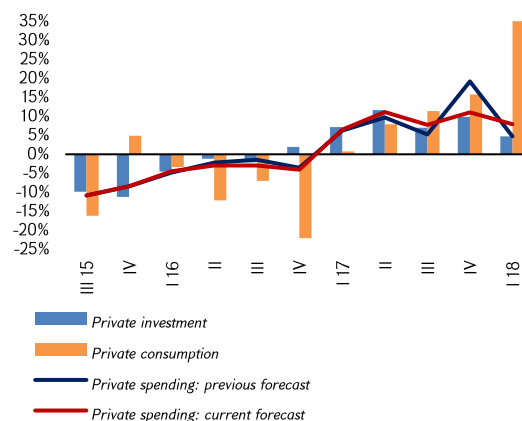


Chart 28

In the first quarter of 2018 the real decline in net exports slowed down
(net real export, y/y, %, positive sign = improvement)

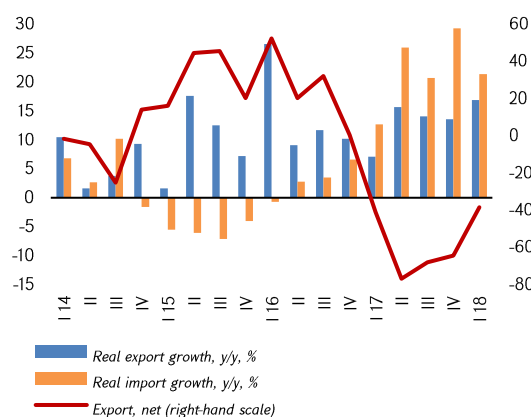
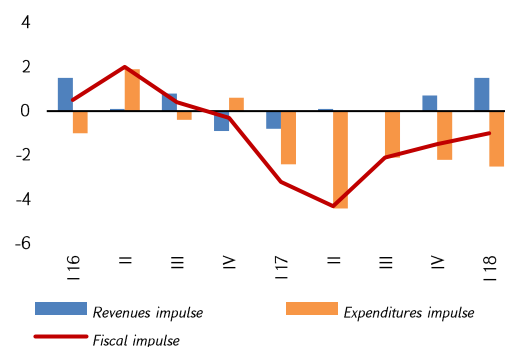


Chart 29

In the first quarter of 2018, the contractionary effect of fiscal policy owed to the contractionary effect of expenditures



⁸ The real export and import growth indicators are the Central Bank estimates.

Chart 30

Main consolidated budget indicators, billion AMD

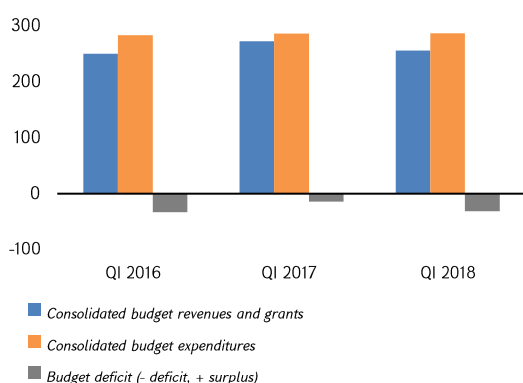


Chart 31

In the first quarter of 2018 the deficit was financed to the expense of domestic sources, billion AMD

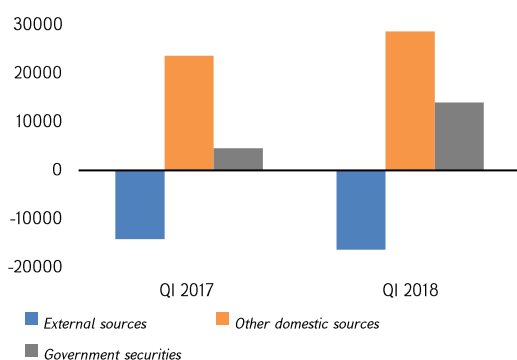
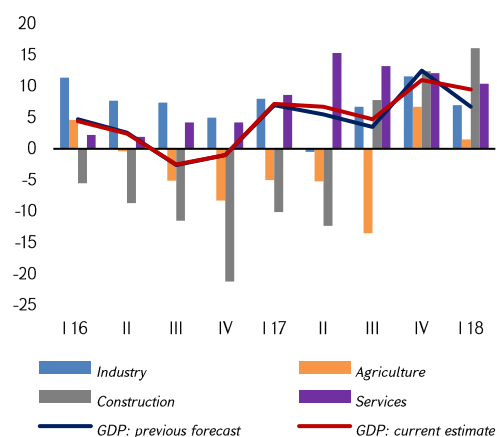


Chart 32

GDP sectoral structure, %



Fiscal policy⁹: In the first quarter of 2018, the State Budget was performed with actual expenditures and revenues deviated from the Central Bank's projections¹⁰. The fiscal policy impulse on aggregate demand was an estimated 1.0 pp contractionary for the quarter, instead of the predicted 2.2 pp expansionary, attributable to both the revenues and expenditures with their deviated impact and the nominal GDP forecast adjusted upward.

In the first quarter of 2018, budget revenues were about 94% of the projection. Tax revenues amounted to 93.7% of the plan if the unified tax account balance is excluded, and the adjusted program was performed by 105.9% if the unified tax account balance is included.

The revenue impulse proved smaller, amounting to 1.5 pp expansionary instead of the forecast 2.6 pp contractionary, pointing to a higher nominal GDP indicator expected for the quarter and to the fact that the unified tax account balance (AMD 31.2 billion) has been treated as a means of resources actually collected from the economy. Although not qualified as tax revenues of the state budget in the law point of view, this has been actually paid by the taxpayers.

The state budget expenditures constituted 96.6% of the projection by the Central Bank.

In the expenditures structure in the first quarter of 2018, **government consumption** was below the predicted figure by 7.3% while expenditures on item **“Transactions with non-financial assets”** were in line with the projection. For the quarter, the expenditures impulse was 2.5 pp contractionary instead of the forecast 0.4 pp contractionary. The deviation also owed to net lending after a loan recovery instead of provision of loan so anticipated for the quarter.

With revenues and expenditures performance described above, the state budget generated a deficit of AMD 26.3 billion in the first quarter of 2018.

3.2.3. The production aspect of the economy

Economic activity in January-March 2018 has increased by 10.6%, and the GDP growth for the first quarter of 2018 is an estimated 9.4-9.6%, which is considerably above the previous Central Bank forecasts.

In the period under review, reporting quarter, the forecast growth of all sectors of the economy, except the agriculture sector, has been revised upside. In particular, the construction sector is estimated to have increased by 16.1% thanks to invigorated investment activity that time, while the industry and services sectors reported, respectively, 7.0% and 10.4% growths, attributable to the external demand growing high and to the domestic demand still keeping elevated.

⁹ The review of the fiscal sector was done using preliminary actual consolidated budget indicators (local budgets as an estimate) prepared on the basis of preliminary actual indicators of the first quarter of 2018 (PIU funds included), excluding off-budgetary funds. The impact of revenues was calculated in respect of the nominal GDP indicator while the impact of expenditures, in respect of an estimated economic potential.

¹⁰ The revenue projection was commensurate with the Q1, 2018 Budget estimate.

There is a moderate 2.1% growth in economic activity reported in agriculture, in which case the growth of the sector in the first quarter is estimated at 1.5%, which is slightly lower than the previous forecast.

The productivity, which was calculated as real output per worker per hour, has demonstrated strong growth rates since the start of 2017, which persisted over the first quarter of 2018 too. The productivity growth rate reached 6.5% in the first quarter, according to the Central Bank estimates, and this has in part determined the economic growth in the period under review.

3.2.4. Labor market¹¹

In the first quarter of 2018, the private sector nominal wage growth rate amounted to 6.5%, which is 0.8 pp higher from previous forecasts by the Central Bank. The nominal wage growth rate did not pace in line with the GDP growth rate, which is attributable to the rigidities in the labor market. In the period under review, the private sector real wage growth rate was 3.2%, which was lower than the productivity growth rate. The productivity growth outpacing the real wage growth has facilitated the labor market to create minor deflationary pressures.

The unemployment rate is an estimated 18.2% in the first quarter of 2018, which is consistent with previous forecast by the Central Bank. This is due to the fact that the economic growth has largely been driven by increased productivity, and there has been no significant change in the employment. Relative to the same reference period last year, the unemployment has declined by 0.8 pp.

In the period under review, unit labor costs of the firms have reduced by 2.6%, reflecting the acceleration of output growth rate per unit of labor in relation to private sector wage growth.

Chart 33

Nominal wage growth in private sector, y/y, %

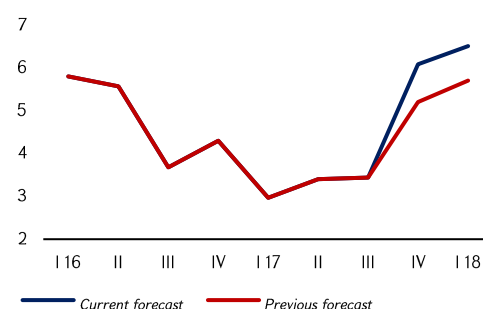
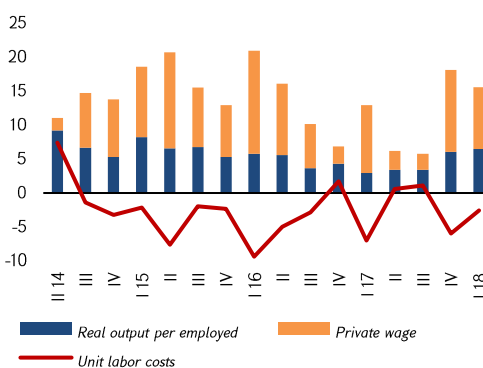


Chart 34

Unit labor costs growth, y/y, %



3.3. Financial market developments

In the first quarter of 2018, the Board of the Central Bank decided to leave the refinancing rate unchanged, at a 6% level.

Both in February and March, the Board preferred to keeping the policy rate unchanged thus contributing to the sustained recovery of domestic demand. At the same time, the Board reiterated the possibility for the expansionary impact of monetary conditions to phase out in the light of predicted developments in future, in fulfillment of the inflation target.

In the first quarter of 2018 the Board of the Central Bank left the refinancing rate unchanged, at a 6% level.

¹¹ The labor market data for the first quarter of 2018 are the Central Bank estimates which are based on the fourth quarter 2017 data and actual January-February 2018 figures. The growth indicators provided in this sub-section are relative to the same reference period last year, unless otherwise specified.

Table 5

Chart 35

During the quarter short-term interest rates approached the Central Bank's policy rate, %

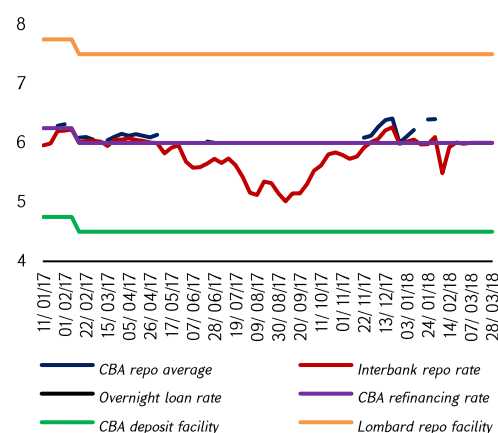


Chart 36

Liquidity injection and absorption through the Central Bank operations (average quarterly inventory), billion AMD

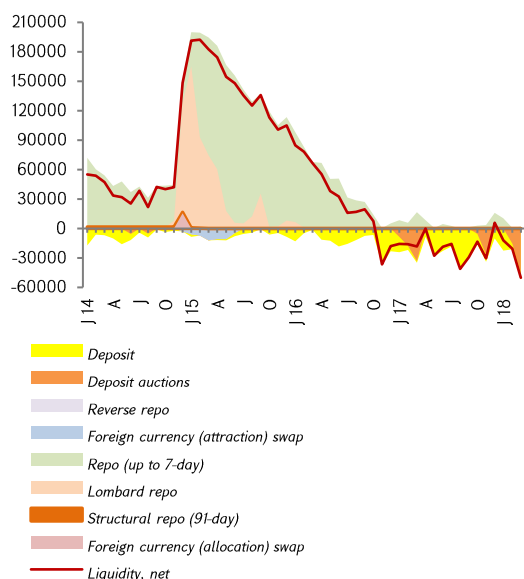
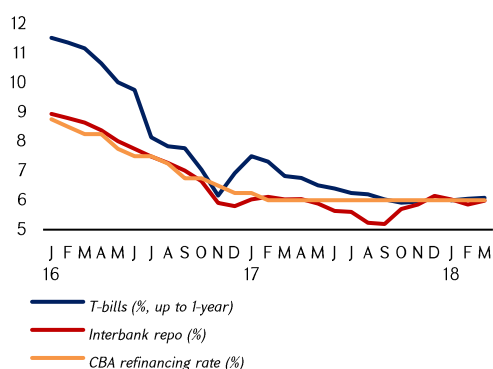


Chart 37

The behavior of short-term interest rates in the first quarter of 2018



Average quarterly interest rates in Armenia's financial market					
Instrument	Q1, 2017	Q2, 2017	Q3, 2017	Q4, 2017	Q1, 2018
Central Bank refinancing rate (end of quarter)	6.00	6.00	6.00	6.00	6.00
Central Bank repo rate	6.13	6.05	6.06	6.20	6.20
Interbank repo rate	6.06	5.86	5.33	5.90	5.94
Short-term treasury bill yield	7.21	6.56	6.19	5.93	6.04
Medium-term notes yield	9.97	8.76	8.45	8.03	7.64
Long-term bonds yield	13.18	13.03	10.03	9.90	12.29

In the first quarter of 2018, the Central Bank carried on using the toolkit it had for the financial market over the previous quarter. Managing the banking system's excess liquidity through the instruments either to inject or absorb liquidity, the Central Bank succeeded in keeping short-term interest rates closer to the policy rate. Thus, the quarterly interbank repo rate has increased by 0.04 pp against the previous quarter to 5.94%; the average monthly repo rate in end-March was 5.99%, having dropped by 0.16 pp against December.

Box 2:

Developments in the currency market

In the first quarter of 2018, interbank MM rates posted a negligible increase compared to the previous quarter, practically stepping in the line with the policy rates at the end of the quarter. In the meanwhile, the US Federal Reserve System continued tightening monetary conditions by raising the federal funds rate to 1.75%.

Given the spread between domestic and external interest rates and Armenia's average quarterly country risk premium reducing with even a faster pace (coupled with patterns of recovery, starting from February, driven by global factors), short-term exchange rate appreciation pressures (net of seasonality) were observed, and the Central Bank purchased about USD 47 million (net) from the foreign exchange market. Under such conditions, the nominal exchange rate of the Armenian dram against the US dollar behaved stably, appreciating by nearly 0.4%. Note also that with most trade partners' currencies having demonstrated faster appreciation versus the US dollar, the nominal effective exchange rate of the Armenian dram depreciated by about 2% in the first quarter, which has been totally offset by the difference in acceleration of inflation rates recorded in Armenia and the main trade partner countries. In the meantime, the real effective exchange rate has appreciated by about 1.0%.

Relatively steady expectations of the financial market participants, expansionary monetary policy pursued by the Central Bank and strong liquidity in the banking system all further contributed over the quarter

to the shaping of high demand for bonds and reducing of the yields, primarily in the mid-term and long-term segments; short-term bond interest rates, incurring the impact of the developments in the money market, have shaped around the Central Bank's policy rate. At the end of March, the average quarterly yield of short-term bonds amounted to 6.05%, which was a 0.18 pp increase against December. Average yields of mid-term and long-term bonds have reduced by 0.11 pp and 0.60 pp, respectively.

Although the policy rate of the Central Bank remains unchanged for quite a long time, the interest rates of funds attracted and allocated by commercial banks further tended to decrease over the first quarter of 2018. Competition between financial institutions, existing liquidity in the banking system, as well as relative stability in money and foreign exchange markets remained among factors that pushed interest rates down. **During the quarter, interest rates reduced as the growth of attracted funds slowed down, mostly owing to attracted foreign currency funds.** The quarter saw foreign currency deposits reducing by 0.84% whereas dram deposits continued growing (by 3.6%). As a result, the level of dollarization – the ratio of foreign currency deposits to total deposits – amounted to 53.8%, dropping by 1.4 pp compared to the previous quarter.

The growth of lending continued during the quarter. With interest rates reducing, lending terms and procedures further improving, the growth of lending amounted to 4.6% over the quarter. In particular, dram loans have grown by 6.2% and foreign currency loans, by 2.7%. The 12-month growth of total lending to the economy in March 2018 reached 20.0%, which is commensurate with the Central Bank's estimation.

Chart 40

Interest rates on deposits of and loans to individuals

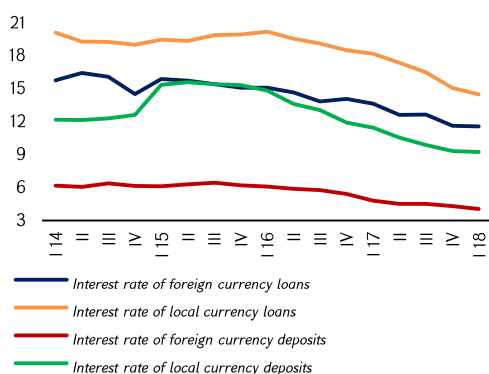


Chart 38

In the first quarter of 2018 yields in the government bond market dropped in mid-term and long-term segments of the curve

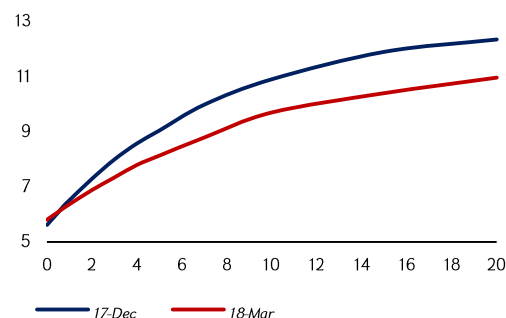


Chart 39

Interest rates on deposits of and loans to companies

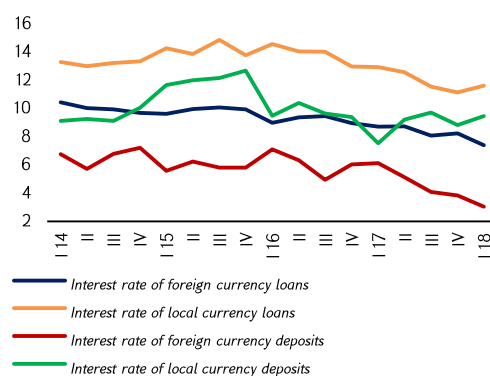
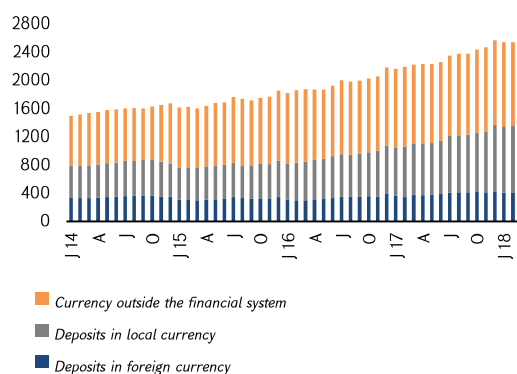


Chart 41

In the first quarter of 2018 the dram deposits continued growing, (billion AMD)



**BOARD OF THE CBA
MINUTES (15.05.2018)**

The Refinancing Rate

**The CBA Board Meeting of May 15, 2018 attended by Chairman
Arthur Javadyan, Deputy Chairman Vakhtang Abrahamyan, and
Board Members Ashot Mkrtchyan, Arthur Stepanyan,
and Arkady Khachatryan**

The Board meeting opened with presentation of Situation Report as of May 15, 2018. It addressed current developments on inflation, external environment and real, fiscal and monetary sectors of the economy.

In April 2018, it was noted, the 12-month inflation rate reduced considerably, amounting to 2.4% at the end of the month. The reduction largely owed to the change in prices of food products, since groups such as “Vegetable and Potato” and “Egg” posted a decrease in prices by 5.3% and 11.9%, respectively, during the month. It is estimated that the fall in prices of agricultural products is largely driven by a seasonal shift in the harvest, and the growth of prices is believed to rebound over the forthcoming quarters, under which circumstance the 12-month inflation rate will remain within the lower part of the confidence band in the near future.

Addressing the current economic situation, the Board stated that economic activity remained relatively high in the first quarter of 2018 too, mainly driven by high productivity growth registered in the industry, construction and services sectors. According to the quarter’s actual preliminary results, the ***Economic Activity Indicator is estimated to have been 9.4-9.6%*** in January-March compared to the same period of the previous year. On the other hand, in spite of some weakening of demand observable since the beginning of the year, which also reflected a certain decline in core inflation in April, the expansionary monetary environment, it was stated, continues to positively contribute to demand. At the same time, it is estimated that the political processes that took place in the country during the second quarter did not affect the inflation developments.

The Board also discussed the external sector developments, which were mostly in line with the Central Bank expectations: the global economic growth continued rebounding and inflation trends in the world’s main commodity markets persisted. Taking into account the aforementioned developments and that such trends may carry on over the upcoming months, the Board considers that minor inflationary effects from the external sector are likely.

The Board looked into the developments in the domestic financial market. The Central Bank, it was noted, continued using instruments to absorb excess liquidity in April, which facilitated the stabilizing of short-term interest rates around the policy rate. It should be noted that the impact of political events in April and May on the financial market was

effectively neutralized through proper and timely action by the Central Bank. In particular, in response to tension in different segments of the financial market, the Central Bank has injected the needed amount of liquidity in the system through various tools in order to maintain the financial stability. At the same time, in macroeconomic terms, no significant fluctuations were seen in the dram's exchange rate and market interest rates, which has been a result of strong confidence of the market participants in both the toolkit applied and the policy pursued that time, since most of the funds withdrawn from the financial system was brought back after a short while.

Following presentation of the Situation Report and the developments in external and domestic macroeconomic environments, the Board began addressing the monetary policy directions and making decision on the interest rate. The options of leaving the refinancing rate unchanged or raising it were discussed. Taking into account weak inflationary expectations from the external and domestic economies, as well as the signs that the growth rates of domestic demand are slowing and stabilizing, the Board again preferred to leave the refinancing rate unchanged. The Board, however, believes that, in the light of predicted developments, expansionary monetary policy conditions would need to phase out gradually ***in the future*** in order to fulfill the inflation target. As a result, ***the 12-month inflation rate is expected to remain within the lower part of the confidence band and will then continue increasing gradually to stabilize around the target.***

The Board approved the decision on interest rates of monetary instruments of the Central Bank and the proposed press release, which are attached hereto.

THE CENTRAL BANK OF THE REPUBLIC OF ARMENIA

BOARD DECISION

Interest rates of operations by the Central Bank in the financial market

By virtue of Article 20 (c) of the Republic of Armenia Law on the Central Bank, the Board of the Central Bank of the Republic of Armenia **enacts:**

1. Leave the refinancing rate of the Central Bank of the Republic of Armenia unchanged, at 6.0%.

2. To the Financial Department of the Central Bank of the Republic of Armenia to carry out operations in the financial market of the Republic of Armenia, using the following interest rates:

2.1. Lombard facility rate offered by the Central Bank to be 7.5%.

2.2. Deposit facility rate offered by the Central Bank to be 4.5%.

3. This decision shall take force on the day following the adoption thereof.

Arthur Javadyan,
Chairman of the CBA

May 15, 2018

PRESS RELEASE

15.05.2018

At the May 15th of 2018 meeting, the Board of the Central Bank of Armenia (the CBA) decided to leave the refinancing rate unchanged, at the level of 6.0%.

There was 0.3% deflation in April of 2018 against 1.0% inflation registered in the same month of the previous year, and the 12-month inflation rate notably reduced during the month amounting to 2.4%. The low inflation environment owed to both the slowing of core inflation rate and the decline in seasonal prices. In the upcoming months, the CBA Board estimates, the inflation will remain within the lower part of the confidence band.

The actual developments in the external sector in April demonstrate that trends for improving global economic growth and minor inflationary patterns in the main commodity markets of the world continued. In view of such developments, the CBA Board keeps anticipating inflationary effects proportional with expanding demand in the external sector.

The CBA Board notes that economic activity in the first quarter of 2018 was relatively strong, driven by high productivity growths reported in industry, construction and services sectors. This was also concomitant with high rates by which the domestic demand recovered, and it is expected that the growth of the latter will, since the second quarter, decelerate to some extent, gradually approaching its equilibrium. The Board believes that inflation expectations have stabilized over the past period of the year and no additional inflationary pressures are expected in the upcoming months. At the same time, the Board reckons that the impact of political events in April and May on the financial market has been effectively absorbed thanks to the adequate toolkit the CBA used under its independence mandate.

Taking the abovementioned into account, the Board finds it appropriate that current monetary conditions will still be maintained, while considering that, in light of predicted developments, a gradual offsetting of expansionary monetary conditions would be needed in the future to fulfill the inflation target. As a result, the expectation is that the 12-month inflation rate will fluctuate within the confidence band in the forecast horizon, stabilizing around the 4% target.

The risks to economic growth outlook and to the inflation deviating from its recovery path are estimated to be more balanced. Should there emerge such risks, the CBA will adjust the monetary policy directions accordingly, while ensuring the price stability.

Press Service of the Central Bank of Armenia

MAIN MACROECONOMIC INDICATORS OF ARMENIA

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
	actual	actual	actual	actual	actual	actual	actual	actual	program	program	program
Prices											
Inflation (y/y, end of period, %)	9.4	4.7	3.2	5.6	4.6	-0.1	-1.1	2.6	4.0	4.4	4.0
Consumer price index (y/y, average, %)	8.2	7.7	2.6	5.8	3.0	3.7	-1.4	1.0	3.2	4.5	4.1
Core inflation (y/y, average, %)	7.5	8.6	5.3	5.8	1.9	5.1	-2.0	0.8	4.8	4.4	4.1
Gross product											
GDP (billion Armenian dram)	3690.0	4028.9	4266.5	4555.6	4828.6	5043.6	5067.3	5568.9	6105.0	6679.4	7293.9
GDP (% real growth)	2.2	4.7	7.2	3.3	3.6	3.2	0.2	7.5	5.5	5.2	5.0
Supply											
Industry (% real growth)	9.2	13.6	6.4	6.3	-0.9	6.2	7.7	6.6	5.5	6.5	5.4
Agriculture (% real growth)	-16.0	14.0	9.5	7.6	6.1	13.2	-5.0	-5.3	4.4	4.5	4.6
Construction (% real growth)	3.3	-12.2	4.5	-7.4	-4.5	-3.1	-14.1	2.5	4.1	4.4	4.0
Services (% real growth)	4.1	4.7	6.3	3.1	6.7	1.6	3.2	12.4	6.0	5.0	5.1
Taxes, net (% real growth)	13.4	3.8	9.9	3.6	1.8	-5.1	-4.7	10.1	5.7	5.4	5.2
Demand											
Consumption (% real growth)	3.9	2.6	7.7	1.9	0.7	-6.2	-0.5	9.5	3.6	3.3	3.4
Public consumption (% real growth)	3.9	1.9	-1.4	8.7	3.4	4.7	5.8	11.5	-2.3	2.2	2.0
Private consumption (% real growth)	3.9	2.7	9.1	0.9	1.0	-7.7	-1.2	8.9	3.7	3.5	3.6
Gross investment (% real growth)	0.5	-5.2	0.5	-10.5	-3.0	-1.2	-8.7	13.9	3.4	9.1	8.9
Public investment (% real growth)	-12.7	-6.1	-22.4	-13.8	10.0	13.6	5.0	31.7	-29.2	18.0	15.0
Private investment (% real growth)	2.6	-5.1	3.6	-10.0	-3.7	-3.6	-10.5	11.1	9.5	7.5	7.7
Export of goods and services (% real growth)	20.4	14.5	12.0	8.9	6.1	9.9	13.5	12.8	12.0	8.6	8.0
Import of goods and services (% real growth)	7.2	-0.1	4.7	5.5	4.2	-5.6	3.4	22.9	5.9	5.6	5.2
External sector											
Balance of trade (million US dollar)	-2065.7	-2109.8	-2111.9	-2196.2	-2055.4	-1186.4	-944.4	-1482.1	-1422.1	-1454.1	-1526.3
Balance of services (million US dollar)	-260.8	-65.8	-101.6	-124.3	-113.0	-94.5	-71.4	-62.5	-53.9	-35.8	-15.7
Remittances (million US dollar)	1421.9	1440.4	1539.8	1755.1	1616.1	1082.4	989.6	1139.9	1229.2	1319.1	1414.5
Current account (million US dollar)	-1261.4	-1058.9	-1057.9	-812.9	-883.1	-279.1	-238.1	-399.9	-472.4	-485.1	-490.9
Balance of trade (share in GDP, %)	-22.1	-20.8	-19.9	-19.7	-17.8	-11.3	-8.9	-12.8	-11.2	-10.5	-10.1
Balance of trade (share in GDP, %)	-2.8	-0.7	-1.0	-1.1	-1.0	-0.9	-0.7	-0.5	-0.4	-0.3	-0.1
Remittances (share in GDP, %)	15.2	14.2	14.6	15.8	14.0	10.3	9.3	10.0	9.8	9.6	9.4
Current account (share in GDP, %)	-13.5	-10.5	-10.0	-7.3	-7.6	-2.7	-2.2	-3.5	-3.7	-3.5	-3.2
Public sector											
Revenues and grants (billion Armenian dram)	780.4	880.9	946.2	1071.4	1144.8	1167.7	1171.1	1237.2	1301.0	-	-
Tax revenues (billion Armenian dram)	699.4	777.4	878.4	1000.9	1064.1	1067.9	1079.7	1158.1	1271.9	-	-
Expenditures* (billion Armenian dram)	954.3	986.5	1006.1	1142.9	1235.1	1409.0	1449.1	1503.9	1427.9	-	-
Deficit (billion Armenian dram)	-173.9	-105.6	-59.9	-71.5	-90.3	-241.3	-278.0	-266.7	-126.9	-	-
Revenues and grants (share in GDP, %)	22.6	23.3	22.2	23.5	23.7	23.2	23.1	22.2	21.3	-	-
Tax revenues (share in GDP, %)	20.2	20.6	20.6	22.0	22.0	21.2	21.3	20.8	20.5	-	-
Expenditures (share in GDP, %)	27.6	26.1	23.6	25.1	25.6	28.0	28.6	27.0	23.4	-	-
Deficit (share in GDP, %)	-5.0	-2.8	-1.4	-1.6	-1.9	-4.8	-5.5	-4.8	-2.1	-	-
Monetary sector											
Broad money (y/y, end of period, %)	11.8	23.7	19.5	14.8	8.3	10.8	17.5	18.5	-	-	-
Dram broad money (y/y, end of period, %)	15.7	26.4	11.9	14.9	-3.5	5.2	24.8	28.9	-	-	-
Loans to economy (y/y, end of period, %)	26.7	35.3	27.6	12.9	20.8	-3.3	6.0	16.2	-	-	-
USD / AMD (Armenian dram for one US dollar)	373.7	372.4	401.8	409.6	415.9	477.9	480.5	482.7	-	-	-

* The 2017 Expenditures and Deficit include the AMD 82.0 billion-worth Russian Commodity Loan received at the end of the year.

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