

*Approved under the Central Bank Board  
Resolution No 216A, dated December 29, 2020*

# Inflation Report/4

*Monetary Policy Program, Q4, 2020*



*Status Report on Implementation of the Monetary  
Policy Program, Q3, 2020*

*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 the 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 December 15, 2020, i.e. the day on which the refinancing rate was set, the results of 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 ([www.cba.am](http://www.cba.am)) which also contains all press-releases and other monetary policy-related publications*

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## 1. EXECUTIVE SUMMARY

*Armenia's macroeconomic environment in the fourth quarter of 2020 shaped as the new wave of coronavirus pandemic broke out all over the world, including Armenia. In addition, important influence came from the martial law declared in Armenia due to the large-scale offensive unleashed by Azerbaijan on September 27th along the entire line of contact with the Artsakh Republic. These factors are estimated to have added to uncertainties about the economic outlook, which will have a significant drag on the recovery to economic activity and aggregate demand in both the outside world and Armenia. At the same time, in light of positive expectations for the use of vaccines in different countries starting from 2021, there is an increase in prices in international commodity markets, which creates some inflationary pressures on domestic prices.*

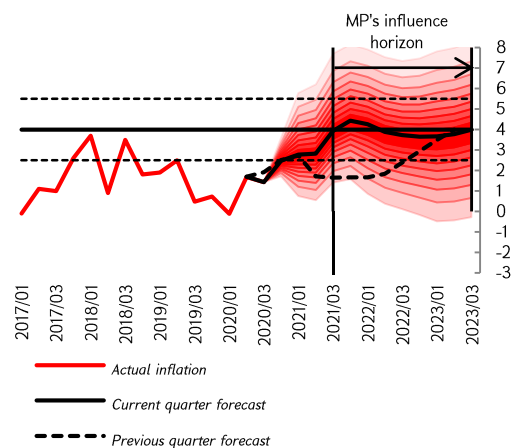
*According to the baseline scenario of the Central Bank of Armenia, inflation will keep on increasing in the forthcoming quarters, yet inflationary environment will run below the target, under which the CBA will continue maintaining the monetary policy stance expansionary, while projecting a gradual phase-out in the medium term.*

With such monetary policy stance and in view of expected economic developments, the 12-month inflation will approach the 4.0% target in the near future and stabilize around it in the medium term. This will be determined by external inflationary trends, the actual depreciation of the exchange rate and some acceleration of inflation expectations along with still a weak private demand amid existing high uncertainties. The stimulative monetary and fiscal policies will also contribute to the above trends. Taking into account some acceleration of inflation on the back of inflationary effects expected from the external sector and actual depreciation of currency exchange rate, as well as the increase in the country's risk premium, the **CBA decided to raise the refinancing rate by 1.0 percentage point, still keeping the monetary policy stance expansionary**. It was estimated that in case of expected economic developments, a gradual reduction of the expansionary monetary policy stance would be required to ensure that inflation stabilizes around the target in the medium term.

*According to the CBA baseline short-term scenario, with a new wave of pandemic, declared martial law and growing uncertainties about economic outlook in the fourth quarter, the 2020 economic growth will float in the negative territory, and in the medium run*

Chart 1

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



Source: RA Statistics Committee, CBA forecast

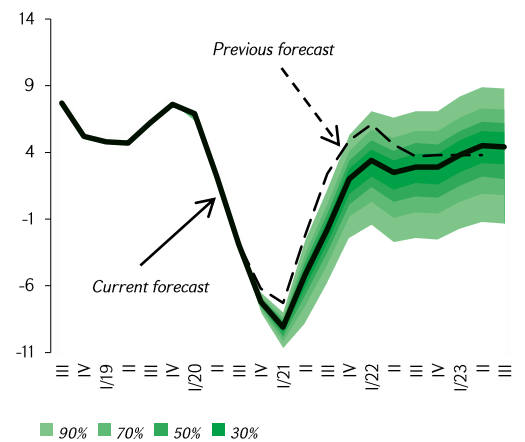
***it will gradually recover, stabilizing around its long-term equilibrium, which is currently estimated to be lower.***

The 2020 economic decline will be determined mainly by a considerable reduction in output in services, which will be accompanied also by persistently weak private demand. The stimulative monetary and fiscal policies and gradual elimination of negative demand factors will greatly facilitate the recovery of economic growth in the medium term.

***In the forecast horizon, risks of inflation deviating from the projection path are on the upside in the short run, while downside risks to projected economic growth path prevail.*** As healthcare, political and economic uncertainties remain high, the Central Bank of Armenia is monitoring the developments and stands ready to respond accordingly should such risks emerge, in order to ensure price stability in the medium run.

Chart 2

Real GDP growth (cumulative)<sup>4</sup> forecast probability distribution for 3-year horizon



Source: RA Statistics Committee, CBA forecast

<sup>4</sup> 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 developments

***In 2020 the global economy registered an unprecedented decline due to the spread of coronavirus pandemic and its economic consequences. Following deep economic downturn in the second quarter, signs of gradual economic recovery were seen in most countries, including Armenia's key partners - the United States, Eurozone countries, and Russia - in the third quarter, largely thanks to the lifting or easing of the pandemic-driven restrictions and lockdowns. Yet, by the end of the year, economic recovery in many countries will be hampered by a new wave of the pandemic, which will have a negative impact on consumer demand and investment. However, positive developments early in the next year are probable as creation of coronavirus vaccines and their use can bring about favorable effects.***

*The global economy posted an unprecedented decline in 2020 due to the spread of coronavirus pandemic and its economic consequences.*

***Economic developments in the United States:*** According to the U.S. Bureau of Economic Analysis estimate, the US economy posted a 3.0% y/y decline in the third quarter of 2020, which is lower than predicted in the previous MP program of the Central Bank of Armenia. During the third quarter the economy benefited from the lifting of restrictions the state had imposed to prevent the spread of coronavirus. The rebounding of economy in the third quarter of 2020 came along with a falling rate of unemployment: it settled on an 8.8% level against 13.0% in the previous quarter. It should be noted that, despite the second wave of pandemic across the nation, no new restrictions were imposed in the fourth quarter, which continued to have a positive impact on further recovery of economic activity and reducing unemployment - the latter amounted to 6.9% in November. The US economy is projected to decline by 3.7% in 2020, below the previous forecasts made by the CBA, owing to faster-than-anticipated recovery of economic activity in the third and fourth quarters.

*Good developments in terms of favorable effects from creation and use of coronavirus vaccines are likely.*

In the USA in the third quarter of 2020, as demand recovered to a certain extent and energy prices rose, the average quarterly personal consumption expenditure price index<sup>2</sup> speeded up a little to 1.2% y/y, but it was still persisting below the US Federal Reserve's medium-term target. Given actual economic growth developments, in the third

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<sup>2</sup> The personal consumption expenditure price index target is 2%, which on average is commensurate with headline inflation of 2.3%.

quarter of 2020 the Fed kept the policy rate in the range of 0.0-0.25%, as set for the first quarter of 2020, and it announced that the program of quantitative easing would continue. Despite rising energy prices, there is expectation that a slow demand recovery would further contribute to the low inflationary environment this year. In such a case, as well as to stimulate economic activity, the US Fed will carry on pursuing a policy of low interest rates for a longer period of time.

**Economic developments in the Eurozone:** In the third quarter of 2020 the Eurozone economy saw signs of recovery, unlike the previous quarter, as the pandemic-driven restrictions eased. According to preliminary estimates provided by the Eurostat, economic decline in the Eurozone in the third quarter of 2020 was 4.4% y/y. As short-term leading indicators suggest, this recovery trend is estimated to slow during the fourth quarter, as major Eurozone member states have already begun imposing both local and large-scale restrictions to prevent the spread of the second wave of pandemic. As a result, the 2020 economic decline is predicted to amount to 7.5%. However, the current news about vaccines has shaped positive expectations in terms of the outlook on economic developments, and the Eurozone economy is expected to kick-start already from the beginning of 2021.

In the Eurozone in the third quarter of 2020, the average 12-month inflation was zero, notably below the European Central Bank's target, and headline inflation, 0.7% y/y. The zero inflation was largely determined by a considerably weak demand and the y/y appreciation of the euro. In anticipation of low inflation and given the economic decline, the ECB announced that it would further pursue a low interest-rates policy, while implementing the program of purchases of assets at EUR 20.0 billion per month.

**Economic developments in Russia:** According to preliminary estimates by State Statistics Service of Russia, the economy posted a 3.6% y/y decline in the third quarter of 2020, in spite of certain recovery in agriculture and private consumption. Although the Russian economy started reviving during the third quarter, it is however expected to slow down again in the fourth quarter, which will be mainly driven by a new wave of widely spreading pandemic in the country. In this case, the decline of the Russian economy in 2020 is projected at 3.7%, and starting from 2021 a certain economic recovery is likely.

In the third quarter of 2020 the average quarterly inflation in Russia accelerated to 3.5% y/y from that of 3.1% reported in the previous quarter, running below its target value of 4%. Already in October inflation ran past the 4% threshold, reaching 4.1%. The main trigger to acceleration of inflation was the depreciating ruble, which

Chart 3

Economic growth in trade partner countries, (%)

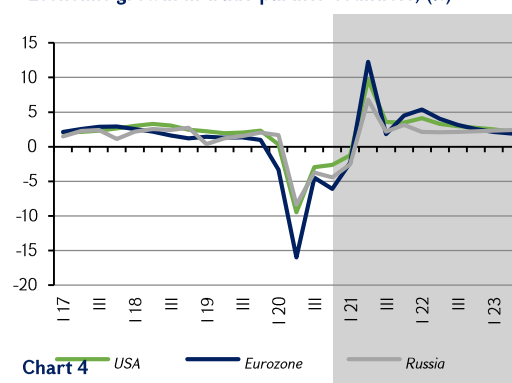


Chart 4

Inflation in trade partner countries, (%)

Source: Bureau of Economic Analysis (BEA), Eurostat, Rosstat, CBA forecasts

has also determined the heightening of inflation expectations. With deflationary pressures persisting under weakening demand, the Bank of Russia cut the policy rate by 0.25 pp early in the third quarter of 2020 (July), then, as inflation speeded up, it kept the policy rate at the same level - 4.25% - at the September and December board meetings. Given a trend of accelerating inflation and in view of predicted economic developments as well as the recovery of the global economy, it is expected that the Bank of Russia will soon pursue a gradually contractionary monetary policy.

### ***Developments in world commodity and food product markets:***

In the third quarter of 2020 commodity and food product markets experienced the effects of reanimated economies as a result of lifted restrictions. In the third quarter of 2020, therefore, prices of many raw materials and food products grew against the previous quarter, and such price rise, besides the rebounding global demand, was also fueled by a number of supply factors. In the short run, in the context of limited supply volumes in commodity markets, prices are expected to recover further.

Bolstered economic activity in China, as well as reduced copper production in Chile - a major player in copper mining - due to the coronavirus pandemic in that country pushed international copper prices up during the third quarter of 2020. As a result, the world copper market registered a 12.5% y/y rise in copper prices in the third quarter. It is expected that prices will keep on rising thanks to high industry growth in China, as well as a gradually recovering global demand. In the third quarter of 2020 international oil prices posted a 39.0% increase q/q, and the increase was driven by the agreement of OPEC+ member states on reduction of supply volumes, on the one hand, and as world demand recovered to a certain extent, on the other. It should be noted that the news on the development of vaccines against coronavirus and their use in the near future, as well as the expectations about extending of terms of the agreement between OPEC+ member states will facilitate a further rise in international oil prices.

In the third quarter of 2020, relative to the previous quarter, price increases were observable in almost all food product markets. Thus, price inflation was registered in the sugar market in anticipation of bad harvest in Brazil and Thailand - key sugar producers. Wheat prices have also risen due to the expected decrease in supply as a result of dry weather in a number of countries. Some recovery in global demand as well as reductions in supply across individual groups in the near term will also contribute to the predicted price increases in the main food product groups.

## **2.2. Forecasts**

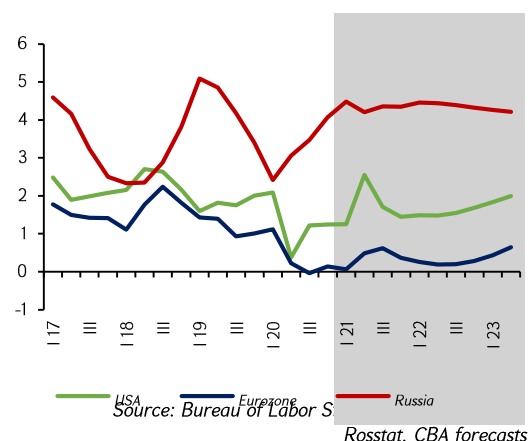
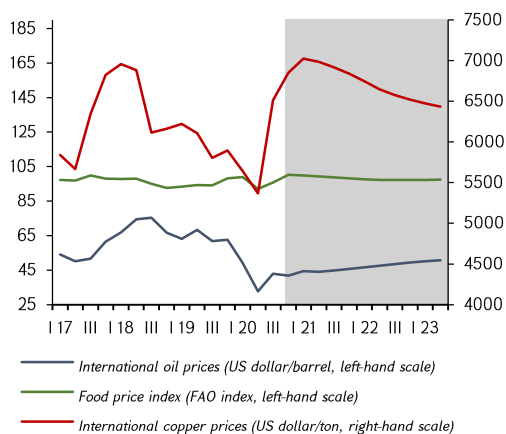


**Chart 5**

### **International commodity and food prices**



Source: World Bank, FAO, CBA forecast

### 2.2.1. Inflation and monetary policy

*Inflation expanded to a certain extent this quarter, but it is still persisting below the target. At the same time, the 12-month core inflation accelerated, amounting to 2% in November. Although, the Central Bank estimates, the external demand came in weaker during the fourth quarter under the influence of the second wave of coronavirus, positive expectations about the use of vaccines in different countries have pushed prices up in the commodity markets since the start of 2021, which will put some inflationary pressures on the Armenian economy. On the other hand, the annual domestic economic growth forecasts for 2020 have not been revised essentially. The declines in sectors of the economy caused by additional uncertainties due to martial law and coronavirus were generally in line with developments predicted by the Central Bank, and the expansionary fiscal policy continued to contribute positively to aggregate demand. In such a situation, reacting to the predicted acceleration of inflation under inflationary pressures spilled over from the external sector and the depreciation of the dram in the foreign exchange market, as well as in view of Armenia's increased risk premium in international markets, the Central Bank raised the refinancing rate by 1.0 pp. However, given the exchange rate depreciation, increased inflationary expectations, and the interest rates persisting low even after the refinancing rate had been raised, the monetary stance is still assessed as expansionary<sup>3</sup>. As a result, inflation will somehow accelerate and stabilize around the 4% target in the upcoming quarters, in which case it would be necessary for expansionary stance of the monetary policy to phase out gradually in the medium term.*

*The 12-month core inflation accelerated, amounting to 2% in November.*

*The Central Bank has raised the refinancing rate by 1.0 pp in response to predicted acceleration of inflation under inflationary pressures from the external sector, the depreciation of dram in the foreign exchange market, as well as in view of Armenia's increased risk premium in international markets.*

*Inflation will somehow accelerate and stabilize around the 4% target in the upcoming quarters, so the expansionary stance of the monetary policy would need to phase out gradually in the medium term.*

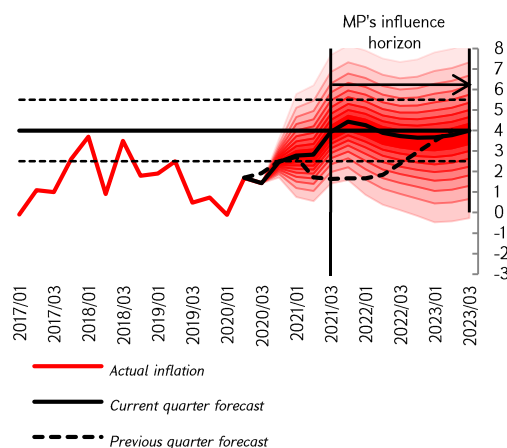
Low economic activity and sluggish demand amid growing uncertainties under martial law, a high rate of spread of the second wave of coronavirus, and other relevant factors will persist over the fourth quarter of the year, according to the Central Bank estimates. In terms of supply, there will be a decline in all sectors of the economy. The decline in output in services will have a notably negative impact. Weak demand will be mainly attributable to an inert consumer and investor behavior amid high uncertainty. On the other hand, implementation of the fiscal policy, which will be considerably expansionary for the fourth quarter of 2020 and for the entire year, will somehow offset demand in terms of impact on it. As a result, the GDP gap estimated for the fourth quarter of 2020 remains negative.

<sup>3</sup> For the monetary policy stance assessment guideline, see Inflation Report 2019/4; Box 4; pp. 18-20.

With short term impact of fiscal stimulus on aggregate demand, a notable growth of remittances from abroad, and an expansionary monetary environment, the GDP gap will reduce temporarily, easing demand-driven deflationary pressures. Certain negative factors, such as possible slowing of the growth rate of financial intermediation and projected weak contractionary effect of fiscal policy, will, starting from 2021, again contain demand to some extent, causing a negative GDP gap. The latter will close as the above factors phase out at the end of the forecast horizon and the relevant monetary policy is conducted. In view of the monetary and fiscal policy scenario described above, inflation will speed up to a degree at the end-2020 yet standing below the target. Short-term inflation expectations of the public are estimated to have increased somehow amid growing uncertainties, some depreciation of the dram in the foreign exchange market and actually expanded inflation. There is, however, anticipation that inflation expectations will stabilize and heightened uncertainty about them will gradually neutralize thanks to implementation of the monetary policy outlined for the medium-term perspective. This will affect the behavior of inflation, which, approaching the target in the upcoming quarters, will stabilize around it in the face of weak demand. Given the anticipated acceleration of inflation under inflationary pressures transmitted from world's commodity markets and actual depreciation of the dram, as well as an increased risk premium for Armenia, ***the Central Bank Board decided to raise the policy rate, even in which case monetary conditions will still be stimulative. At the same time, in expectation of macroeconomic developments, the CBA Board is prone to gradually reducing the expansionary stance of monetary policy to fulfil the inflation target.***

Chart 6

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



Source: RA Statistics Committee, CBA forecast

Table 1

| Period  | Inflation interval forecast probability distribution |          |          |          |       |
|---------|------------------------------------------------------|----------|----------|----------|-------|
|         | <1.0%                                                | 1.0-2.5% | 2.5-5.5% | 5.5-7.0% | >7.0% |
| Q4 2020 | 0.1%                                                 | 42.0%    | 57.9%    | 0.0%     | 0.0%  |
| Q1 2021 | 6.0%                                                 | 27.2%    | 58.8%    | 6.9%     | 1.2%  |
| Q2      | 7.5%                                                 | 25.3%    | 55.7%    | 9.0%     | 2.5%  |
| Q3      | 2.2%                                                 | 11.8%    | 56.5%    | 18.8%    | 10.8% |
| Q4      | 1.9%                                                 | 9.2%     | 52.9%    | 21.7%    | 14.2% |
| Q1 2022 | 5.4%                                                 | 13.4%    | 51.5%    | 18.6%    | 11.0% |
| Q2      | 8.5%                                                 | 16.7%    | 51.2%    | 15.6%    | 8.0%  |
| Q3      | 10.7%                                                | 18.1%    | 50.1%    | 14.2%    | 6.8%  |
| Q4      | 12.6%                                                | 18.3%    | 47.7%    | 13.9%    | 7.5%  |
| Q1 2023 | 14.4%                                                | 17.6%    | 44.5%    | 14.1%    | 9.4%  |
| Q2      | 13.9%                                                | 17.0%    | 44.1%    | 14.6%    | 10.4% |
| Q3      | 12.4%                                                | 15.8%    | 43.6%    | 15.8%    | 12.5% |

### 2.2.2. Economic activity<sup>4</sup>

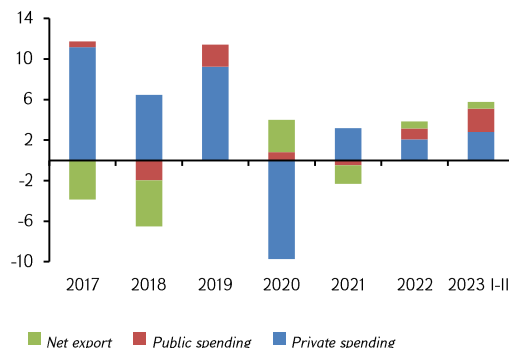
Economic activity slowed down significantly in 2020, mainly due to a decrease in private demand. Private demand had declined first and foremost due to the spread of pandemic in March 2020, and suspended consumption and investment under uncertainties and cautious behavior was observable. Private demand was further reduced due to the war unleashed by Azerbaijan against the Artsakh Republic on September 27th, which brought in additional uncertainties and psychological factors to economic agents. The 2020 economic activity, as a result, has been revised downside, and the decline will be an estimated 7.2%, according to the Central Bank. Subsequently, the decline in private demand will be 10.1%, with private consumption to reduce by 9.3% and gross accumulation of private fixed assets by 15.3%. Public spending and net export will have positive contribution to GDP, although both import and export will shrink considerably.

In the forecast horizon, economic activity will slowly recover, mainly owing to private spending, but GDP growth is estimated to persist below the previously projected long-term growth rate of 5.0% due to the negative impact of military offensive in the Artsakh Republic and accumulated uncertainty. The state budget's and net export's contribution to economic growth will be negative in 2021, but their impact in the medium term will be positive, as well.

**External demand:** Estimations suggest that the 2020 current account deficit-to-GDP ratio will improve relative to 2019 to stand at around 5.0% instead of 5.5% outlined in the previous MP program. The forecasts for the fourth quarter of 2020 were revised due to the effects from announced martial law. Thus, in the fourth quarter the decrease in export will be greater than predicted previously, largely because of downside revision for gold and copper concentrate exports. Remittances from individuals were revised upside, taking into account the higher-than-estimated remittances in the third quarter. The growth of remittances from the USA and other countries (as a group) during the year will remain strong until the yearend. As a result of such revisions, the current account deficit-to-GDP ratio will decrease slightly relative to the previous forecast.

Chart 7

Demand components contributing to the growth (percentage point)<sup>5</sup>



Source: RA Statistics Committee, CBA forecast

*The 2020 economic activity has been revised downside, and its decline will reach 7.2%, according to the Central Bank estimation.*

<sup>4</sup> For a detailed economic growth forecasts, see the "GDP Projection Probability Distribution", chart 18, table 2.

<sup>5</sup> The change in tangible working capital inventories is not included in demand; it is considered by the RA Statistics Committee as a balancing item and does not show the true level of investments, so supply and demand-side calculated economic growths may vary from each other. See [https://www.armstat.am/file/article/sv\\_04\\_19a\\_112.pdf](https://www.armstat.am/file/article/sv_04_19a_112.pdf).

The real growth of export of goods and services in 2021 is predicted in the range of 4.0-6.0%, which implies a lower growth compared to previous forecasts. Although global demand is projected to recover at somewhat faster rates in 2021, a slow growth of export will be inevitable due to sluggish export of tourism, on the one hand, and restricted supply of gold and copper mining and exporting derived from the effects of martial law, on the other. Tourism will remain the most-affected sector. Despite the positive news on the coronavirus vaccine use in the world, travelers will still be wary. Armenia expects that its external tourism would rebound starting from the third quarter of 2021, though at a slower pace than world tourism, given the negative medium-term effects of martial law.

In view of a scenario that weak domestic demand persists, the real growth of import of goods and services in 2021 is projected in the range of 7.0-9.0%. The slow recovery of import of tourism will also be attributable to the effects of weak demand.

The volumes of remittances of individuals from the US and other countries (as a group) are forecast to decrease in 2021 after an unprecedented high growth recorded in 2020, whereas remittances from Russia will recover to a certain extent in the light of expected revival of the Russian economy and some progress in labor migration. In case of these predictions, the decrease of net inflow of total remittances in 2021 will be in the range of 4.0-6.0%.

Based on the aforementioned forecasts, the current account deficit-to-GDP ratio will increase relative to 2020 and in 2021 it will be in the range of 7.0-8.0%.

In the medium run, once global economy and domestic economies rebound, the current account deficit-to-GDP ratio will gradually reduce and stabilize within its estimated equilibrium of 3.0-5.0%.

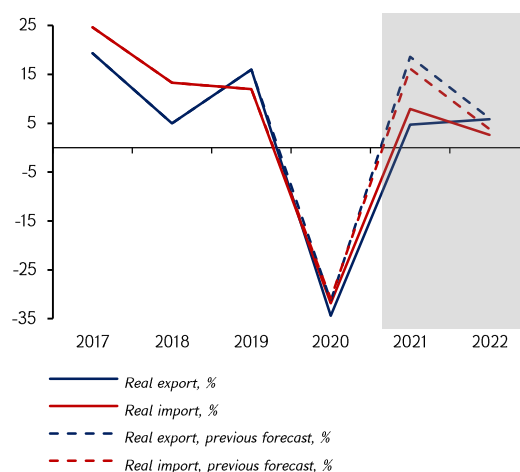
**Fiscal policy:** The fiscal policy's impact on aggregate demand for 2020 was estimated using the figures outlined in the RA Law on State Budget 2020, current changes to that law, and the Central Bank assessment based thereon. Note that the new fiscal policy impact estimates are in line with the assessments provided in the previous program.

Overall, the implementation of the 2020 state budget was markedly influenced by the spread of COVID-19, the government's anti-crisis measures, as well as the announced martial law, leading to reduced tax revenues (in view of actual and expected economic downturn) and to increased budget expenditures.

In 2020 tax revenues will trim down notably against the figure outlined in the RA Law on State Budget 2020, according to estimates<sup>6</sup>.

**Chart 8**

**Change in real export and import of goods and services in the medium term, (%)**



Source: RA Statistics Committee, CBA forecast

<sup>6</sup> Estimate made by the Armenian Government in the macroeconomic framework.

As a result, the tax-to-GDP ratio<sup>7</sup> will amount to 22.0%, reducing by 0.3 pp relative to 2019.

The Central Bank estimate of public expenditures makes up 96.4% of the adjusted expenditures figure<sup>8</sup>, including economic assistance packages and increased expenditures in a war situation. The expenditures plan may fall short especially on capital expenditures under foreign aid. Thus, capital expenditures under foreign aid programs in the first nine months of 2020 amounted to only 31% of the adjusted plan or AMD 34.1 billion. As a result, the public expenditures-to-GDP ratio will reach 30.6%, an increase of 5.8 pp over the previous year, according to the Central Bank.

In 2020, it should be mentioned, the state budget deficit in GDP will, primarily because of downsized taxes, reach 6.2%, increasing by 4.8 pp against the previous year.

With the above tax and expenditure projections, net of one-off streams that do not influence the domestic demand, and in view of an estimate of economy lending<sup>9</sup>, the 2020 fiscal policy's impulse on aggregate demand is estimated 5.6 pp expansionary compared to 2019, which is in line with the estimate in the previous program. This is attributable to the expenditures and economy lending impulse of as much as 5.0 pp expansionary and the revenues impulse<sup>10</sup> of only 0.6 pp expansionary.

*In 2020, relative to 2019, the fiscal policy's impulse is estimated 5.6 pp expansionary, which is consistent with the estimate in the previous program.*

In 2020 the Government debt in GDP will also increase considerably, by 11.6 pp, to reach 61.5%.

The draft law on state budget 2021 indicators denote that in 2021, relative to 2020, the tax-to-GDP ratio is expected to increase by 0.3 pp and the deficit-to-GDP ratio to decrease by about 1.0 pp, with the fiscal policy to be slightly contractionary, creating conditions for the RA Government debt reduction and fiscal sustainability in the medium run.

***The baseline scenario under Mid-Term Expenditure Framework for 2021-2023 envisages mostly a neutral fiscal policy to be implemented in 2022-2023.*** In the macroeconomic stability point of view, as the economy recovers, the debt-to-GDP ratio needs to decrease gradually in the medium term through increased tax revenues and improved expenditures structure, in compliance with fiscal rules.

<sup>7</sup> The 2020 GDP indicator is the Central Bank forecast.

<sup>8</sup> The adjusted plan constitutes the program revised under Government resolutions in the given period of time.

<sup>9</sup> The calculation of the impulse includes lending to the economy; even though not affecting the deficit, it does affect aggregate demand as a lending.

<sup>10</sup> The revenues impulse is estimated to be slightly expansionary due to the inclusion of both tax and other revenue changes in the single tax account. To ensure comparability with previous year, the impulse calculation in 2020 had extra-budgetary funds of state institutions to be included in other revenues. Such extra-budgetary funds are, effective 2019, being incorporated in the indicators of budget law.

**Labor market<sup>11</sup>:** In 2020 the growth rate of private sector nominal wage is predicted to slow down to about 3.0%. The economic growth revised downside and the unemployment expected to rise will keep the private sector's nominal wage growth rate low – at around 3.1% – in 2021. In the medium term, nominal wage growth in the private sector will accelerate slightly, concurrent with economic growth and inflation developments. In 2022 the private sector's nominal wage is projected to grow by 3.6%, and at the end of the forecast horizon it will be around 4.5%.

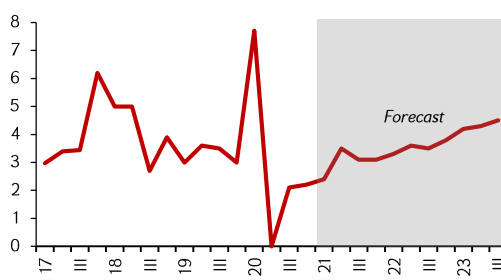
As the economy posted a substantial decline in 2020 while the announced martial law continues, unemployment is expected to gradually increase, reaching 19.0%<sup>12</sup> in 2020 and 20.0% in 2021. The gradual increase happens as many firms, mainly those affected by government projects, in times of a sharp fall in demand in 2020, stood back from cutting their staff but reduced work hours instead. In 2021, assuming that these projects would be accomplished, while high uncertainties would linger, a certain increase in unemployment is inevitable. In the medium term, as economic activity rebounds, the unemployment rate will fall by about 0.4-0.5 pp annually, approaching a 19.0% level at the end of the forecast horizon.

In 2020, the growth of firms' unit labor costs will increase (as the fall in productivity outstrips the slowing of wage growth in the private sector) but will stabilize around the 4% inflation target in the end of forecast horizon.

In conclusion, the labor market will see short term inflationary effects, which will phase out gradually in the medium term, as economic growth accelerates and productivity bounces back.

Chart 9

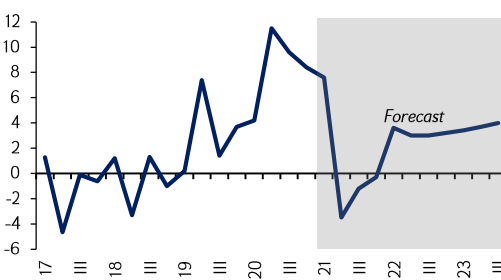
Nominal wage growth in private sector, y/y, (%)



Source: RA Statistics Committee, CBA forecast

Chart 10

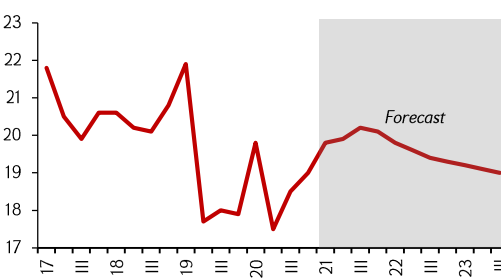
Unit labor costs growth, y/y, (%)



Source: RA Statistics Committee, CBA forecast

Chart 11

Unemployment rate, (%)



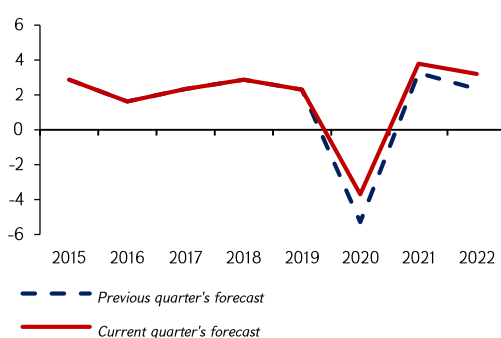
Source: RA Statistics Committee, CBA forecast

### 2.2.3. Comparison with the previous forecast

The United States, the Eurozone, and a number of countries elsewhere in the world saw the coronavirus pandemic spread rapidly during the fourth quarter, followed by local or large-scale restrictions applied in some countries. These developments notwithstanding, there are good prospects for creation of vaccines and their use in developed countries early in the next year. This will have influence on finding a way to restore soon the recovery path of economic activity in countries

Chart 12

US economic growth forecasts, (%)



Source: Bureau of Economic Analysis (BEA), CBA forecast

<sup>11</sup> The labor market data for 2020-2023 are the Central Bank projections which are based on the actual second and third quarter 2020 data. The growth indicators presented in this sub-section are relative to the same reference period last year, unless otherwise specified.

<sup>12</sup> The indicator is adjusted reflecting a changed methodology in calculation by the RA Statistics Committee. It's calculated relative to the number of labor resources, as per permanent population, rather than factual, as it used to be previously.

since 2021. As a result, although uncertainties about the economic outlook have somehow diminished, they now have come up with possibility of obtaining and widespread use of vaccines.

The US economy will post somewhat a smaller economic decline this year compared to previous forecasts of the Central Bank of Armenia. This will be attributable to higher-than-expected actual economic activity in the third quarter, despite some slowing anticipated in the fourth quarter. In the medium term, rebounding of demand under a widespread use of vaccines and its subsequent economic impact is expected earlier than thought previously, resulting in a faster recovery of the economy.

In the Eurozone in the fourth quarter of 2020, recovery will be slower due to new local short-term economic restrictions imposed to fight the coronavirus in a number of countries. However, with the third quarter's economic activity standing above the previous estimate, the economic decline will be lower for the year than predicted in the previous quarter's MP program of the CBA. Starting next year and in the medium term, the recovery will be faster in the light of scenario of vaccine use.

In Russia, similar to the other two economies, real economic growth rates will be higher along the entire forecast horizon owing to the impact of the vaccine uses worldwide.

***On the back of a faster restoring demand, the US and Russia will have higher inflations than anticipated previously. Meanwhile, somewhat a lower inflationary environment is predicted in the Eurozone mainly because of the appreciated euro against the US dollar.***

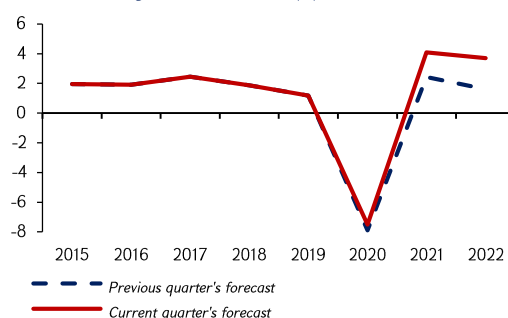
**Commodity prices will persist at a higher level than predicted previously almost along the entire forecast horizon, largely owing to the faster-than-expected recovery in China's economy (industry).**

In the world's food product markets, mid-term price forecasts have been revised upside, in line with actual developments and new forecasts of global demand. In the coming years, food prices will be at a higher level than predicted previously, shaping inflationary trends, after which inflation developments will gradually phase out.

Revisions in international oil price forecast have remained almost intact for the entire horizon, in which case oil prices in the medium term will trend up, concurrent with the recovery of global demand. The price of Brent crude will be in the range of USD 40-50 per barrel over the forecast horizon.

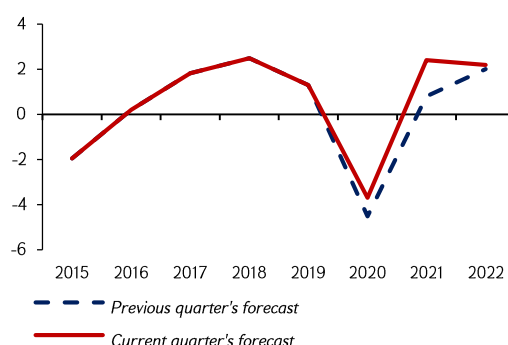
International copper prices have settled at levels above previous predictions due to the faster-than-expected recovery of the Chinese

**Chart 13**  
**EU economic growth forecasts, (%)**



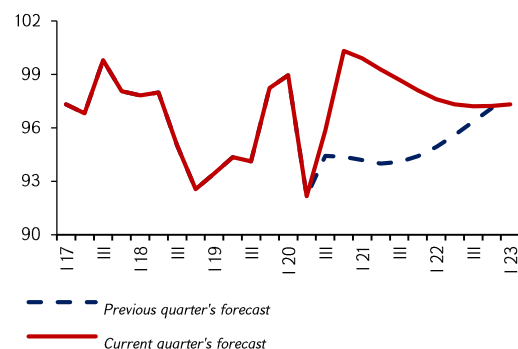
Source: Eurostat, CBA forecast

**Chart 14**  
**Russia economic growth forecasts, (%)**



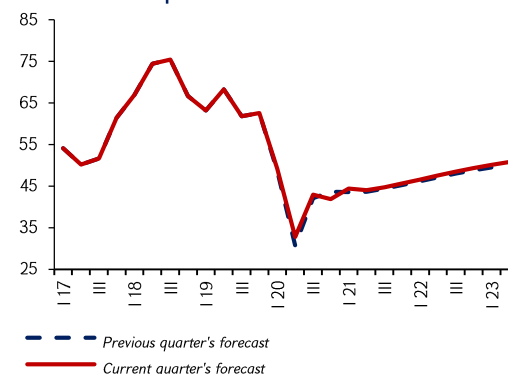
Source: Rosstat, CBA forecast

**Chart 15**  
**International food price forecasts**



Source: FAO, CBA forecast

**Chart 16**  
**International oil price forecasts**



Source: World Bank, CBA forecast

economy. In the medium term, as China returns to a stable economic growth path and after current supply-related difficulties are dealt with, international copper prices will decrease to a certain extent. At the end of the horizon, international copper prices will shape within previous forecasts of the CBA.

### **Armenia's economic growth estimations have been revised downside along the forecast horizon.**

The 2020 economic activity indicator has been revised downside; now estimated in the region of -7.2% compared to the previous -6.2%, this has resulted from actual declines in the economy due to the second wave of pandemic, and prediction of trends on recoveries in sectors of the economy. In particular, economic agents will remain precautious, and uncertainties grown after a martial law had been announced since end-September will certainly fuel such behavior.

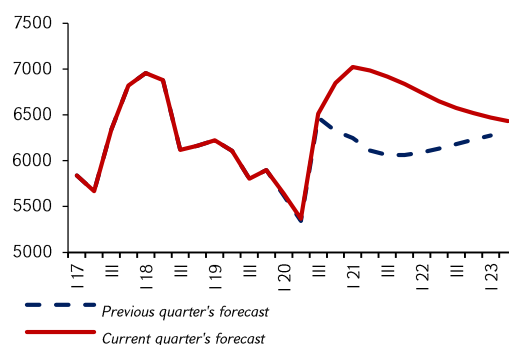
In 2020 the biggest decline is expected in services sector, which will be driven especially by large decreases in its sub-sectors in the course of martial law. Tourism will recover more slowly, given certain restrictions imposed in the country under martial law. There will also be some slowdown in the industry primarily due to a slackening in mining. There is assumption that construction sector will bounce back faster than forecast previously, and this will owe to state-funded construction, although still at a low level. Unlike other sectors of the economy, some growth is expected in agriculture, as the shocks from the beginning of the year did not have a significant impact on this sector.

The aforementioned economic slowdown will depend largely on a 10.1% decrease in private demand, which has been revised slightly upside against the previous forecast mainly because of the de facto little fall in private demand in the third quarter. Government spending has contributed positively to economic growth; compared to the previous forecast, it has also been revised upside, while the decline in export and import, on the contrary, has been adjusted downside.

In the forecast horizon, economic growth has been revised downside against the previous forecast (Chart 18) and it will still be running below the long-term potential mainly due to a decline in productivity as well as currently and predictably low level of investment amid increased uncertainty.

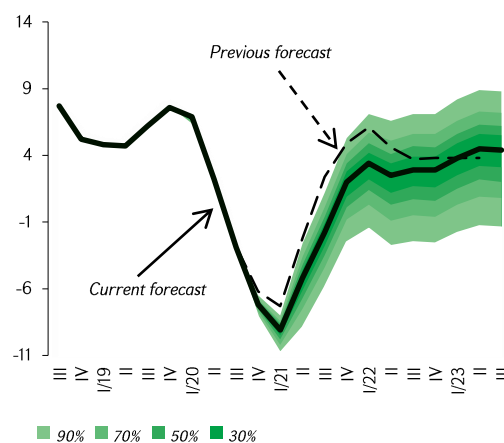
In the outcome, the above-mentioned factors will have a negative impact on the potential economic growth, with the GDP gap to still linger in a negative territory in the medium term, closing only at the end of the forecast horizon as negative factors of demand phase out gradually and an expansionary monetary policy carries on.

**Chart 17**  
**International copper price forecasts**



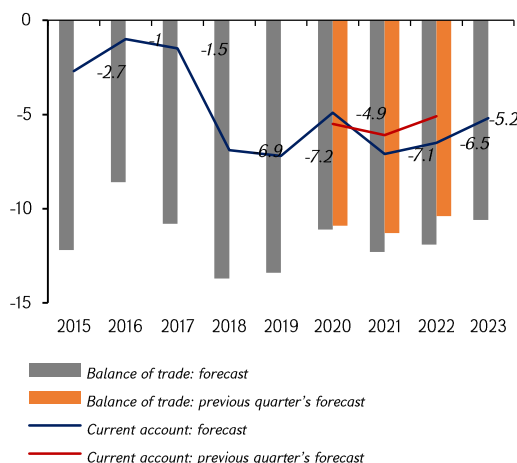
Source: World Bank, CBA forecast

**Chart 18**  
**Real GDP growth (cumulative)<sup>13</sup> forecast probability distribution for 3-year horizon**



Source: RA Statistics Committee, CBA forecast

**Chart 19**  
**Mid-term current account-to-GDP ratio forecasts, (%)**



Source: RA Statistics Committee, CBA forecast

<sup>13</sup> The growth rate of each quarter is calculated as the cumulative growth rate of the last 4 quarters.

**Table 2**

| <i>Real GDP growth (cumulative) forecast probability distribution</i> |                          |                          |
|-----------------------------------------------------------------------|--------------------------|--------------------------|
| Period                                                                | 30% probability interval | 90% probability interval |
| January-December 2020 / January-December 2019                         | (-7.4) - (-7)            | (-8.1) - (-6.5)          |
| January-December 2021 / January-December 2020                         | 0.9 – 2.8                | -2.5 – 5.3               |
| January-December 2022 / January-December 2021                         | 1.6 – 3.9                | (-2.6) – 7.1             |
| January-September 2023 / January-September 2022                       | 3.1 – 5.5                | (-1.4) – 8.8             |

In 2021 the current account deficit-to-GDP ratio will stand higher from previous forecast mainly attributable to deteriorated trade balance deficit because of negative supply-side effects. At the same time, contribution of a record high growth of remittances of individuals from the USA will gradually abolish in 2021.

The estimate of fiscal sector's impact remained much the same against previous forecast and stands at 5.6 pp expansionary.

According to current forecast, headline inflation kept on following the path in the short term (for 2020) as projected in the previous MP program, although prices of seasonal agricultural products will settle on a lower level than predicted. Instead, core inflation rate will probably stand rather high. Inflation in the short run will continue expanding due to the inflationary pressures expected from international commodity markets and the developments in the currency market. On the other hand, the deflationary pressures from the real economy will ease after domestic demand leaves its sluggish state and restores in the medium term. So, approaching the target faster than projected in the previous program, the inflation will stabilize in the medium term and float around the target at the end of the forecast horizon (see Chart "Inflation Forecasts Probability Distribution").

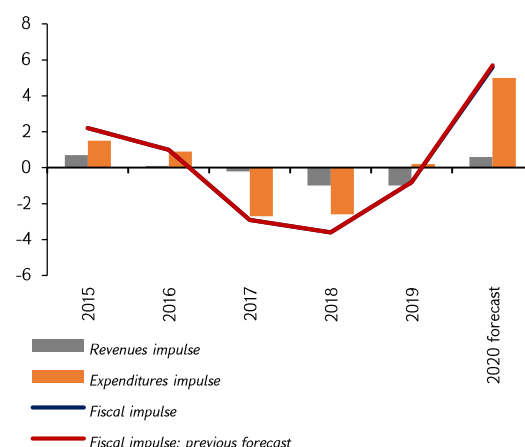
***Short-term inflation expectations will be lingering somewhat above the previous forecasts, driven by the prospect that core inflation would recover at a faster rate.***

#### 2.2.4. Main assumptions and risks

This section contains the main assumptions underlying the MP program for the fourth quarter of 2020 and the risks to implementation of the program, which derive from the external sector developments, the fiscal policy implementation, current trends and short-term forecasts.

**Chart 20**

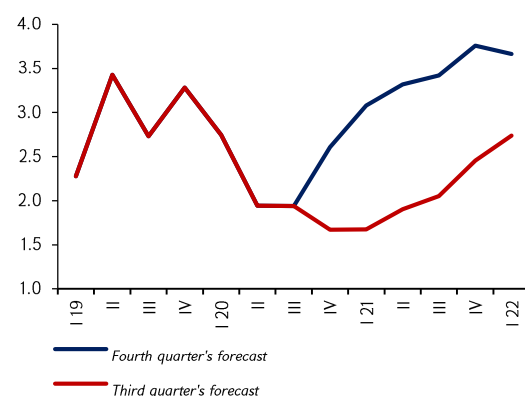
**Fiscal impulse forecast, (percentage point)**



Source: CBA estimate

**Chart 21**

**Short-term inflation expectation estimates, (%)**



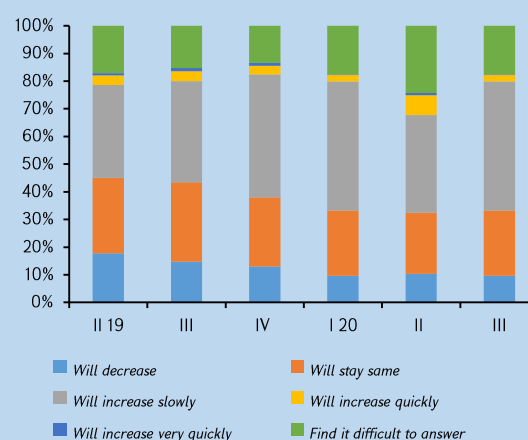
Source: CBA estimate

### Box 1:

#### The results of survey on the household and the financial system expectations

According to the results of the third quarter 2020 survey on selected macroeconomic indicators, which the CBA usually conducts by way of inquiries among households and companies in the financial sector, inflation expectations in the third quarter continue to demonstrate steadiness and did not change much against the indicators of the previous quarter. Specifically, the share of households expecting high and very high inflation rates for a one-year horizon in a total respondent base is still small. In the same token, the survey shows that people's uncertainty about the expected inflation in the third quarter has somewhat decreased and the share of those expecting low inflation has slightly increased.

Chart 22  
Household inflation expectation surveys



Source: CBA

### Forecast assumptions

Table 3:

| Main judgments and assumptions                                                                                                                                                                                                                                                                                                                                                                                                                                       | Possible developments, if this assumption proves correct                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p>In developed countries, the negative effects of the pandemic will decrease as vaccinations roll out, but will persist until the second quarter of 2021; in developing countries, the negative effects will carry on until the end of 2021, but with a weaker impact.</p> <p>Uncertainties will depend on the possibility of acquirement of vaccines and their widespread use.</p> <p>The reduction of oil production under the OPEC+ agreement will continue.</p> | <ul style="list-style-type: none"> <li>✓ Negative effects of the coronavirus spread will persist in the short term, but these effects will gradually decrease as a result of vaccine use in the medium term.</li> <li>✓ Global demand over the forecast horizon will be slightly higher than expected previously, underpinned by expectations for the reach of the coronavirus vaccine and the results of its de facto use.</li> <li>✓ In view of positive developments in demand in partner countries, the inflation will follow a path somewhat higher against previous projections.</li> <li>✓ In international markets of raw materials and especially food products, mostly inflationary developments have been in place and are expected.</li> </ul> |
| Country risk premium for Armenia will remain somehow high in the near future.                                                                                                                                                                                                                                                                                                                                                                                        | <ul style="list-style-type: none"> <li>✓ The fourth quarter saw the risk premium increase to a certain extent, and in the near future it will persist at the same level amid high uncertainty about the domestic economic and political outlook.</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
| Inflation expectations increase.                                                                                                                                                                                                                                                                                                                                                                                                                                     | <ul style="list-style-type: none"> <li>✓ It is estimated that short-term inflation expectations of the society have increased to some extent driven by inflation developments in international markets, certain acceleration of core inflation amid some depreciation of the dram in the domestic currency market.</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                              |

|                                                                                                                                                             |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| A fiscal policy considerably expansionary for 2020 and slightly contractionary for 2021.                                                                    | <ul style="list-style-type: none"> <li>✓ The fiscal policy's impact in 2020 is estimated considerably expansionary, 5.6 pp, at a time of Government-led anti-crisis programs, increase in military spending, and somehow underperformed foreign-funded capital expenditures. The estimate of stimulative effect is based on the following key assumptions: a/notable decrease in tax revenues, and b/ increase in public expenditures. In the medium term, in 2021 in particular, the fiscal policy's impact is estimated to be slightly contractionary<sup>14</sup>, and to be neutral pursuant to baseline scenario figures under MTEF, 2022-2023.</li> </ul>                                         |
| The uncertainties arisen amid the second wave of the pandemic and martial law will have some negative effects in the short run.                             | <ul style="list-style-type: none"> <li>✓ The impact of the pandemic in Armenia will possibly diminish and will almost abolish from early 2021 after the use of foreign vaccines starts and group immunity develops in Armenia.</li> <li>✓ The volumes of international tourism are expected to remain almost zero by the end of 2020, and will only gradually, by the end of 2021, hit 40% of the pre-crisis level.</li> <li>✓ The observed increase in economic and political uncertainty during martial law and in the aftermath period leads to a delay in the recovery of domestic demand (consumption-investment), as well as a temporary decrease in potential GDP in the medium term.</li> </ul> |
| Slowing of long-term stable GDP growth.                                                                                                                     | <ul style="list-style-type: none"> <li>✓ Due to the hostilities in Artsakh, the potential GDP level and growth in Armenia will possibly suffer a loss and slowdown. The potential GDP growth will be about 1.4% lower from previous estimates.</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                               |
| Gradual adjustments in the financial and banking sector.                                                                                                    | <ul style="list-style-type: none"> <li>✓ Some adjustment to balance sheets in the financial sector is expected in the near future, which will have a restraining effect on the aggregate demand developments.</li> <li>✓ However, throughout the forecast horizon, <b>macro-prudential policy</b> actions will be aimed at ensuring that the financial system operates under normal conditions, without creating additional risks for the real sector and macroeconomic stability.</li> </ul>                                                                                                                                                                                                           |
| Change in excise duty and customs rate driven by the requirement to apply general rates within the EEU.                                                     | <ul style="list-style-type: none"> <li>✓ The impact of the excise duty change expected in 2021 is estimated at about 0.4 pp, and the impact of the customs rate change, up to 0.2 pp.</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |
| Certain problems arise in the beef and pork market as a consequence of the war.                                                                             | <ul style="list-style-type: none"> <li>✓ In Artsakh, as well as in Syunik region, an increase in slaughtered animal due to the problems in the livestock production has led to a certain deflation of beef and pork price. This, however, will be short-term, and later on prices will gradually return to the previous level.</li> </ul>                                                                                                                                                                                                                                                                                                                                                               |
| About a 140-day long downtime of the Metsamor NPP, and some exchange rate depreciation of the dram may drive electricity fee to a possible revision upside. | <ul style="list-style-type: none"> <li>✓ The primary inflation impact is estimated at 0.2-0.4 pp, and the secondary impact, at about 0.15 pp.</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
| Import of goods of Turkish origin banned effective from January 2021.                                                                                       | <ul style="list-style-type: none"> <li>✓ The imposed ban will not have a significant inflationary effect, as it is estimated that adequate opportunities and time will allow to organize the import of substitutes of comparable-quality goods from other countries, particularly China and Russia, and to handle chains &amp; logistics issues.</li> </ul>                                                                                                                                                                                                                                                                                                                                             |

<sup>14</sup> Based on the indicators of the RA draft law on "State Budget 2021".

## Forecast risks

Current developments point out that the rate of coronavirus spread in the world remains high in a number of countries. Although rumors about chances of successful use of several vaccines have given markets some optimism, uncertainties over the future remain high around the world, especially in developing countries, including Armenia. The martial law announced following the September 27th large-scale offensive launched by Azerbaijan against the Artsakh Republic has added to uncertainties for Armenia's economy, which also expand the risks around the baseline scenario. Overall, increased uncertainty further leads one to handle broader ranges of uncertainty when making forecasts of central values of inflation and other key macroeconomic indicators (see inflation and economic growth forecasts probability distribution charts 1 and 2). In this case, therefore, only most quantitatively significant risks around the baseline scenario are presented below.

### **In terms of aggregate demand, risks are as follows:**

- External demand risks depend on the possibility, scalability and effectiveness of the vaccine use, as well as on efficiency and timing of anti-pandemic measures.
- Wariness in consumer behavior lingers, which will come out as structural changes in the consumption-savings dilemma. These developments can have an additional restraining effect on aggregate demand and may, by putting pressure on a further flow of investment in individual sectors, even lead to longer-term losses as to the potential level of the economy.

### **In terms of supply, the following are risks to the inflation:**

- In the short run, inflation risks are assessed upwards in terms of supply. In the foreign exchange market, some depreciation of the dram may influence inflation to a greater extent than predicted in the baseline scenario, which increases the short-term inflationary risks to imported goods and, through a secondary impact, the short-term inflationary risks to domestic goods and services.
- In terms of commodity prices, risks will depend on the widespread use of vaccines and how fast the global economy, underpinned by success in the vaccine use, recovers.

Risks to the inflation deviating from projection path in the medium term are assessed as balanced and, overall, quite large in amount (see Chart 1 "Inflation Forecasts Probability Distribution").

Besides the aforementioned inflation risks, there are additional mid-term risks to potential economic growth, and although bilateral, the downside risks prevail. In particular, risks are related to the following domestic factors:

- Uncertainties over the course and duration of both the pandemic and the measures to overcome it may lead to undermined consumer

and business environment, which, if lingered for some longer while, could create additional negative risks to the mid-term GDP potential.

- In the event the pandemic proves long lasting, change in the structure of consumption may be inevitable; in particular, the share of services requiring social interaction may decrease, which poses additional risks in terms of redistribution of labor resources in the medium term and may contribute to increased structural unemployment.
- Additional risks to a decrease in investments amid growing uncertainty driven by the war in the Artsakh Republic and the martial law in the Republic of Armenia.

Overall, as long as a lot of uncertainty about the developments in healthcare, political and economic situation persists, the Central Bank of Armenia attempts to reduce potential risks arising therefrom by building and discussing various scenarios of the situation and considering appropriate policy response options. This would allow the CBA to react accordingly to the situation at the first reasonable signs if such risks materialize.

### 3. ACTUAL DEVELOPMENTS IN Q3, 2020

#### 3.1. Inflation

##### 3.1.1. Fulfilment of the inflation target

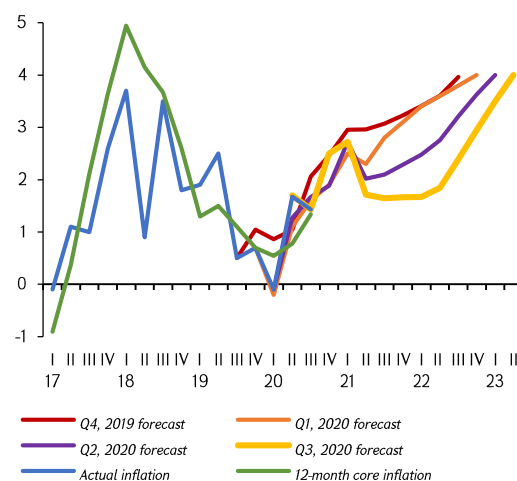
According to forecasts of the monetary policy program for the fourth quarter of 2019, the inflationary environment in the reporting period would remain low in anticipation of a weak aggregate demand. The latter, in turn, would be affected by the contractionary fiscal policy to be pursued at that time and the influences transmitted from a low inflationary environment persisting in the outside world. At the same time, some supply factors such as continued competition in commodity markets and a certain shift in demand from non-durable consumer goods market to durable consumer goods market would further contribute significantly to the shaping of low inflation. Under such conditions, the Central Bank intended to continue implementing a stimulative monetary policy, giving preference to the gradual recovery of inflation. As a result, the 12-month inflation rate would still be kept low in the short term perspective and approach and stabilize around the 4% target in the medium term perspective.

In the reporting period, as expected, a low inflationary environment was shaped, but because of some new deflationary patterns, the 12-month inflation proved lower than anticipated, deviating downside the projection path. The deviation was due to both demand and supply factors observable for that period.

In terms of their impact on inflation, the reporting period may fall into two parts, related to the differences in fiscal policy implementation, private consumption behavior, and a number of supply factors. Thus, the Government's fiscal policy carried out in the fourth quarter of 2019 and first quarter of 2020 proved more contractionary than expected. However, domestic demand in that period tracked higher growth than predicted owing to increased growth in private consumption, which in turn was fueled by a relatively large increase in consumer loans the financial system provided to the economy. In the meantime though, certain supply-side factors that contained the inflation included the impact of low prices in the outside world transmitted onto domestic prices, the increased effectiveness of the use of resources in the non-tradable sector of the economy, and the increasingly competitive commodity markets. Based on this, the Central Bank has revised the quarterly inflation forecasts and the path to

Chart 23

The 12-month inflation will approach the target in the short run and stabilize around it over the forecast horizon, according to the Central Bank forecasts



Source: RA Statistics Committee, CBA

recovery. At this period of time the Central Bank left the refinancing rate unchanged.

The inflationary developments in the second and third quarters of 2020 derived totally from healthcare and economic consequences of the New coronavirus disease (COVID-19) that broke out in a number of countries around the world at the start of the year and in Armenia since March. After healthcare and economic constraints were imposed on the back of uncertainty about the economic outlook at that time, a sharp decline in economic activity was observable, with significant reductions in all sectors of the economy. In such a situation, the Government implemented considerably a stimulative fiscal policy aimed at social and economic assistance. However, high uncertainty accumulated due to the pandemic has driven the public to take a precautionous approach to private consumption and investment, which has outpaced fiscal stimulus, leading to weakening domestic demand and maintaining a low inflationary environment. A wide scale offensive launched by Azerbaijan on September 27th along the entire line of contact with the Artsakh Republic, and the martial law declared in the Republic of Armenia in that situation, as well as the new wave of coronavirus that broke out and spread rapidly have brought in addition to uncertainties at the end of the quarter in terms of outlook to economic recovery and inflation developments.

In the reporting period, taking into account the possible deflationary effects under a persistent weak aggregate demand, the Central Bank conducted a stimulative monetary policy and further prioritized the gradual recovery of inflation, since, according to the Central Bank estimation, a low inflation in the macroeconomic situation at that time was contributing to the anchoring long-term inflation expectations and enhancing public confidence in the monetary policy pursued by the Central Bank. In the course of a one-year period under review, the Central Bank has gradually cut the refinancing rate by a total 1.25 pp, in anticipation of slowing of aggregate demand under high uncertainty caused by the spread of the pandemic.

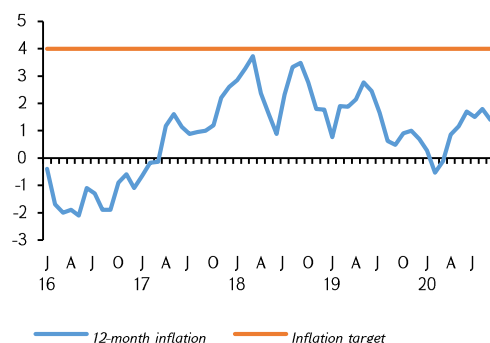
At the same time, reacting to the significant increase in demand for dram liquidity amid the pandemic, the Central Bank has injected, through its main tool, the required amount of liquidity into the system, helping short-term interest rates shape around the policy rate of the Central Bank. In the reporting period, the Central Bank repeatedly signaled the financial market that, in view of predicted macroeconomic developments, the monetary conditions will be kept expansionary for as long a period of time as necessary, to fulfil the inflation target in the medium term.

### 3.1.2. Prices

In the one-year course following the fourth quarter of 2019, the 12-month inflation remained low and demonstrated certain volatility primarily attributable to agricultural product price changes. Specifically, a fall in seasonal food prices in the fourth quarter of 2019 and early in 2020 has generally contributed to the inflation negatively, pushing it down to -0.1% y/y in March. Starting from the second quarter of 2020, inflation recovered to a certain extent, which is a result of the rise in prices of seasonal agricultural products, especially fruits. So, in September the 12-month inflation amounted to 1.4%. In the meantime, the 12-month core inflation rate has recovered to a certain extent during the third quarter of 2020 - to around 1.3% as of September, whereas regulated service tariffs and seasonal food product prices have risen by 1.1% and 5.1% y/y, respectively. It should be noted that the inflationary impact of a change in customs rates on some goods in the beginning of 2020, as was estimated, amounted to about 0.2 pp. The price increase on items “Tobacco” and “Alcoholic beverage” still incurs the inflationary impact of a change in excise duty rates at the beginning of the year.

Chart 24

Inflation persisted considerably lower from the target over the last one-year horizon



Source: RA Statistics Committee

Table 4

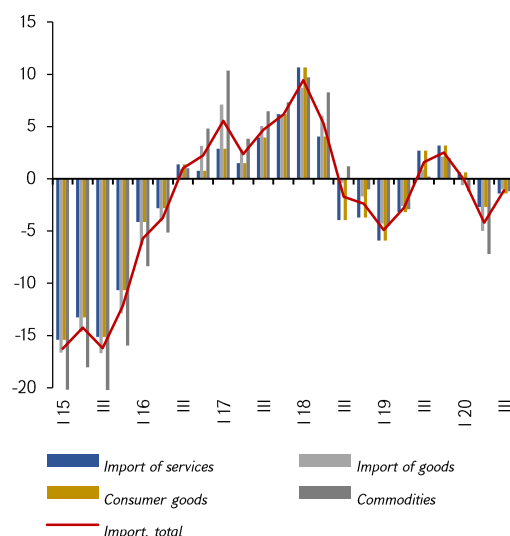
| Consumer price inflation by commodity items as key contributors |              |                                     |              |
|-----------------------------------------------------------------|--------------|-------------------------------------|--------------|
| Item                                                            | Weights      | 12-month inflation, as of September | Contribution |
| <b>Core inflation</b>                                           | <b>72.7</b>  | <b>1.34</b>                         | <b>0.97</b>  |
| Bread and cereals                                               | 7.73         | 3.77                                | 0.29         |
| Meat                                                            | 9.58         | -3.04                               | -0.29        |
| Oils and fats                                                   | 2.37         | 2.38                                | 0.06         |
| Sugar                                                           | 0.53         | 6.42                                | 0.03         |
| Alcoholic beverage                                              | 2.79         | 11.49                               | 0.32         |
| Tobacco                                                         | 1.39         | 6.32                                | 0.09         |
| Clothing                                                        | 2.45         | -2.75                               | -0.07        |
| Footwear                                                        | 1.32         | -2.75                               | -0.04        |
| Medicines and health products                                   | 4.62         | 2.92                                | 0.14         |
| Fuel                                                            | 5.29         | -1.60                               | -0.08        |
| Air passenger transportation services                           | 0.48         | -0.78                               | 0.00         |
| Education                                                       | 3.14         | 2.04                                | 0.06         |
| Hospital services                                               | 2.66         | 1.37                                | 0.04         |
| Outpatient care services                                        | 2.37         | 2.84                                | 0.07         |
| <b>Seasonal food products</b>                                   | <b>11.47</b> | <b>5.14</b>                         | <b>0.59</b>  |
| Eggs                                                            | 1.15         | -3.68                               | -0.04        |
| Fruits                                                          | 4.19         | 20.11                               | 0.84         |
| Vegetables                                                      | 6.13         | -6.87                               | -0.42        |
| <b>Regulated services</b>                                       | <b>15.88</b> | <b>1.05</b>                         | <b>0.17</b>  |

**Import prices:** The dollar prices in the world had an inflationary effect on prices of domestic economy of Armenia during the third quarter of 2020. The dollar prices of import to Armenia have grown by 3.3% relative to the previous quarter, with prices having fallen at a slower pace against the same period of previous year to 1.1% y/y. During the third quarter, the dollar prices posted an increase in both consumer goods and intermediate consumption goods.

As for the developments relative to the same period of previous year, a 1.1% y/y drop in prices has been mainly driven by the fall in oil prices (around 31.0%, on average). The decline in consumer prices against the previous year has been largely attributable to Russian ruble and Turkish lira nominal exchange rate depreciation y/y. On the part of intermediate consumption goods, the decrease in oil prices has offset the y/y increase in prices of the rest of goods.

Chart 25

In the third quarter of 2020 the dollar prices of import of goods and services dropped more slowly against the same quarter of the previous year, y/y, %



Source: CBA calculations

## 3.2. Economic developments

### 3.2.1. Economy position

**In the reporting period, the GDP gap persisted in a negative territory.** In the third quarter of 2020, the economic decline reached 9.1% due to slackening of both aggregate supply and aggregate demand. Compared to the previous quarter, aggregate supply has recovered to some extent amid easing of temporary restrictions on the economy, but demand remained subdued, letting the GDP gap linger in the previous quarter's negative territory. The negative GDP gap is mainly a result of sluggish private demand and is reflected in a low inflationary environment (see section II. 2.1), whereas the stimulative impact of the state budget and growth of remittances in the third quarter contributed positively to the GDP gap.

### 3.2.2. The expenditures aspect of the economy

The 9.1% economic slowdown in the third quarter of 2020 has been mostly attributable to reduced private spending, although the latter's decline proved less dramatic than predicted by the Central Bank. In the reporting quarter, it should be noted, private demand still incurs the impact of growing uncertainties amid the pandemic spread, precautionary behavior, and postponed consumer and investor decisions. With an economic downturn mentioned above, private consumption fell by 8.1% in the third quarter, which is a smaller decrease compared to the Central Bank's previous estimations and

largely driven by more positive developments in remittances than expected. Gross accumulation of private fixed assets has decreased by 13.3% and it also stood at a level above the previous forecasts of the Central Bank owing to more positive developments in construction than expected (see section 3.2.3). As a result, private spending reduced by 8.8% in the reporting quarter instead of a previously projected 13.7% decline.

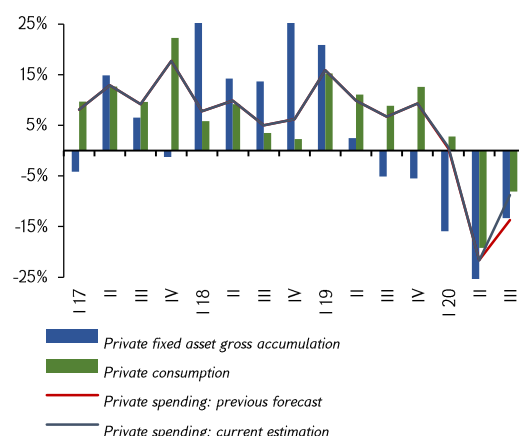
Though the decrease in private demand was smaller than expected, it continued to have a deflationary effect in the consumer market, according to the Central Bank.

In the third quarter of 2020, the lifting of the pandemic-driven restrictions in the global and domestic economies facilitated the recovery of exports and imports, which was in line with the forecasts of the CBA. Note that, relative to the second quarter, the growth of real import of goods and services has exceeded the growth of real export of goods and services. As a result, net real export's contribution to the GDP has been negative. As for the developments against the same quarter of the previous year, both exports and imports declined at a faster rate, as expected. This was largely explained by an estimated close-to-zero level of international tourism. Thus, in the third quarter of 2020, the decrease in real export of goods and services was 44.7% y/y, and the decrease in real import of goods and services, 36.1% y/y. The decline in export was attributable to a persistently weak global demand and almost a zero level of export of tourism. The decrease in import was due to domestic private demand having reduced against the same quarter of the previous year, as well as nearly a zero level of import of tourism.

In the third quarter of 2020, net remittances of individuals (seasonal workers' income and personal transfers inclusive) in US dollar somewhat reduced, by 0.1% y/y, according to the Central Bank estimates, which is rather lower from previous quarter's CBA prediction of nearly 11.0% decrease. The geography of private remittances continued shifting during the third quarter too – the reduction in remittances from Russia was more than offset by a record high growth of remittances from the United States and from the other countries (as a group). The decrease in remittances from Russia was largely determined by the restrictions on migration flows, persisting since the first quarter.

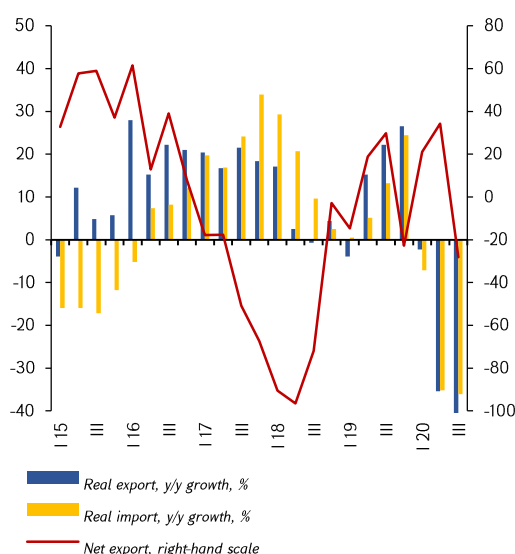
In the outcome of the aforementioned developments, the current account deficit-to-GDP ratio dropped in the third quarter of 2020 by about 1.1 pp, mainly thanks to improved terms of trade and a reduced negative balance of investment income, according to the CBA estimates.

**Chart 26**  
**Structure of private spending, (y/y growth)**



Source: RA Statistics Committee, CBA estimate

**Chart 27**  
**In the third quarter of 2020 net export position deteriorated as export reduced faster than import did (net real export, y/y, %, positive sign = improvement)**



Source: RA Statistics Committee

**Fiscal policy<sup>15</sup>:** In the third quarter of 2020, the state budget performed with the actual revenues exceeding the projection<sup>16</sup> and the actual expenditures being in line with the CBA's projected indicator for the third quarter. As a result, the fiscal policy's impact on aggregate demand in the third quarter of 2020 is an estimated 5.5 pp expansionary instead of predicted 7.1 pp expansionary, mainly driven by revenue deviation.

In the third quarter of 2020, the actual budget revenues amounted to 107.8% of the adjusted budget<sup>17</sup> as larger volumes of tax revenues were collected. As a result, the revenue impulse made up 1.0 pp expansionary, smaller than the projected impulse of 1.7 pp expansionary.

State budget expenditures in the third quarter were in accordance with the CBA projection, although net lending was lower than predicted by the CBA. So, the expenditures impulse amounted to 4.5 pp expansionary instead of the projected 5.4 pp expansionary (with deviated net lending and a new estimate of GDP potential). The implementation of certain items in state budget expenditures fell short of the CBA projection, with item **public consumption** outperformed by 3.8%, which includes the anti-crisis measures taken to fight the spread of coronavirus and the increase in healthcare costs. The actual expenditures on **non-financial assets** also surpassed the CBA projection largely because of expenditures funded by domestic sources.

With third quarter 2020 revenues and expenditures performance described above, the state budget generated a deficit of AMD 105.9 billion; the figure stood below the CBA deficit projection as a result of more revenue collection. In the third quarter of 2020, local governments further posted budget surpluses, so the consolidated budget deficit amounted to AMD 103 billion.

It should be noted that, in terms of demand and inflation, the fiscal policy's impact in the third quarter of 2020 proved less expansionary than expected.

As to the state budget's main indicators over the past nine months, total revenues amounted to AMD 1075.1 billion, down by 6.4% compared to the same period last year, and expenditures totaled AMD 1229.9 billion, up by 16.8% against the same period last year.

In the outcome, over the past nine months of 2020, the state budget deficit has been AMD 154.8 billion, and the impact of fiscal policy on aggregate demand, 5.6 pp stimulative, owing to an expansionary impact of expenditures.

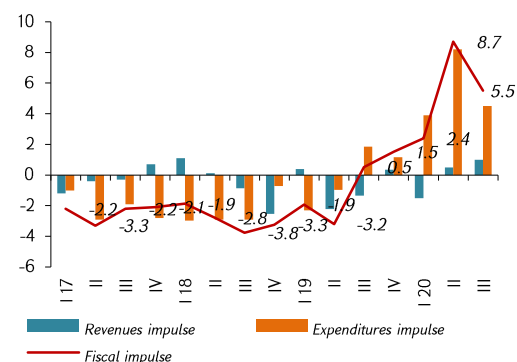
<sup>15</sup> The review of the fiscal sector used the actual consolidated budget indicators of the third quarter of 2020.

<sup>16</sup> The revenue projection was based on the Government's adjusted 2020 plan, available at the moment.

<sup>17</sup> In the adjusted program, taxes were reduced commensurate with economic downturn estimates, and more so under a pessimistic scenario.

Chart 28

In the third quarter of 2020 the expansionary effect of fiscal policy owed mainly to the grown expenditures

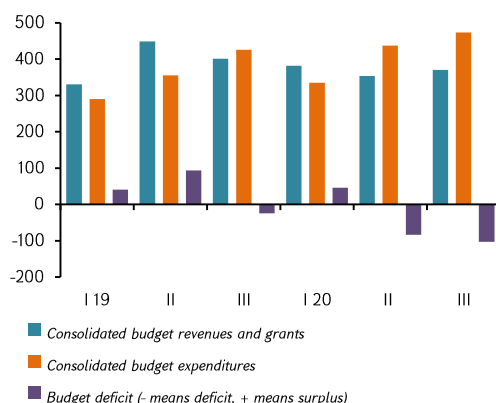


Source: CBA estimate

The fiscal policy's impact on aggregate demand is estimated to be 5.5 pp expansionary for the third quarter.

Chart 29

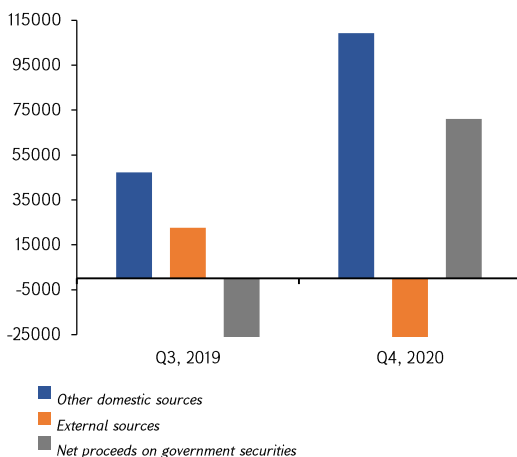
Main indicators of the consolidated budget (billion Armenian dram)



Source: RA Statistics Committee

Chart 30

In the third quarter of 2020 the state budget generated a deficit, and the share of domestic funding sources has increased (million Armenian dram)



Source: RA Ministry of Finance

### 3.2.3. The production aspect of the economy

In the third quarter of 2020 the GDP decline was -9.1%, consistent with the CBA prediction, although some deviations across sectors of the economy were observable. Specifically, services reported a deeper decline than anticipated (reaching -13%), fueled by largely contracted subsectors *culture, entertainment, recreation, accommodation, public catering, transport* because of the downturn in tourism and such other industries that require social interaction. However, financial and insurance, information and communications, and healthcare services had a positive contribution. Smaller-than-expected decreases were reported in other sectors, as follows: -2.2% in industry, -3.4% in agriculture, -6.7% in construction. Although the slackening of household-funded construction was noticeable, state-funded construction has nevertheless grown. In the reporting quarter, the smallest decline compared to other sectors was recorded in industry, since the growth in mining has positively contributed to it.

### 3.2.4. Labor market

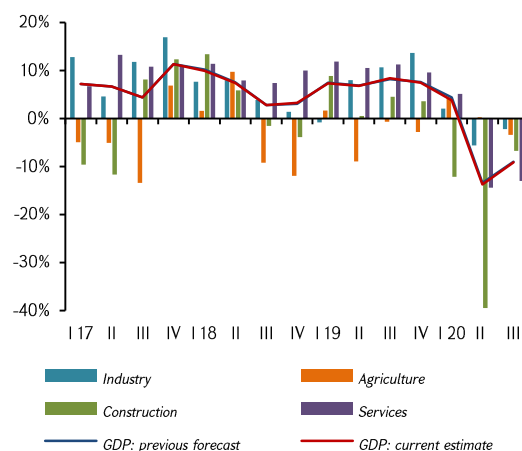
In the third quarter of 2020, the private sector nominal wage growth rate is 2.1% – consistent with the CBA projections. However, the private sector real wage growth has outpaced the productivity growth rate, which is estimated at 9.5%. As a result, inflationary pressures from the labor market have emerged.

The unemployment rate is an estimated 18.5% in the third quarter of 2020. This figure stands below previous CBA estimates due to both the change in the Statistics Committee's unemployment calculation methodology<sup>18</sup> and because the employment indicator embraced those in forced idleness. The latter was part of the Government-led measures that were aimed at preserving jobs and sustaining low unemployment. As a result, the aforementioned economic growth and productivity slowdowns have been concurrent not so much by reduction in employment but rather reduction in hours worked<sup>19</sup>.

In the reporting quarter, firms' unit labor costs grew by 11.6%, pointing to a slower output growth per unit of private labor in relation to private wage growth rate.

Chart 31

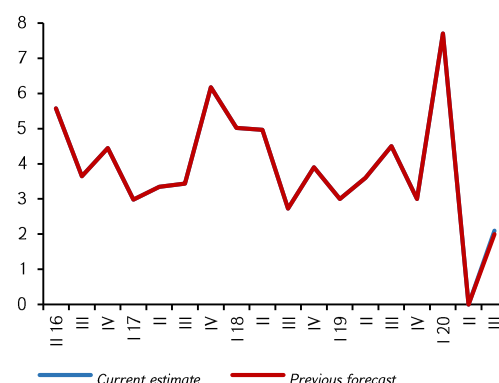
GDP structure by sector, (y/y growth, %)



Source: RA Statistics Committee, CBA estimate

Chart 32

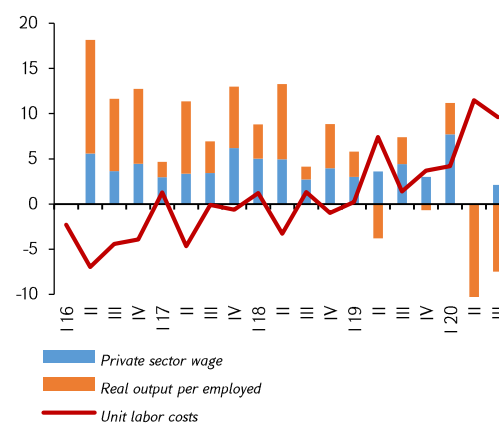
Private sector nominal wage (y/y growth, %)



Source: RA Statistics Committee, CBA estimate

Chart 33

Unit labor costs (y/y growth, %)



Source: RA Statistics Committee, CBA estimate

<sup>18</sup> [https://www.armstat.am/file/article/sv\\_09\\_20a\\_141.pdf](https://www.armstat.am/file/article/sv_09_20a_141.pdf)

<sup>19</sup> The reduction in average hours worked per week is estimated at about 16%.

### 3.3. Financial market developments

**In the third quarter of 2020, the CBA Board lowered the refinancing rate by 0.25 pp to 4.25%.**

As the inflationary environment persisted low while external and domestic demand began recovering at a slower pace amid high uncertainty about when the pandemic will end, the Board of the CBA decided, at the September 15th meeting, to reduce the refinancing rate by 0.25 pp. In the meantime, in view of the need to keep the monetary policy stance expansionary in the medium term, the Board announced further easing of monetary conditions assuming that the developments were to unfold as predicted. In addition, there was a signal to the financial market participants that the CBA would stand ready to react accordingly to risks to inflation deviating from the projection path, in order to achieve the inflation target in the medium run.

**Table 5**

| Average quarterly interest rates in financial market of Armenia     |        |        |        |        |        |
|---------------------------------------------------------------------|--------|--------|--------|--------|--------|
| Indicators                                                          | Q3, 19 | Q4, 19 | Q1, 20 | Q2, 20 | Q3, 20 |
| Central Bank refinancing rate (end of quarter)                      | 5.50   | 5.50   | 5.25   | 4.5    | 4.25   |
| Central Bank repo rate                                              | 5.80   | 5.63   | 5.57   | 5.16   | 4.54   |
| Interbank repo rate (up to 7-day)                                   | 5.78   | 5.54   | 5.52   | 5.04   | 4.46   |
| Yield of government securities on a yield curve (as of end-quarter) |        |        |        |        |        |
| Short-term treasury bill (1-year)                                   | 6.26   | 6.01   | 5.83   | 5.8    | 5.59   |
| Medium-term notes (5-year)                                          | 7.99   | 7.44   | 6.90   | 6.98   | 6.95   |
| Long-term bonds (30-year)                                           | 10.99  | 10.46  | 9.93   | 9.04   | 8.53   |

The Central Bank of Armenia kept on supplying the required amount of dram liquidity through its main repo instrument during the third quarter, enabling short-term market rates to adjust around the CBA policy rate.

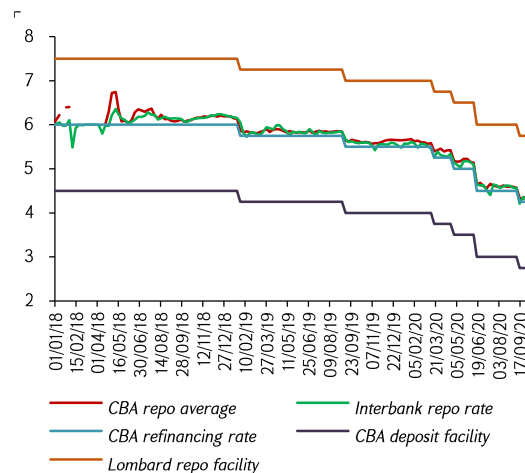
The financial market performed relatively quiet during the quarter. Though the pandemic-driven uncertainty persisted, the Central Bank actions (repeated lowering of the refinancing rate, fully met demand on dram liquidity for the banking system) made it possible to ease tensions in both foreign currency and dram markets, observable since mid-March, and helped maintain some calmness during the third quarter.

The response from government bond yields to the refinancing rate cuts was not simple. In the reporting quarter too, demand for government bonds was rather high among the financial market participants, which can in part be attributable to the banks altering

**The refinancing rate was reduced by 0.25 pp to 4.25% in the third quarter of 2020.**

**Chart 34**

**During the quarter short-term interest rates continued shaping around the Central Bank's policy rate**



Source: CBA

**Chart 35**

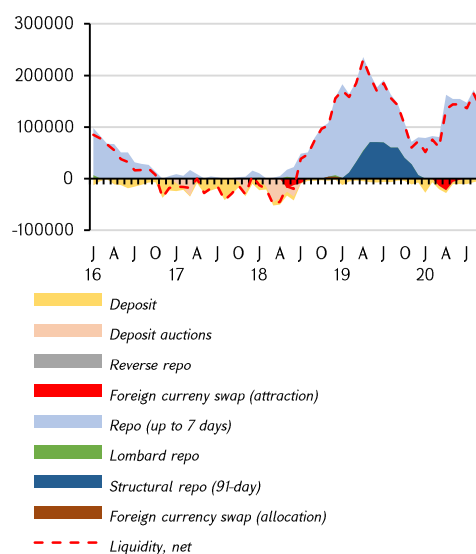
**USD/AMD exchange rate dynamics over nine months of 2020**



Source: CBA

**Chart 36**

**Liquidity injected and absorbed through Central Bank transactions (average monthly inventory), million Armenian dram**



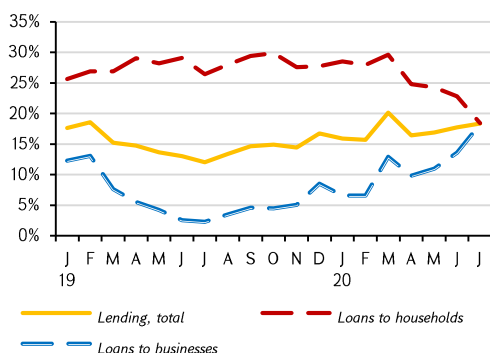
Source: CBA

their investment decisions in line with tightened terms of lending. Certainly, high demand for bonds was accompanied by falling yields, but in the time of economic uncertainty and risks, a weaker policy impact of the CBA, particularly in the short-term segment of bond market, was observable. Despite some narrowing of yield spreads, the government bond yield curves did not change significantly for most of the quarter and were close to the curve formed in late June. An exception was late September when uncertainties grew after declaration of martial law, slightly pushing short-term and long-term yields up.

A negative impact of pandemic on the lending market continued in the third quarter of 2020. The influence of pessimistic expectations for economic activity on lending has diminished largely through implementation of government support programs, contributing to the growth of business lending, whereas continued decline in consumer lending has pointed to persisting economic risks.

However, total lending volumes posted an increase over the quarter, and the 12-month growth in September of 2020 stood at 18.3%.

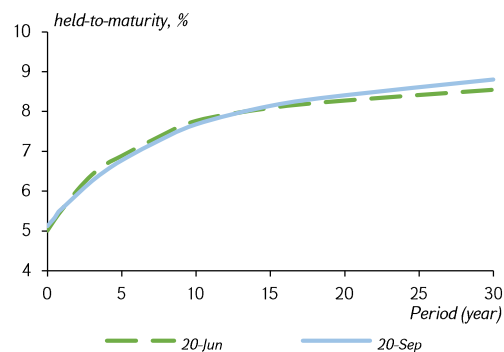
**Chart 39**  
The 12-month growth of loans provided by banks



Source: CBA

**Chart 37**

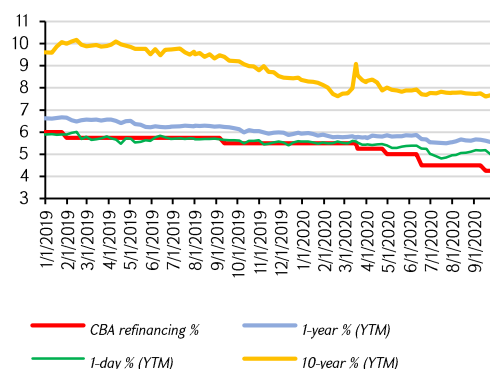
As of end of the third quarter of 2020 government bond yields had increased in short and long-term segments of the curve



Source: CBA

**Chart 38**

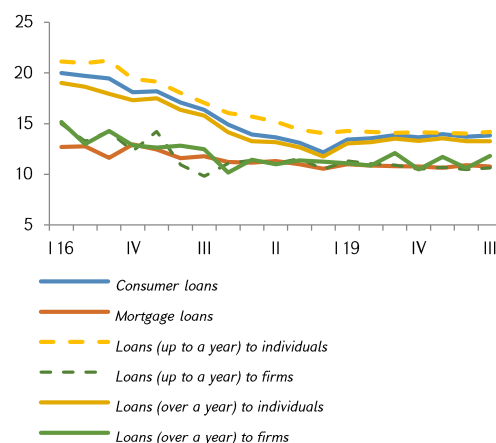
The CBA refinancing rate and government bond yields dynamics



Source: CBA

**Chart 40**

Interest rates of dram loans



Source: CBA

## 4. SUMMING-UP

***According to Q4 2020 monetary policy program, in the near future the 12-month inflation will approach and stabilize around the target,*** driven by inflationary effects expected from the external sector, and on the other hand, private demand, now sluggish due to high uncertainties, will gradually restore, which will be facilitated in the short term by stimulative fiscal and monetary policy implementation. In light of expected economic developments, the monetary policy stance will need to be scaled down gradually in the medium term, while making sure the inflation stabilizes around the 4% target.

***In the forecast horizon, risks that inflation would deviate from the projection path are generally balanced, and in the short run they trend upside, however.*** The CBA is monitoring these risks and stands ready to react should they emerge, while maintaining price stability in the Republic of Armenia.

## BOARD MEETING OF THE CBA

### MINUTES

(15.12.2020)

#### On the Refinancing Rate

**The CBA Board Meeting of December 15, 2020 attended by Governor M. Galstyan, Deputy Governors N. Yeritsyan and V. Abrahamyan, and Board Members H. Ghahramanyan, A. Darbinyan, A. Stepanyan, O. Aghasyan, and H. Khachatryan**

The Board meeting opened with presentation of the Situation Report as of December 15, 2020. It addressed current developments on inflation, external environment and real, fiscal and monetary sectors of the economy in the context of outbreak of the second wave of coronavirus disease, the martial law and its ending, and the impact of high uncertainties about the economic outlook deriving from these developments.

Inflation in November 2020 stood at 1.3% compared to that of 1.1% recorded in the same month last year, in which case the **12-month inflation rate has increased to 1.6%**, staying below the lower part of the confidence band. The month's inflation owed to a 2.8% rise in prices of item "Food products and non-alcoholic beverage", a 0.6% rise in prices of non-food products, and a 0.1% increase in service tariffs. In November, the **12-month core inflation rate** increased as well, amounting nearly to **2.0%** at the end of the month.

The developments in the external sector in the fourth quarter unfolded in the middle of outbreak of the new wave of coronavirus and restrictions that a number of countries have consequently imposed. Uncertainties and risks associated with the global economic development outlook and recovery of aggregate demand have also increased due to this factor. However, this negative impact will decrease to some extent in light of expectations for a possible effective use of the coronavirus vaccines in early 2021, which has already begun to be reflected in inflation trends in main commodity markets. Nevertheless, out of main partners to Armenia, in the USA and the EU inflation is still below the target, and there central banks will therefore continue carrying out a stimulative monetary policy. Whereas inflation in Russia has somehow grown high, and to contain it, the Central Bank of Russia will soon be choosing to let the stimulative monetary policy phase out.

More extensive was the discussion around Armenia's economic developments, as a new wave of the coronavirus pandemic in the fourth quarter came about with a martial law declared in the Republic of Armenia after Azerbaijan's large-scale attack on September 27th along the entire line of contact in the Artsakh Republic. It was noted, in the first place, that economic developments in the third quarter were in line with the Central Bank's forecasts, with economic growth of -9.1% due to decreased output in all sectors. Driven by negative impact of the above-mentioned factors, the Board admitted, economic activity remained low and domestic demand weak in the fourth quarter, while uncertainties over the economic outlook have also grown to some extent. In such a circumstance, a deeper decline is expected in all sectors of the economy - the services in particular - by the end of the year, which will be reflected in both supply and demand factors. In the fourth quarter, the Government continued implementing a stimulative fiscal policy, and the decline in remittances from abroad proved smaller than expected, which somehow mitigated the negative impact of the above factors on domestic demand. In this situation, the economic growth estimate for 2020 remained intact and is expected in the region of -7.2%. Looking to the inflationary risks accumulated in the Armenian economy in the fourth quarter and a consequent increase in inflation expectations, the Board stated that this had been fueled by the rise in prices of some goods importable amid price increases observable in food product and commodity markets of the world, depreciation of the dram and currently high uncertainties. Although, it was recorded, some acceleration of inflation is anticipated, it will remain manageable, and no risks to unanchored inflation expectations, including as a result of adequate actions of the Central Bank, will emerge.

Talking about the situation in Armenia's financial market in the fourth quarter, the Board noted that under martial law the demand for dram liquidity had increased to a certain extent and been fully satisfied by the Central Bank: short-term market rates stayed floating around the CBA refinancing rate, as a result. Also, driven by the martial law-induced risks, an increase in the country's risk premium was observable in international capital markets in October, which has notably decreased in November-December, making Armenia's entry into these markets possible. In the meantime, it was recorded, yields on government bonds, grown from short-term to long-term along the entire curve, pointed out to the accumulation of domestic risks. The uncertainties over an economic and political outlook have had repercussions in the Armenian currency market, where some depreciation of the local currency, the dram, had been registered. Committed to a floating exchange rate policy, the CBA has had a small situational participation in the currency market in order to remedy momentary disruptions in the financial market activity.

In the fourth quarter, it was noted, interest rates on loans and deposits behaved steadily in the banking system. Despite some slowing in the momentum, the economy lending through the banking system, where contribution to economic support programs remains critical, continued over the quarter.

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. As the inflation was predicted to somehow accelerate in view of inflationary pressures expected from the external sector, and given Armenia's increased risk premium and current uncertainties, the **Board considered the option of raising the refinancing rate by 1.0 pp.** And even with such an increase of interest rate, the Central Bank was thought to be maintaining the stimulative stance of monetary policy, which, coupled with a substantial fiscal stimulus, will be good for further economic activity and restoring of domestic demand. While unanimous in raising the refinancing rate, the Board's votes went divided over the extent of the increase. In the current situation, some members of the Board believed, it's necessary to raise the refinancing rate by a larger step to exclude risks that inflation expectations would become unanchored in the face of depreciating dram exchange rate and inflationary developments. Others, drawing on inflation expectations strongly anchored thanks to a low-inflation policy in recent years, were more for a small-step increase. As a result, the CBA Board decided by a majority of votes **to raise the refinancing rate by 1.0 pp, while estimating that the monetary policy's stimulative stance will need to be reduced gradually over the forecast horizon** to help the inflation stabilize around the 4% target.

With economic outlooks under high uncertainty, the Board thinks that short-term risks to inflation deviating from the path trend upside, so the Central Bank carefully follows the developments and stands ready to respond to them accordingly, ensuring price stability in the medium term.

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

## **The Central Bank of the Republic of Armenia**

### **Board Decision**

#### **Interest Rates on Central Bank of Armenia Operations in the Financial Market**

By virtue of Article 2 (3), Article 20 “c” and “e” of the Republic of Armenia Law on the Central Bank, and clauses of the Republic of Armenia Law on Normative Regulations, the Board of the Central Bank of the Republic of Armenia **enacts:**

1. Set the Refinancing rate of the Central Bank of the Republic of Armenia to be 5.25%.
2. Set the Lombard facility rate offered by the Central Bank of the Republic of Armenia to be 6.75%.
3. Set the Deposit facility rate offered by the Central Bank of the Republic of Armenia to be 3.75%.
4. This decision takes force on the day following its publishing on Internet homepage of the Central Bank of the Republic of Armenia.

***Martin Galstyan,***  
***Governor of the Central Bank***

***December 15, 2020***

*c. Yerevan*

**PRESS RELEASE**  
**15.12.2020**

At the December 15, 2020 meeting the Board of the Central Bank of Armenia decided to raise the refinancing rate by 1.0 percentage point to 5.25%.

Inflation in November 2020 stood at 1.3%, compared to 1.1% in the same month of the previous year. As a result, the 12-month inflation amounted to 1.6%, still below the 4% target. In November, the 12-month core inflation also continued rising, which at the end of the month stood at about 2.0%.

In the fourth quarter, the world economy developments were mainly affected by the new wave of coronavirus pandemic and the coronavirus-related restrictions in some countries, which had a negative impact on global demand and economic activity. On the other hand, expectations about the possible effective use of vaccines since the beginning of 2021 have created a positive momentum for the outlook of global demand. Under such circumstances, inflationary trends have been recorded in both international commodity and food product markets, which is gradually fueling the inflationary environment of the partner countries. Based on these developments, the CBA Board expects some inflationary impact from the external sector on the Armenian economy.

In Armenia in the third quarter, in line with the CBA forecasts, a y/y 9.1% economic decline was registered, caused by decreases in all sectors of the economy, and services in particular. In the fourth quarter, due to the negative impact of the announced military situation in Armenia, the outbreak of a new wave of coronavirus pandemic, as well as heightened uncertainty, sluggish economic activity and weak domestic demand are expected to persist. On the other hand, implementation of the expansionary fiscal policy will continue contributing positively to aggregate demand. Under such conditions, the estimates of annual economic growth for 2020 have not been revised.

Taking into account some acceleration of inflation amid the expected inflationary effects from the external sector and considering the increase of the country's risk premium, the CBA Board considers it appropriate to raise the refinancing rate. The Board also reckons that the monetary policy stance still remains expansionary, which will need to be gradually reduced over the forecast horizon, in order to stabilize inflation around the 4% target.

The Board considers that, in view of high uncertainties about economic growth outlook, risks of inflation deviating from the projection path are on the upside in the short run. The Central Bank is monitoring the developments, and should they unfold, the CBA will stand ready to react accordingly, ensuring price stability in the medium run.

*Press Service of the Central Bank of Armenia*

## MAIN MACROECONOMIC INDICATORS OF ARMENIA

| Items                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  | 2012    | 2013    | 2014    | 2015    | 2016   | 2017    | 2018    | 2019    | 2020    | 2021    | 2022    |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------|---------|---------|---------|--------|---------|---------|---------|---------|---------|---------|
|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        | actual  | actual  | actual  | actual  | actual | actual  | actual  | actual  | program | program | program |
| <b>Prices</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |         |         |         |         |        |         |         |         |         |         |         |
| Inflation (y/y, end of period, %)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      | 3.2     | 5.6     | 4.6     | -0.1    | -1.1   | 2.6     | 1.8     | 0.7     | 2.5     | 4.4     | 3.7     |
| Consumer price index (y/y, average, %)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 | 2.6     | 5.8     | 3.0     | 3.7     | -1.4   | 1.0     | 2.5     | 1.5     | 1.1     | 3.4     | 4.0     |
| Core inflation (y/y, average, %)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       | 5.3     | 5.8     | 1.9     | 5.1     | -2.0   | 0.8     | 4.0     | 1.2     | 1.2     | 4.0     | 3.4     |
| <b>Gross product</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |         |         |         |         |        |         |         |         |         |         |         |
| GDP (billion Armenian dram)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            | 4266.5  | 4555.6  | 4828.6  | 5043.6  | 5067.3 | 5568.9  | 6017.0  | 6569.0  | 6189.7  | 6526.3  | 6917.0  |
| GDP (% real growth)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | 7.2     | 3.3     | 3.6     | 3.2     | 0.2    | 7.5     | 5.2     | 7.6     | -7.2    | 2.0     | 2.9     |
| <b>Supply</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |         |         |         |         |        |         |         |         |         |         |         |
| Industry (% real growth)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               | 6.4     | 6.3     | -0.9    | 6.2     | 7.7    | 11.7    | 4.9     | 8.3     | -2.6    | 1.4     | 5.1     |
| Agriculture (% real growth)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            | 9.5     | 7.6     | 6.1     | 13.2    | -5.0   | -5.1    | -6.9    | -2.6    | 1.1     | 2.3     | 3.4     |
| Construction (% real growth)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           | 4.5     | -7.4    | -4.5    | -3.1    | -14.1  | 2.8     | 0.6     | 3.7     | -13     | 1.7     | 4.0     |
| Services (% real growth)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               | 6.3     | 3.1     | 6.7     | 1.6     | 3.2    | 10.6    | 9.1     | 10.7    | -9.4    | 2.3     | 1.5     |
| Taxes, net (% real growth)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             | 9.9     | 3.6     | 1.8     | -5.1    | -3.7   | 9.7     | 8.0     | 7.1     | -9.9    | 1.3     | 4.4     |
| <b>Demand</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |         |         |         |         |        |         |         |         |         |         |         |
| Consumption (% real growth)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            | 7.7     | 2.3     | 1.2     | -6.0    | -2.1   | 11.6    | 3.8     | 11.8    | -7.5    | 3.1     | 2.8     |
| Public consumption (% real growth)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | -1.4    | 7.6     | -1.2    | 4.7     | -2.4   | -2.1    | -3.0    | 12.5    | 4.6     | 0.0     | 4.2     |
| Private consumption (% real growth)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | 9.1     | 1.7     | 1.6     | -7.5    | -2.1   | 14.0    | 4.8     | 11.7    | -9.3    | 3.7     | 2.5     |
| Gross accumulation of fixed assets* (% real growth)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | -1.9    | -7.0    | -2.2    | 2.5     | -11.4  | 9.7     | 4.8     | 4.4     | -9.8    | -1.7    | 3.1     |
| Public investment** (% real growth)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | -22.4   | -13.8   | 10.0    | 13.6    | 5.0    | 31.7    | -37.4   | 31.1    | 13.0    | -11.8   | 13.6    |
| Gross accumulation of private fixed assets (% real growth)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             | 0.9     | -7.8    | -3.4    | 1.2     | -13.9  | 6.2     | 19.6    | -0.5    | -15.3   | 1.6     | 0.5     |
| Export of goods and services (% real growth)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           | 12.0    | 8.6     | 6.4     | 4.9     | 21.3   | 19.3    | 5.0     | 16.0    | -34.4   | 4.7     | 5.8     |
| Import of goods and services (% real growth)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           | 4.7     | 0.0     | -2.7    | -15.3   | 6.3    | 24.6    | 13.3    | 12.0    | -31.8   | 7.9     | 2.6     |
| <b>External sector</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |         |         |         |         |        |         |         |         |         |         |         |
| Balance of trade ((million US dollar))                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 | -211.9  | -2196.2 | -2055.4 | -1186.4 | -976.9 | -1400.9 | -1759.0 | -1805.5 | -1425.9 | -1648.6 | -1685.1 |
| Balance of services ((million US dollar))                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | -101.6  | -124.3  | -113.0  | -96.4   | 70.4   | 159.4   | 56.7    | -23.4   | 25      | 64.8    | 75.6    |
| Remittances ((million US dollar))                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      | 1539.8  | 1755.1  | 1616.1  | 1098.3  | 1009.4 | 1179.3  | 1136.2  | 1143.8  | 1038.3  | 989.3   | 1048.6  |
| Current account ((million US dollar))                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  | -1057.9 | -812.9  | -883.1  | -284.7  | -107.9 | -173.9  | -860.0  | -987.5  | -619.1  | -910.5  | -876.9  |
| Balance of trade (share in GDP, %)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | -19.9   | -19.7   | -17.8   | -12.2   | -8.6   | -10.8   | -13.7   | -13.4   | -11.1   | -12.3   | -11.9   |
| Balance of services share in GDP, %)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | -1.0    | -1.1    | -1.0    | -0.9    | 0.7    | 1.4     | 0.5     | -0.2    | 0.2     | 0.5     | 0.6     |
| Remittances (share in GDP, %)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          | 14.6    | 15.8    | 14.0    | 10.4    | 9.5    | 10.2    | 9.1     | 8.4     | 8.2     | 7.7     | 7.7     |
| Current account (share in GDP, %)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      | -10.0   | -7.3    | -7.6    | -2.7    | -1.0   | -1.5    | -6.9    | -7.2    | -4.9    | -7.1    | -6.5    |
| <b>Public sector</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |         |         |         |         |        |         |         |         |         |         |         |
| Revenues and grants (billion Armenian dram)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            | 946.2   | 1071.4  | 1144.8  | 1167.7  | 1171.1 | 1237.8  | 1341.7  | 1559.1  | 1505.7  | -       | -       |
| Tax revenues (billion Armenian dram)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | 878.4   | 1000.9  | 1064.1  | 1067.9  | 1079.7 | 1158.0  | 1258.1  | 1464.3  | 1360.5  | -       | -       |
| Expenditures (billion Armenian dram)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | 1006.1  | 1142.9  | 1235.1  | 1409.0  | 1449.1 | 1504.8  | 1447.1  | 1623.0  | 1891.4  | -       | -       |
| Deficit (billion Armenian dram)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        | -59.9   | -71.5   | -90.3   | -241.3  | -278.0 | -267.0  | -105.4  | -63.9   | -385.7  | -       | -       |
| Revenues and grants (share in GDP, %)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  | 22.2    | 23.5    | 23.7    | 23.2    | 23.1   | 22.2    | 22.3    | 23.7    | 24.3    | -       | -       |
| Tax revenues (share in GDP, %)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         | 20.6    | 22.0    | 22.0    | 21.2    | 21.3   | 20.8    | 20.9    | 22.3    | 22.0    | -       | -       |
| Expenditures (share in GDP, %)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         | 23.6    | 25.1    | 25.6    | 28.0    | 28.6   | 27.0    | 24.1    | 24.7    | 30.6    | -       | -       |
| Deficit (share in GDP, %)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | -1.4    | -1.6    | -1.9    | -4.8    | -5.5   | -4.8    | -1.8    | -1.0    | -6.2    | -       | -       |
| <b>Monetary sector</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |         |         |         |         |        |         |         |         |         |         |         |
| Broad money (y/y, end of period, %)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | 19.5    | 14.8    | 8.3     | 10.8    | 17.5   | 18.5    | 7.5     | 11.2    | -       | -       | -       |
| Dram broad money (y/y, end of period, %)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               | 11.9    | 14.9    | -3.5    | 5.2     | 24.8   | 28.9    | 13.2    | 21.5    | -       | -       | -       |
| Loans to economy (y/y, end of period, %)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               | 27.6    | 12.9    | 20.8    | -3.3    | 6.0    | 16.5    | 17.2    | 18.5    | -       | -       | -       |
| USD/AMD (Armenian dram for one US dollar)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | 401.8   | 409.6   | 415.9   | 477.9   | 480.5  | 482.7   | 483.0   | 480.4   | -       | -       | -       |
| <p>* From now on the Central Bank will only present the indicator of gross fixed asset accumulation instead of gross accumulation, since the change in tangible working capital inventories is considered by Armenia's Statistics Committee as a balancing item and it does not show the true level of gross accumulation. See <a href="https://www.armstat.am/file/article/sv_04_19a_112.pdf">https://www.armstat.am/file/article/sv_04_19a_112.pdf</a>:</p> <p>** Actual indicators of public investment are the capital expenditures of the consolidated budget, and the forecasts are based on the Mid-Term Expenditures Framework, 2021-2023.</p> |         |         |         |         |        |         |         |         |         |         |         |

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