



Central Bank
of Armenia

2024 Q1

**Executive
Monetary
Policy
Statement**

Published March 12, 2024

A. Executive Monetary Policy Statement

The Board of the CBA today decreased the Refinancing Rate to 8.5%.

At its meeting today, the Board of the Central Bank of Armenia decided to reduce the key policy rate (refinancing rate) by 25 basis points, setting it at 8.5 percent. At the same time, the Board set the Lombard repo facility rate at 10.0 percent, and the Deposit facility rate at 7.0 percent. The Board agrees that a lower refinancing rate is necessary to continue to meet its price stability objective of ensuring an inflation rate of 4 percent over the medium term.

Annual CPI inflation has continued to remain at low levels well below the target, registering -1.7% in February 2024. Core inflation also continued to decrease, at -0.4% year-over-year in January.

The inflationary effects of the global economy on Armenia's economy continue to weaken considerably. In the first quarter of 2024, economic activity globally and in the key trading partner countries of Armenia continue to slow, and annual inflation there continues to decrease. However, the overall inflationary environment continues to remain elevated amid sustained inflationary pressures coming from strong labor markets. Key trading partner central banks would be expected to maintain a tight monetary policy stance in the near term, which could pose contractionary risks to global demand and commodity prices. Further sources of downside risk related to the global outlook and volatility in commodity prices include the impact of heightened geopolitical tensions in the Middle East on oil prices and supply chain disruptions, as well as risks of a worsening outlook for the Chinese economy.

Economic activity in Armenia remained robust in the fourth quarter, continuing to be driven by high growth in the construction and trade sectors. External demand has continued to slow, but domestic demand continues to remain at relatively strong levels. Inflation in Armenia continues to remain low, primarily driven by contractionary policy stance conducted by the CBA, the deflationary pressures from the external sector, and the implications of the appreciated dram. At the same time, growth in labor supply has contributed to somewhat fewer imbalances between aggregate supply and aggregate demand, which has been reflected in cooling wage growth, gradually declining non-traded sticky price inflation, and lower inflation expectations.

In the face of high uncertainty, and given its commitment to achieving the price stability objective, the Board considers multiple scenarios during its deliberations. On the one hand, the Board discussed scenarios where possible underlying economic forces, including the potential for inflation expectations to prove to still be high, as well as uncertainty around the country risk premium, would require a tighter policy stance to cool domestic demand, re-anchor inflation expectations, and meet the price stability objective. On the other hand, the Board discussed scenarios where possible underlying economic developments, including a continued broad expansion of labor supply and weakening demand conditions, generate excess supply conditions that contribute to inflation persistently remaining at low levels. This would imply a more rapid and sizable downward policy rate path to sustainably bring inflation to target over the medium term horizon.

In summary, balancing the aforementioned risks in both directions, the Board of the Central Bank of Armenia finds it appropriate to continue to gradually ease the policy stance. The Board will continue to monitor risk scenarios, and stands ready to take adequate actions to ensure that the price stability objective of 4 percent inflation over the medium-term horizon is met.

Approved by the Board of the Central Bank of Armenia
March 12, 2024

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B. Summary of Economic Conditions

Global Economy

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

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

Domestic Demand Conditions

The growth rate of economic activity in Armenia remained robust in Q4 2023, standing at 8.7% Y-o-Y, well above estimates of long-run sustainable growth of approximately 5%. Growth continues to be driven by strong activity in the trade and construction sectors. However, the structure of growth and concentration in some subsectors serves as a source of uncertainty relating to the sustainability of growth. Moreover, growth in private consumption has slowed, though risks for future growth exist given accumulated savings and the potential for future credit expansion. Despite uncertainty, there appear to be somewhat fewer imbalances between aggregate demand and supply in the economy than in recent quarters.

Labor Market & Inflation

In the context of continued strong growth and demand, pressures in the labor market continue to persist despite some softening. Relative to prior quarters, the labor market has softened somewhat, with private wage growth standing at 7.9% y/y in Q4 2023 and 10.7% y/y in January 2024 due to increases in labor supply. The potential for labor supply to increase further, due to a combination of migrant workers to Armenia and the integration of forcibly displaced Armenians from Nagorno-Karabakh into the labor market, could help ease labor market conditions, potentially moderating inflationary pressures in the medium to long term. The inflationary environment continued to soften, primarily driven by

weakened pressures coming from the external sector and the impacts of the CBA's policy stance over the past several quarters. Overall CPI inflation has remained below target since April 2023, registering -1.7% Y-o-Y in February 2024. Non-Traded Sticky Price Inflation, which captures domestically-driven demand dynamics, remained relatively stable in January 2024, at 3.0% Y-o-Y, continuing along its gradual downward path. At the same time, inflation for services that are highly exposed to external demand have softened.

Monetary Policy

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

In the context of the latent risks and uncertainties in the current period, the CBA builds and discusses various scenarios, summarized in the Taxonomy of Scenarios, with the aim of managing possible risks and assessing sources of uncertainty. At the same time, the MPR includes a deeper dive into two illustrative scenarios, which reflect illustrative future paths of the economy that would require either a higher path for the policy rate (Case A) or a lower path of the policy rate (Case B) relative to current market expectations. These illustrative scenarios do not represent a most-likely future, assign weight or probability to outcomes, or include all possible risks and uncertainties.

