



Monetary Policy Outlook

2024Q4 Monetary Policy Program
December 11, 2024



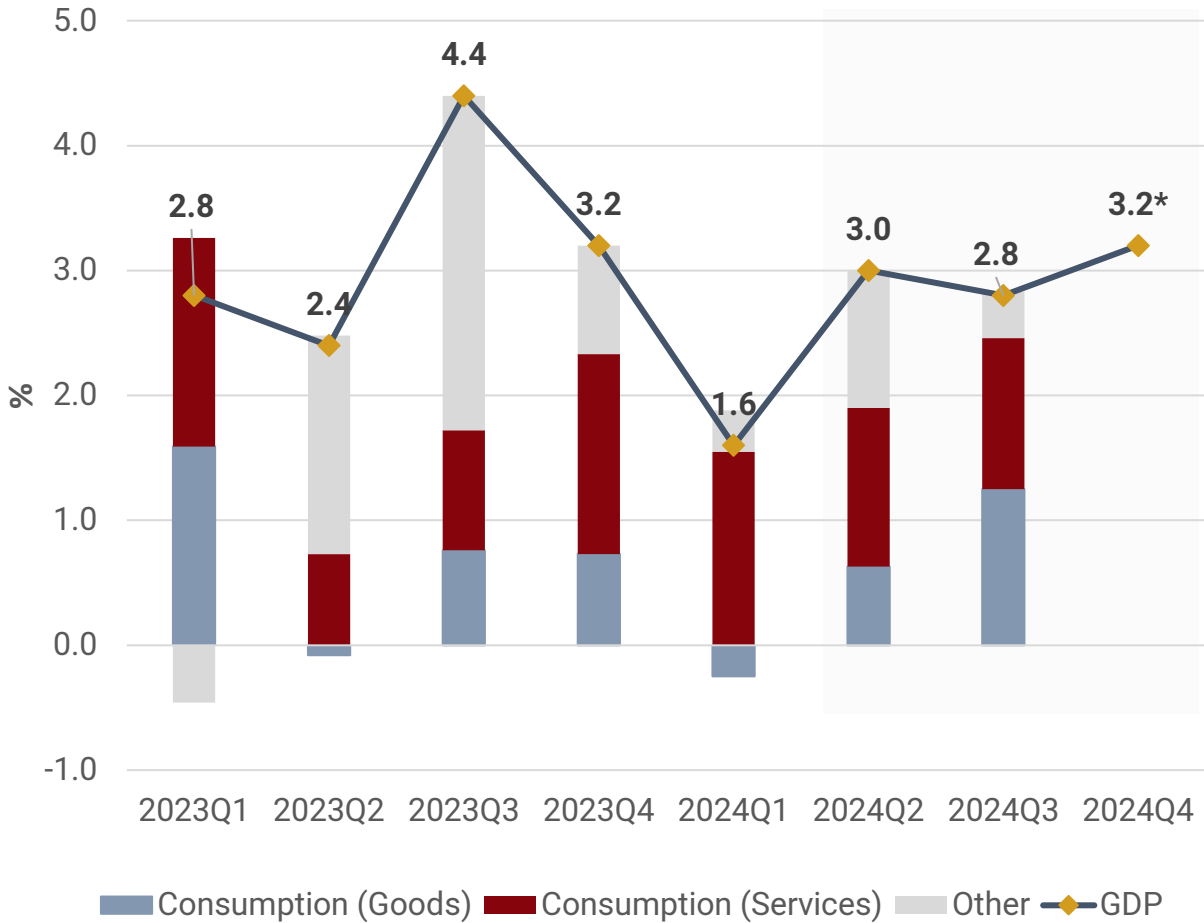
Current and Fundamental Economic Factors

Global Economic Developments

USA: High uncertainty around the fundamentals persists. Despite high market interest rates, private consumption continues to accelerate...

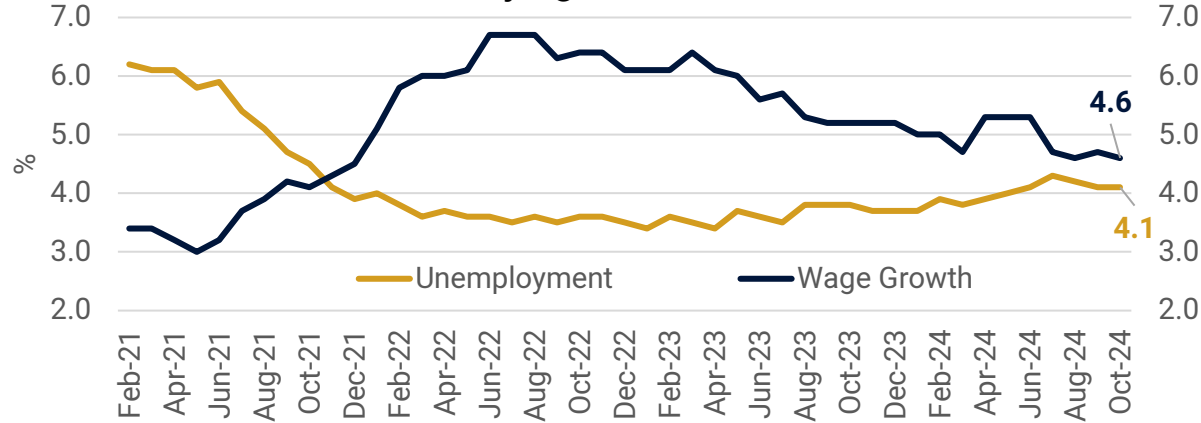


GDP, Q-o-Q annulized, %

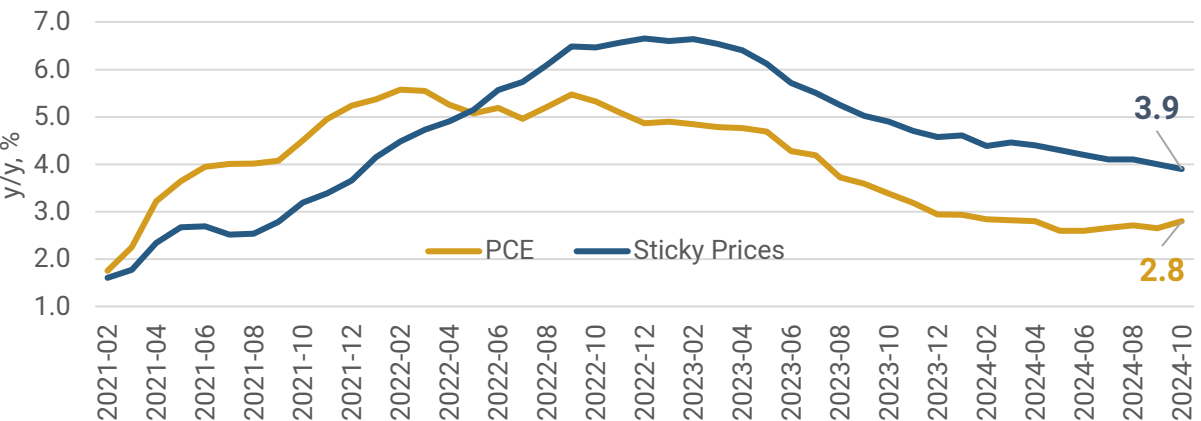


Source: Bureau of Economic Analysis (BEA), Atlanta Fed

A potentially stricter immigration policy will exert pressure on an already tight labor market.



Headline inflation is gradually decreasing, but some measures of underlying inflation suggest that high inflationary pressures persist.



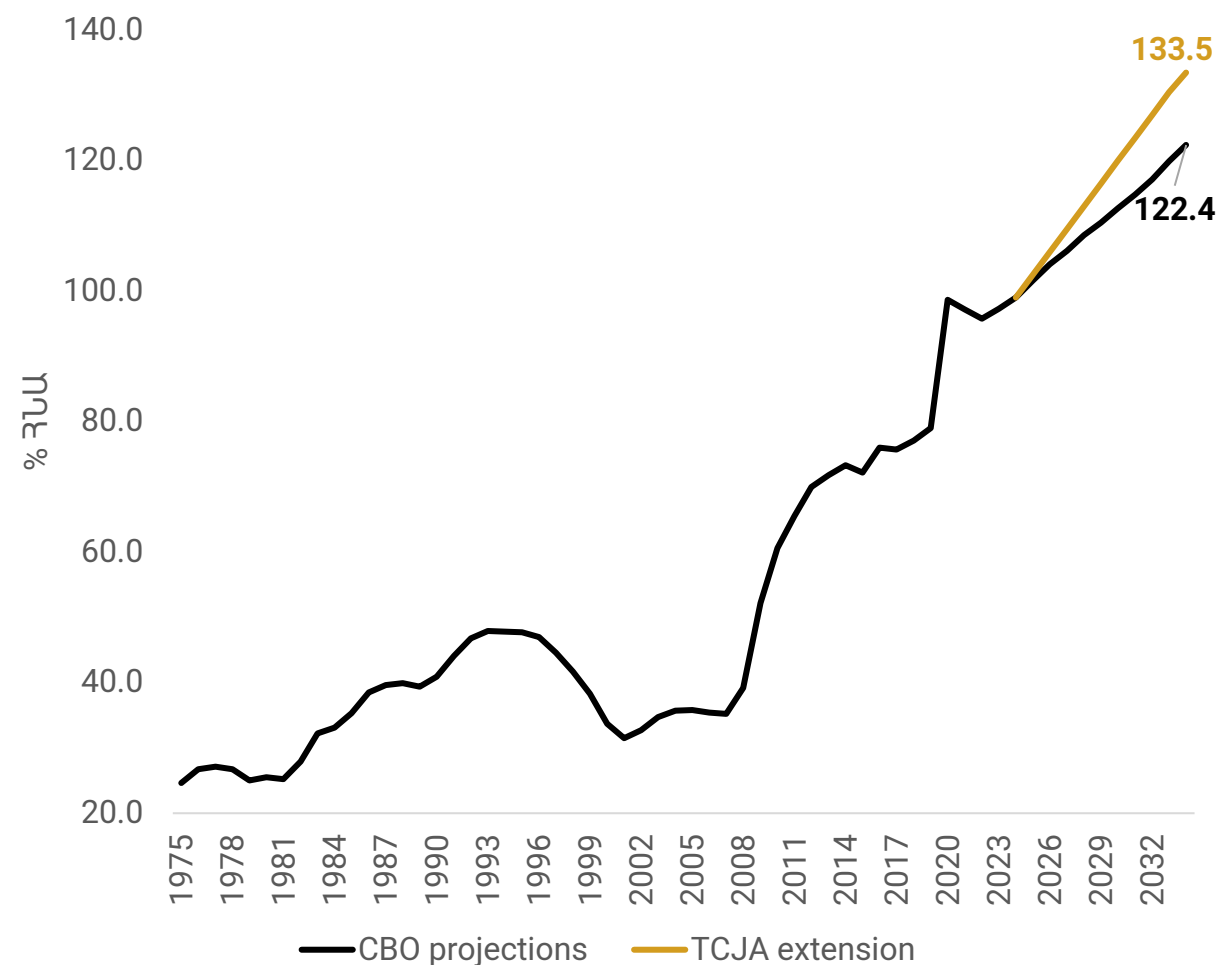
Source: U.S. Federal Reserve, U.S. Census Bureau

USA: A potentially more expansionary fiscal policy creates risks regarding debt burden and its sustainability...

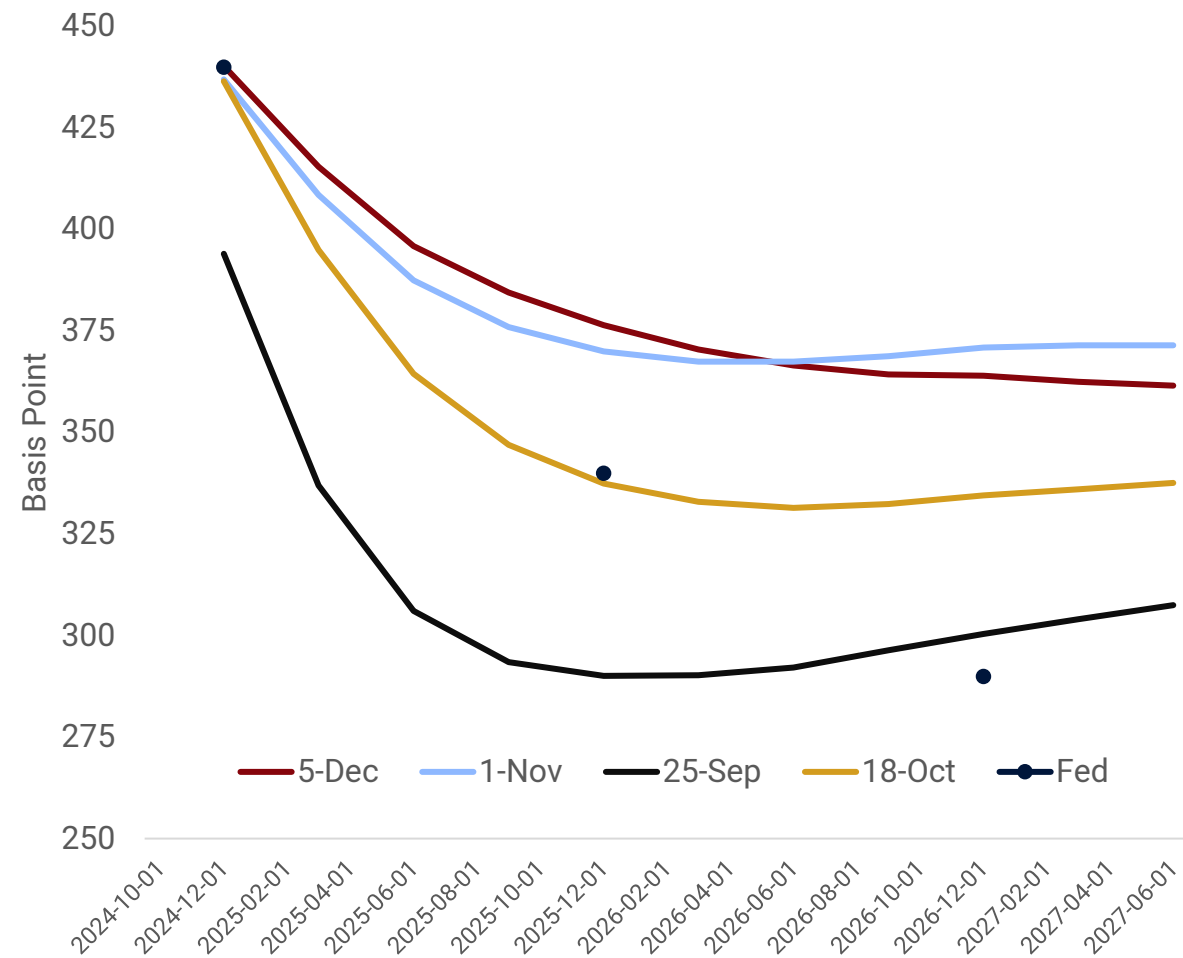
A higher neutral interest rate and term premium in the U.S.?



The potential impact of the likely extension of tax incentives on debt



Does the increase in expectations regarding interest rate levels indicate a revision of the market's assessment of the neutral rate?



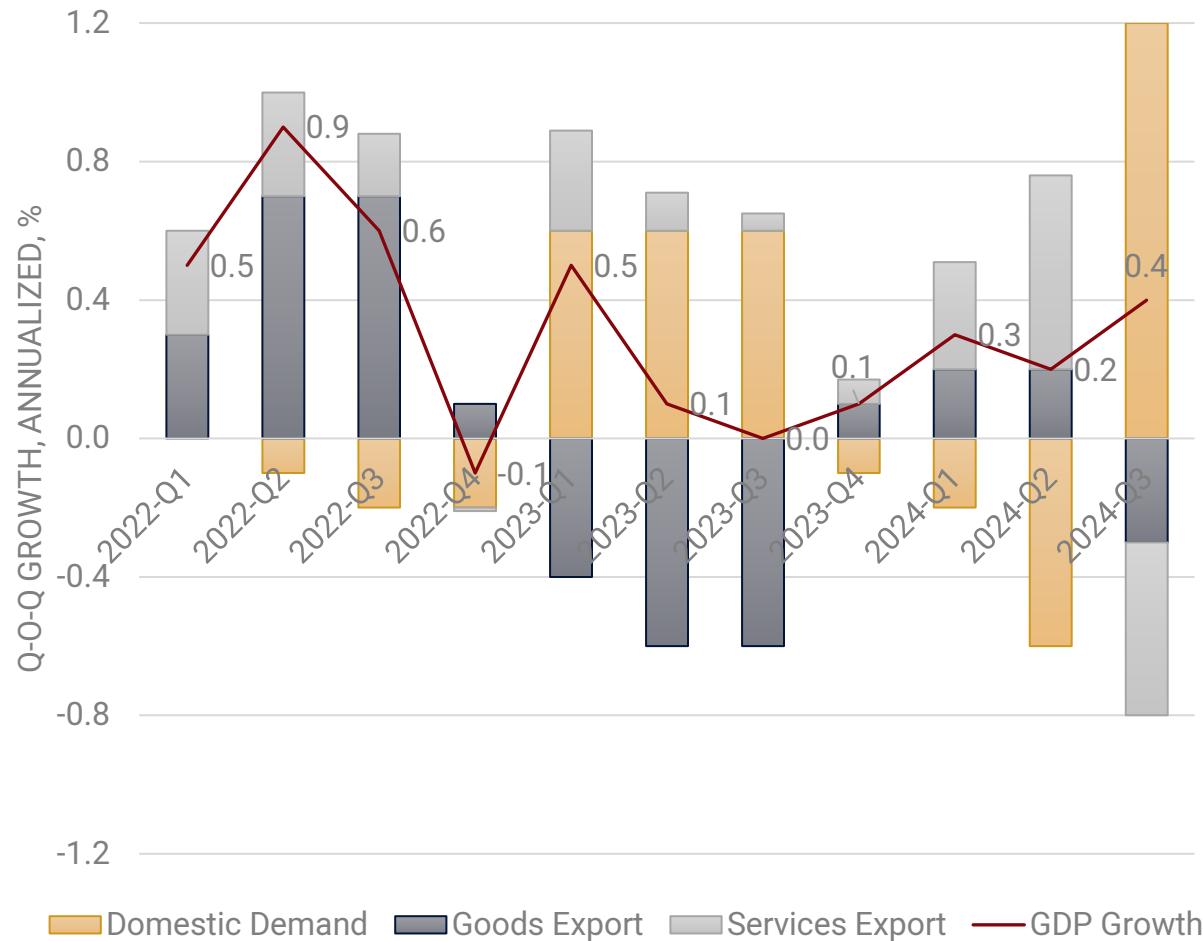
* TCJA = Tax Cuts and Jobs Act of 2017

Source: Atlanta FED

EU: Economic growth prospects and structure remain concerning, especially in the context of risks associated with the tightening of trade policy with the U.S.
Some short-term factors have contributed to the current acceleration of domestic demand.

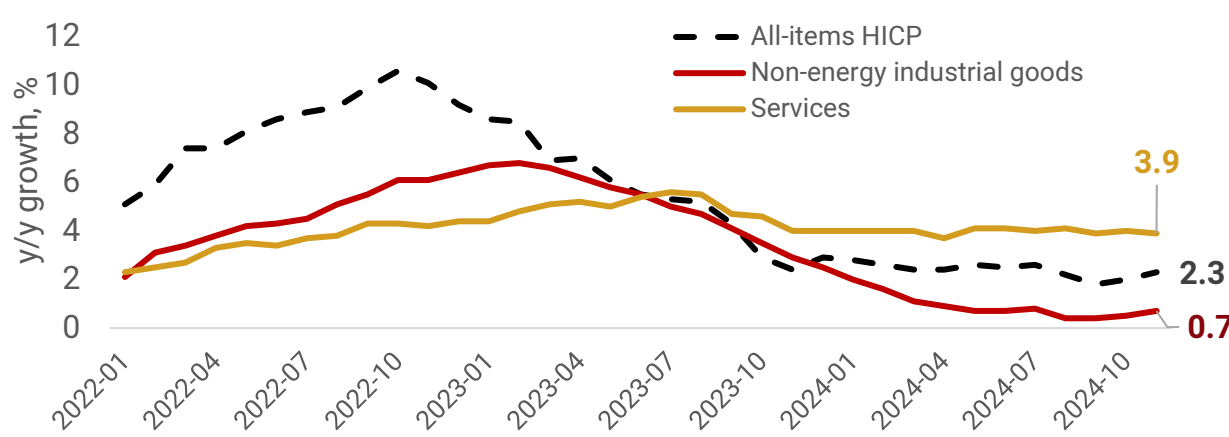


Demand remains weak amid high uncertainty and tight monetary policy

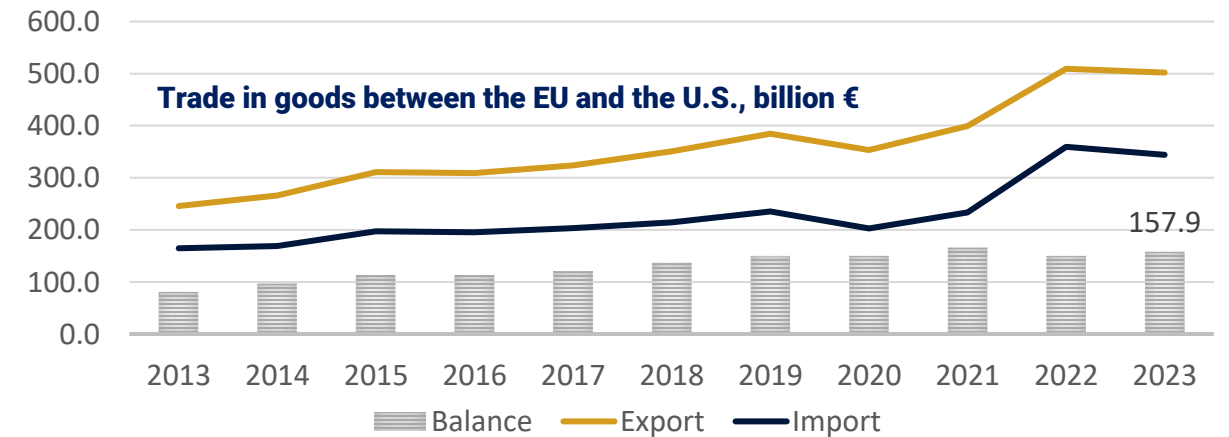


Source: Eurostat

ECB's policy dilemma deepening?

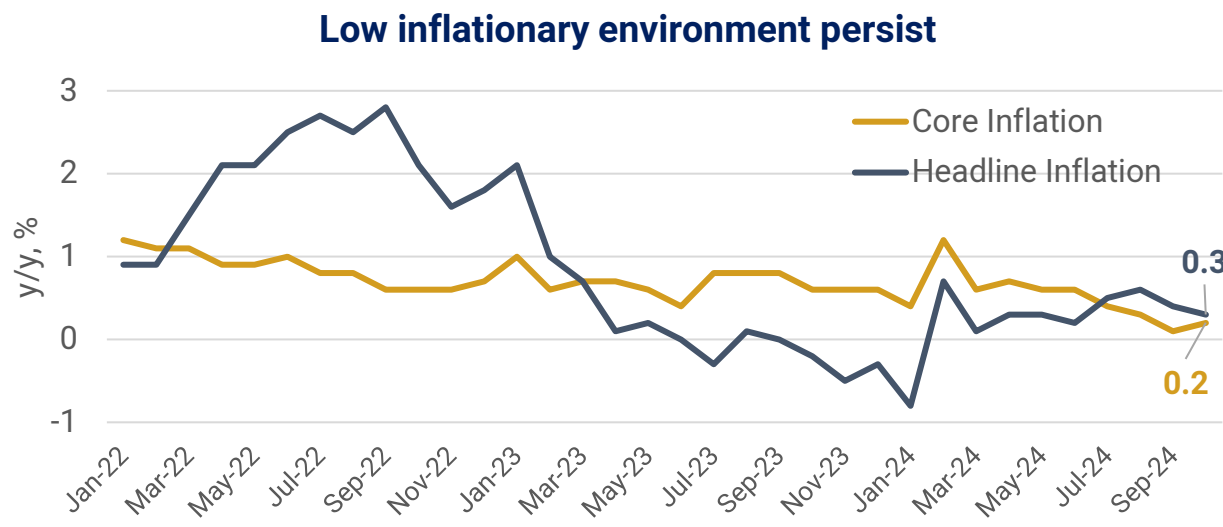
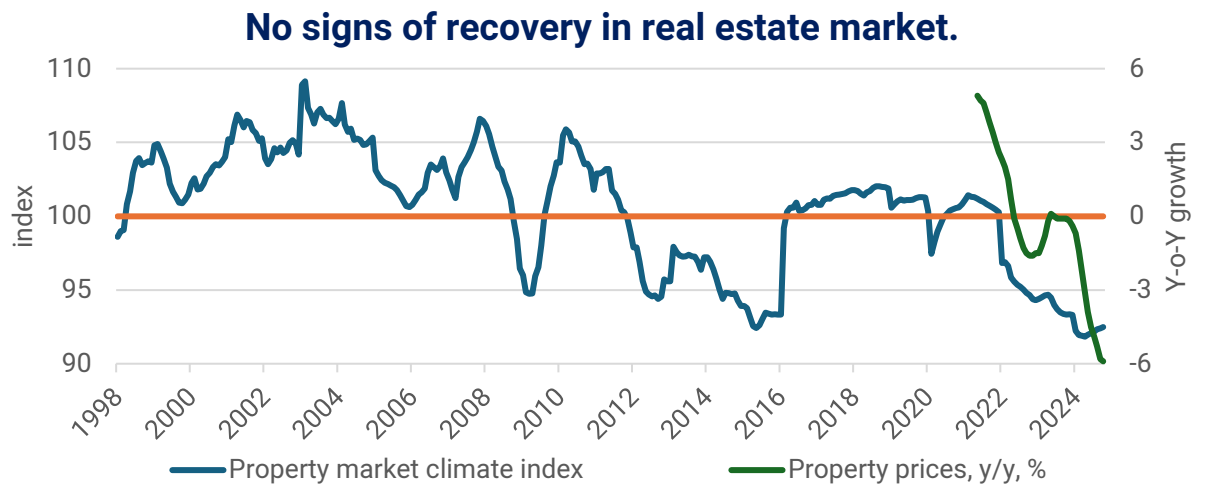
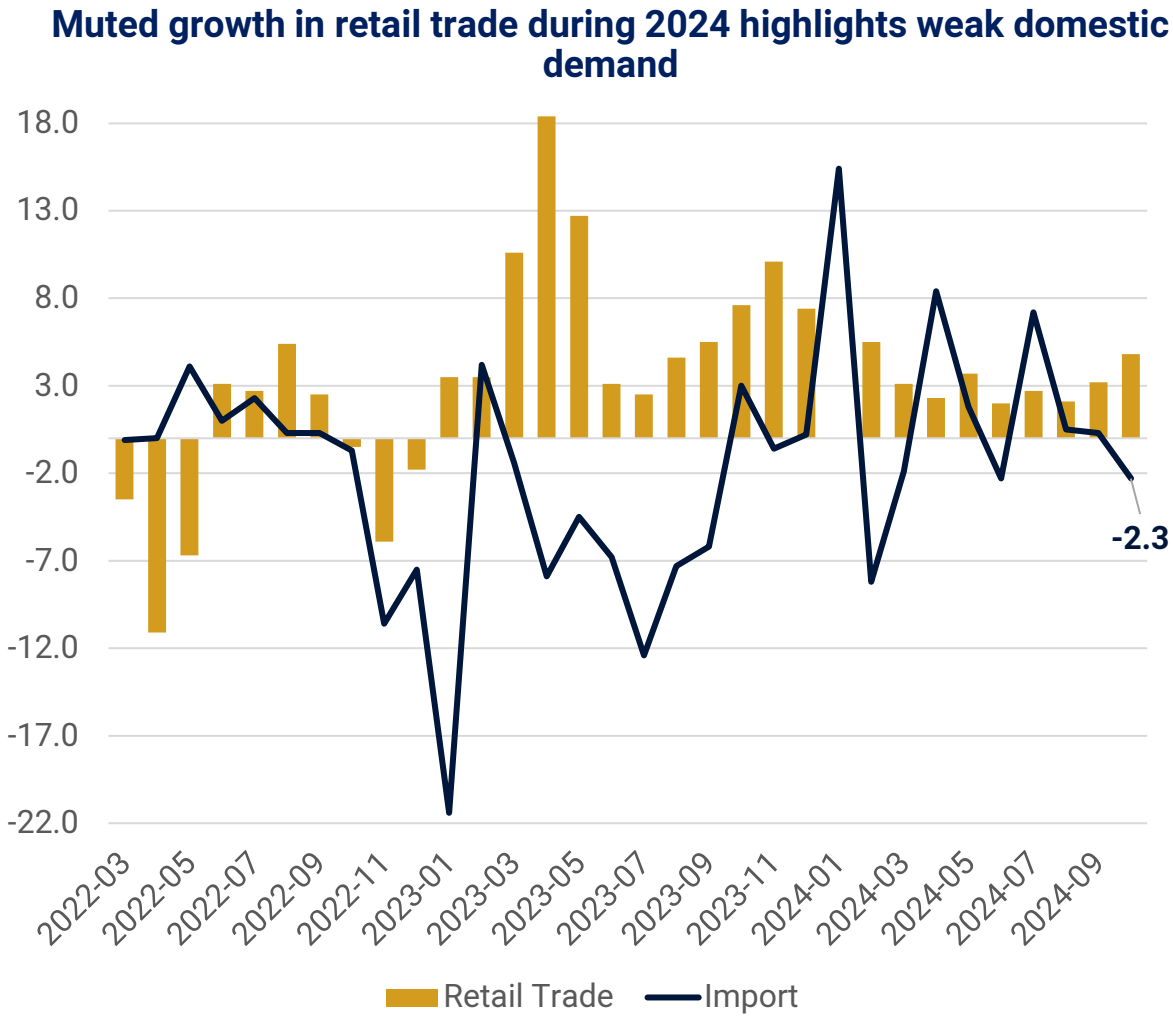


Potential import tariffs from the U.S. might be very costly for the EU.



Source: Eurostat

China: Weakening domestic demand remains one of key sources of uncertainty regarding the global economy outlook.

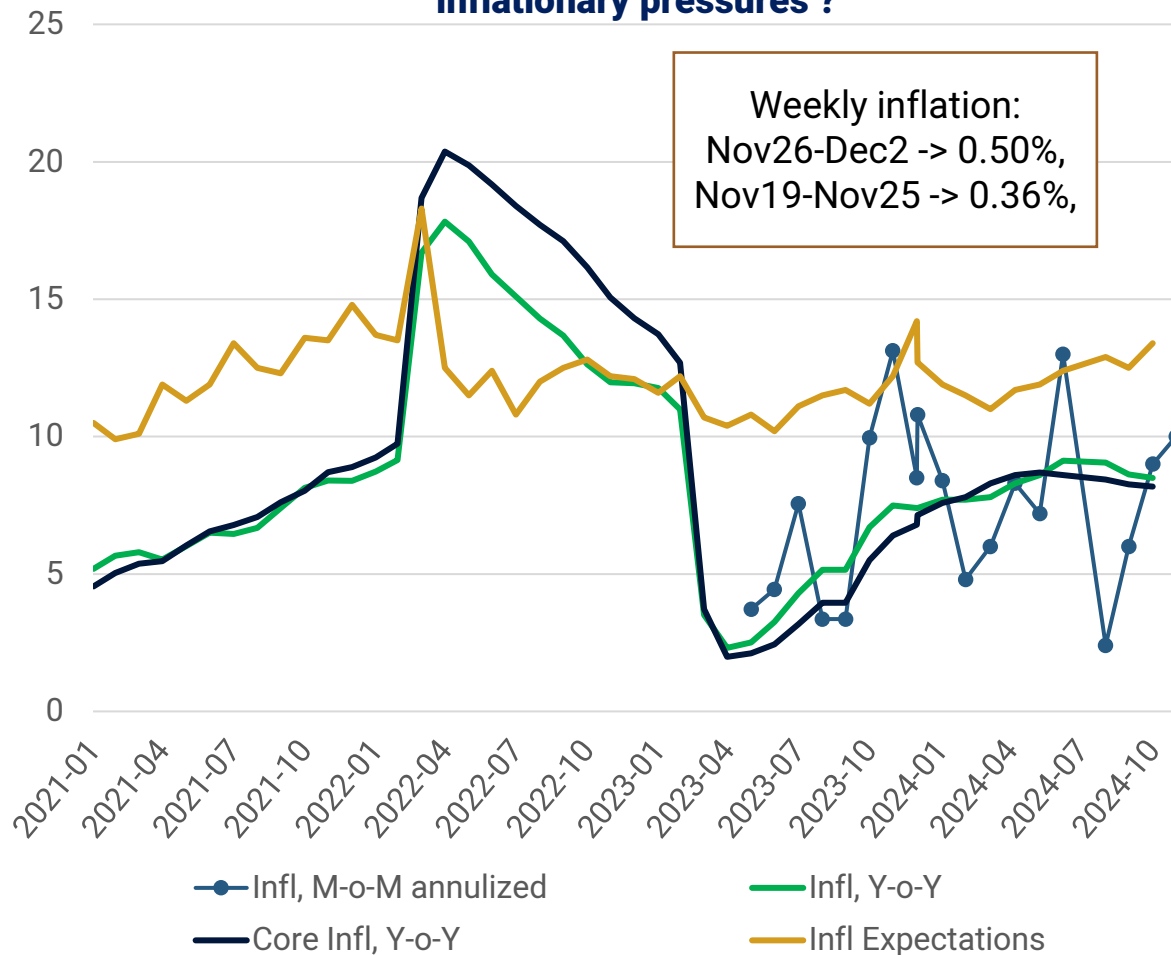


Source: National Bureau of Statistics of China

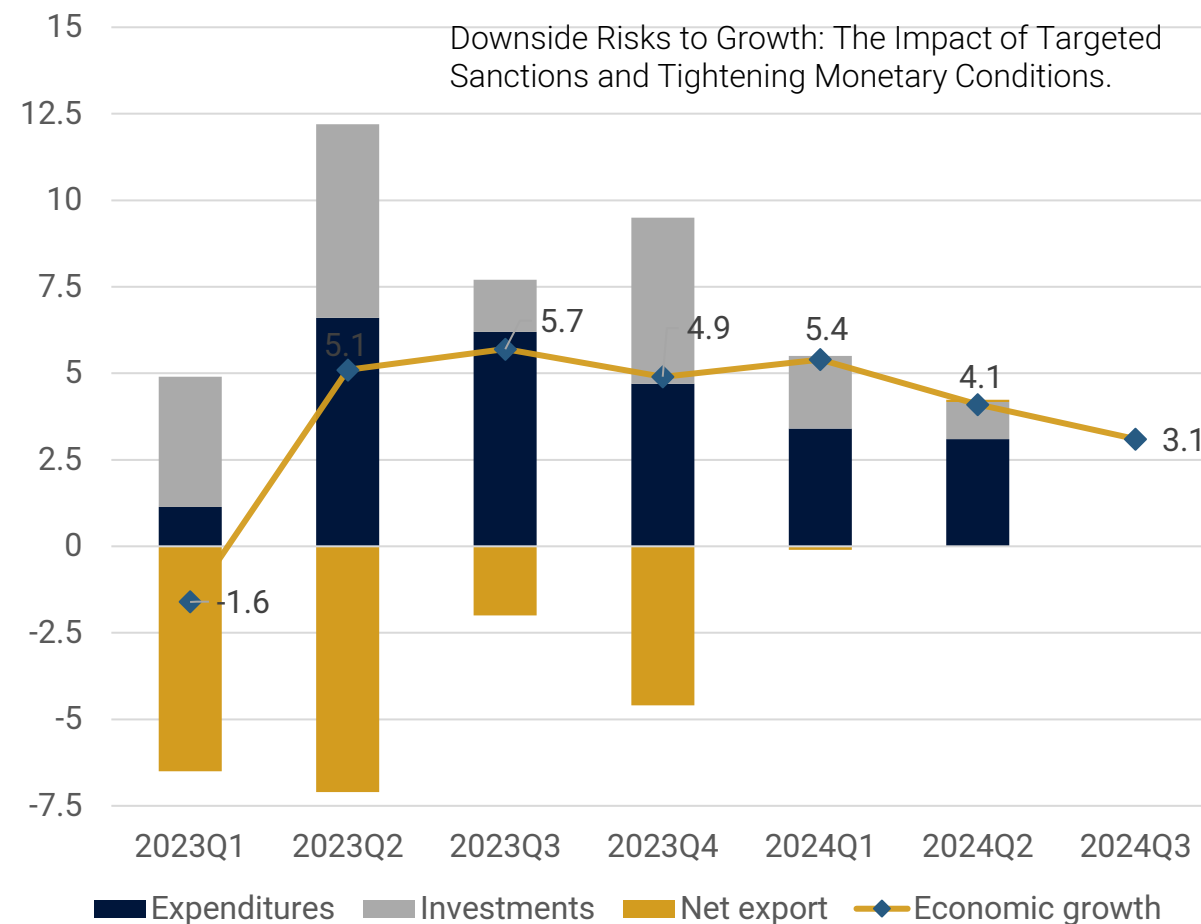
Russia: Amid accelerating inflation expectations, strong domestic demand persists posing risks for further deterioration of inflationary environment.



Are higher policy rates (21%) not enough to contain inflationary pressures ?



Strong domestic demand is the main driver for economic growth.



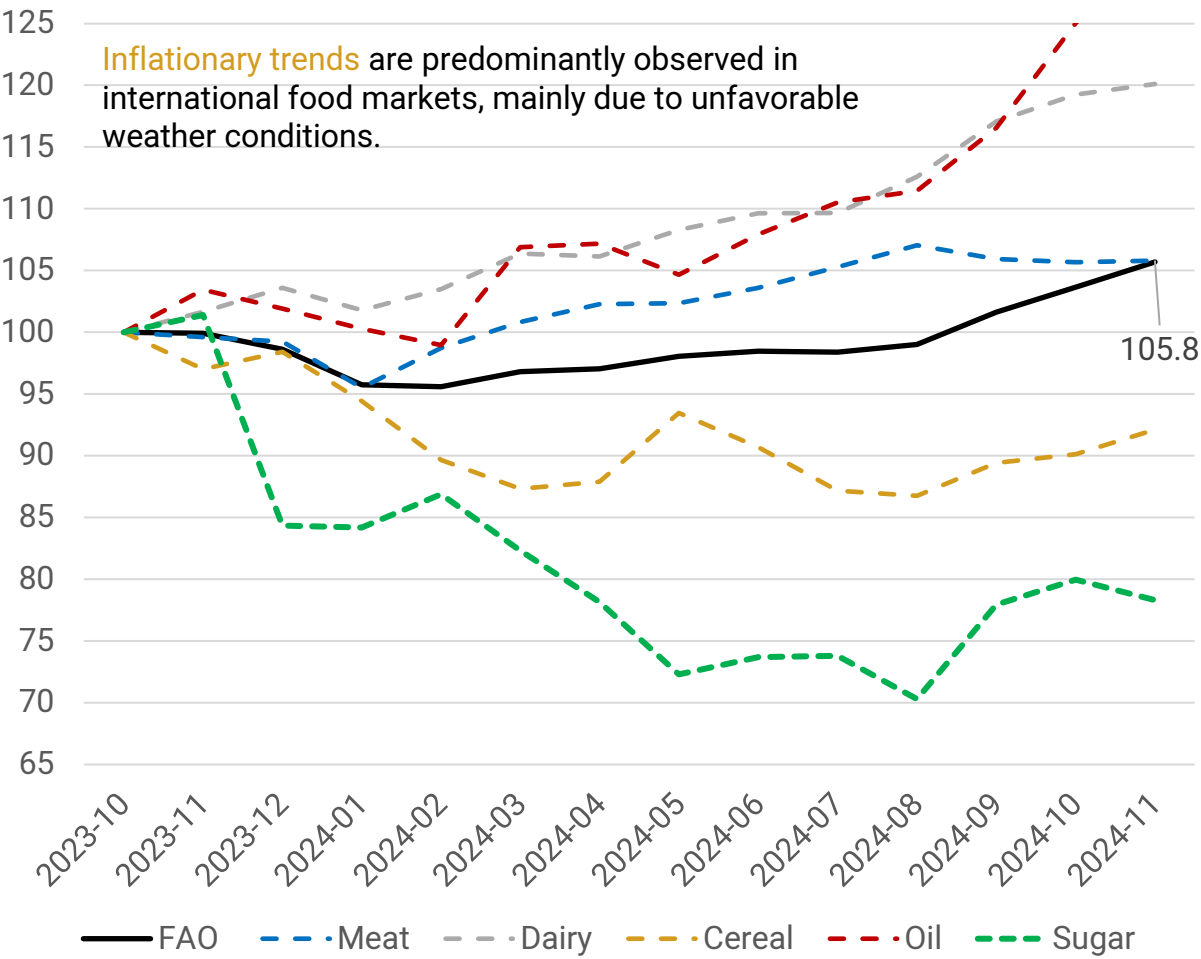
Source: Russian Statistics service, Central Bank of Russia

Source: Central Bank of Russia

Commodity markets: Geopolitical Uncertainty in the Middle East and U.S.: Risks of Higher Prices, Volatility, and Supply Chain Disruptions.



Global food price index, November 2023 = 100



Source: FAO

International oil prices (Brent), daily, US\$/barrel



Source: FRED

Main sources of uncertainty related to the global economy.



USA

- Uncertainty regarding long-term (neutral) interest rates
- Rising fiscal stimulus: assessing the uncertainties around debt and long-term sustainability
- Risks from the Tightening of External Trade Policies

EA

Despite some economic recovery in 2024, uncertainty persists regarding growth outlook and its structure.

China

Ongoing Risks to Real Estate, Financial Stability, and Demand.

Russia

- Amid accelerating inflation expectations, strong domestic demand persists.
- Downside Risks to Growth: The Impact of Targeted Sanctions and Tightening Monetary Conditions.

Commodity Markets

Geopolitical Tensions and Weaker Demand: Diverging Risks for Commodity and Oil Prices



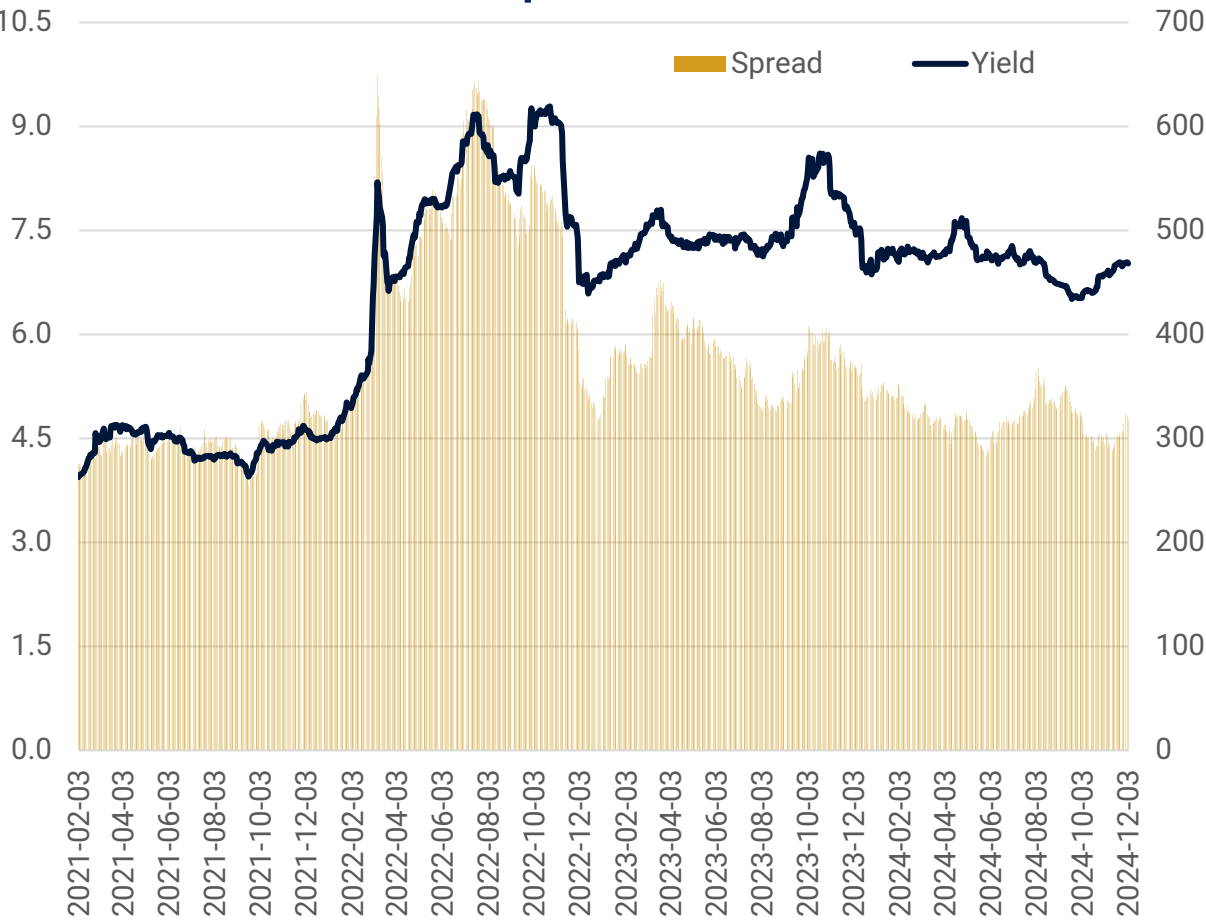
Current and Fundamental Economic Factors

Domestic Economic Developments

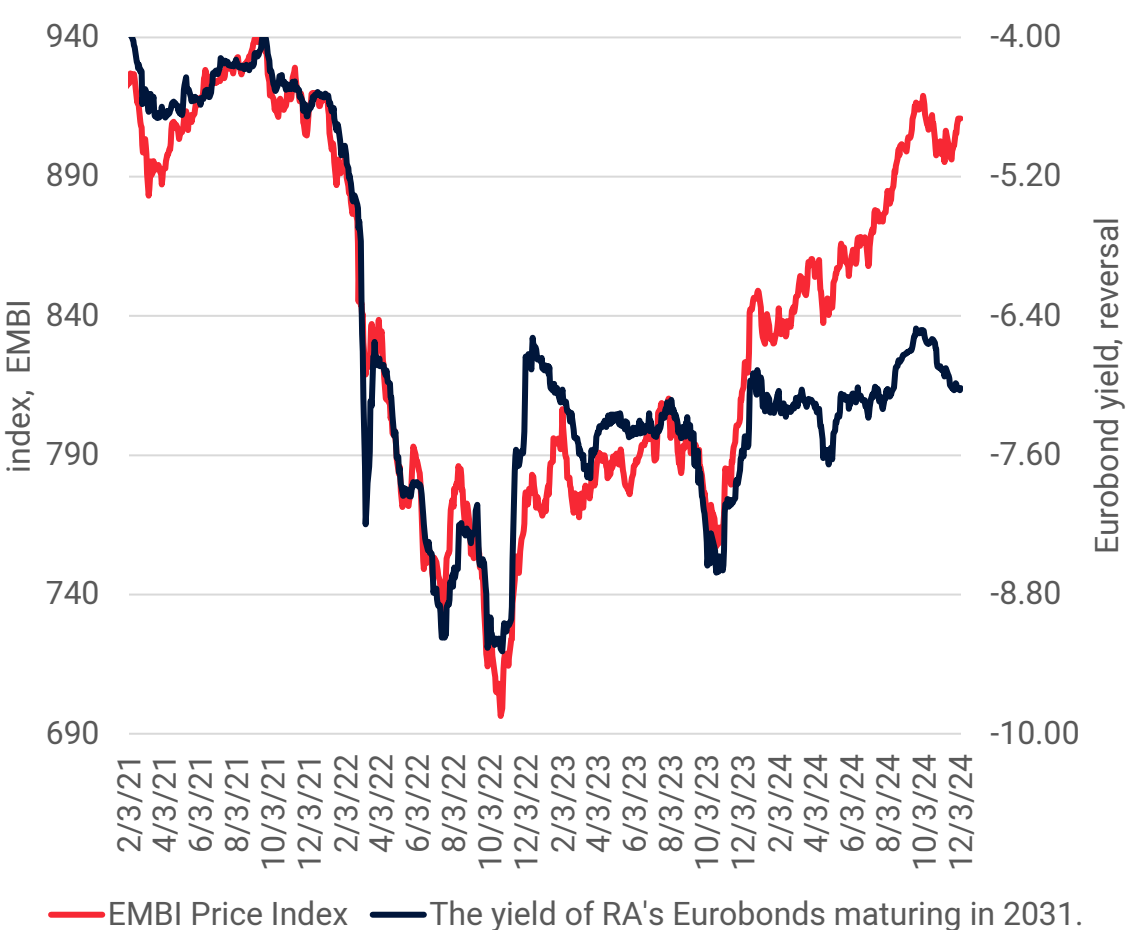
Uncertainties persist from the perspective of the market's further reassessment of Armenia's country risk.



Current country risk premium remains well below the long-term equilibrium levels.

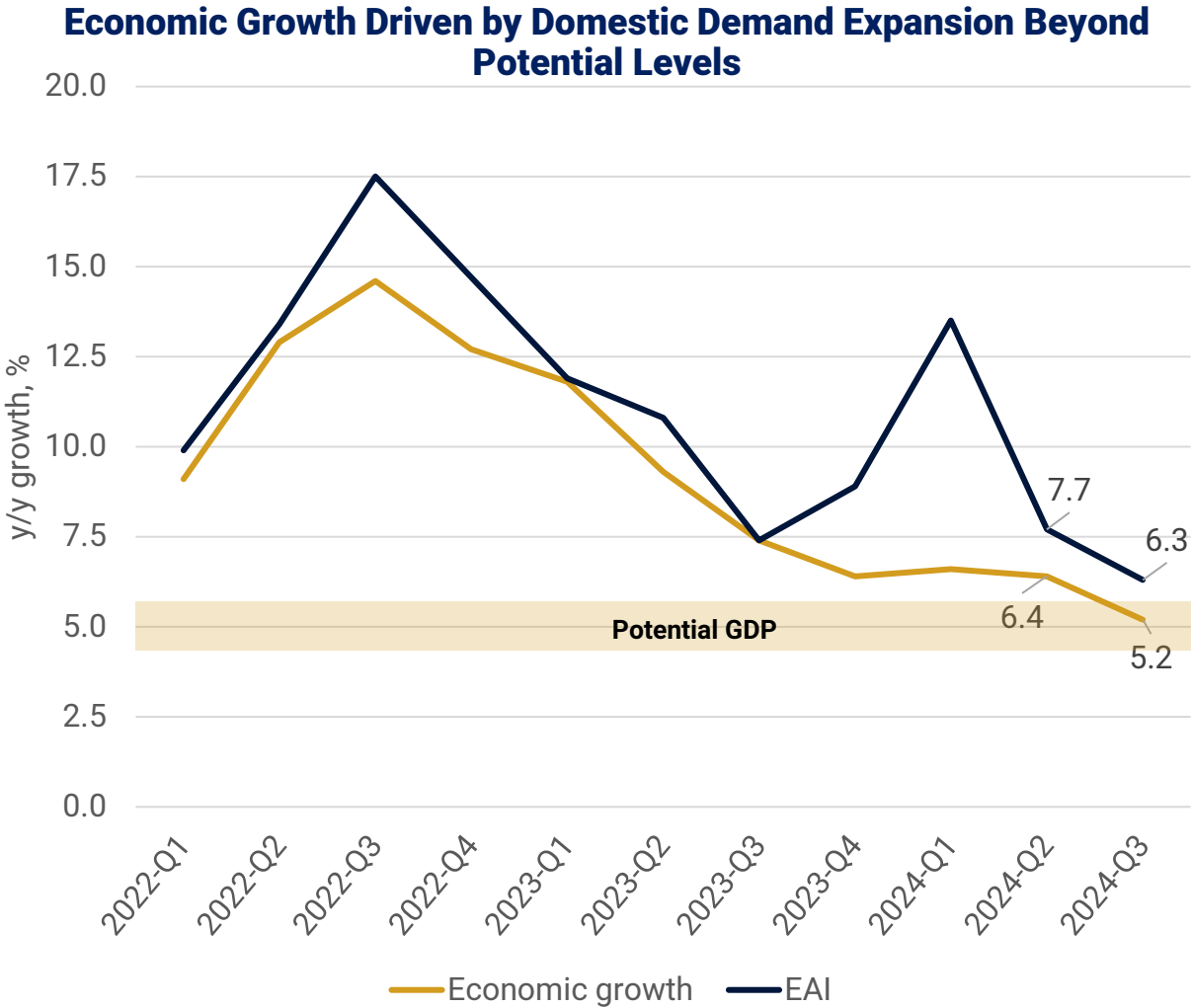


A Continued Divergence from Emerging Market Trends

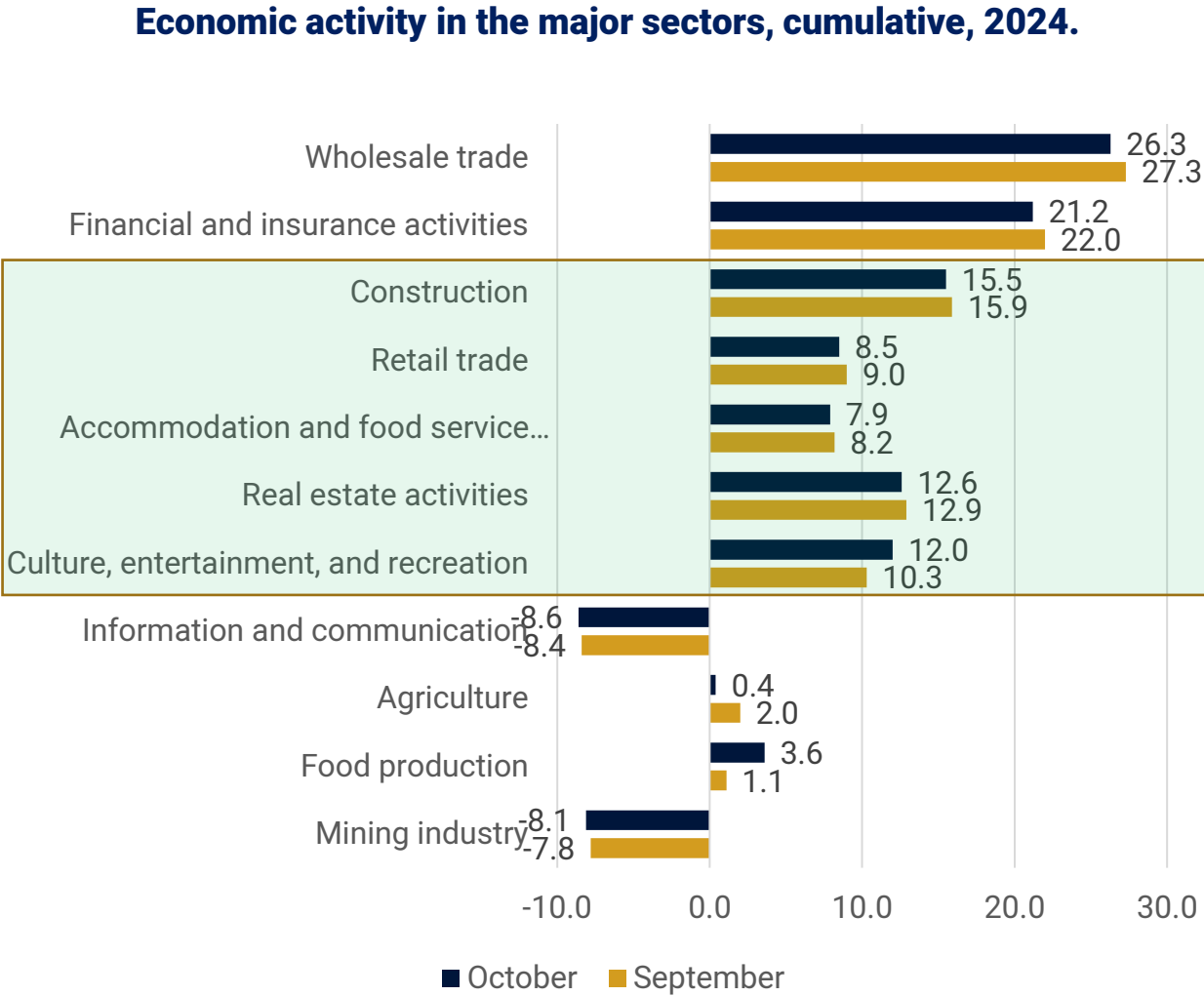


Source: CBA Calculations

Despite Weakening, Strong Economic Activity Continues mainly concentrated in Demand-Driven Sectors

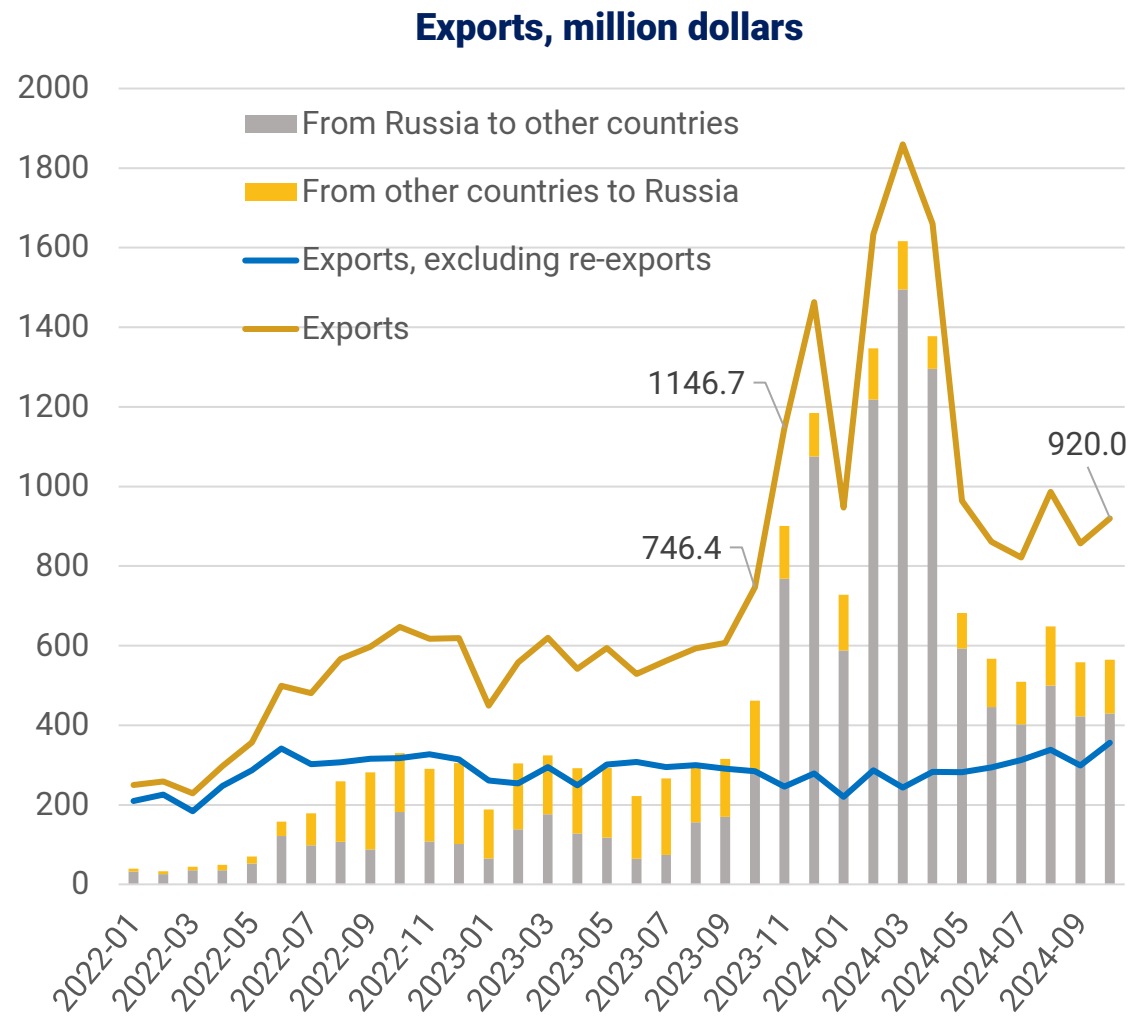


Source: RA Statistical Committee

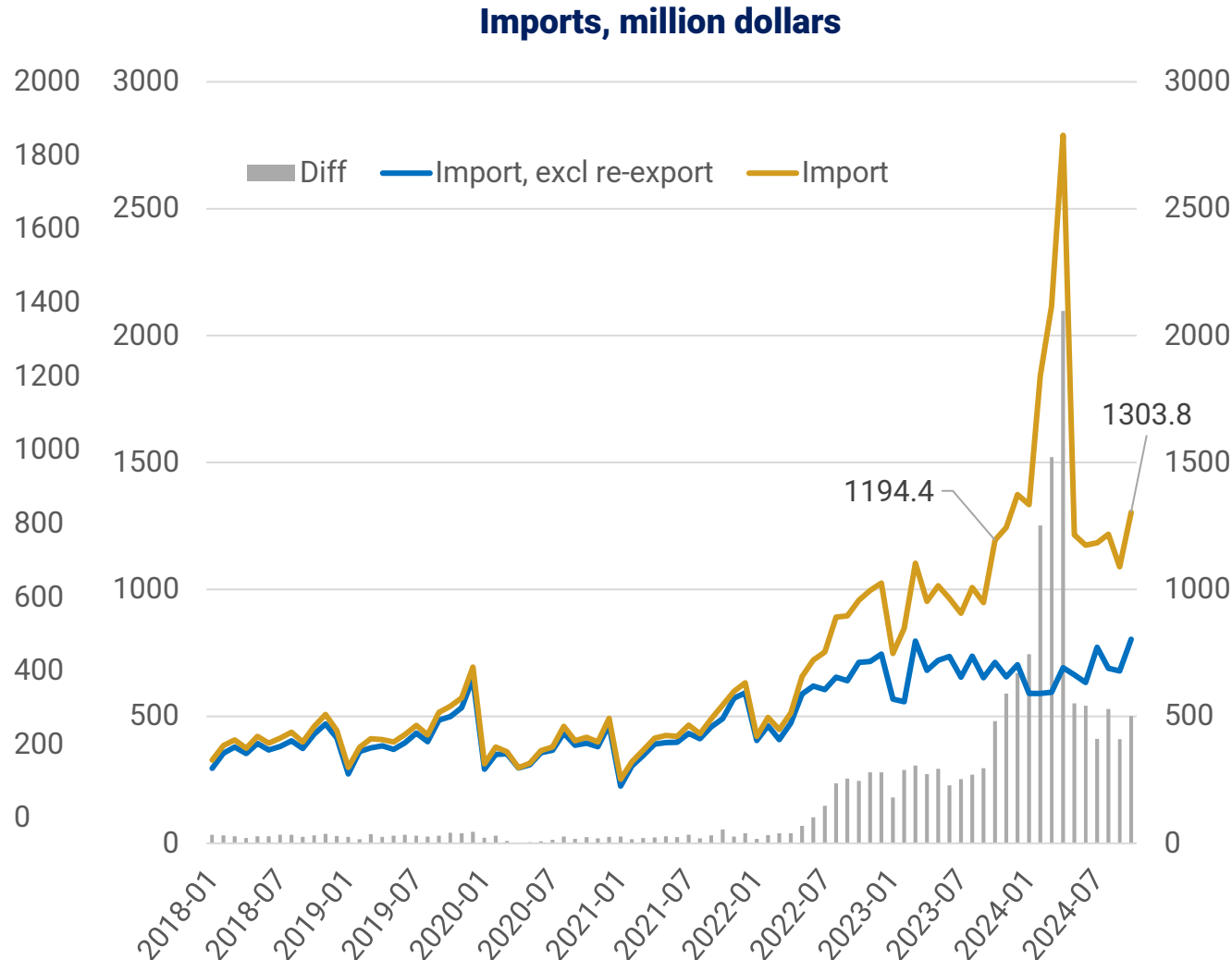


Source: RA Statistical Committee

Significant uncertainties remain regarding the stability of external trade flows.



Source: National Statistical Committee of Armenia , CBA estimates

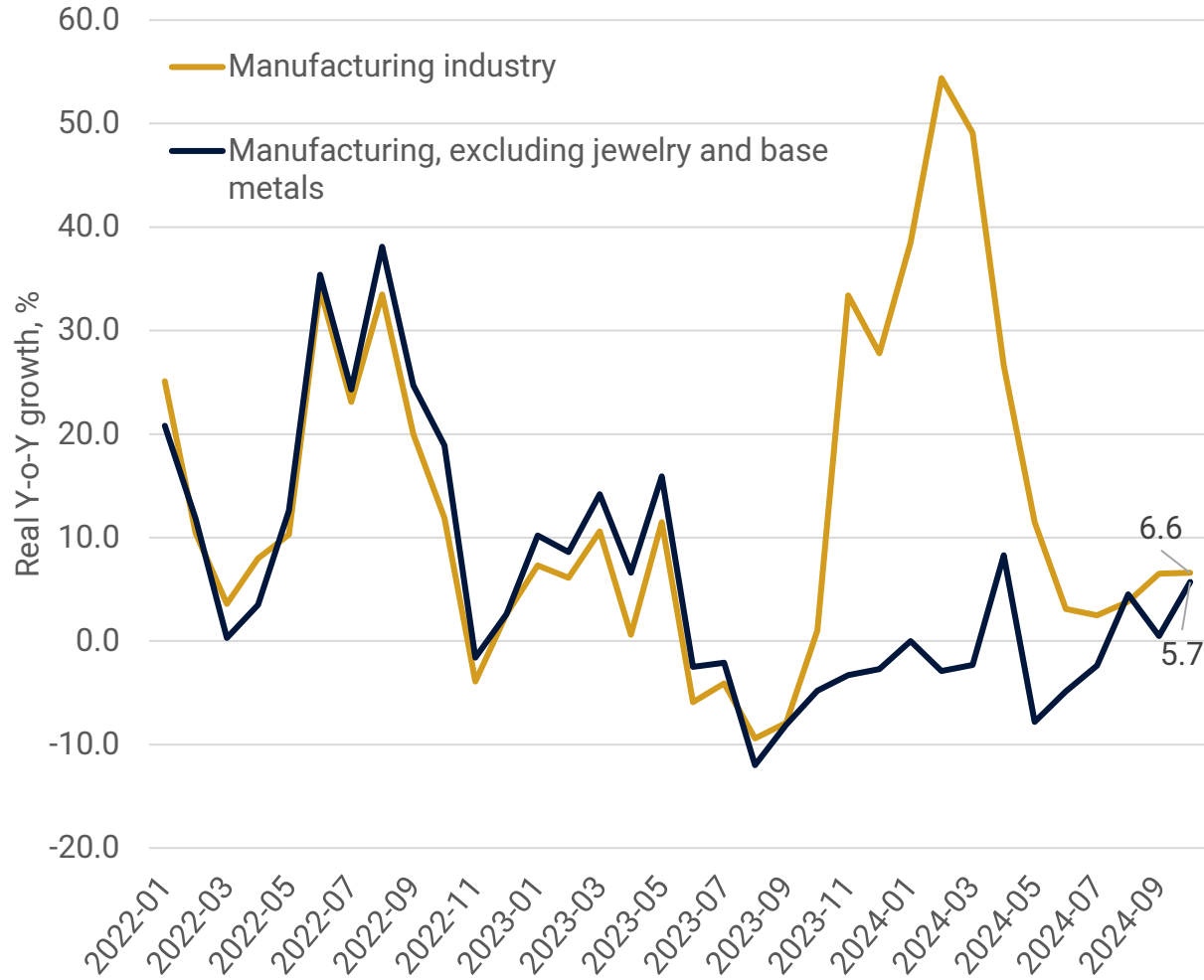


Source: National Statistical Committee of Armenia , CBA estimates

Some Signs of Recovery in Manufacturing Sector: Uncertainty About Medium-Term Growth Prospects

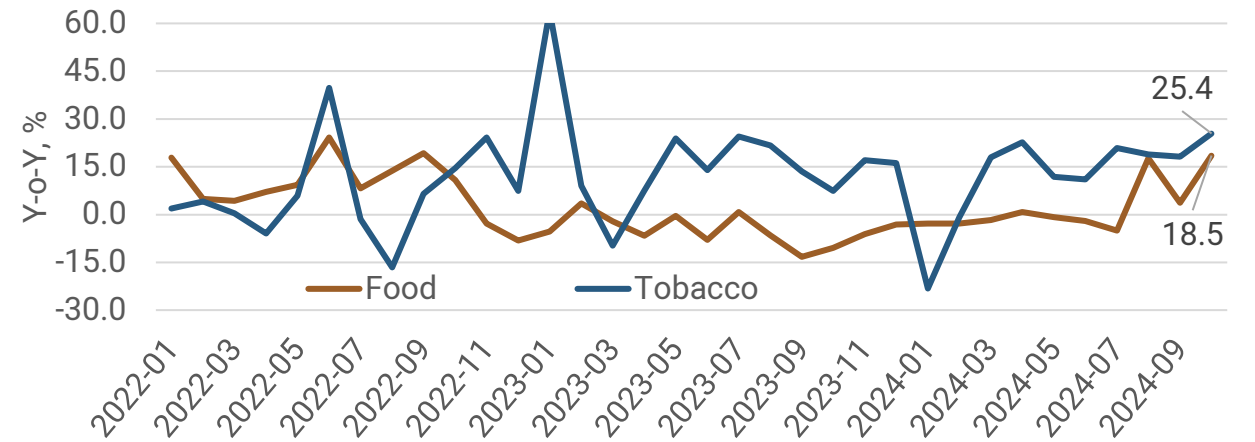


Accelerating Growth in Manufacturing: Driven by the Food Industry

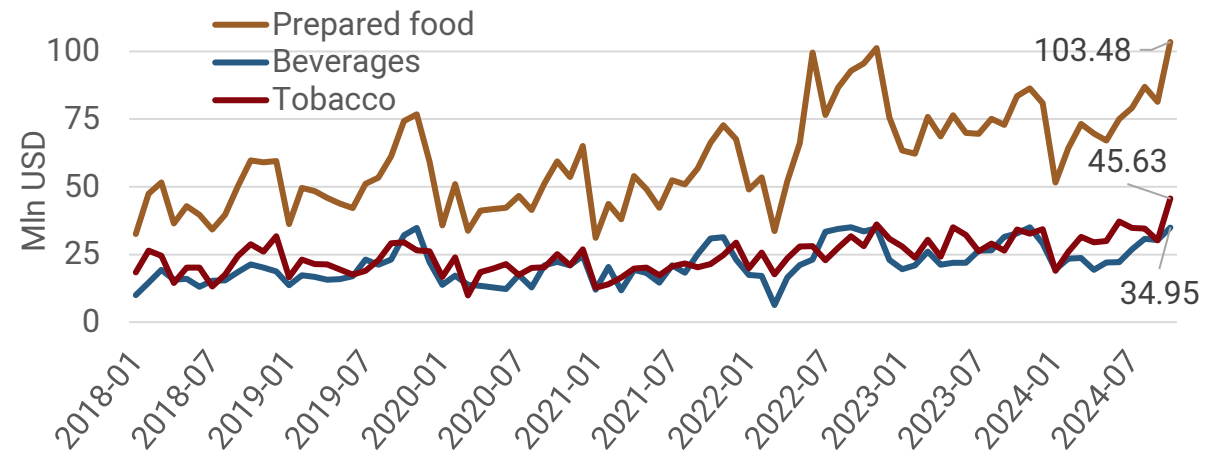


Source: National Statistical Committee of Armenia , CBA estimates

Tobacco and Prepared Food Sectors Leading the Growth



Exports of some product groups

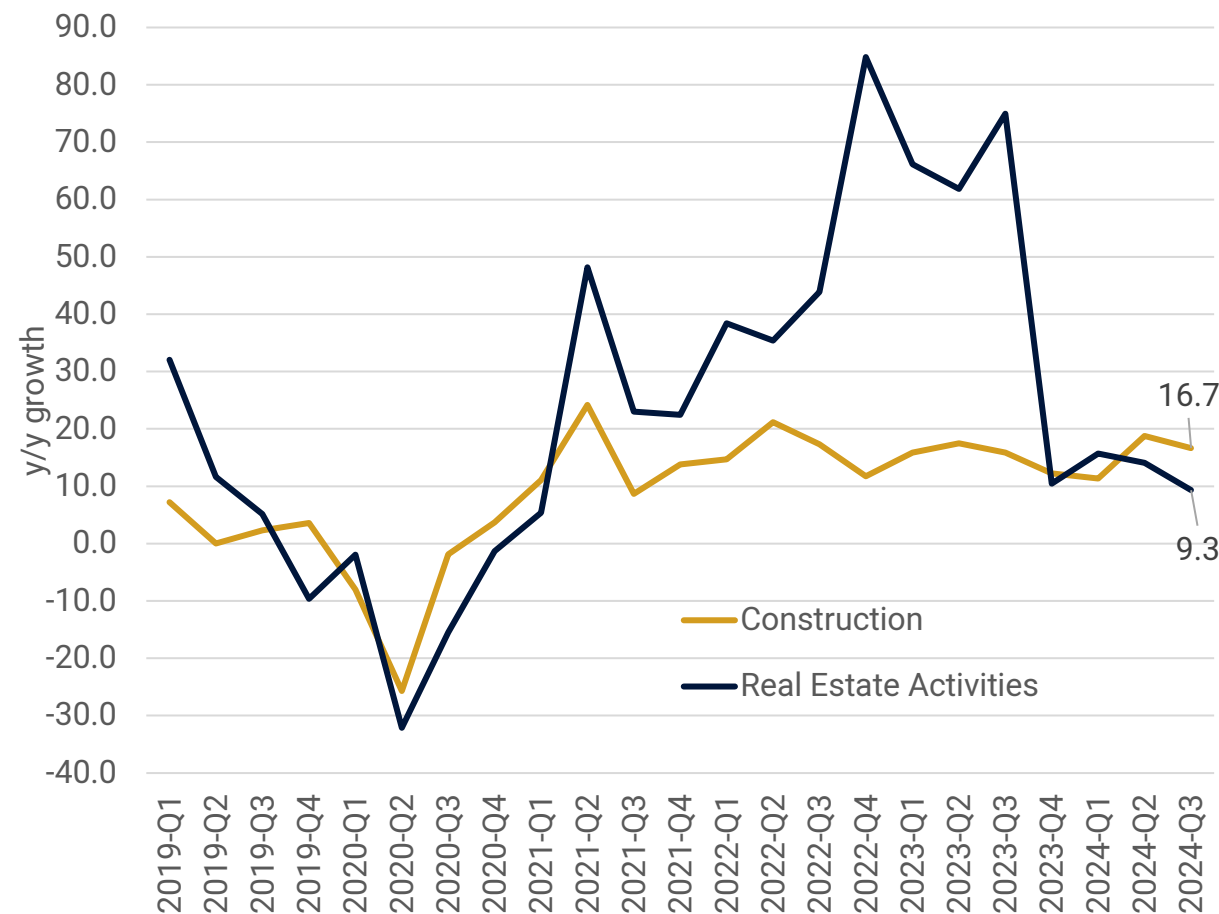


Source: National Statistical Committee of Armenia

Sustained Growth in Construction: Emerging Weakness in Residential Sector

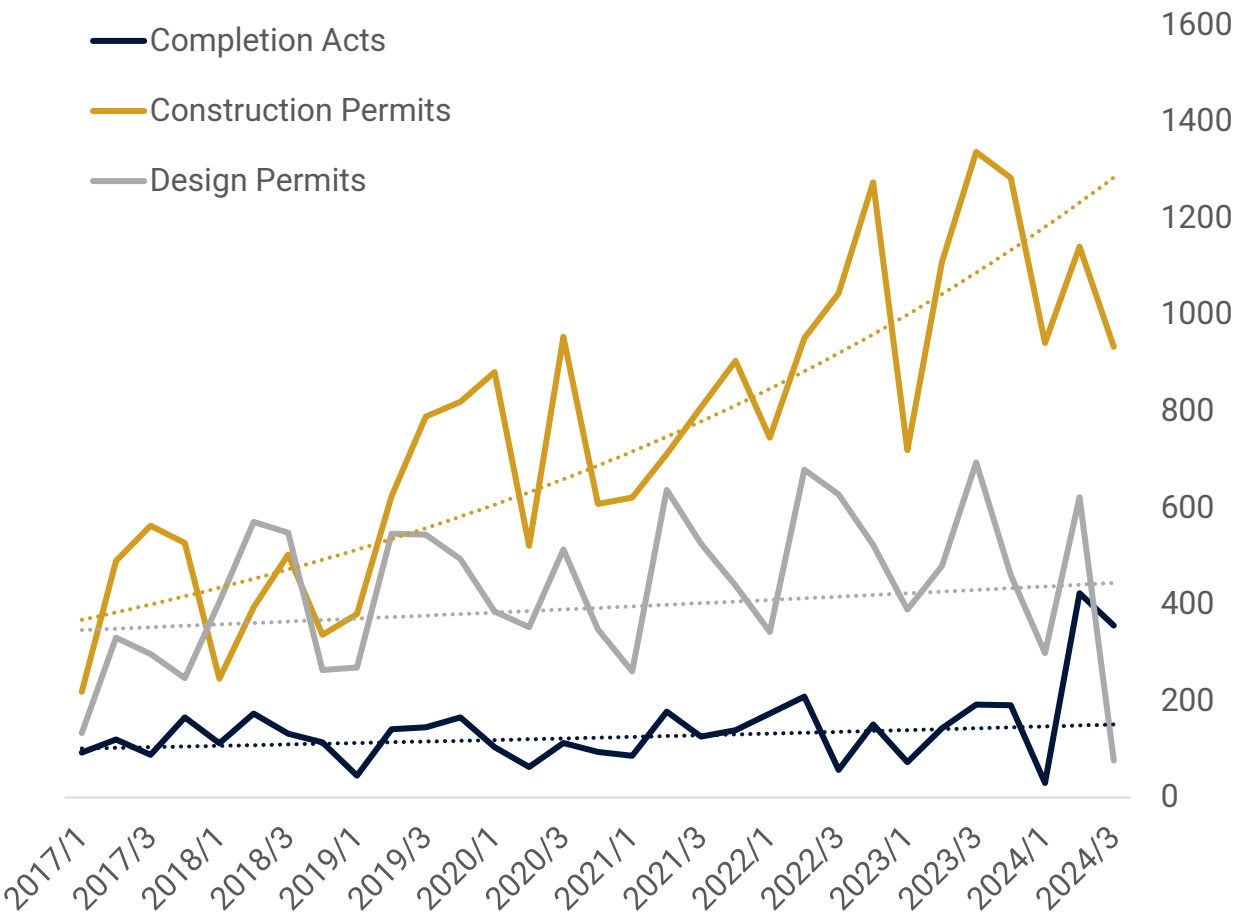


Half of Construction Output Attributed to Real Estate Activities



Source: NSS (National Statistical Service)

Permits granted by the Yerevan Municipality, quarterly

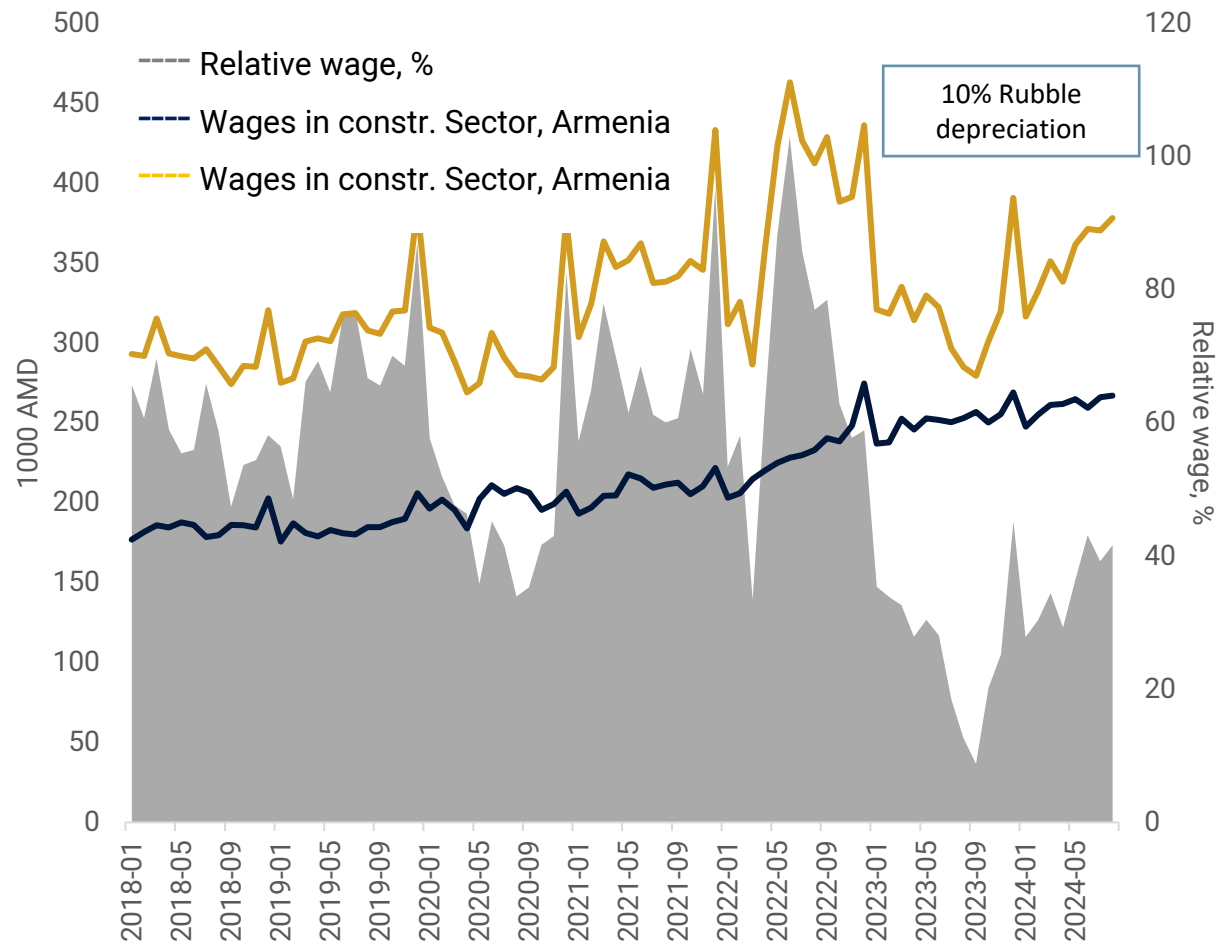


Source: Yerevan Municipality

External Demand Normalization: Uncertainty around Tourism, Labor Migration to Russia, and Non-Commercial Transfers

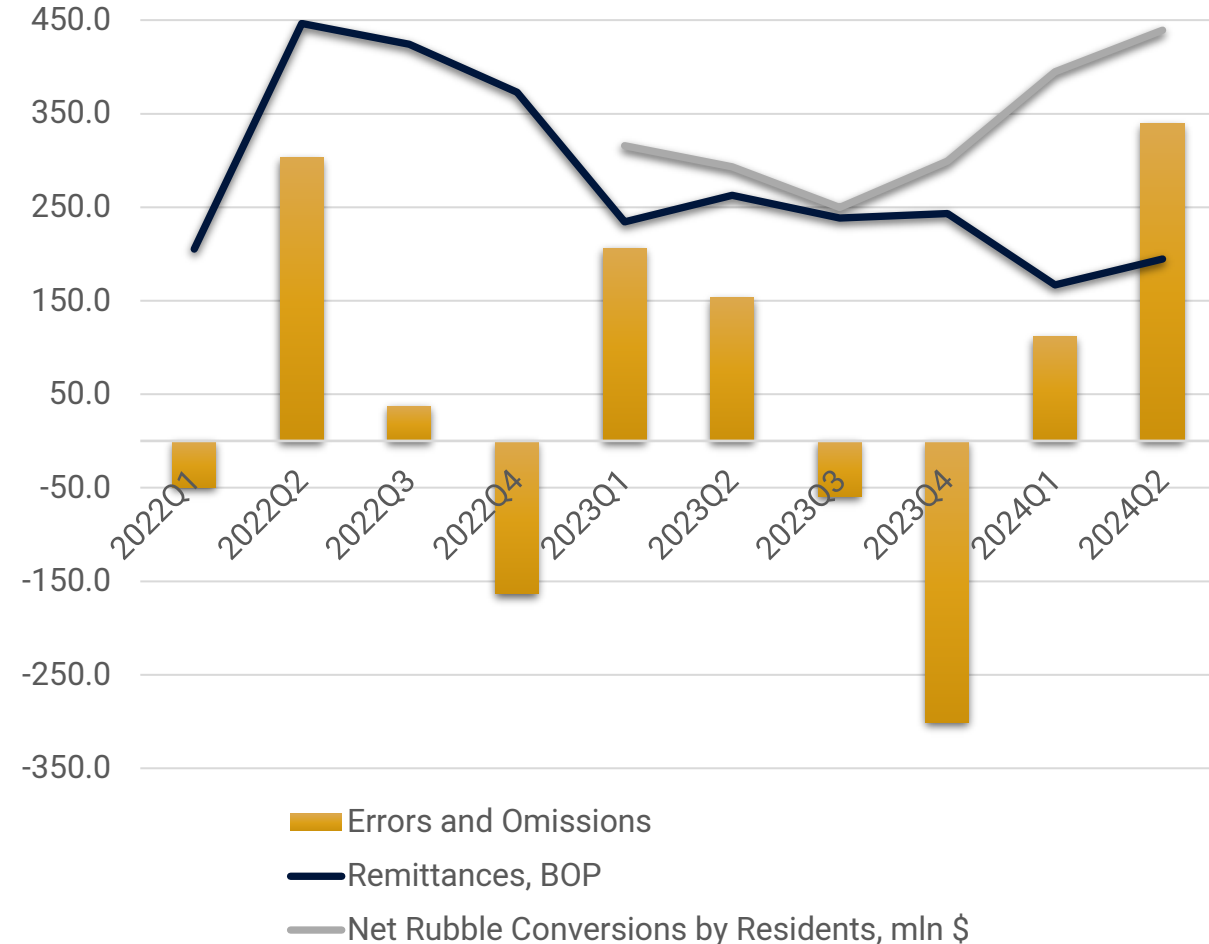


Difference in wages in the construction sectors of Armenia and Russia.



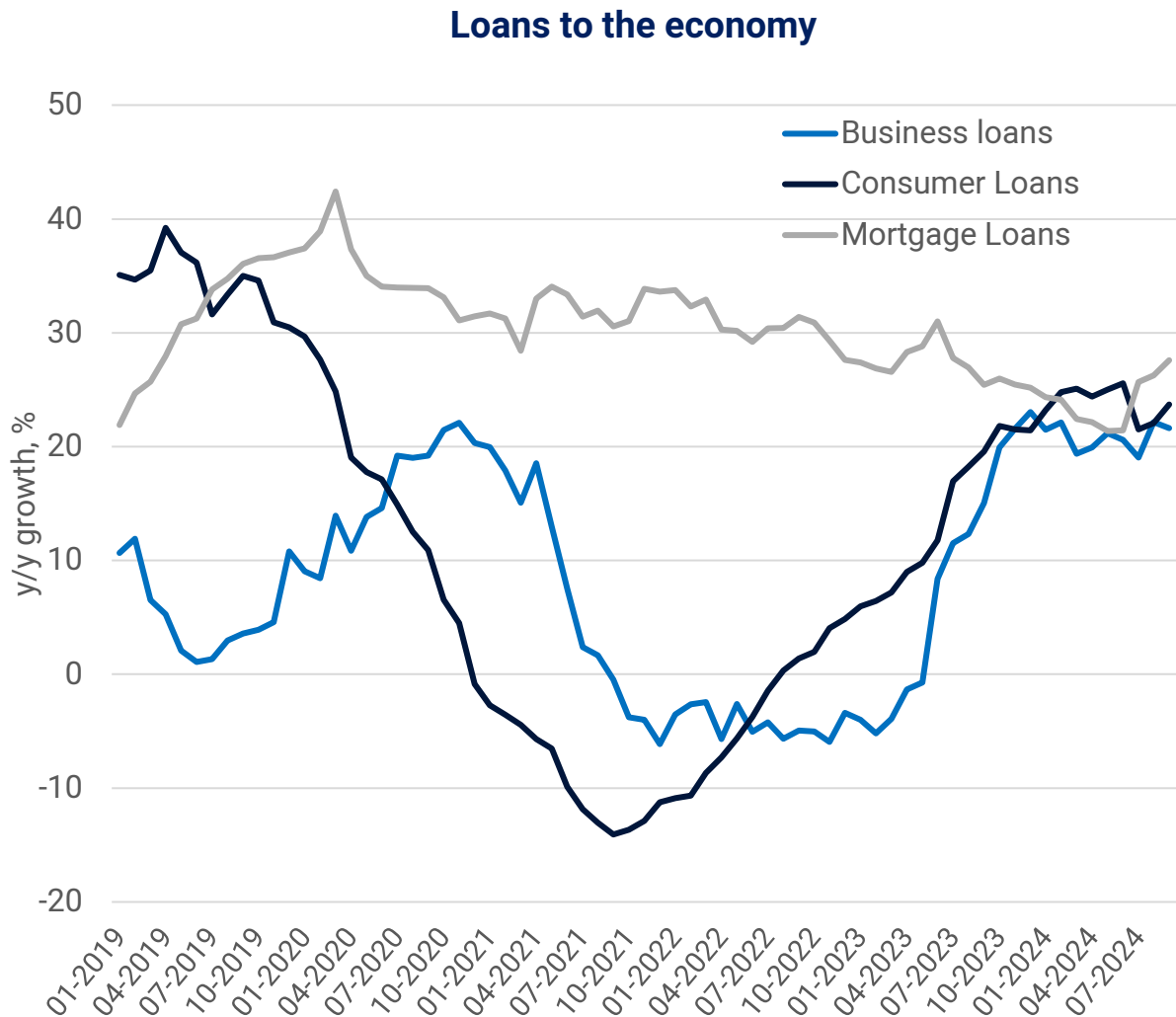
Աղբյուր՝ Ռոսստատ, ՀՀ ՎԿ, ԿԲ հաշվարկներ

Alongside the decline in non-commercial transfers, a significant increase in Ruble conversions by residents is observed.

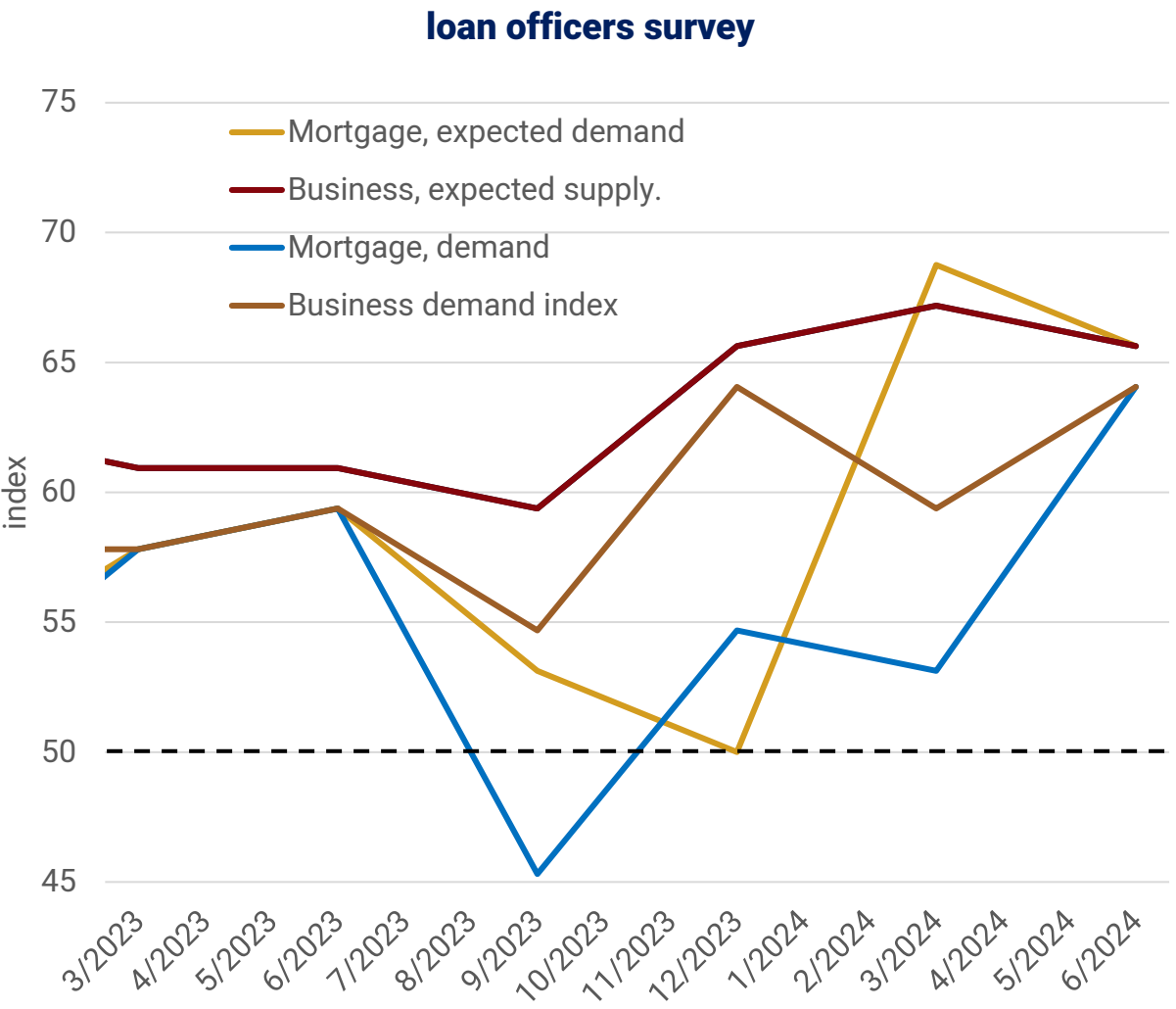


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Risks of Sustaining High Credit Expansion in the Banking System persist

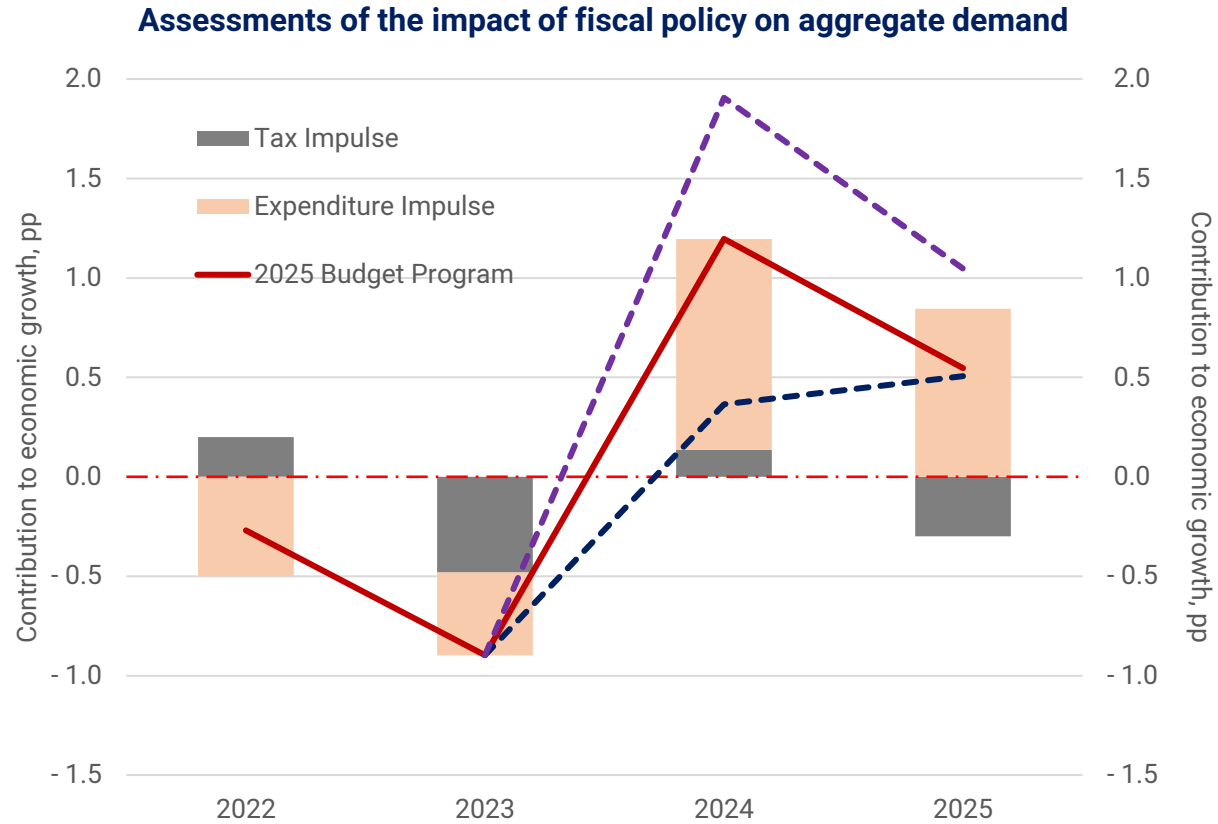


Source: CBA



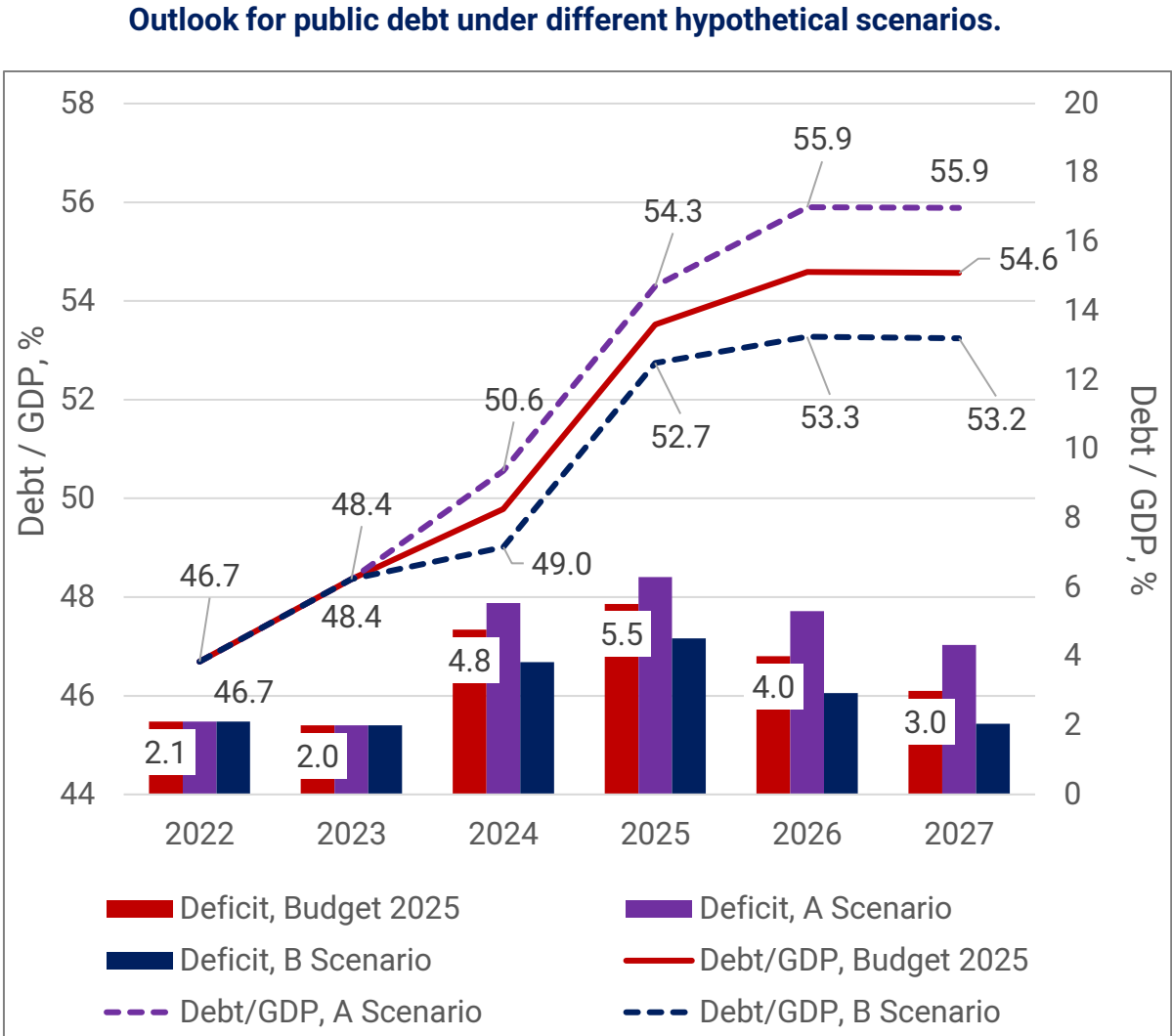
Source: CBA

Uncertainty persists regarding the outlook of fiscal policy and, consequently, its impact on demand and public debt.

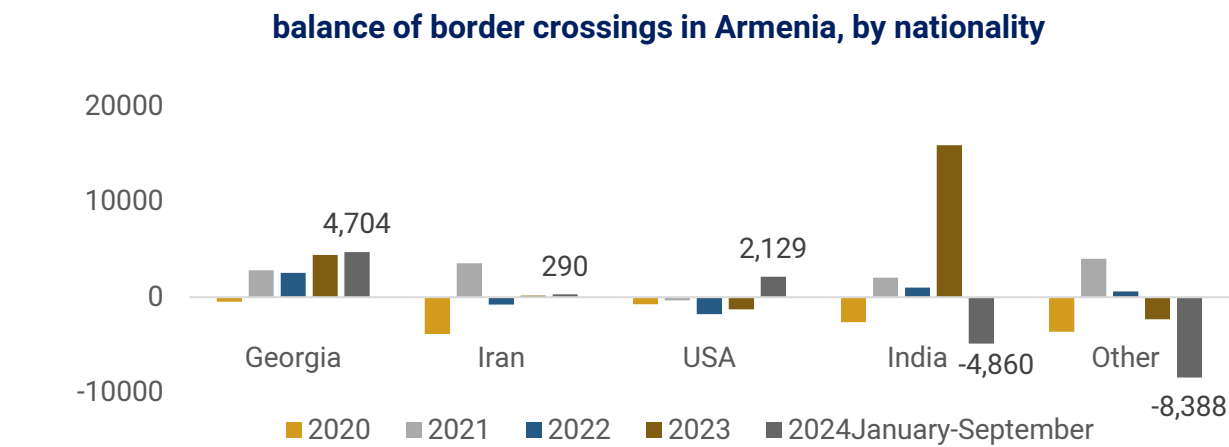
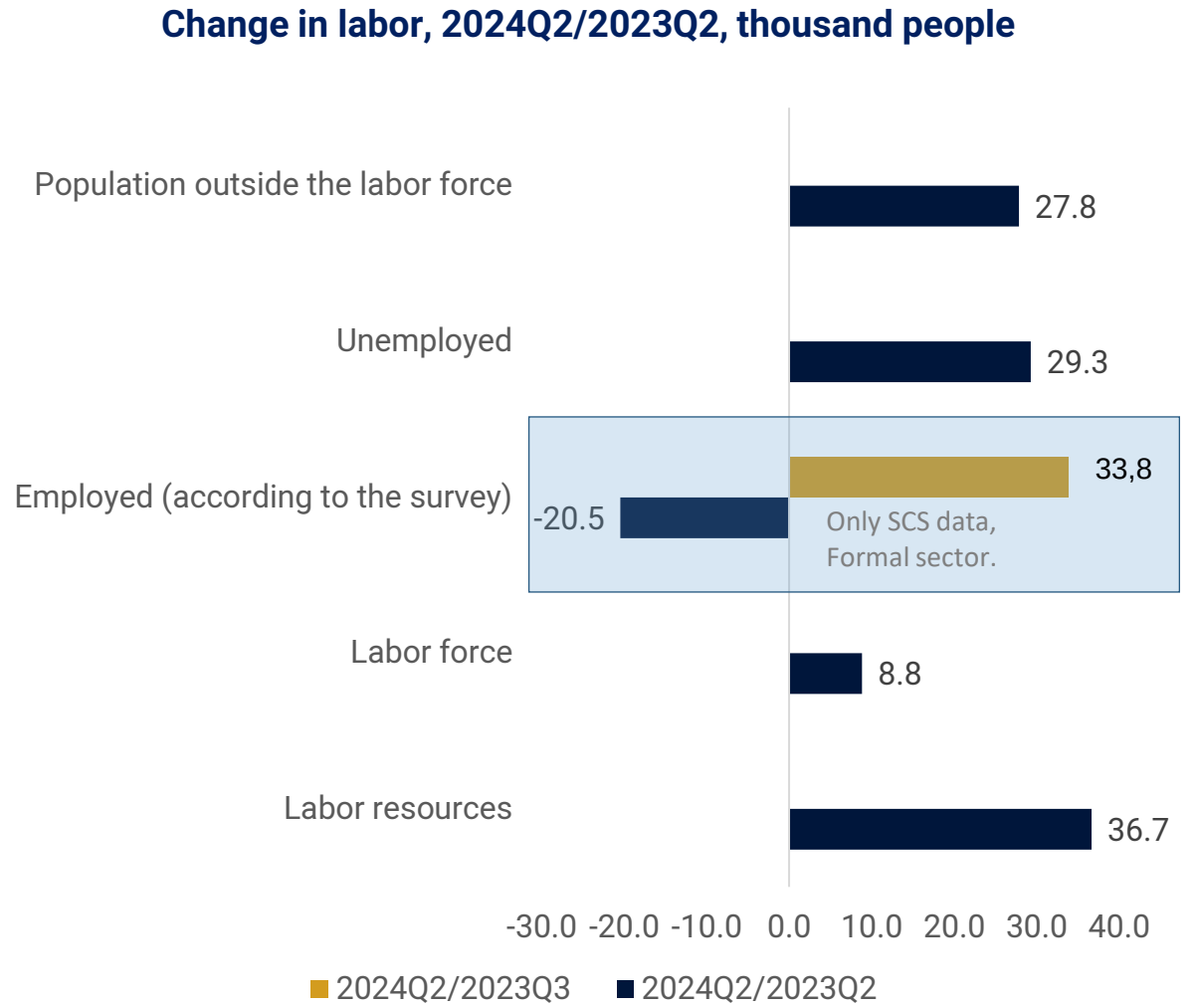
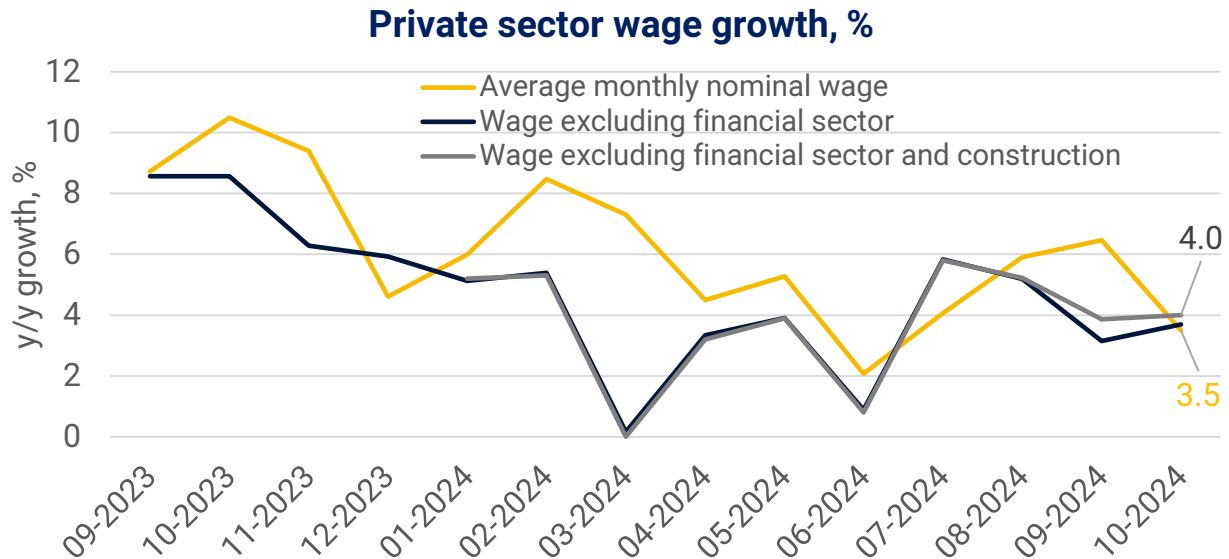


Scenario A – Under-collection of revenues and gradual recovery of the Taxes/GDP ratio in 2025-27, along with full utilization of the reserve fund.
Scenario B – Underachievement of capital expenditures, close to historical performance (85%).

Source: CBA calculations, RA minfin



Important to monitor the potential scenario-based outcomes stemming from Labor Market developments. Weakening labor market conditions?



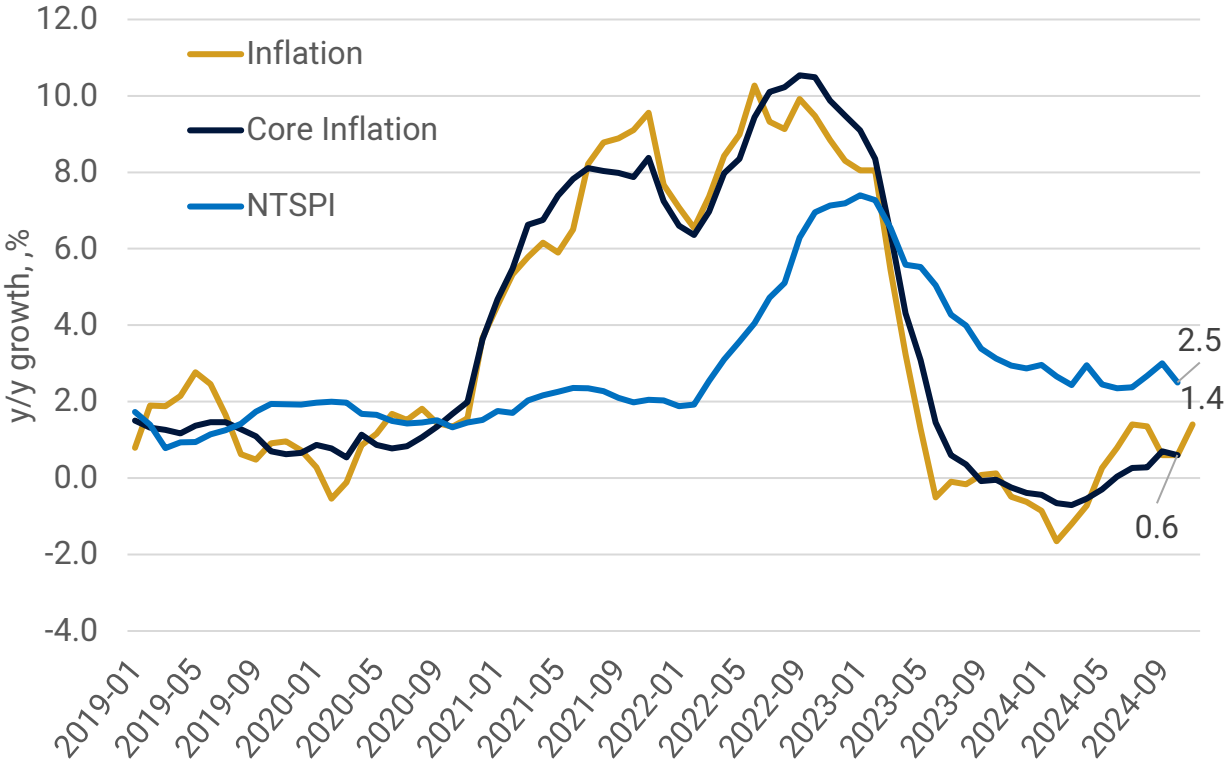
Source: RA Statistical Committee

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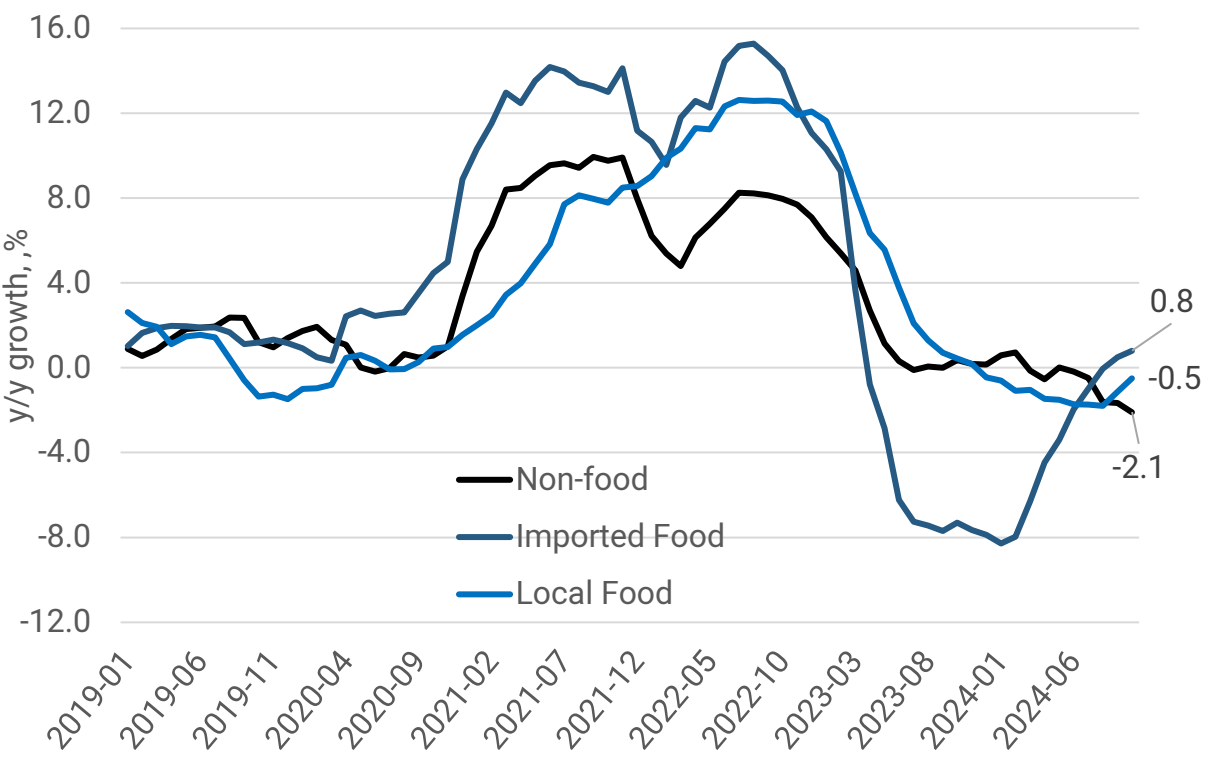
Despite the slight increase recorded in November, the overall inflationary environment in Armenia remains weak, largely due to imported low inflation.



Inflation and core inflation indicators



Some large CPI components



Imported food prices growth has accelerated in line with global trends. However, the increase in international prices has not yet been fully reflected in local prices.

The low inflationary/deflationary environment in China is one of the main contributors to the prices of non-food imported goods.

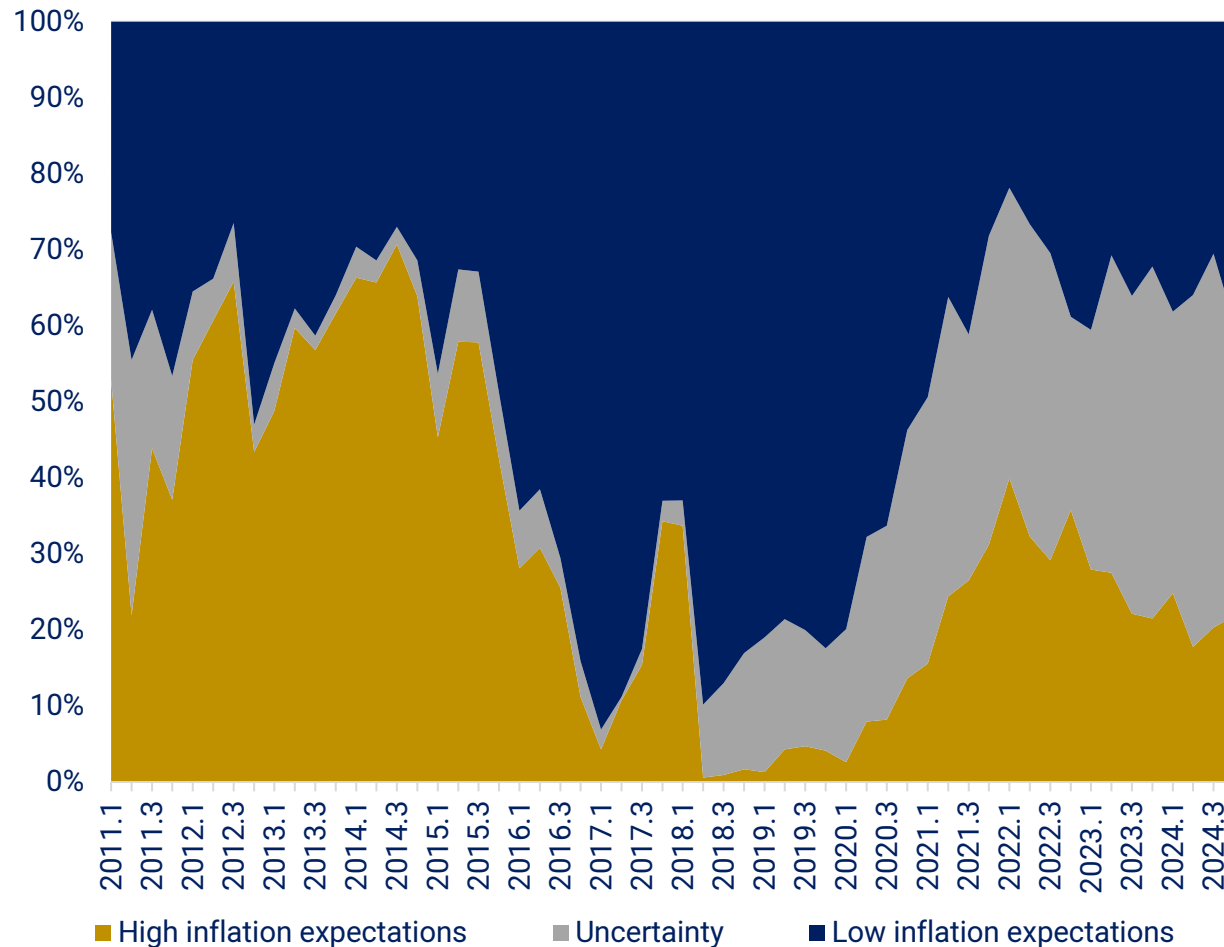
Slightly lower inflation observed in local food products compared to its historical seasonal patterns was adjusted in November. Vegetable prices have increased by 22% year-on-year.

Decline in prices of unregulated services was almost entirely driven by adjustments in air transportation and rental prices in October (due to some adjustment in external demand).



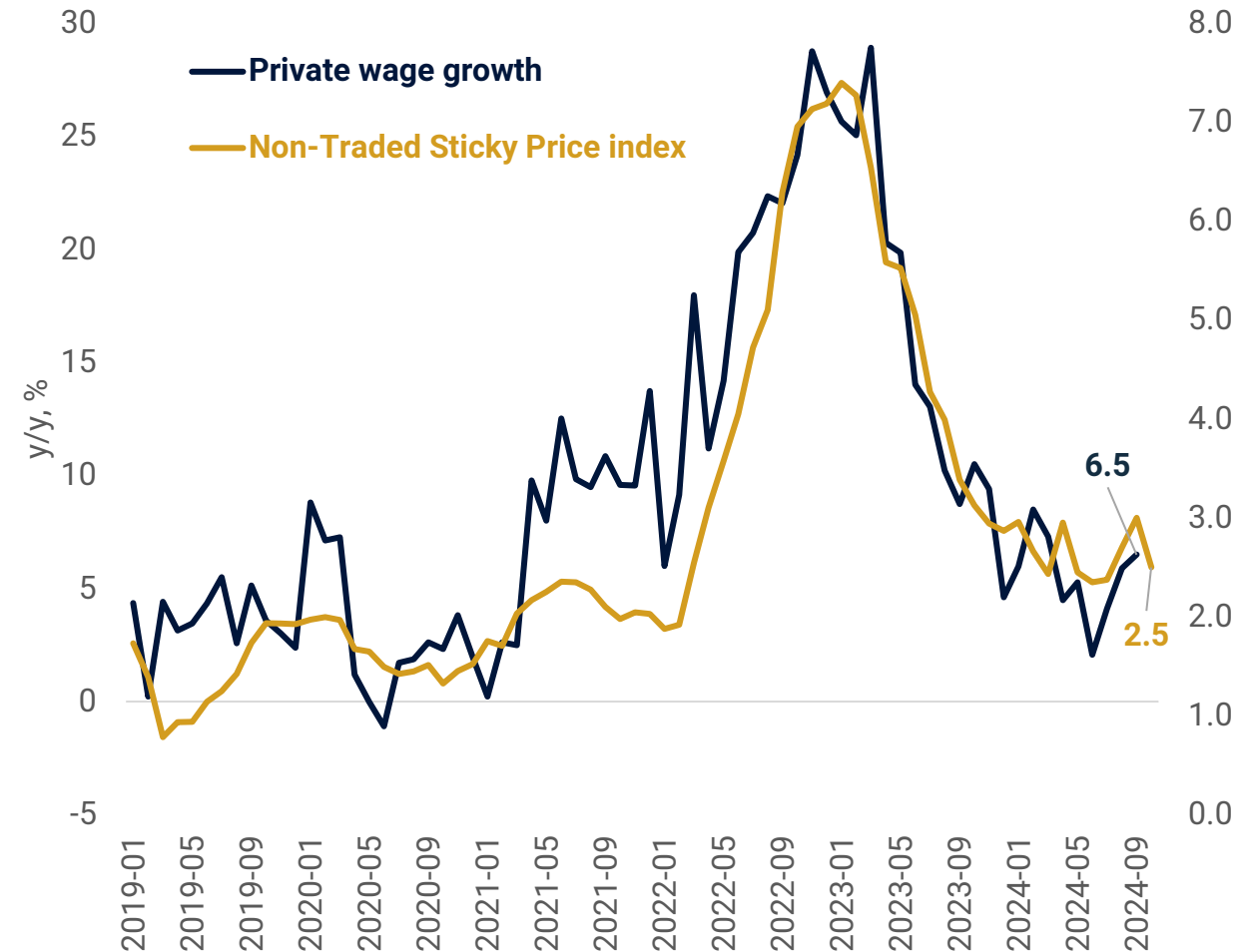
Inflation expectations continue to decrease...

Inflation expectations according to central bank surveys.



Source: CBA

Non-traded goods price and wage growth, quarter-on-quarter,



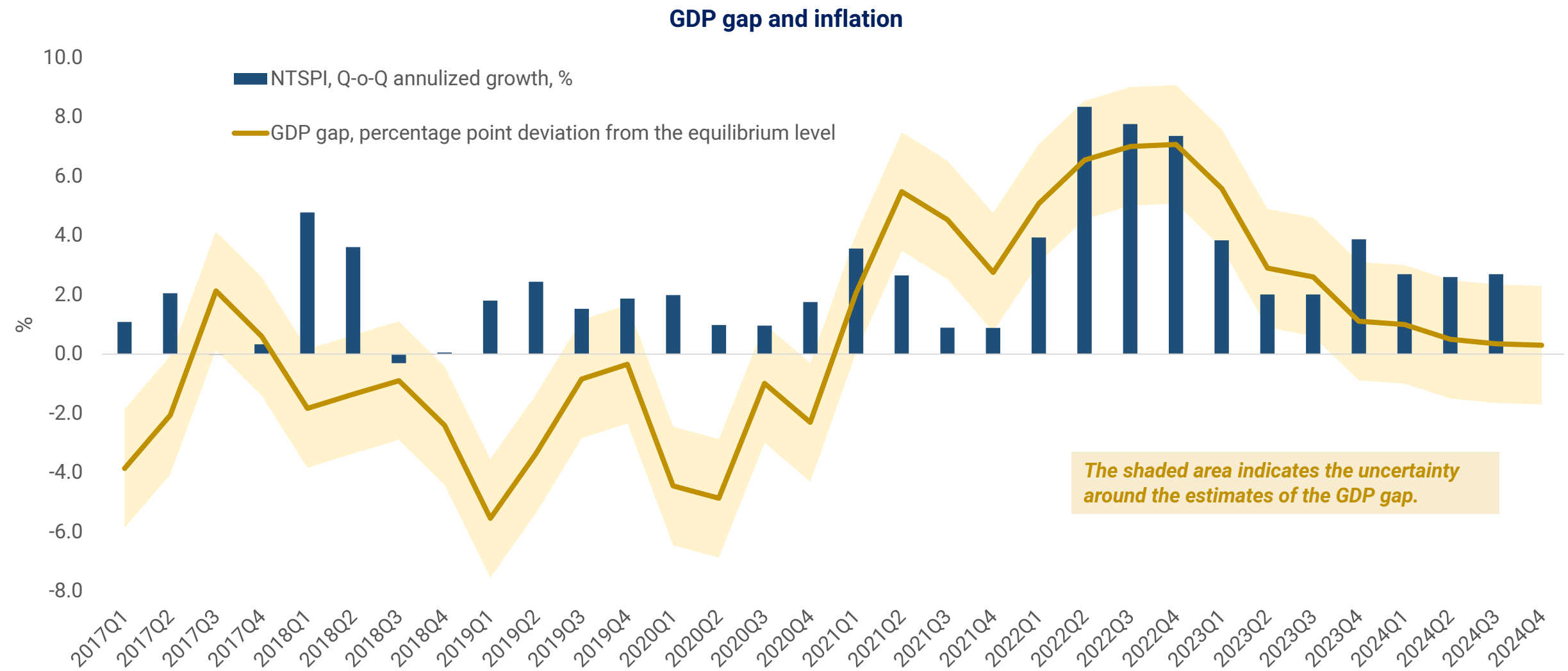
Source: CBA



The cyclical position of the economy

Domestic Economy

The imbalance between supply and demand – the positive GDP gap – has almost been neutralized, but high uncertainty regarding the relative positions of demand and supply persists.

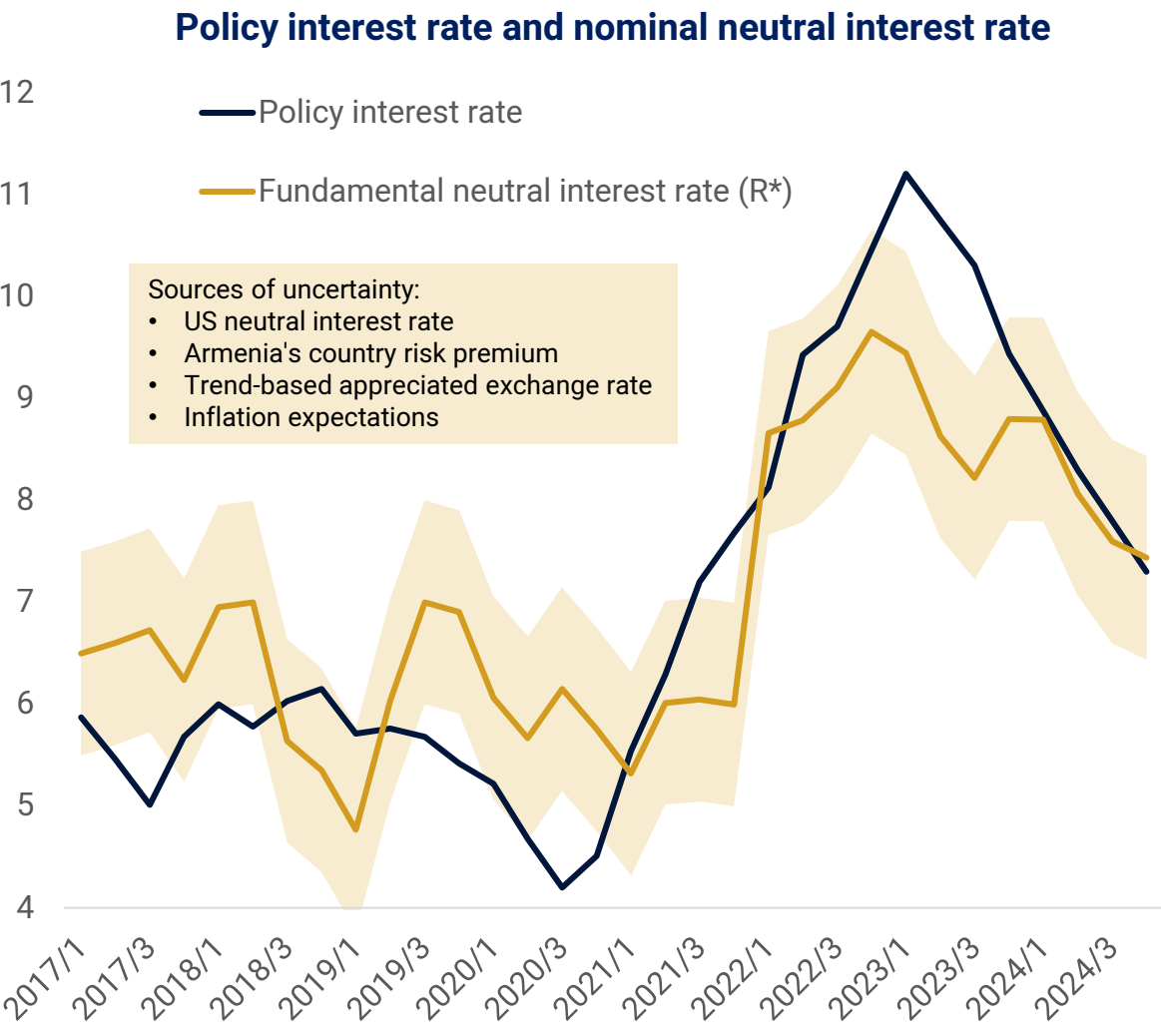


Source: CBA estimates

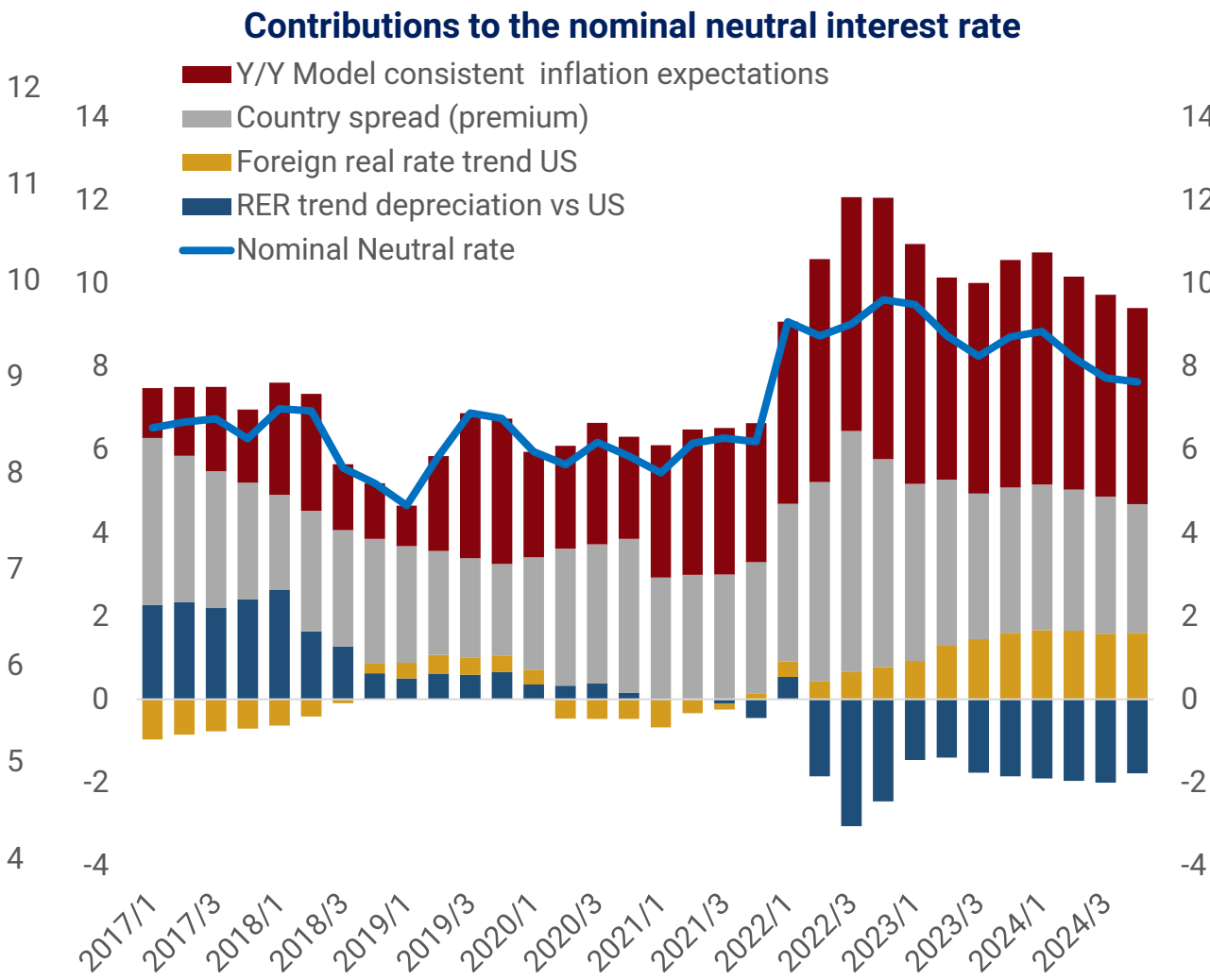
Along with the adjustment of the demand environment and the weakening of sticky inflation, monetary policy has been significantly loosened.

Uncertainties around neutral rate remain.





Source: CBA calculations



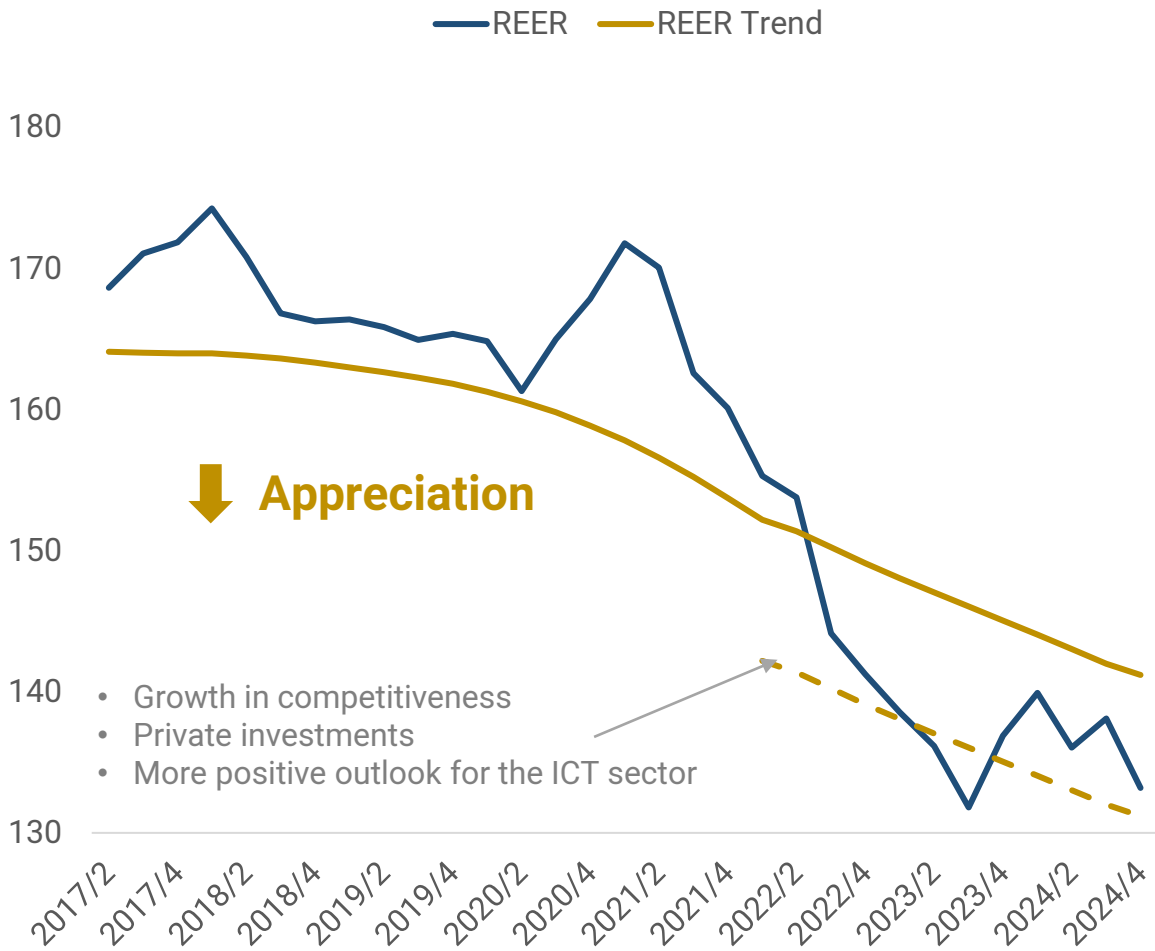
Source: CBA calculations

The real effective exchange rate has appreciated recently, mostly due to the nominal depreciation of some trading partners.

Uncertainty surrounding the trend level of economic activity raises concerns about potential adjustments in aggregate demand.

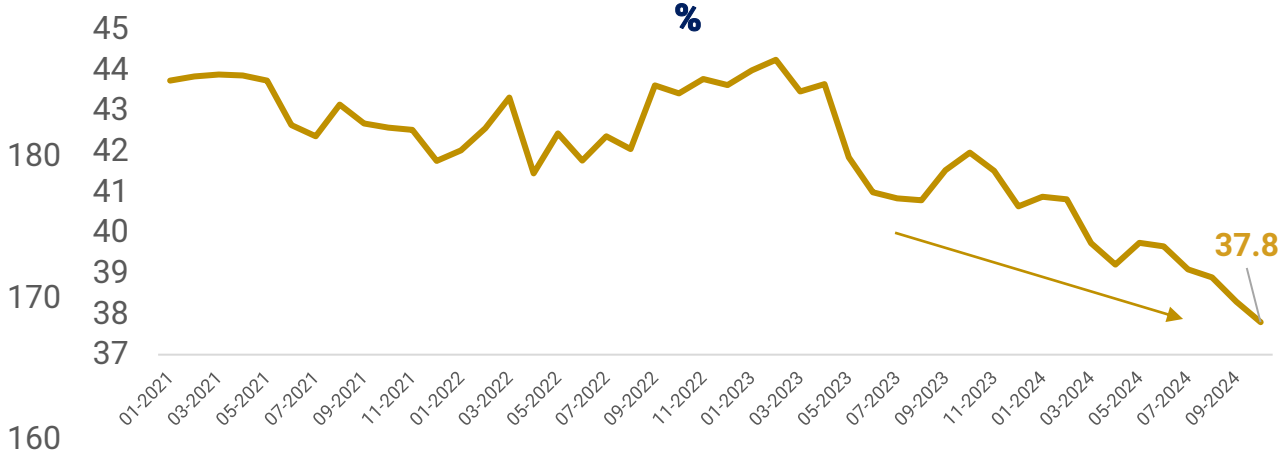


Real effective exchange rate, index

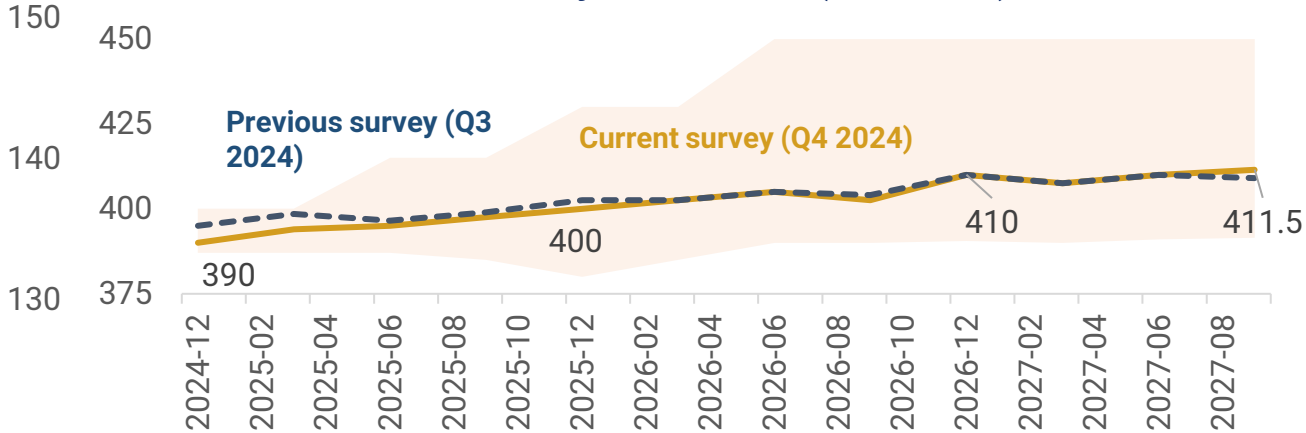


Source: CBA calculations

Dollarization, the share of foreign currency deposits in total deposits, %



Nominal exchange rate expectations according to the Central Bank's macro survey for Q4 2024 (AMD/USD)





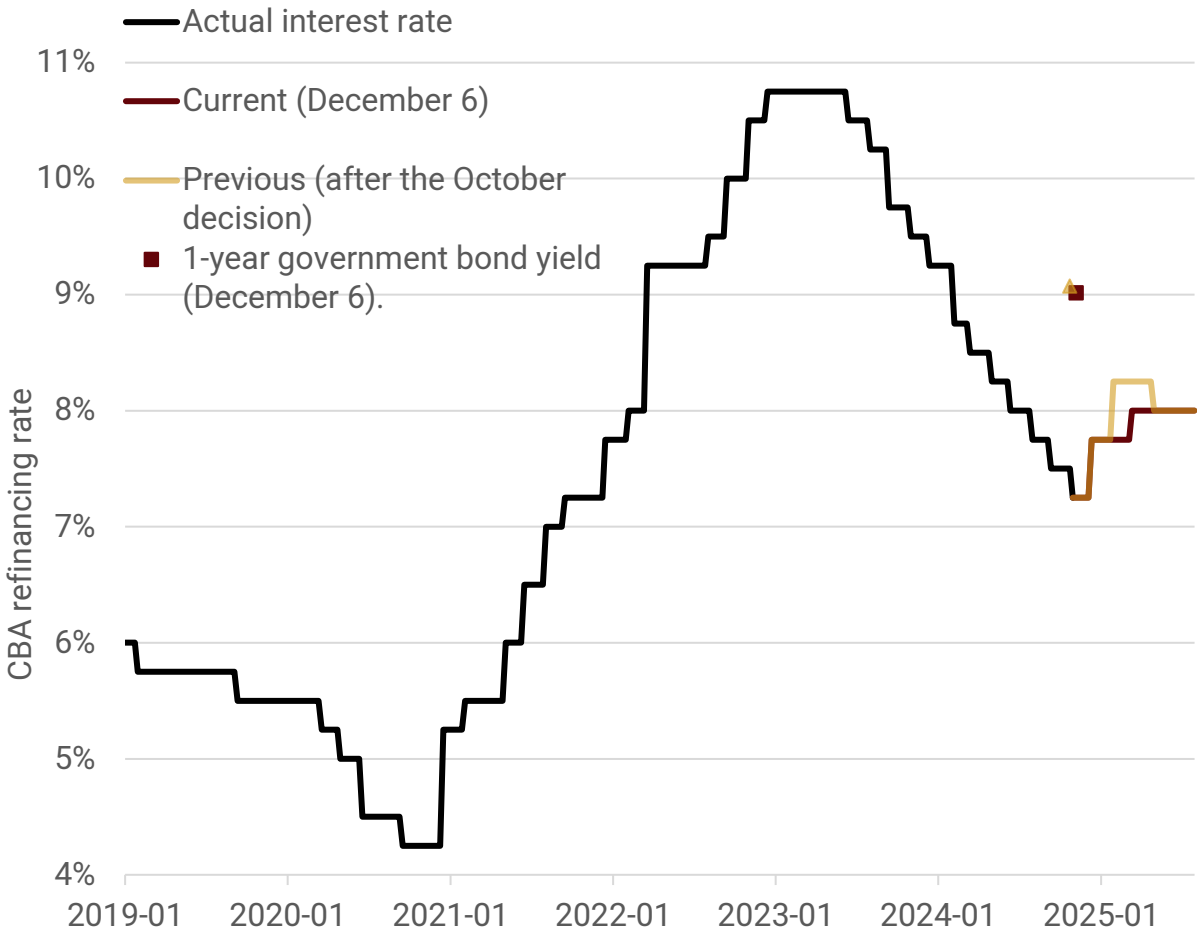
Market Expectations

Change in financial market expectations after October's monetary policy decision.



Analysis of the yield curve:

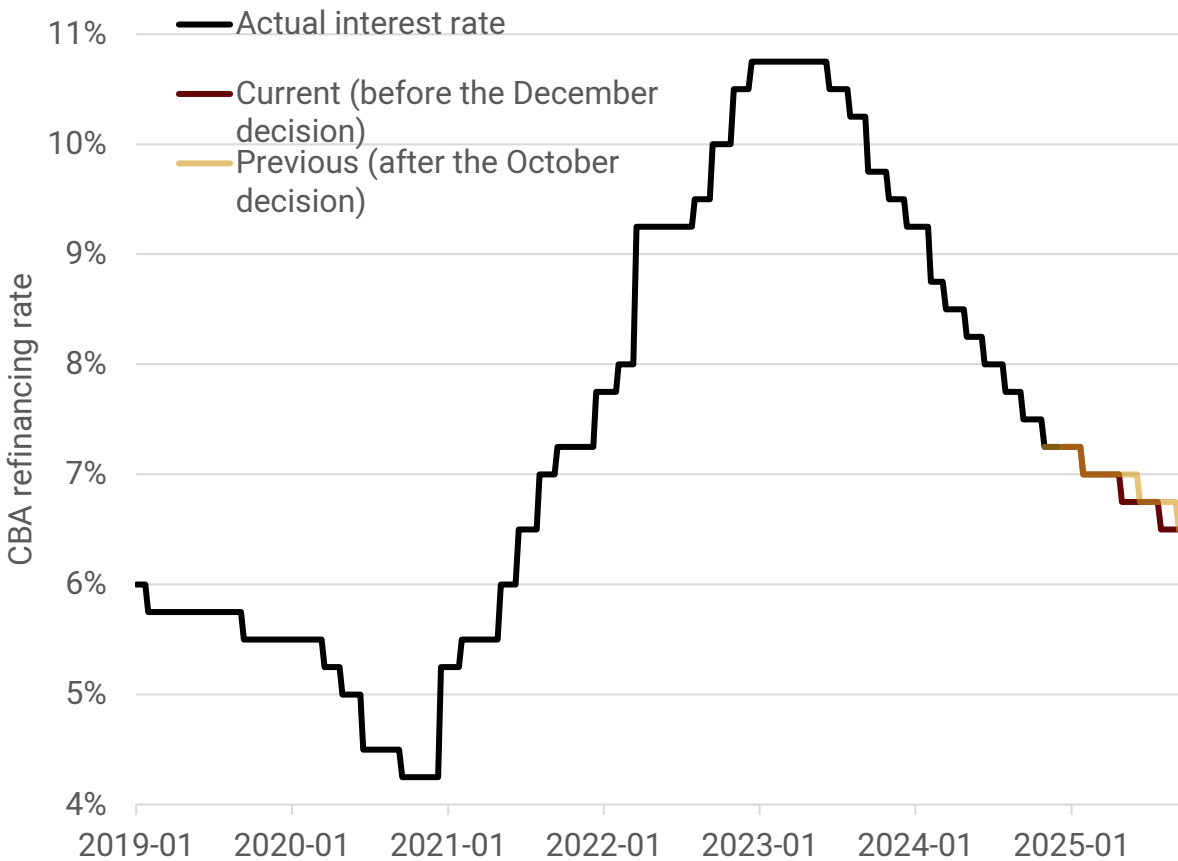
Expectations regarding policy interest rates.



Source: CBA calculations

Survey of market participants:

Expectations regarding policy interest rates.

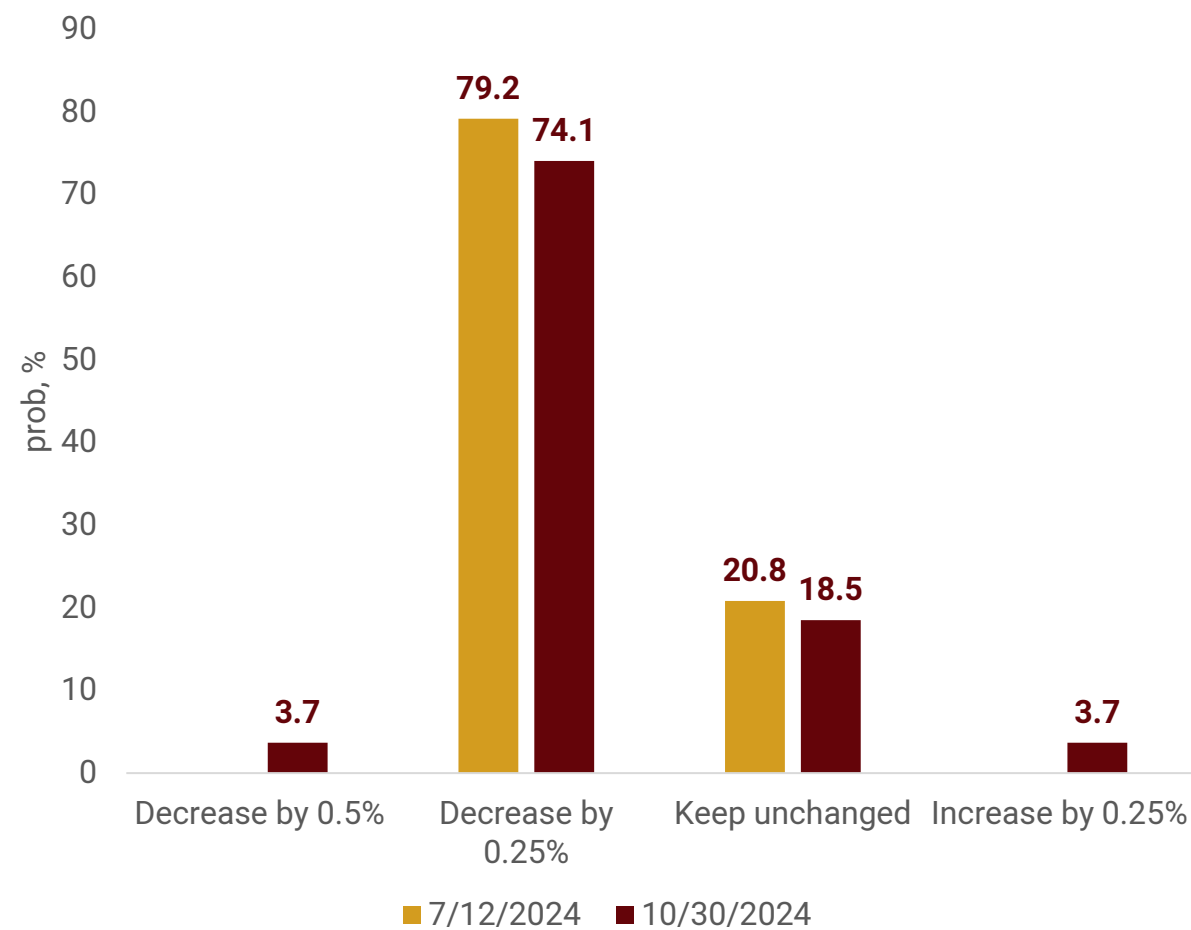


Source: Central Bank of Armenia, Financial Market Survey.

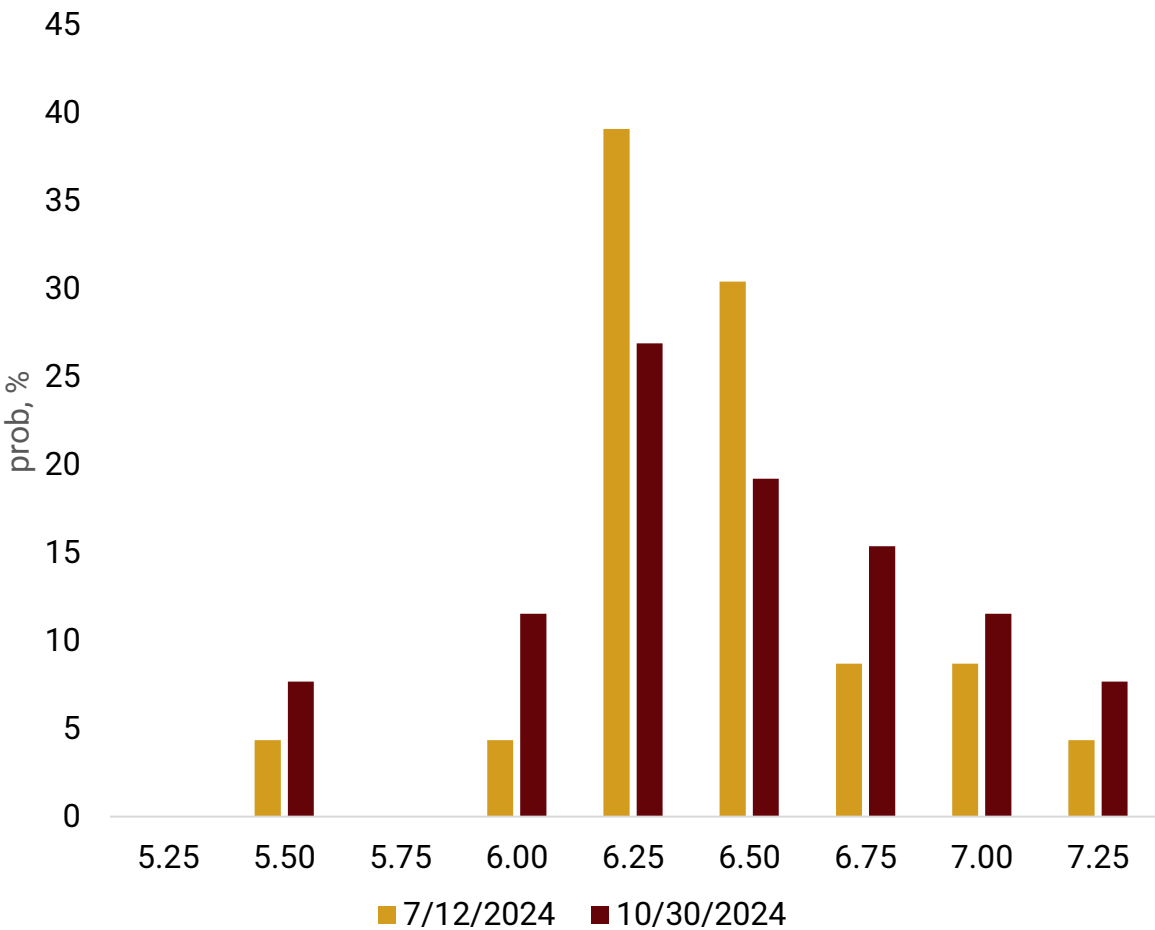
Policy rate Expectations over the next 12 months



Expected change in the policy rate in the upcoming MP meeting.



Expected policy rate in September 2025.

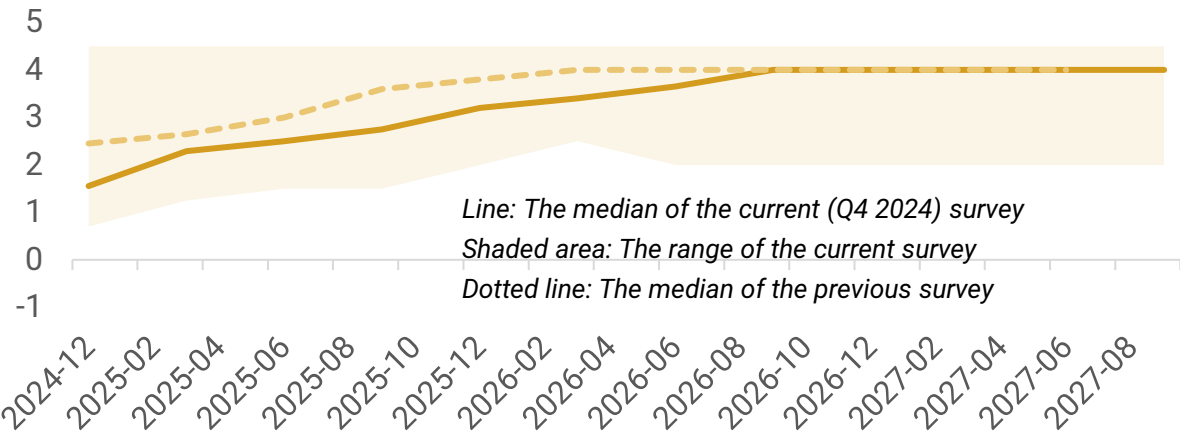


Source: Central Bank of Armenia's Fourth Quarter Macro Survey.

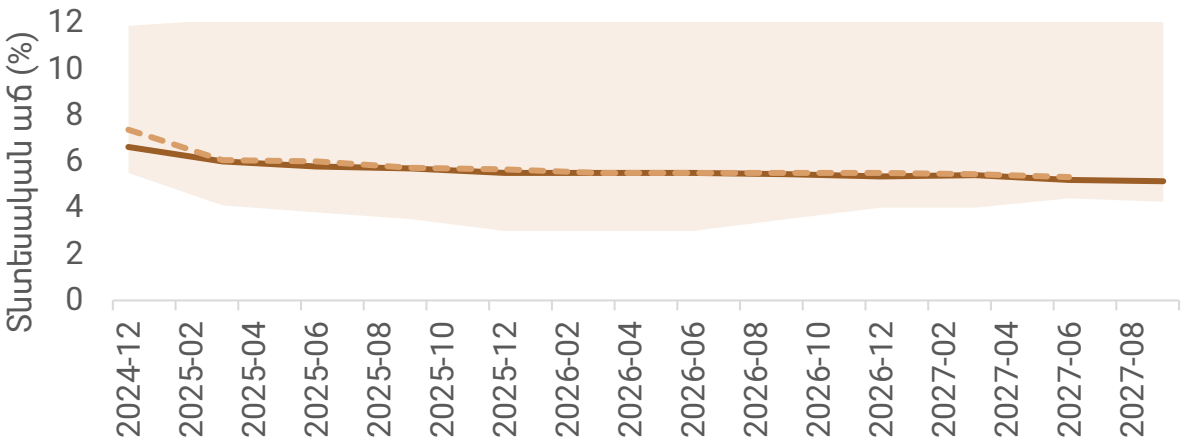
In the context of diminishing expectations of exchange rate depreciation (and an expected trend of appreciation), financial markets expect that slightly lower interest rates will be needed to support the gradual return of inflation to target.



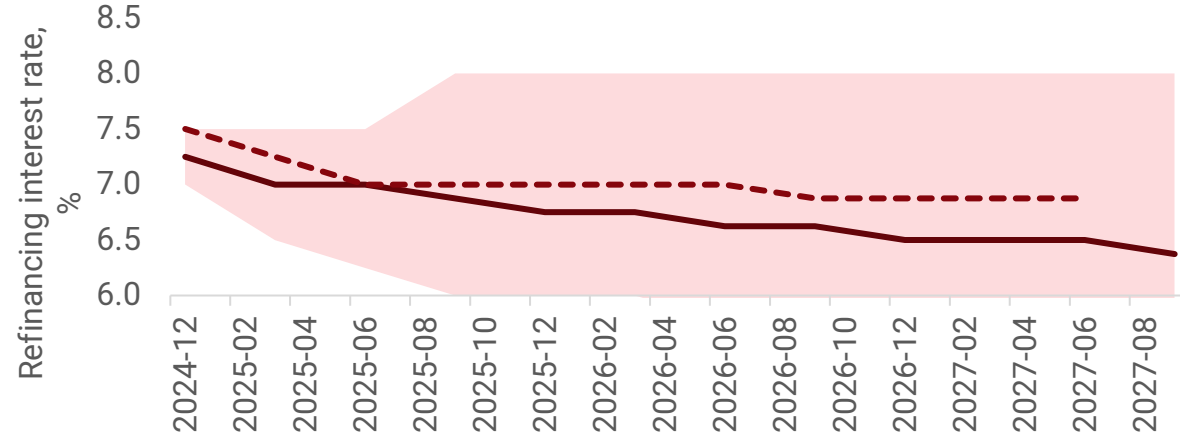
Inflation, YoY, % (Year-over-Year)



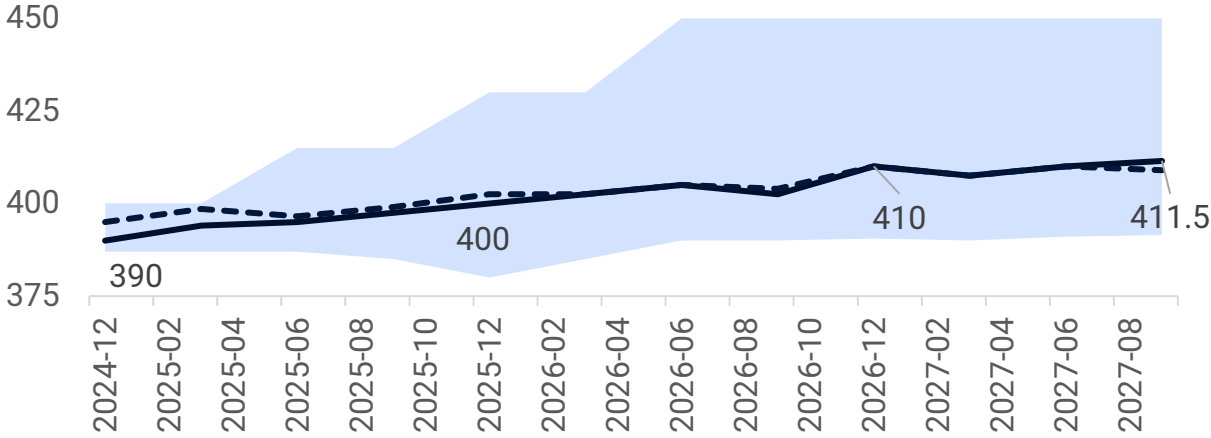
Economic growth, YoY, % (Year-over-Year)



Refinancing interest rate



Nominal exchange rate (1 USD to AMD)



Source: Central Bank of Armenia's Fourth Quarter Macro Survey.



Scenarios

The structure and significance of the table summarizing the variety of scenarios.



The main purpose of the table summarizing the variety of scenarios is to systematically provide an assessment of the key diverse potential risks and uncertainties for the Armenian economy, and describe the possible and likely impacts of these risks on inflation and the economic environment. It may also include a description of the appropriate response of the Central Bank of Armenia's monetary policy in the case of different risks and shocks.

Risks characteristic of Scenario A.	Risks characteristic of Scenario B.
Expansion of demand. Shocks that could lead to a higher growth of aggregate demand relative to aggregate supply, which, in turn, could cause an increase in domestic inflation. In such a situation, ensuring price stability and anchoring inflation expectations might require a relatively tight response in terms of raising interest rates from a monetary policy perspective. Complications: Trust in the Central Bank might be weak. Output + Inflation +	Contraction of demand. Shocks that could lead to weaker aggregate demand relative to aggregate supply, which, in turn, could cause a decrease in domestic inflation. In such a situation, ensuring price stability and anchoring inflation expectations might require a relatively strong response in terms of lowering interest rates from a monetary policy perspective. Complications: The effective lower bound for interest rates, a low inflation or deflationary environment. Output - Inflation -
Contraction of supply. Stagflationary shocks that may require a tough and aggressive response in the direction of raising the expected policy interest rate path, resulting in a significant short-term trade-off between inflation, economic growth, or other objectives (e.g., unemployment). Complications: Issues related to further restraining a weak economy. Output - Inflation +	Expansion of supply. Favorable supply-side shocks that could bring inflation back to its target level, lead to higher economic growth, and lower interest rates. Complications: There may be risks when extrapolating current trends onto the future. Output + Inflation -

Taxonomy of scenarios.



Expansion of demand.
Output + | Inflation +

Contraction of supply.
Output - | Inflation +

Contraction of demand.
Output - | Inflation -

Expansion of supply.
Output + | Inflation -

Risks characteristic of Scenario A.	Risks characteristic of Scenario B.
- The revaluation of economic policies in the United States has increased uncertainty regarding the extent of fiscal stimulus, particularly in the medium and long term. In this context, potential reductions in tax rates, combined with higher-than-expected public spending, could significantly increase the debt burden, contributing to a rise in the neutral interest rate in the U.S., thus also affecting the neutral interest rates in emerging economies, including Armenia. - Due to the risks stemming from regional geopolitical conflicts and the potential escalation of border tensions in Armenia, the country's risk premium is adjusting rapidly toward its long-term, fundamental level. This adjustment reflects the unique characteristics of Armenia and the region, including uncertainties surrounding border tensions, regional geopolitical developments, and other factors. In this context, a potential upward adjustment of the country risk premium poses risks related to an upward revision of the neutral interest rate, which, all else being equal, could predominantly result in inflationary pressures given a more accommodative monetary policy stance. - Due to the under-collection of tax revenues and the necessity of implementing social and other expenditures (which do not contribute to internal growth), there is a risk of a significant increase in the debt burden compared to expectations in the medium term, leading to an upward adjustment of the country risk premium toward its fundamental level. - The high economic growth recorded in the domestic economy may reflect higher levels of productivity, an increase in the marginal cost of capital and a rise in the neutral interest rate. In this case, there are risks of continued acceleration of demand and increased inflationary pressures. - Uncertainties regarding demand conditions in the domestic economy: emerging excess demand conditions. - Long-term above-potential economic growth, primarily driven by domestic demand factors, reflects the risks of sustaining an excess demand environment in Armenia. - Private consumption (and resulting inflationary pressures) could accelerate on the back of accumulated private savings, the continued high growth of consumer loans and income growth driven by positive developments in the tradable sector. - Formation of a more stimulative fiscal policy than expected, posing risks related to the expansion of domestic demand. - Under conditions of persistent uncertainty surrounding inflation (or exchange rate) expectations, various potential shocks could lead to scenarios where these expectations become unanchored in an upward direction.	- Concerns about a weak economic outlook persist in the global economy, especially in the European Union and China, the presence of structural issues and high uncertainties may result in sustained weak domestic demand, potentially leading to a prolonged period of subdued inflationary conditions in international commodity and raw material markets. - While growth in Russia remains at high levels, the more targeted and consistent application of Western sanctions nevertheless pose risks of a sharp slowdown in Russia's economic growth, particularly under tightening economic policies. In this context, these could have negative implications on Armenia, including further slowdowns in inflows of remittances to Armenia as well as general contractionary impacts on external demand for goods and services in the Armenian economy. - The gradual adjustment of the overheated real estate market poses risks to both the growth outlook in the construction sector and real estate prices. A slowdown in the construction sector could have negative spillovers on other sectors of the economy and overall demand, potentially leading to a deceleration in economic activity and domestic demand-driven disinflation. - Slowing wage growth and rising unemployment amid non-widespread and non-inclusive economic growth reflected in highly concentrated income in specific sectors in parallel with relatively muted private consumption and low inflationary environment, drive uncertainty about domestic demand conditions in Armenia and pose risks that a negative demand environment could emerge, with implications for sustained deflationary pressures in the medium term. - Headline inflation remains persistently below the target for a long period, which could lead to a sustained decline in long-term inflation expectations and contribute to restrained consumption patterns. - Risks of additional demand restraint by fiscal policy. - Additional restraint on demand, along with possible tax administration tightening, legislative changes and other measures needed to improve the tax-to-GDP ratio and finance the budget deficit in the future. - Enhanced tax revenue collection in the face of relative increase of capital expenditures share in the total government expenditure could result in fiscal policy having much more restrictive impacts on aggregate demand. - In recent years, due to the inflow of capital and highly productive labor, significant uncertainties exist regarding productivity, long-term potential growth, the degree of real effective exchange rate appreciation, and the medium-term stability and trends of the capital flows that underpin these factors. This could contribute to the formation and maintenance of lower neutral interest rates in Armenia.
Risks associated with disruptions in global supply chains. - The potential for further escalation and worsening of regional conflicts (Middle East, Russia-Ukraine conflict) creates risk in terms of disrupting global supply chains (including oil and food) that can feed through to higher global inflation. This could result in, on the one hand, a tighter-than-expected policy stance in advanced economies, and on the other hand, higher prices being transmitted to the domestic economy through the imported goods channel. - In the context of tightened trade policies among major economies and with the rest of the world, disruptions in production chains are likely to lead to increased production costs and global inflationary pressures in the short to medium term. - External trade-driven growth contributes to the sustained appreciation pressure on the dram. Due to the ongoing and increasingly targeted sanctions against the Russian Federation and third countries, along with a sharp slowdown in economic growth could generate inflationary risks stemming from the potential for significant financial outflows and increased volatility in financial markets.	- Due to the gradual narrowing of the wage gap between Armenia and Russia (particularly following the recent depreciation of the ruble) and heightened uncertainty regarding Russia's medium-term growth prospects, there is an expectation of reduced seasonal migration from Armenia to Russia. This could lead to an excess supply of labor in Armenia, which would likely reduce wage growth and significantly ease inflationary pressures. - Due to periodic disruptions in regional export logistics routes and subsequent trade flows, particularly for seasonal food products, there is an increased risk of an excess supply of these products, which may lead to downward price pressures. Specifically, the seasonal supply of food products, driven by the expansion of greenhouse farming, may result in higher overall production, potentially coupled with difficulties in exporting agricultural goods. - In the case of significant tightening of external trade policies by the US, medium-term global economic conditions may see an excess supply of goods and services (such as freight services) from several leading economies, posing deflationary risks for smaller economies.



Illustrative Case A

Emerging excess demand conditions

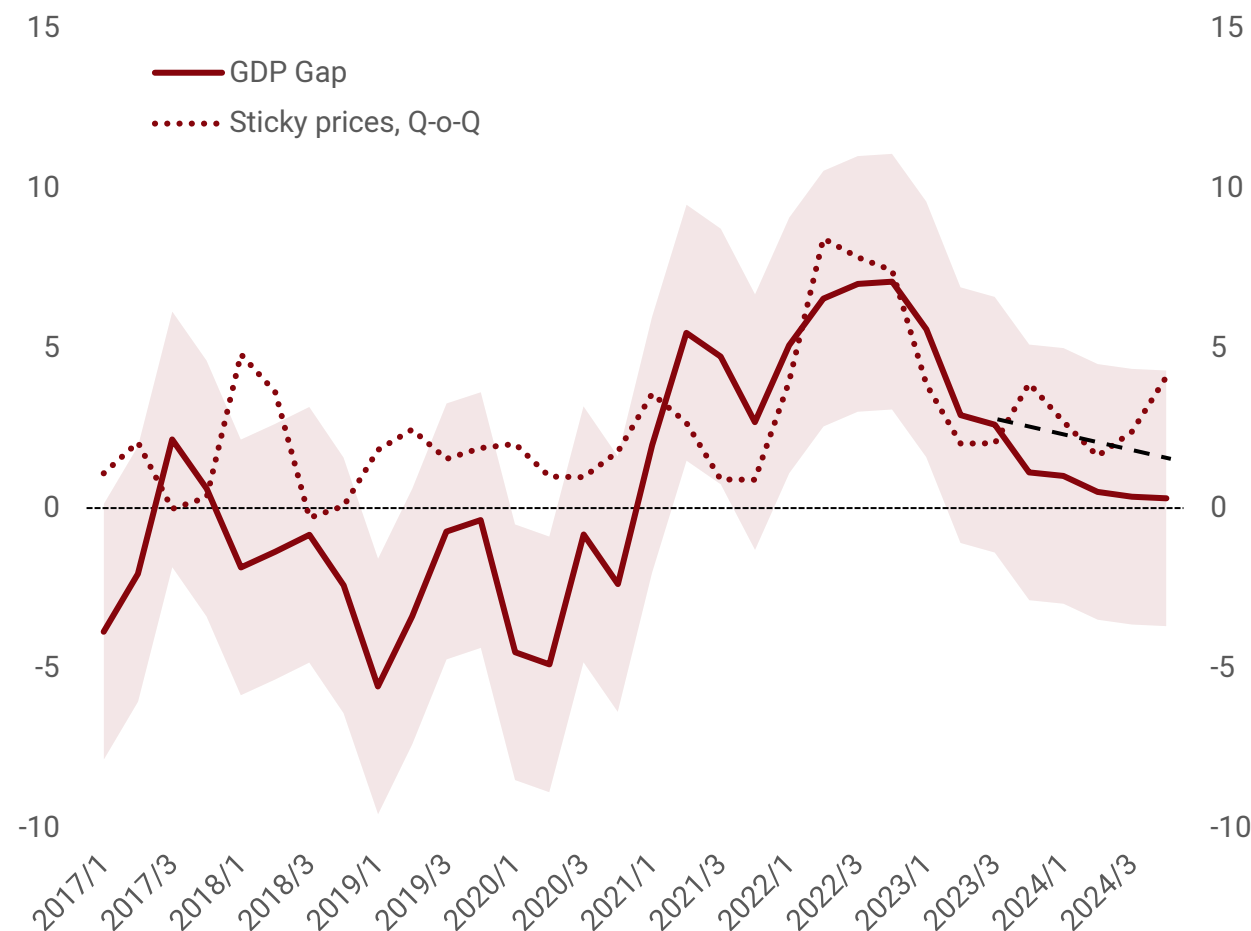
Illustrative Case A.



Uncertainties regarding demand conditions in the domestic economy: emerging excess demand conditions

- Long-term above-potential economic growth, primarily driven by domestic demand factors, reflects the risks of sustaining an excess demand environment in Armenia.
- Private consumption (and resulting inflationary pressures) could accelerate on the back of accumulated private savings, the continued high growth of consumer loans and income growth driven by positive developments in the tradable sector.
- Formation of a more stimulative fiscal policy than expected, posing risks related to the expansion of domestic demand.

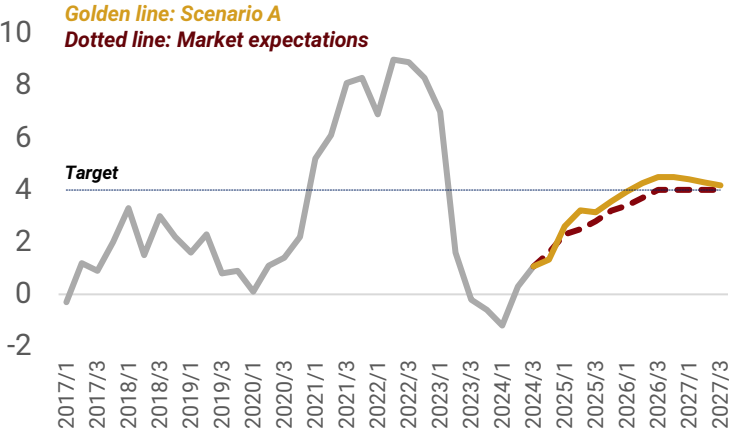
GDP gap and sticky prices



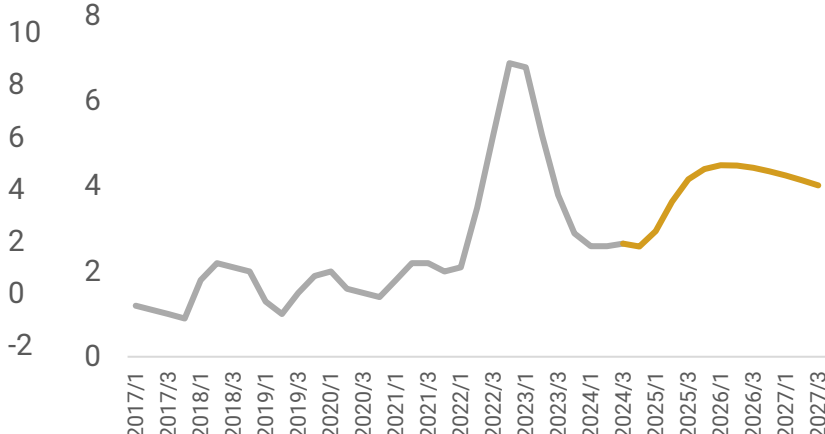
Case A. Uncertainties regarding demand conditions in the domestic economy: emerging strong demand conditions.



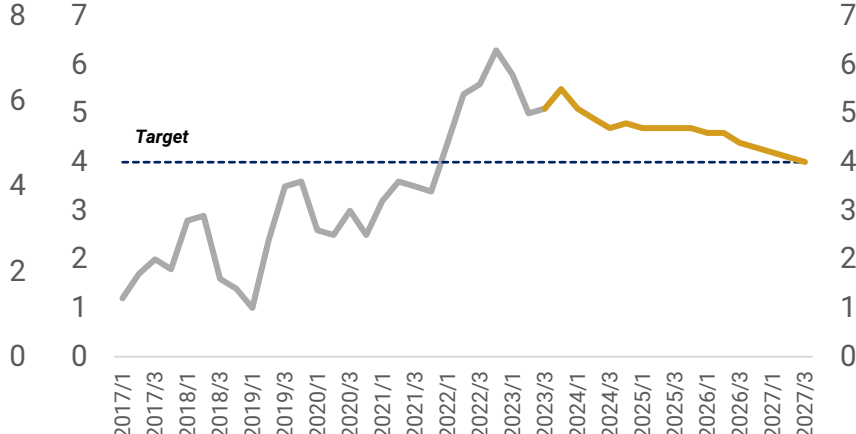
Inflation, Y-o-Y



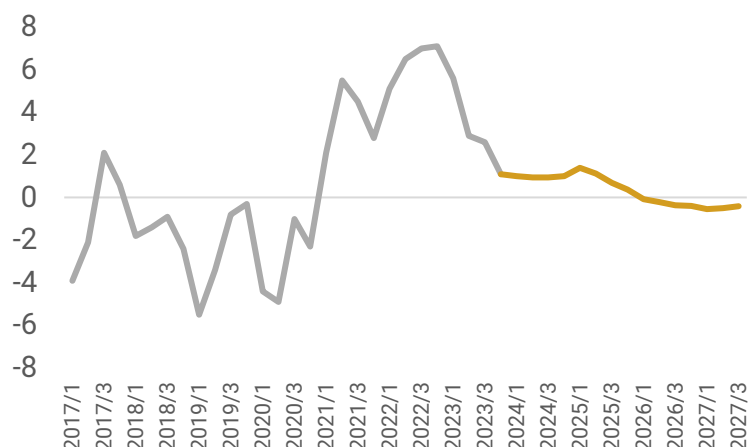
NTSP, Y-o-Y



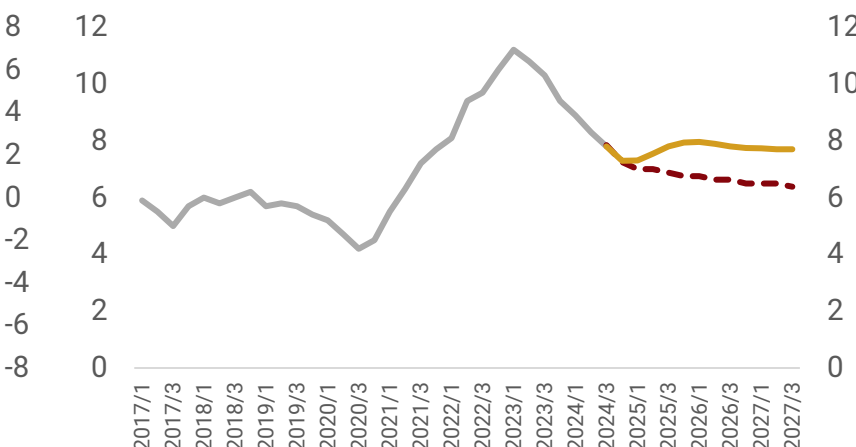
Inflation Expectations, Y-o-Y



Output Gap



Interest rate



Source: CBA calculations



Illustrative Case B

Real Estate Market Adjustment: Potential Spillovers on Construction, Prices, and Domestic Demand.

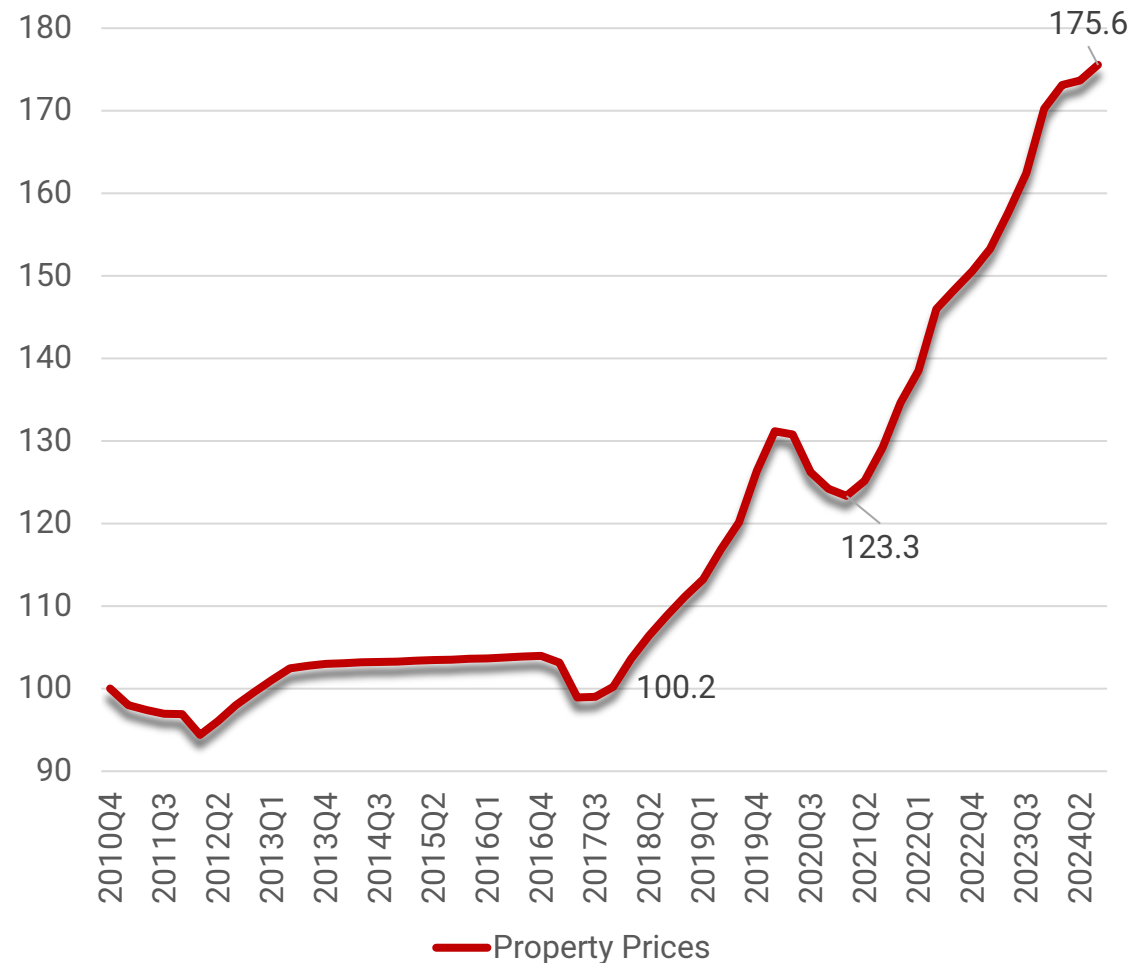
Illustrative Case B.



Real Estate Market Adjustment: Potential Spillovers on Construction, Prices, and Domestic Demand

- Fluctuations in real estate prices have a significant impact on economic activity.
 - Expenditures on real estate,
 - Wealth effect,
 - Balance sheet effect.
- ❑ In Armenia, in recent years, due to the scarcity of alternative investment assets, high income growth, and especially the substantial subsidization of mortgage interest rates, high demand for real estate (preference shock?) and significant price increases were observed.
- ❑ As a result of the significant price increases, the supply in the real estate market has notably grown (initially, naturally lagging behind the demand increase), and in the case of a potential weakening of demand, excess supply could be formed. In this case, for the new market equilibrium to form, real estate prices would decrease, leading to significant negative effects on the overall economy.

Increase in real estate prices in Yerevan.

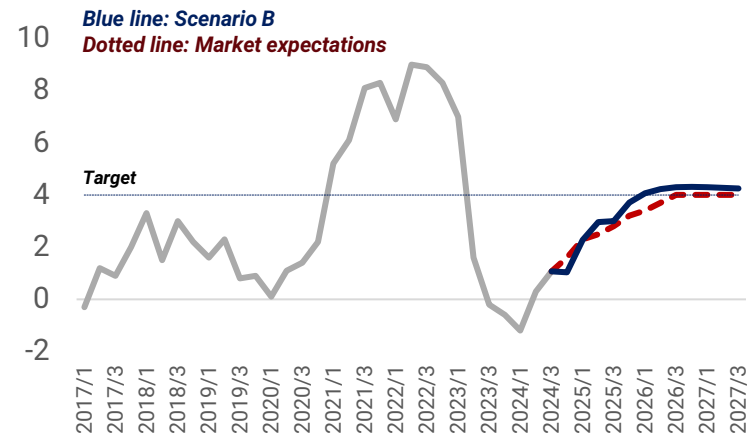


Source: Armenian Real Estate Cadastre Committee, Central Bank calculations.

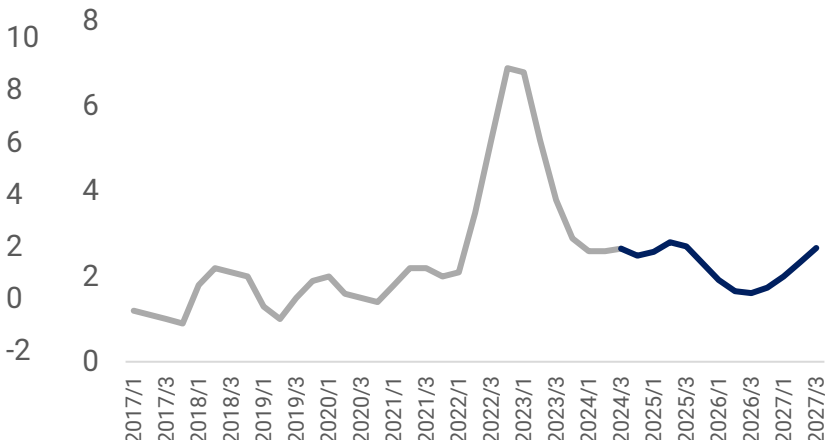
Case B. Real Estate Market Adjustment: Potential Spillovers on Construction, Prices, and Domestic Demand



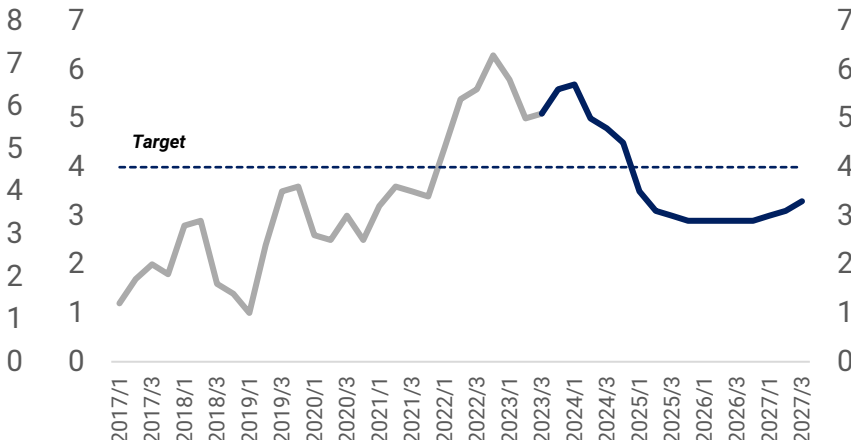
Inflation, Y-o-Y



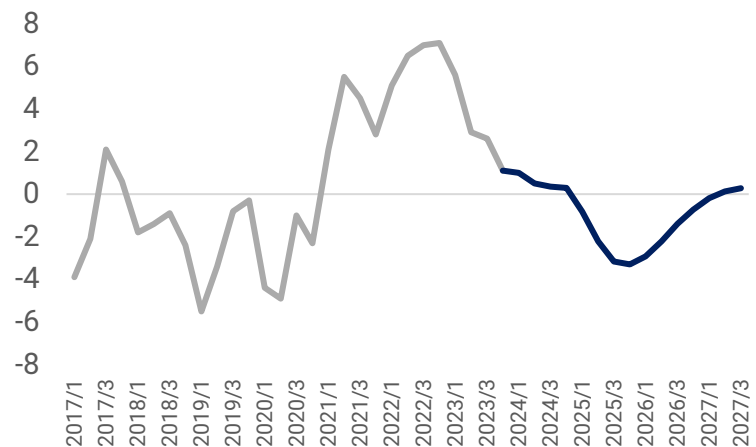
NTSPI, Y-o-Y



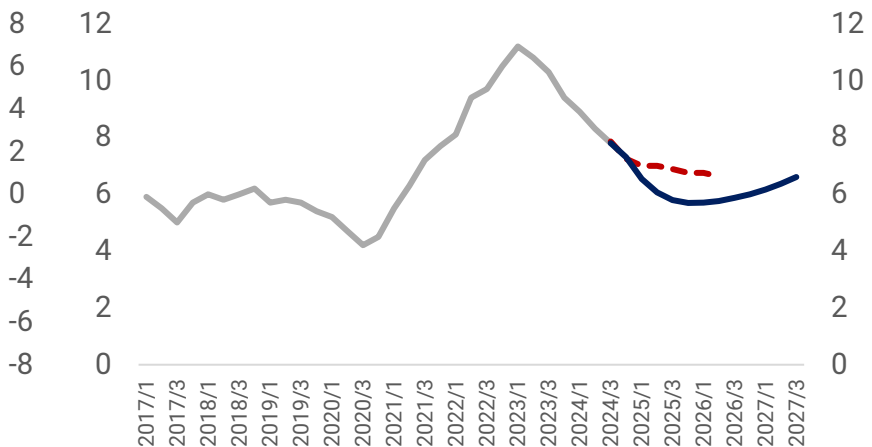
Inflation expectations, Y-o-Y



GDP Gap



Interest Rate



Source: CBA calculations

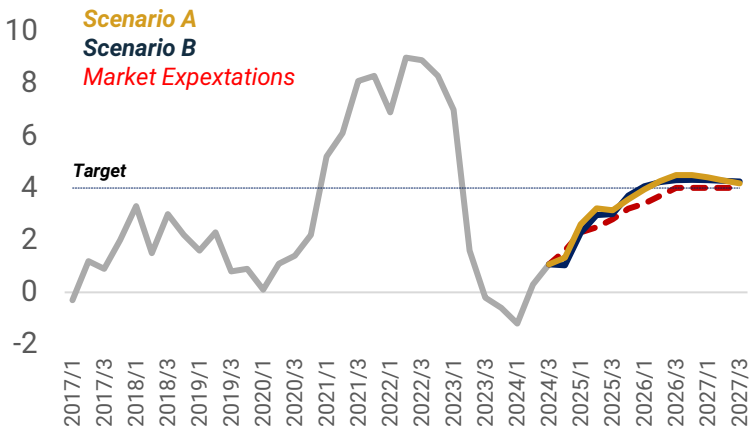


Policy Discussion

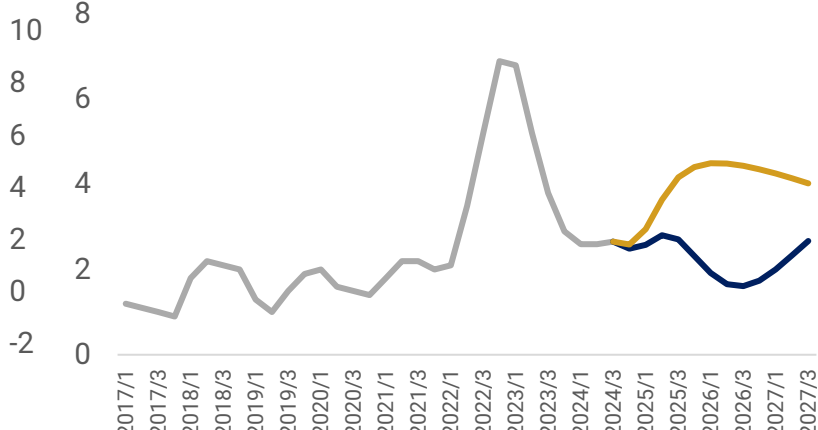
Summary: Case A and B



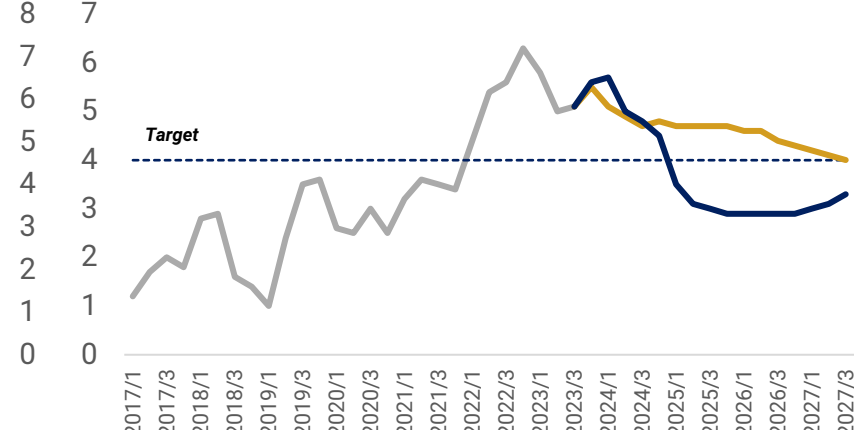
Inflation, Y-o-Y



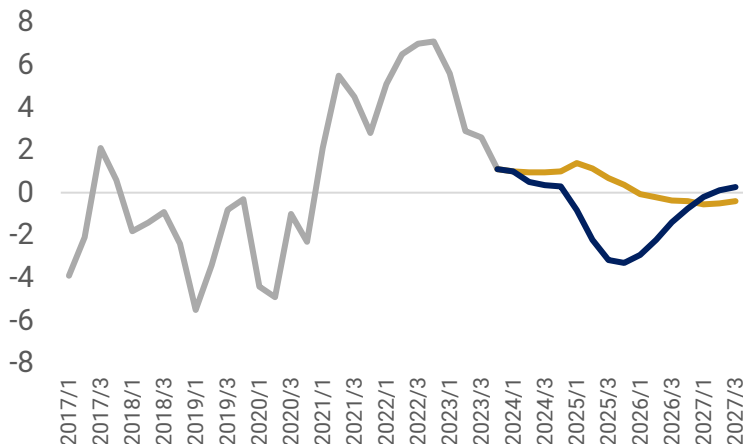
NTSPI, Y-o-Y



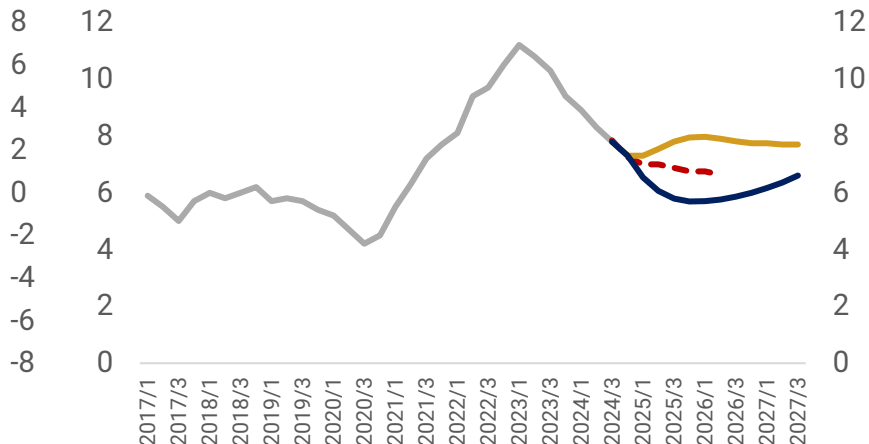
Inflation expectation, Y-o-Y



GDP gap



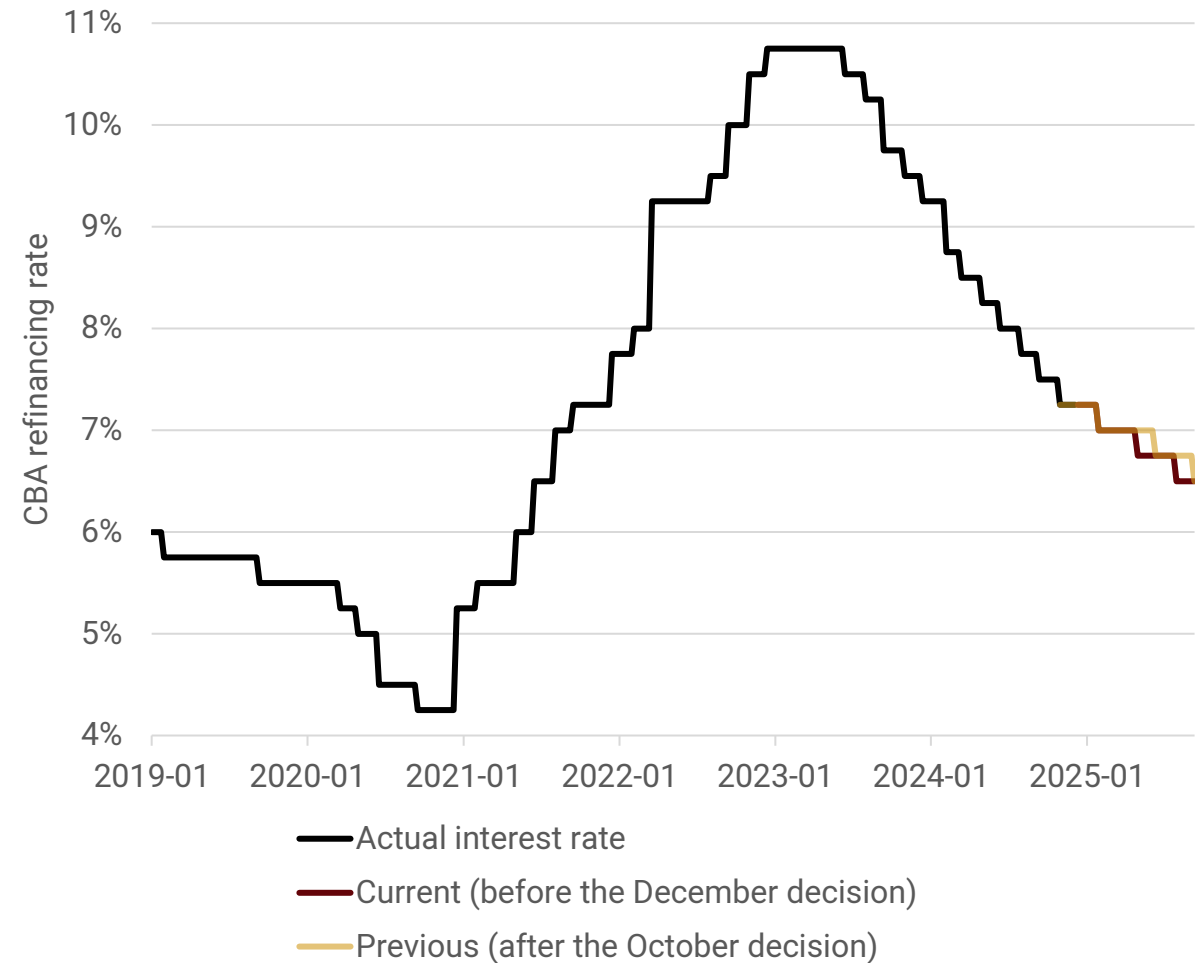
Interest rate



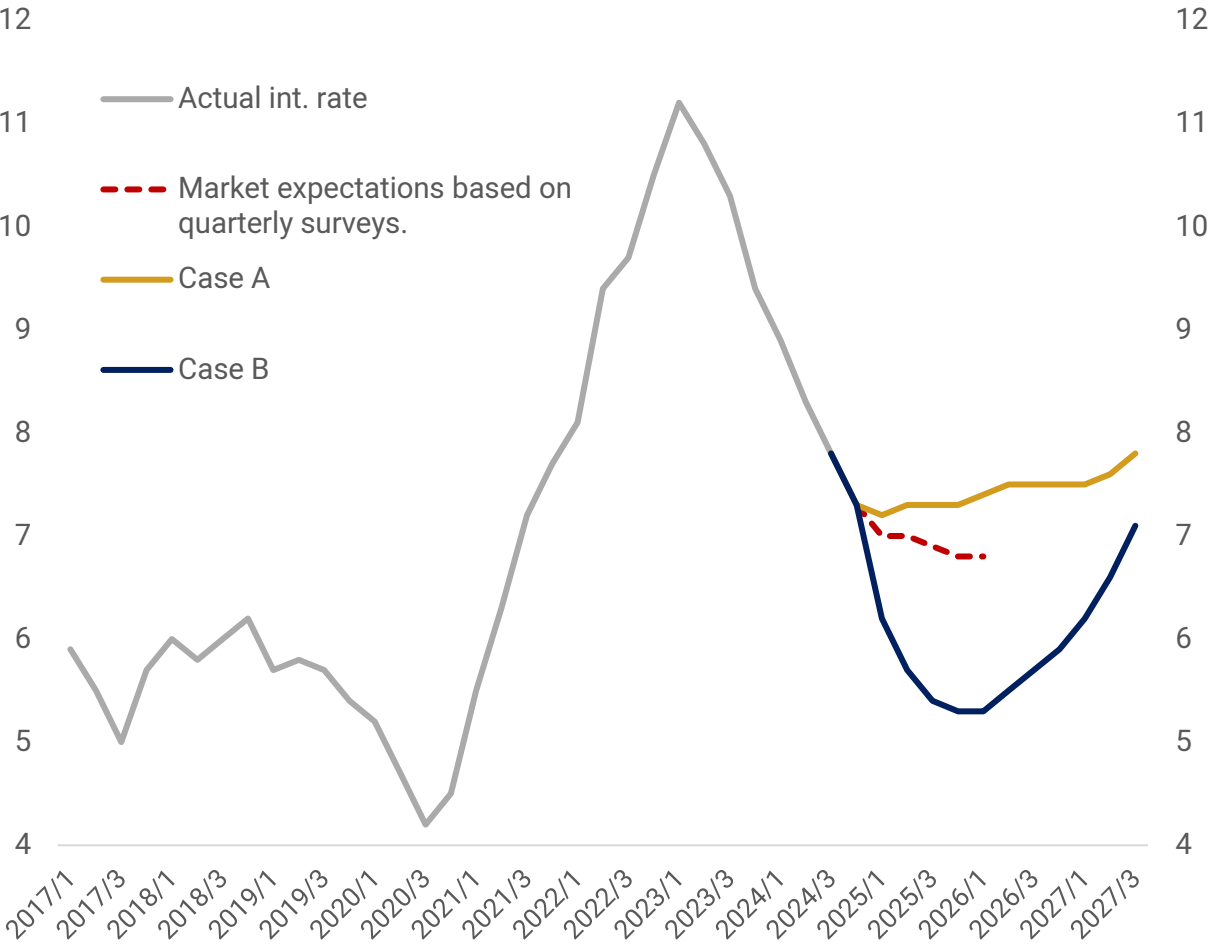
Source: CBA calculations



Policy rate expectations, financial market participants survey.



Illustrative Scenarios– 2024 Q4



Source; CBA



Thank You