



Monetary Policy Outlook

Interim Decision
February 4, 2025



Central Bank
of Armenia

Taxonomy of Scenarios

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.
❑ Uncertainties regarding Armenia's Neutral Interest Rate and Its Components - 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. ❑ Scenarios of Armenia's Country Risk Premium Rapid Adjustment: 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. ❑ Scenario of an Upward Adjustment in Armenia's Fundamental Country Risk Premium Level: 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 return on 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 strong demand environment . - 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 expansionary 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.	❑ Risks Related to the Weakening of External Demand. - 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. - The more targeted and consistent application of Western sanctions against the Russian Federation pose risks of a sharp slowdown in Russia's economic growth, particularly under tightening economic policies. ❑ Risks Related to Negative Macroeconomic Impacts Amid Real Estate Market Adjustment: The gradual weakening (adjustment) in construction sector output and real estate prices may lead to the formation and deepening of a weak demand environment in the economy. ❑ 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 downward adjustment in inflation expectations, postponement of demand, and the emergence of a deflationary spiral. ❑ Uncertainty Regarding the Fiscal Policy Stance: In the event of higher-than-expected tax revenues alongside a stronger increase in expenditures on investments that do not contribute to demand growth (such as capital goods purchases), fiscal policy could have a significantly restrictive impact on aggregate demand. ❑ Uncertainties regarding Armenia's Neutral Interest Rate and Its Components. 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 global supply chains disruptions. - 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. ❑ Due to the ongoing and increasingly targeted sanctions against the Russian Federation and third countries, a sharp slowdown in trade-related flows in Armenia, with corresponding macroeconomic implications.	❑ Risks Related to the Growth of Labor Supply in Armenia. 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. ❑ 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. ❑ Tightening of trade policies among major global economies in the medium-term horizon, leading to excess supply of goods and services in international markets and the emergence of deflationary scenarios.

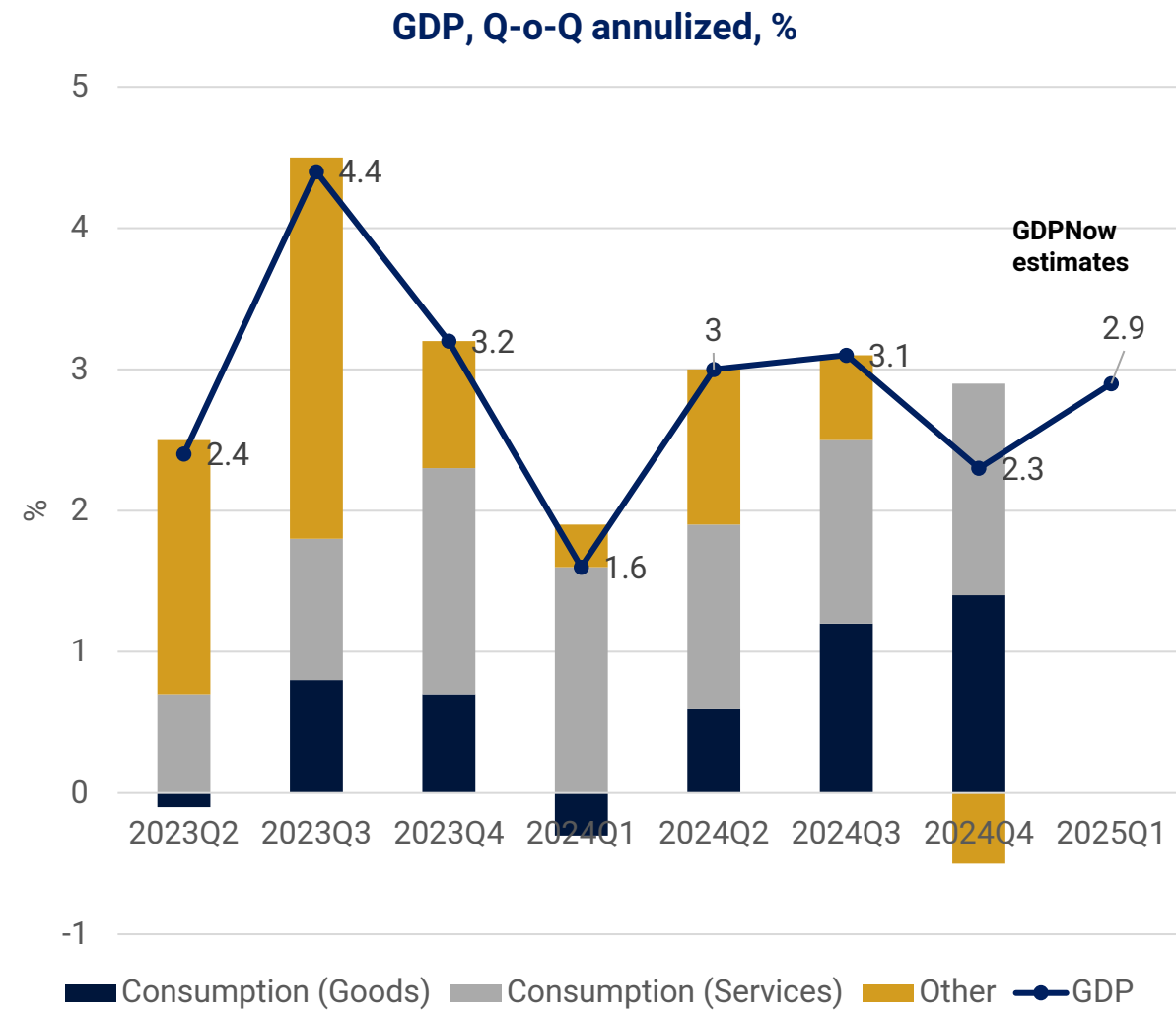


Current and Fundamental Economic Factors

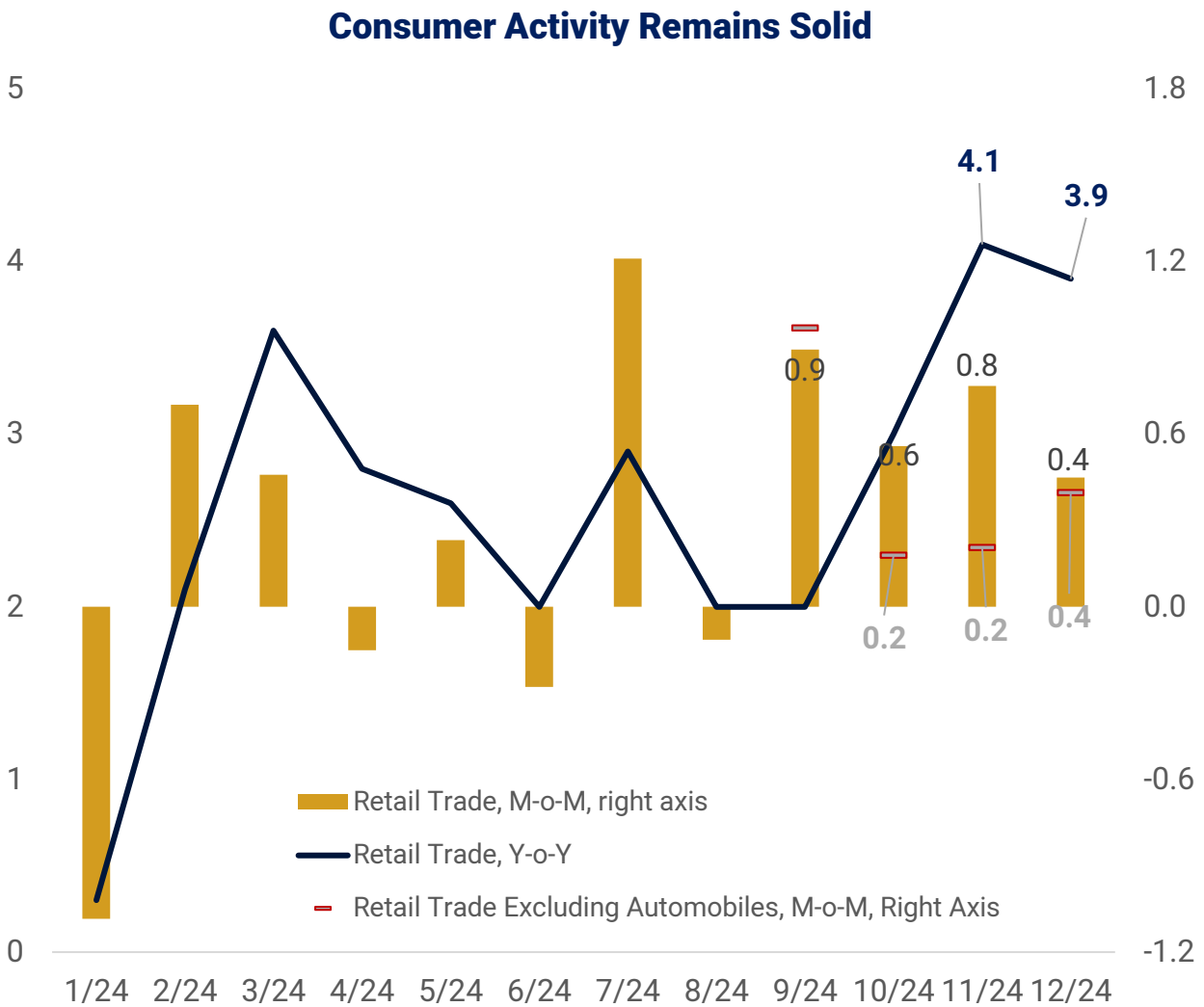
Global Economic Developments

USA: Consumption in the U.S. Continues to Grow at a Rapid Pace, Supporting Economic Activity.

High Uncertainty Surrounding U.S. Economic Fundamentals Persists.



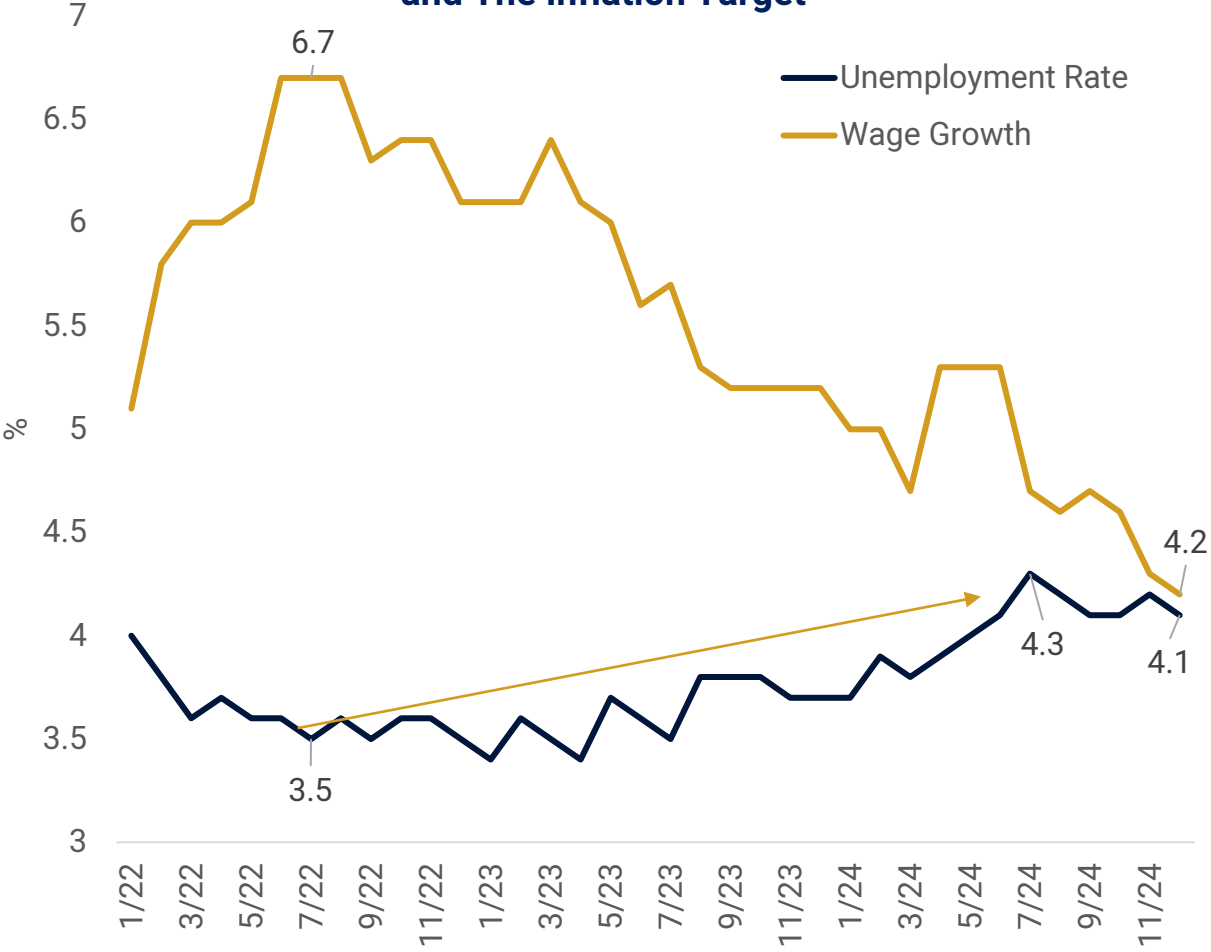
Source: Bureau of Economic Analysis (BEA), Atlanta Fed



Source: US Census Bureau, FED

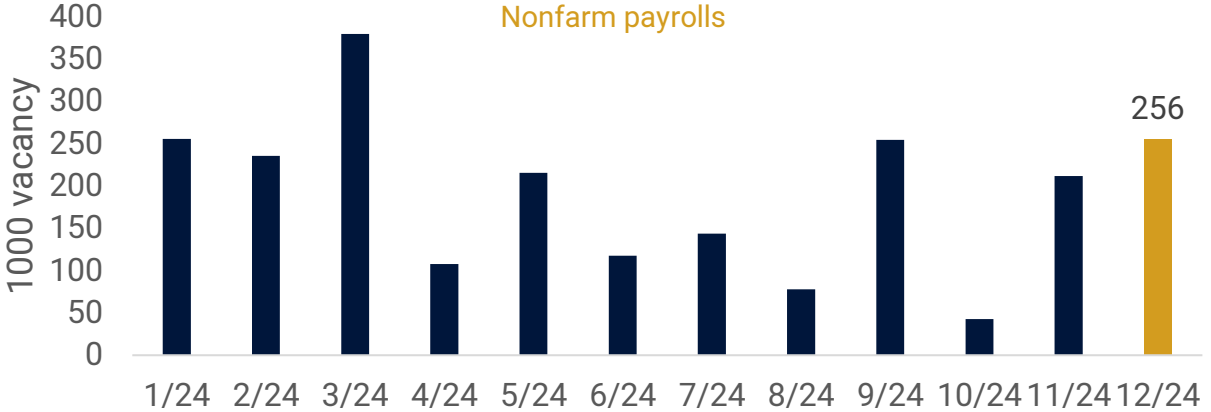
USA: Despite a Significant Improvement in the Balance Between Labor Supply and Demand Over the Past Year, Inflationary Risks from the Labor Market Persist.

Wage Growth Remains Above Levels Aligned with Productivity Gains and The Inflation Target

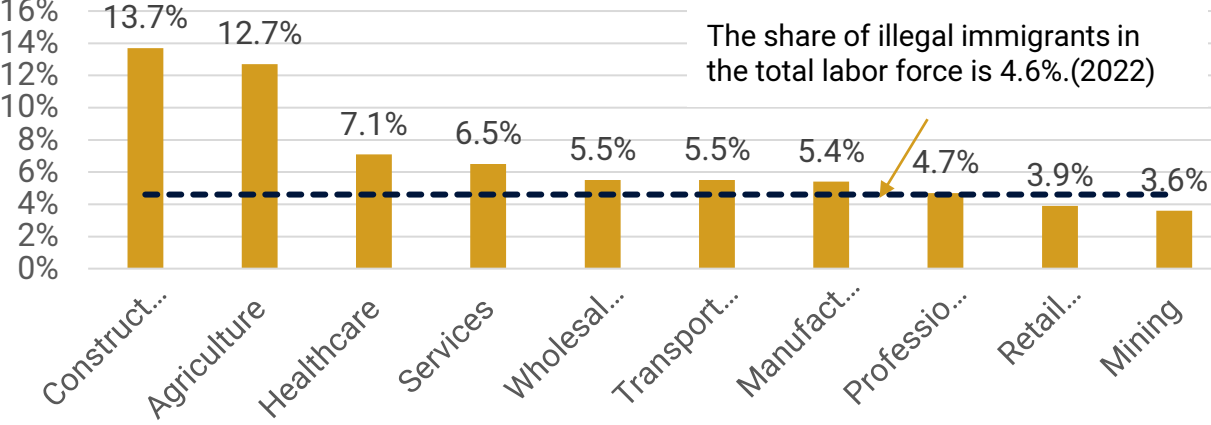


Source: Bureau of Economic Analysis (BEA), Atlanta Fed

In Recent months, more jobs are created in the real economy



A potentially stricter migration policy could exert significant pressure on already tight labor market.

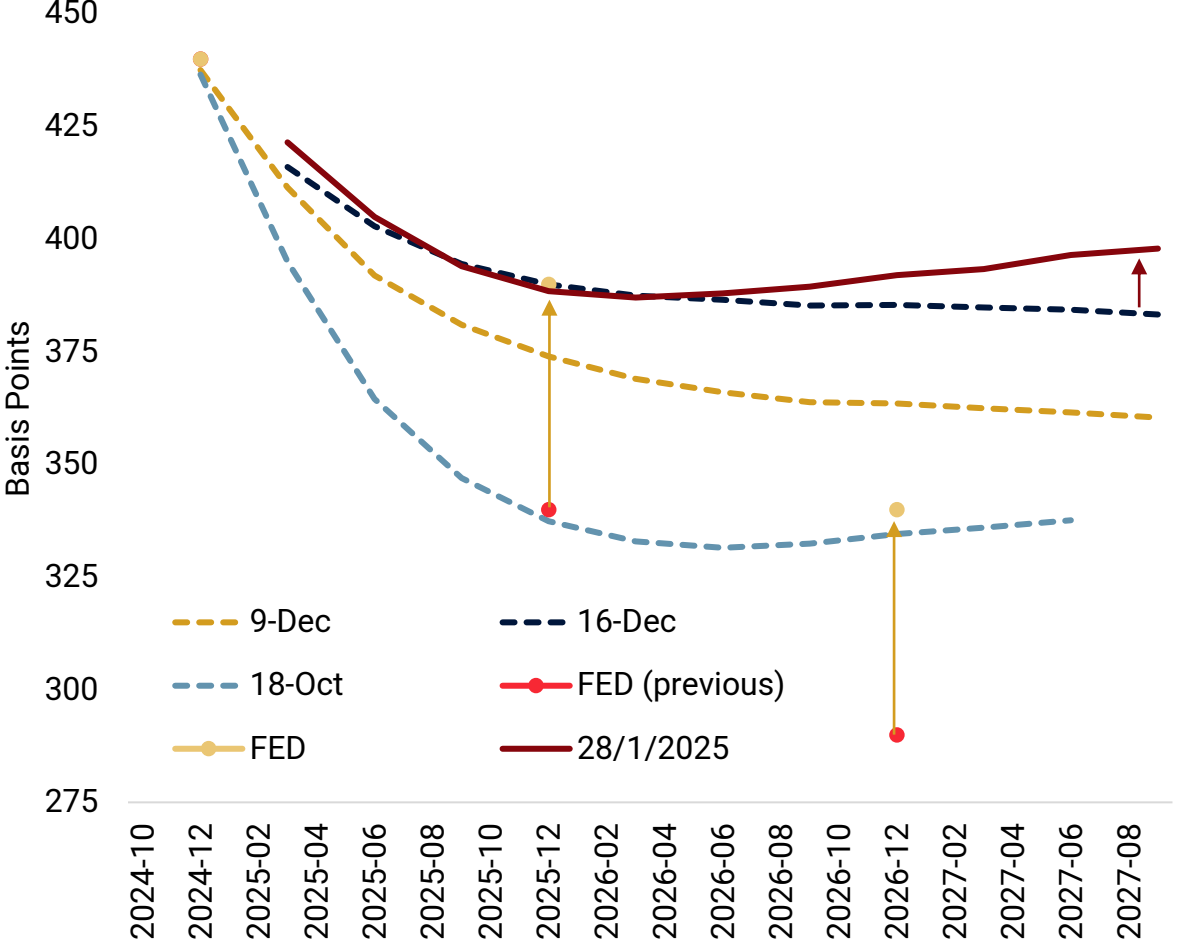


Source: AMC

USA: Market participants' expectations regarding the policy rate trajectory have risen significantly in recent periods.

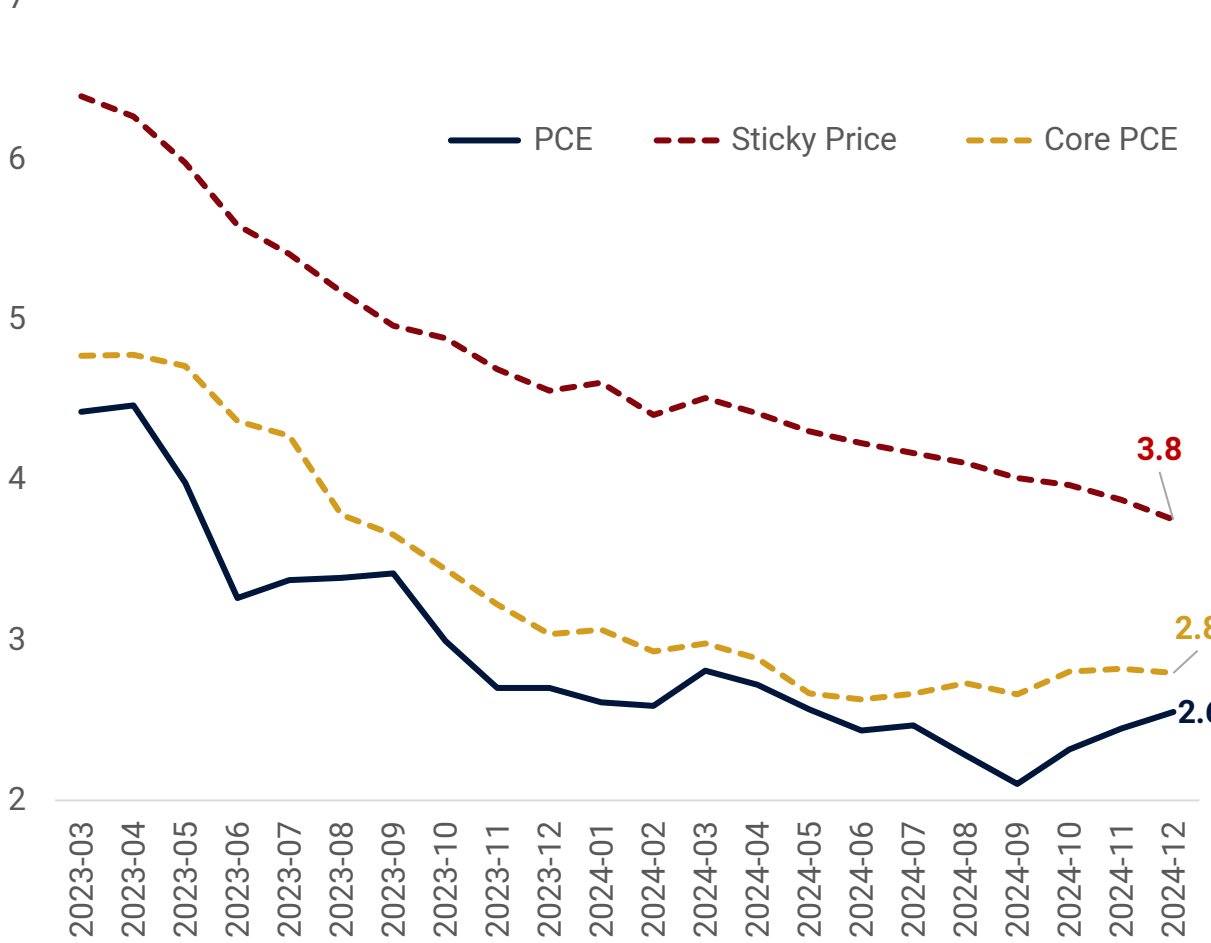
Reassessments of the neutral rate?

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



Source: Atlanta FED

The key measures of underlying inflation remain substantially above the target level.

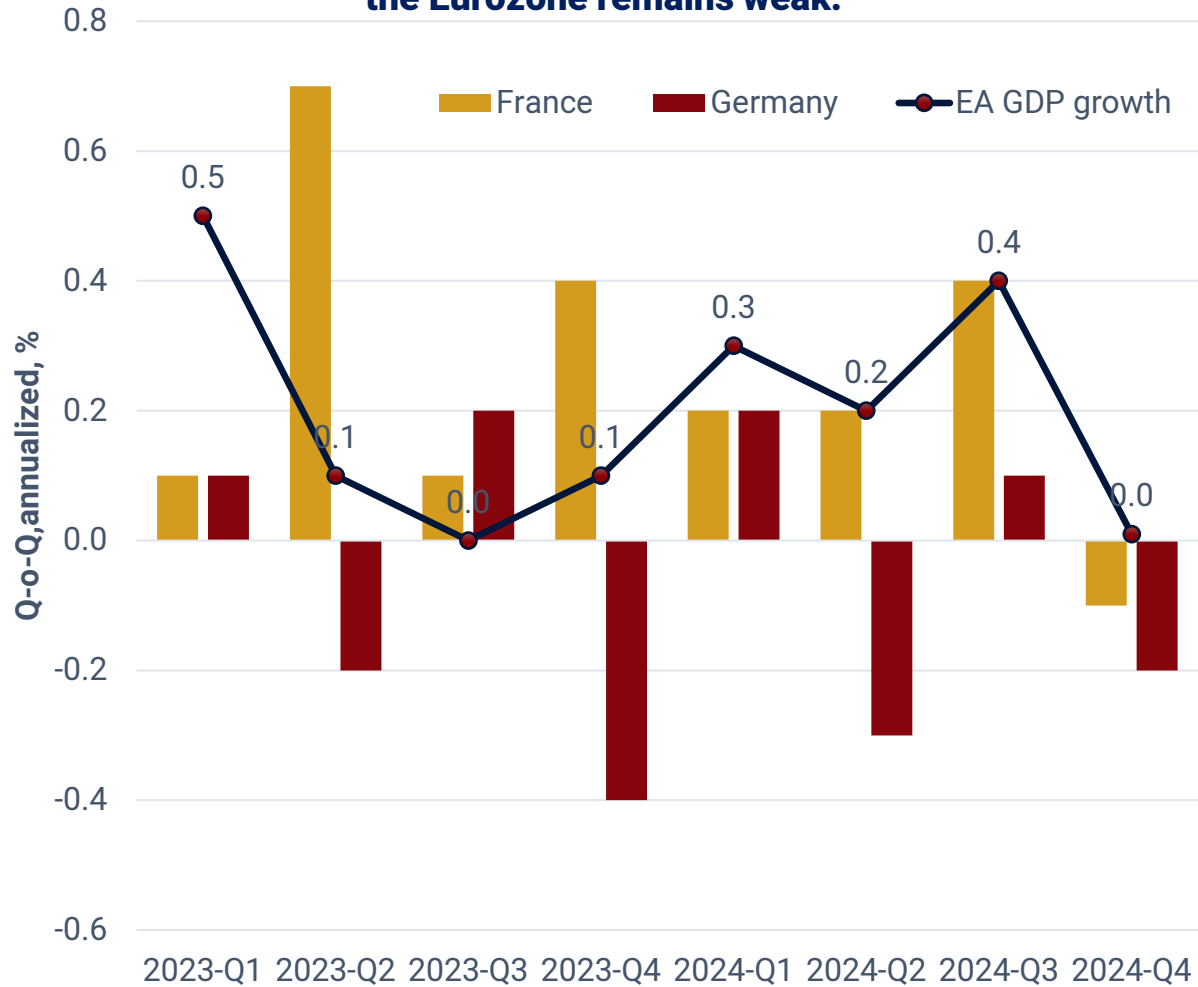


Source: Atlanta FED

EU: Economic growth prospects and structure remain concerning, especially in the context of risks associated with the tightening of trade policy with the USA and the risks of further slowdown in China's economy

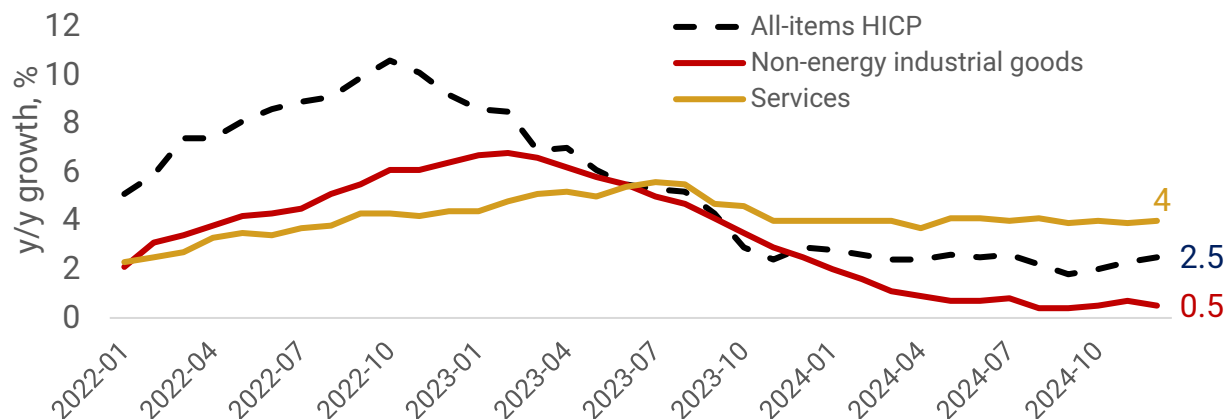


Under high uncertainty and contractionary monetary policy, demand in the Eurozone remains weak.

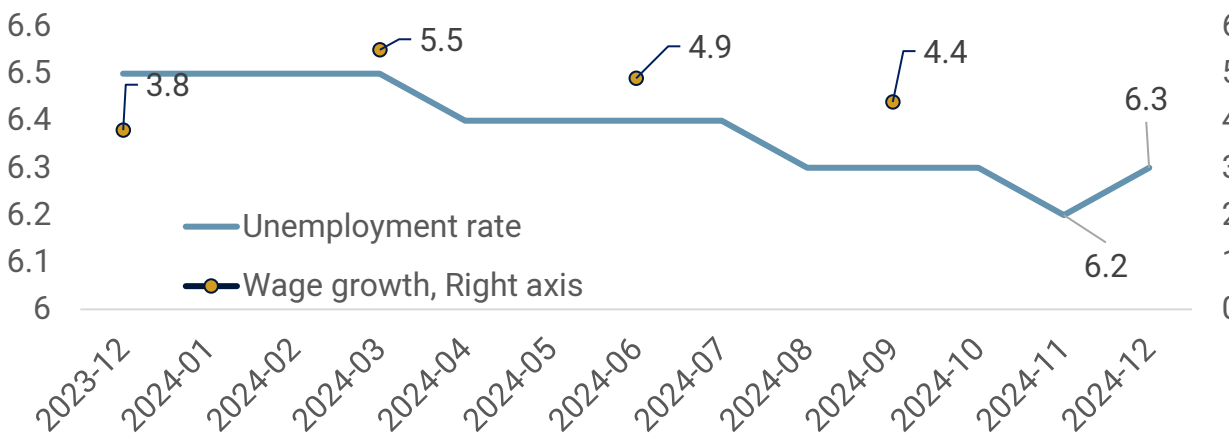


Source: Eurostat

ECB's policy dilemma deepening?



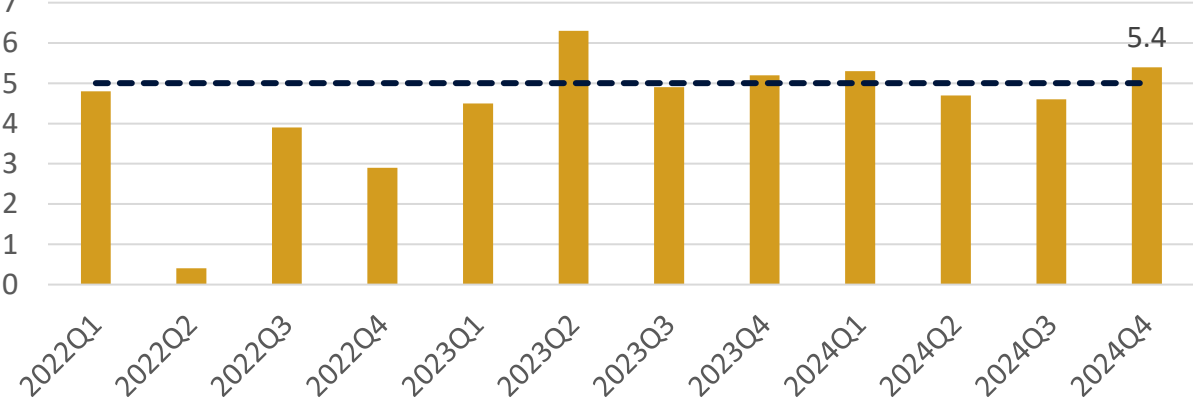
While some first signs of labor market cooling are evident, inflationary pressures persist



Source: Eurostat

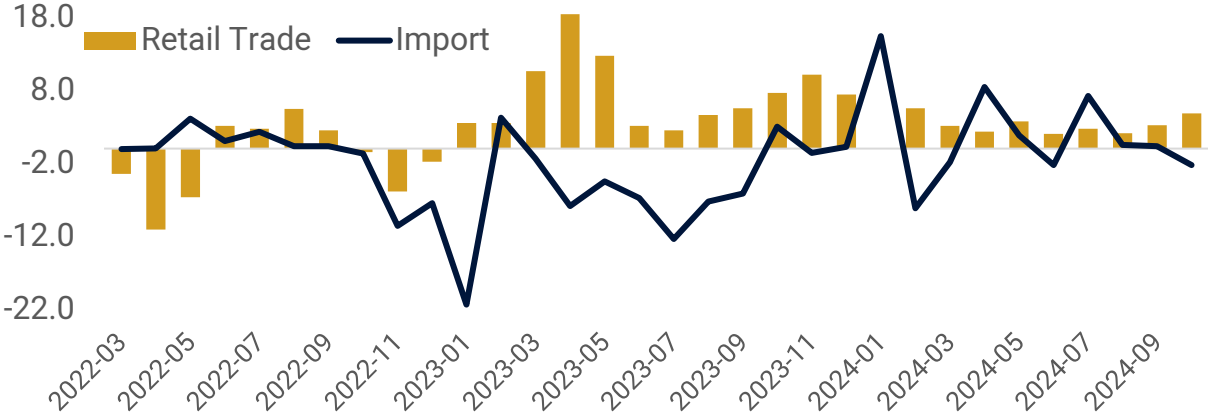
China: Weakening domestic demand in China remains one of the key sources of uncertainty regarding the global economic outlook.

Although China managed to achieve its 5% growth target, the outlook for economic growth remains concerning.



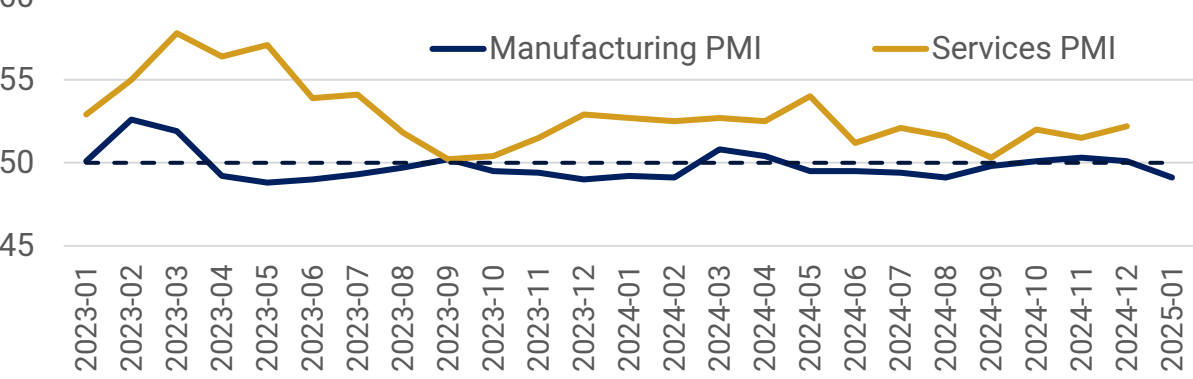
Source: National Bureau of Statistics of China

Despite a slight acceleration in economic growth, domestic demand remains subdued.



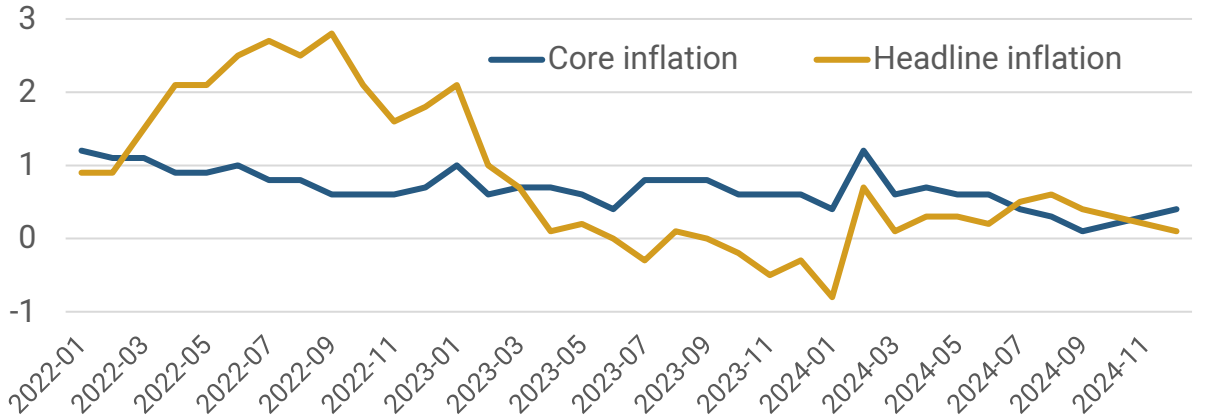
Source: National Bureau of Statistics of China

Certain leading indicators also point to persistent challenges, particularly in the productive sectors of the economy.



Source: National Bureau of Statistics of China

Inflation remains low

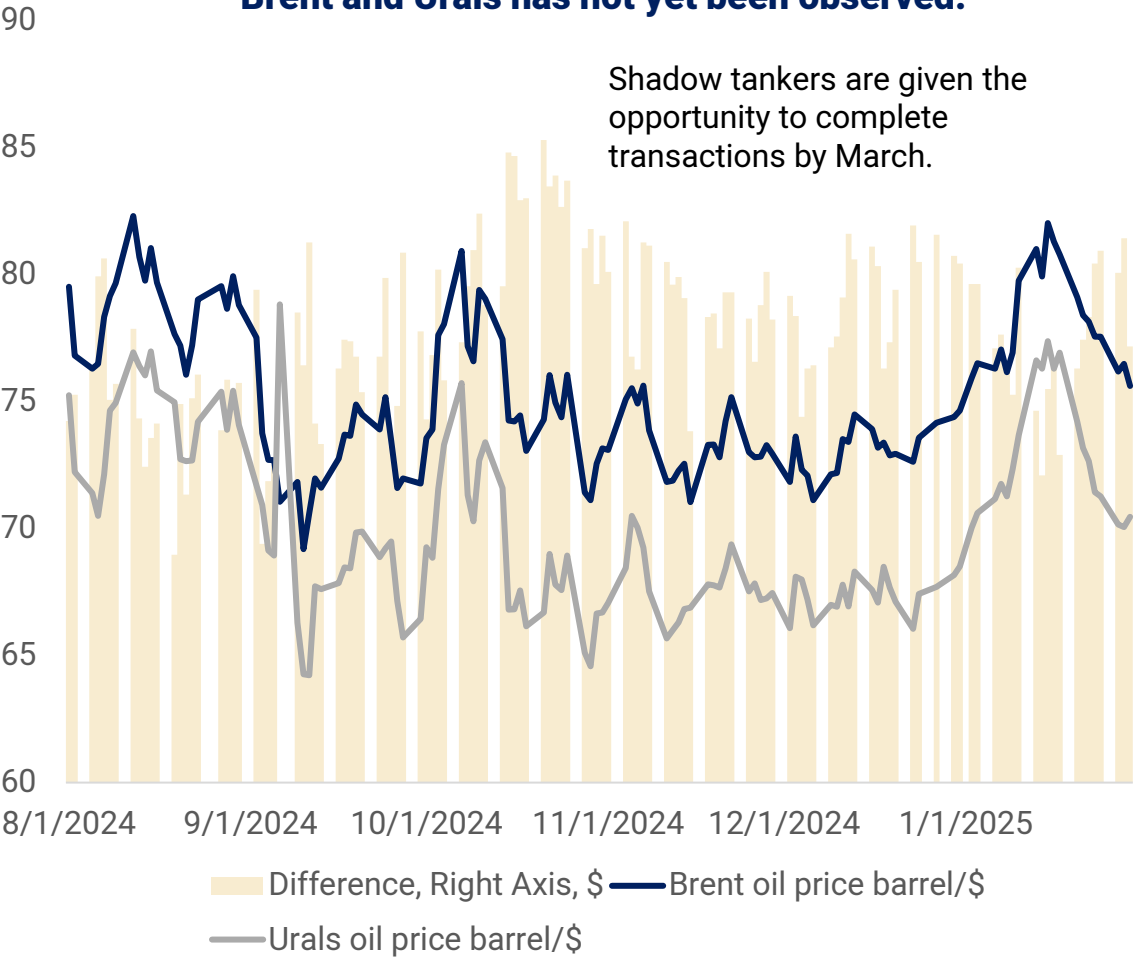


Source: National Bureau of Statistics of China

Commodity markets: The U.S. targeting of Russian "shadow fleet" and the intensification of sanctions may serve as a potential source of supply contraction in the oil market.



Nevertheless, a significant increase in the price differential between Brent and Urals has not yet been observed.



Source: EIA, IEA, OPEC, CBA Estimates

As a result of the U.S. sanctions imposed on January 10, Russia's oil production could decline by up to 1 mb/d, according to various estimates.



Source: EIA, IEA, OPEC, CBA Estimates

The projected surplus for 2025 could be absorbed if the potential impact of sanctions on Russia materializes, mb/d.

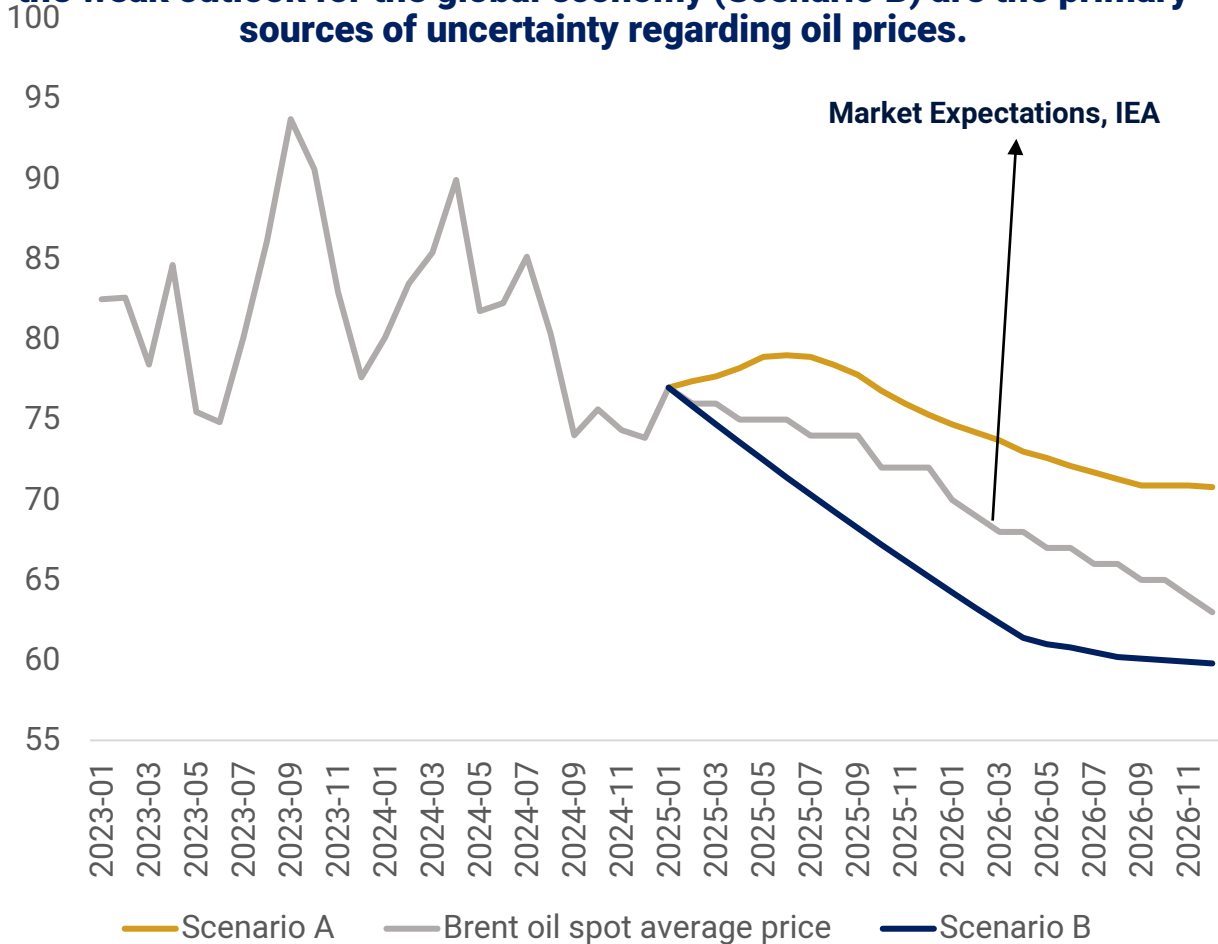


Source: EIA, IEA, OPEC, CBA Estimates

Commodity markets: The latest sanctions against Russia, along with risks surrounding the medium-term growth outlook of the global economy, are making the oil market more vulnerable and volatile.

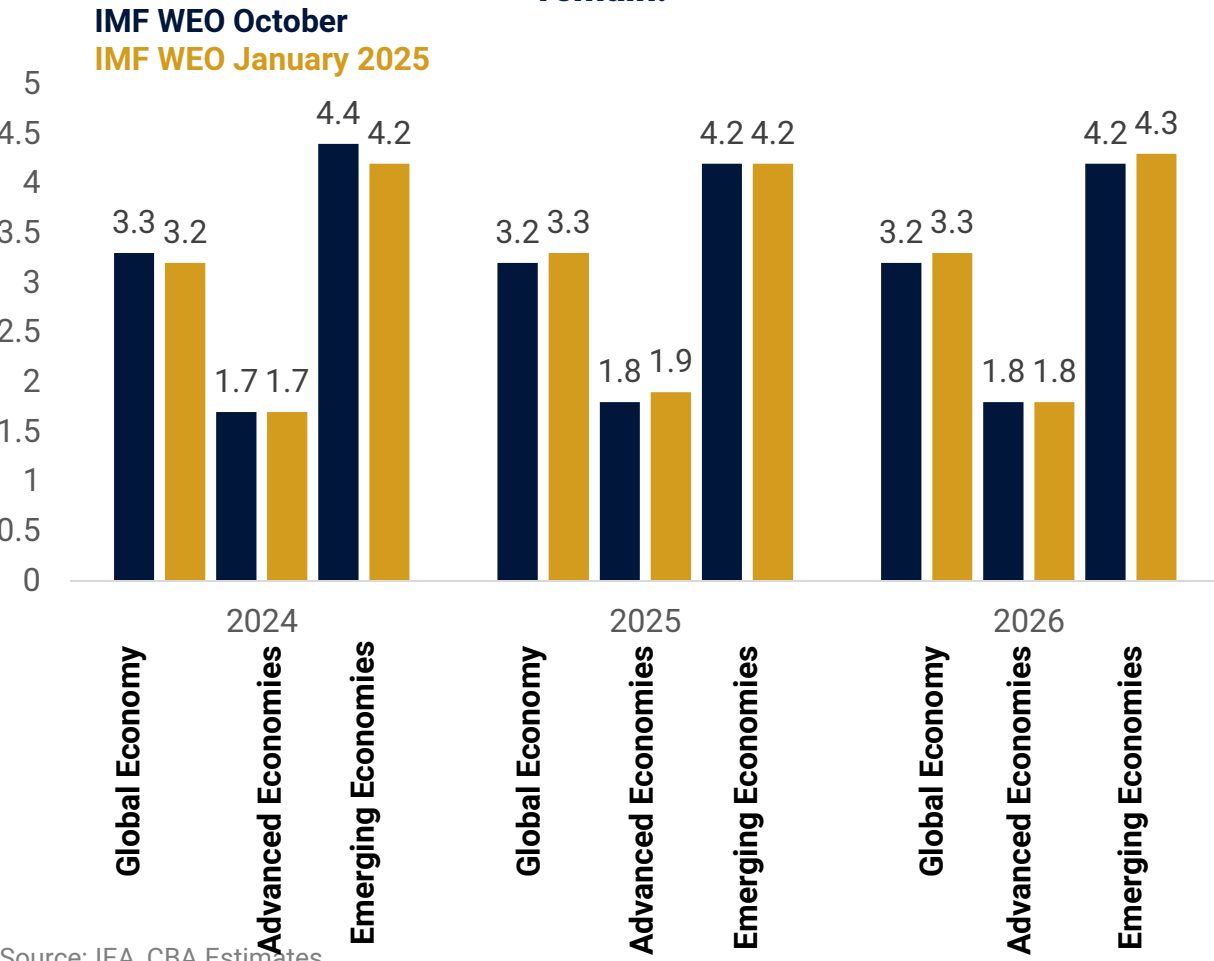


The absorption of market surplus due to sanctions (Scenario A) and the weak outlook for the global economy (Scenario B) are the primary sources of uncertainty regarding oil prices.



Source: IEA, CBA Estimates

Although the global economic growth forecast for the current year has been slightly revised upwards, risks surrounding medium-term growth remain.

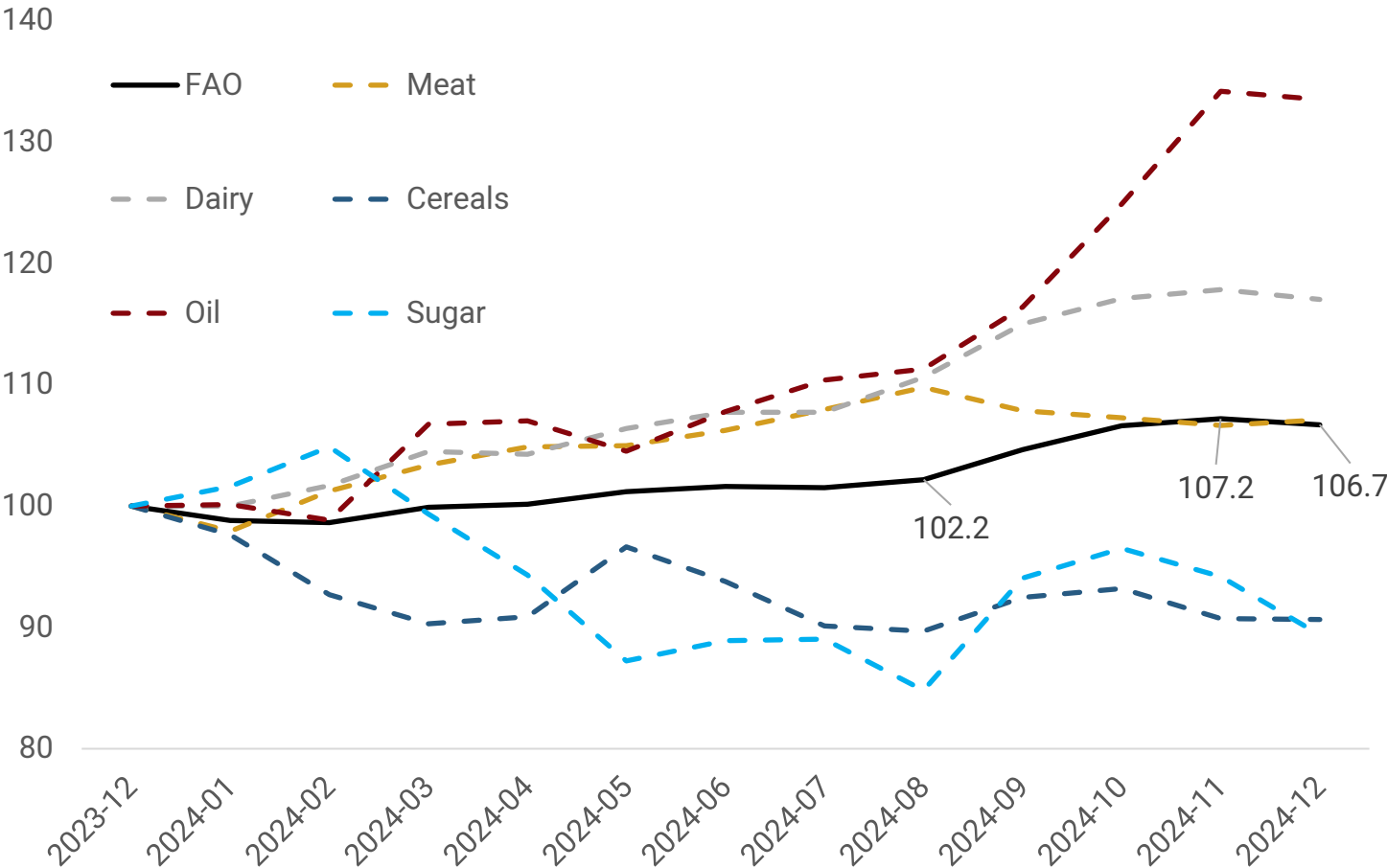


Source: IEA, CBA Estimates

Commodity markets: Following price increases in the second half of 2024 due to adverse weather conditions, food prices in international markets have stabilized. However, uncertainties around the balance of supply and demand persist in certain markets.



FAO Food Price Index, 2023 December=100

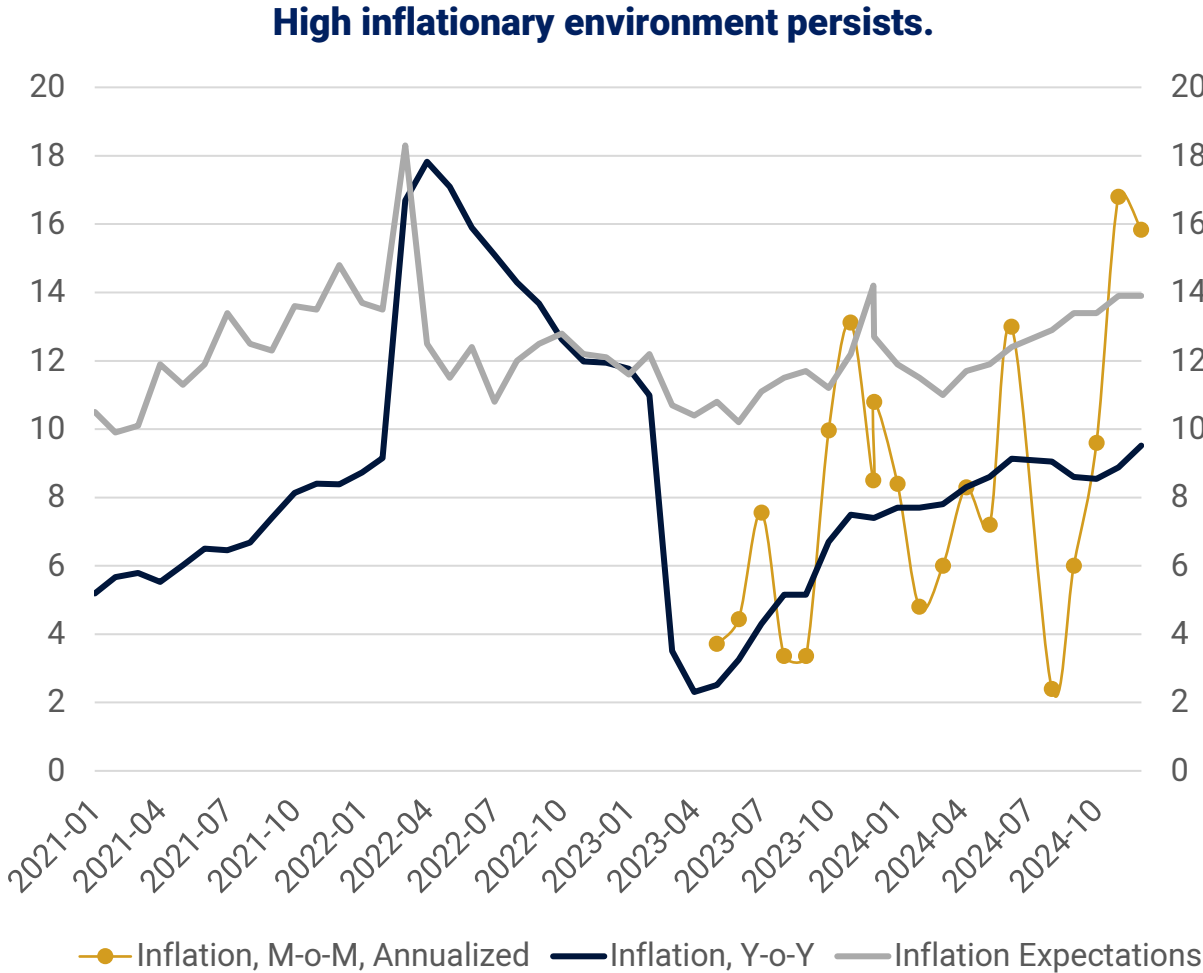


International food markets: the price increase in recent months was primarily driven by the cost of oils, influenced by unfavorable weather conditions in Asian countries. However, this stabilized in December, largely due to a slight weakening of demand in the US

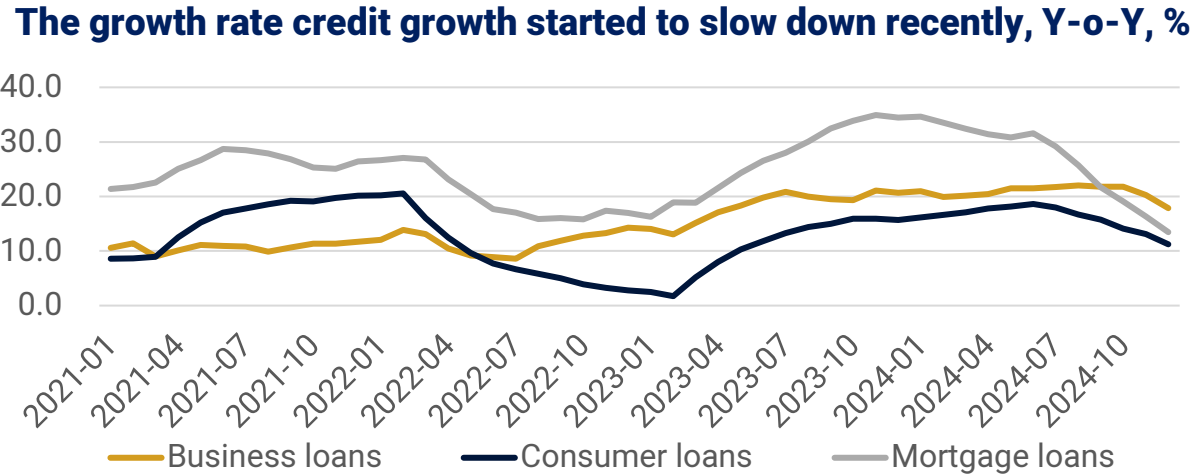
The decline in global sugar prices was driven by higher-than-expected production in Brazil during the second half of November.

Risks related to the further slowdown of **global economic growth** persist, serving as a moderating factor for the increase in food prices.

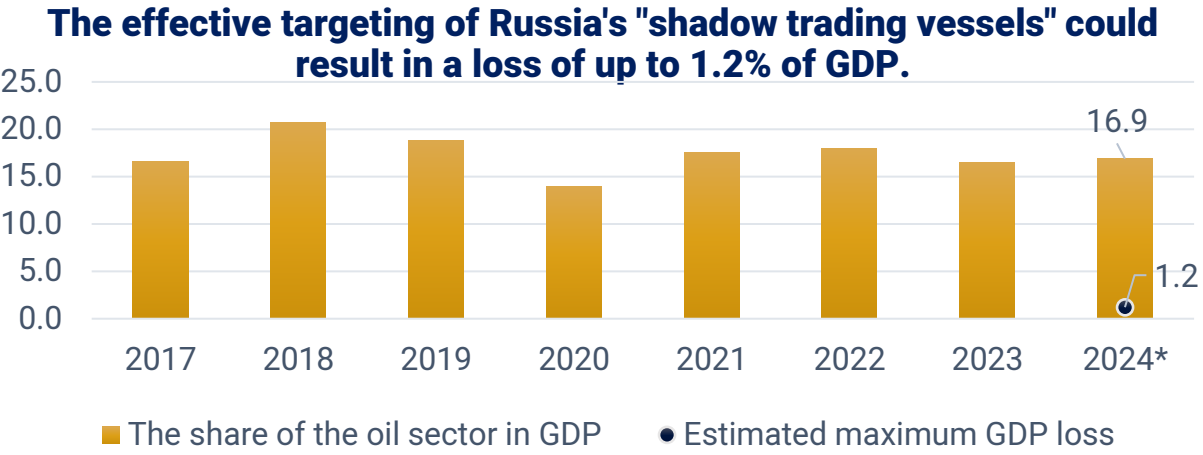
Russia: A high inflationary environment persists under strong domestic demand. On the other hand, risks surrounding the medium-term growth outlook are intensifying, partly due to the implementation of new U.S. sanctions.



Source: CB of RF



Source: CBR



Source: Rosstat, CBA estimates

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 levels and long-term sustainability
- Risks from the Tightening of External Trade Policies

EA

Uncertainty regarding growth prospects, economic structure, and fundamentals remains.

China

Despite the acceleration of economic growth at the end of 2024, risks related to the real estate sector, financial stability, and further weakening of demand persist.

Russia

- Within accelerating inflation expectations, strong domestic demand persists.
- More targeted and flexible Western sanctions continue to pose certain risks for the Russian economy and third countries.

Commodity Markets

The further escalation of geopolitical tensions, sanctions against Russia, and weather and trade risks pose potential threats to global supply chains, with risks of continued increases in global oil prices and heightened volatility.



Current and Fundamental Economic Factors

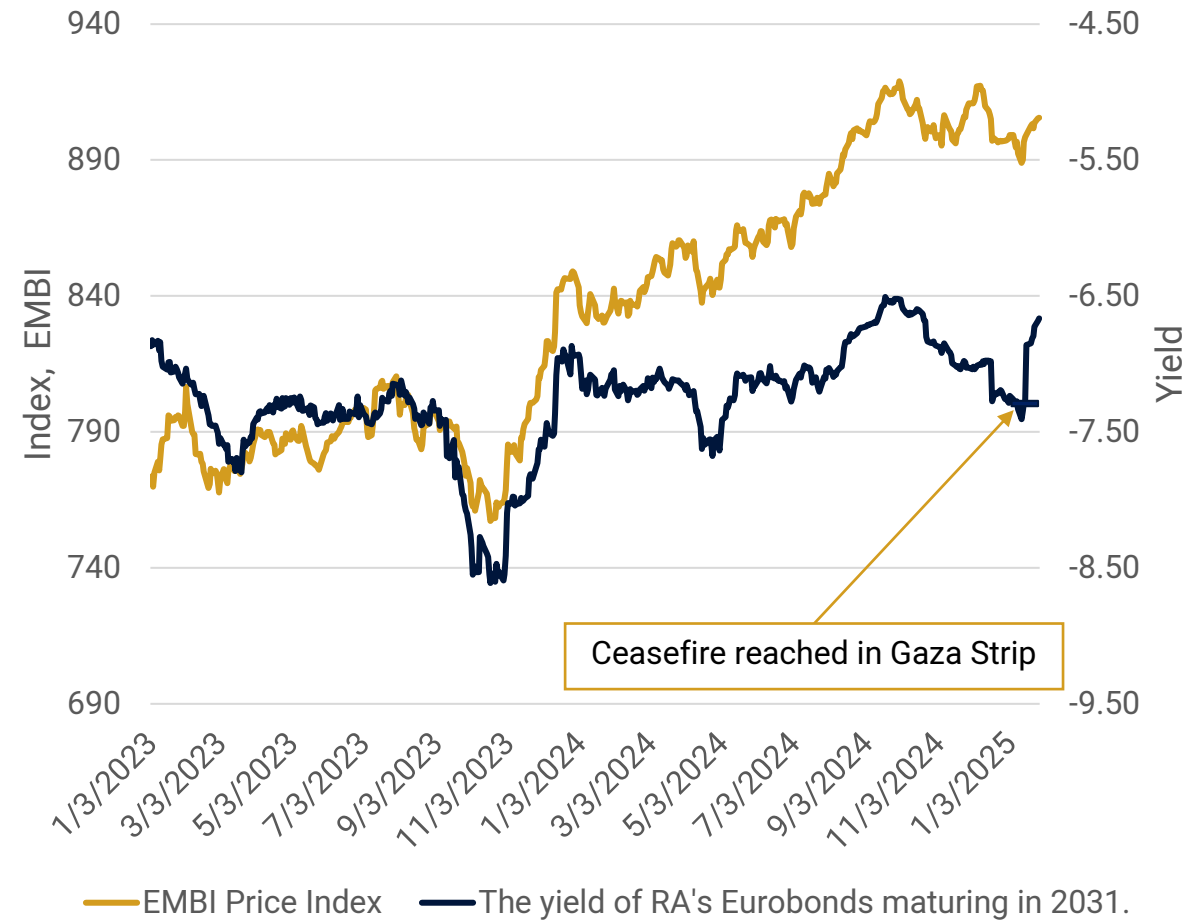
Domestic Economic Developments

Armenia's risk premium remains significantly below its long-term stable level...

Geopolitical tensions in the region and around Armenia pose risks of rapid adjustments to the sovereign risk premiums of both Armenia and its neighboring countries.



The yield on Armenia's Eurobonds is declining at a faster pace compared to other emerging markets, reflecting a reduction in both country-specific and regional risks.



Source: CBA Estimates

Recently, due to the improvement in the situation in the Middle East, Armenia's short-term risk premiums have decreased (Arm_2031).



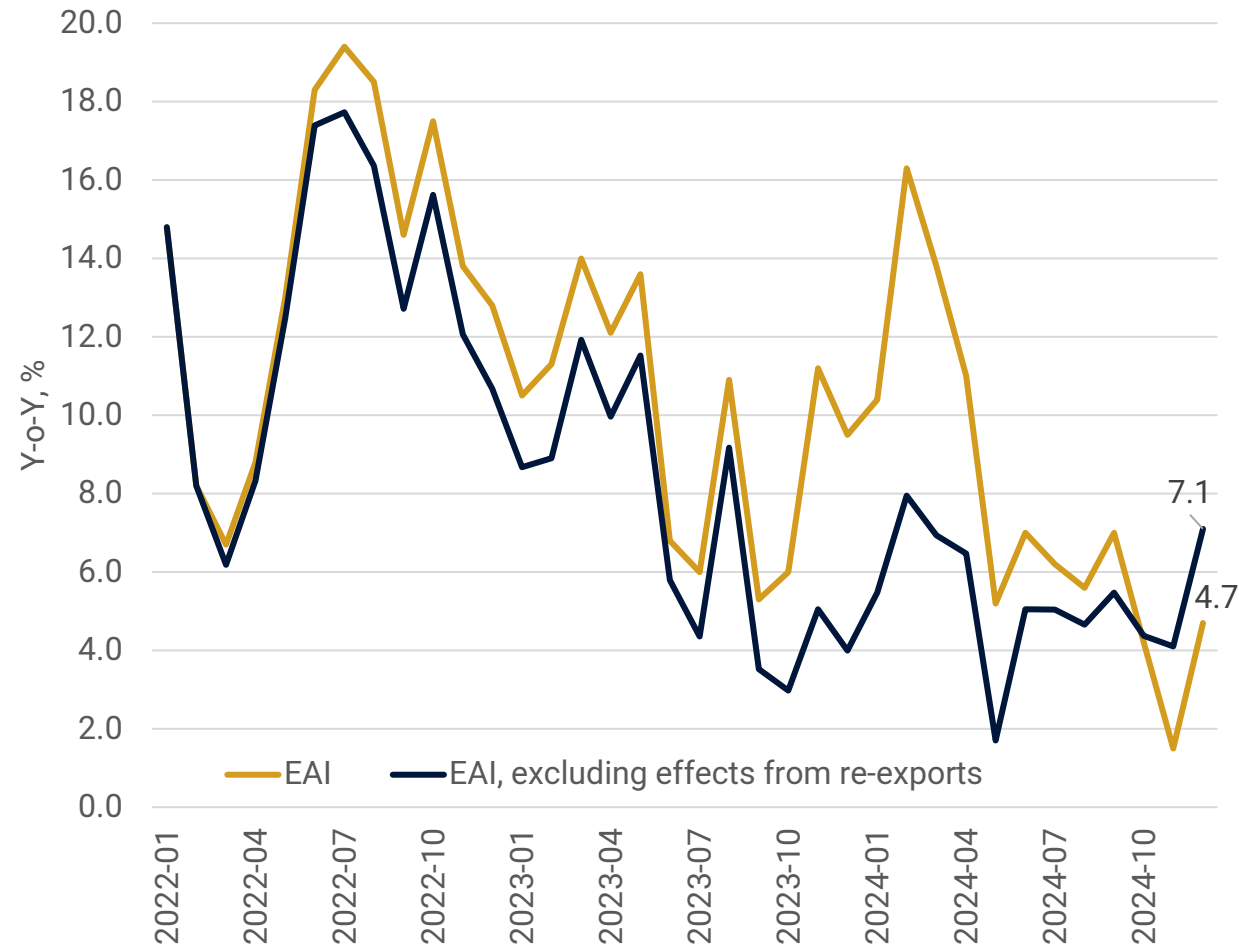
Source: CBA Estimates

Economic activity is approaching long-term stable growth levels.

The increase in growth volatility reflects changes in external trade flows.

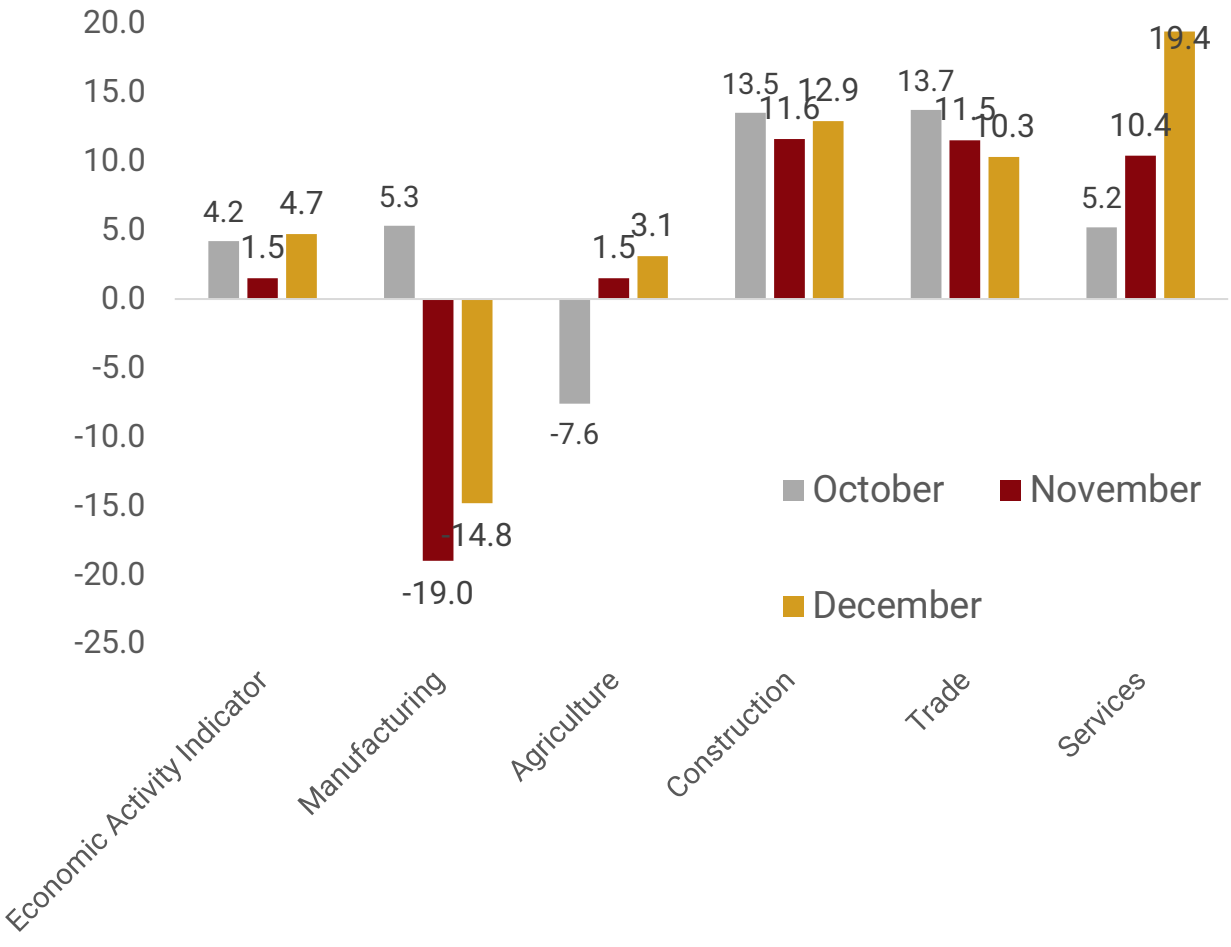


Economic Activity Indicator(EAI),%



Source: RA Statistical Committee, CBA estimates

Economic activity by sector, real growth

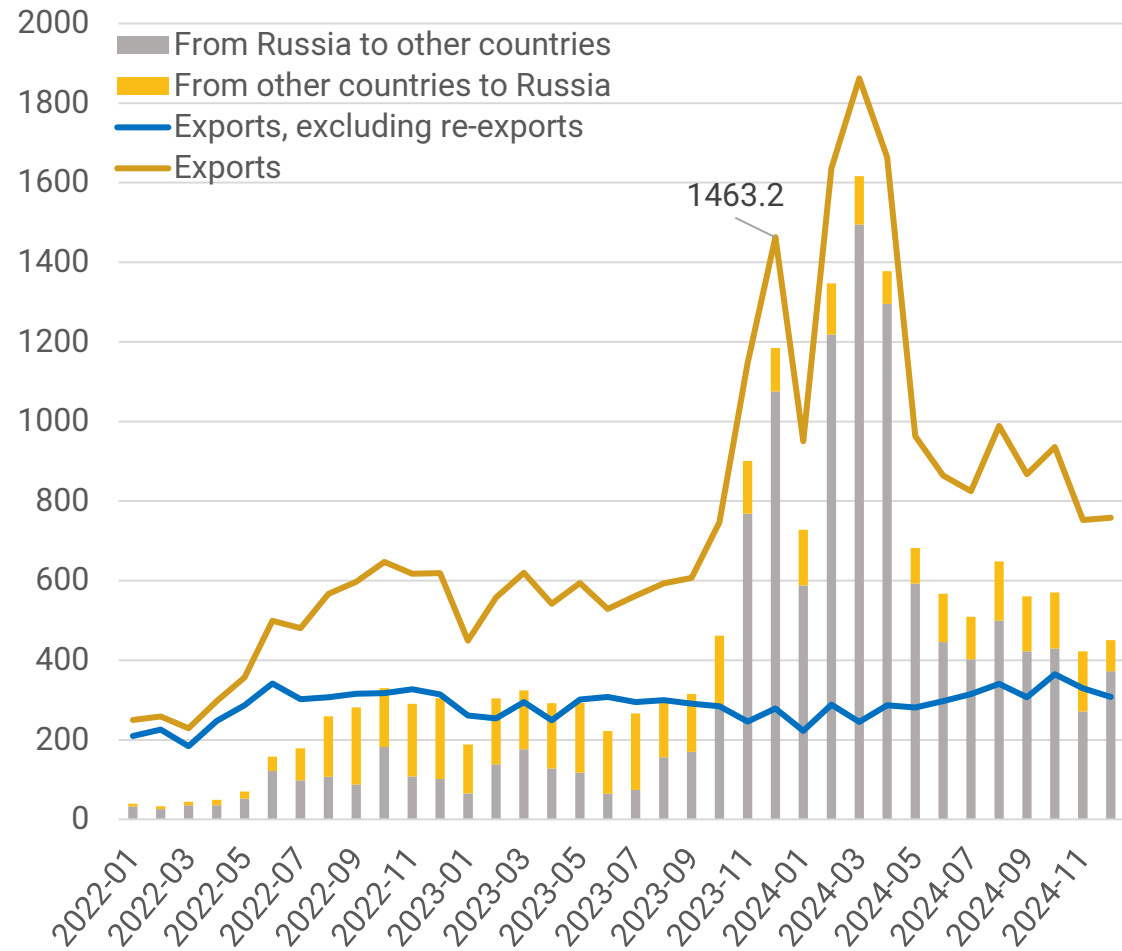


Source: RA Statistical Committee, CBA estimates

Significant uncertainties remain regarding the stability of external trade flows and magnitude of economic impacts in the event of further deterioration.

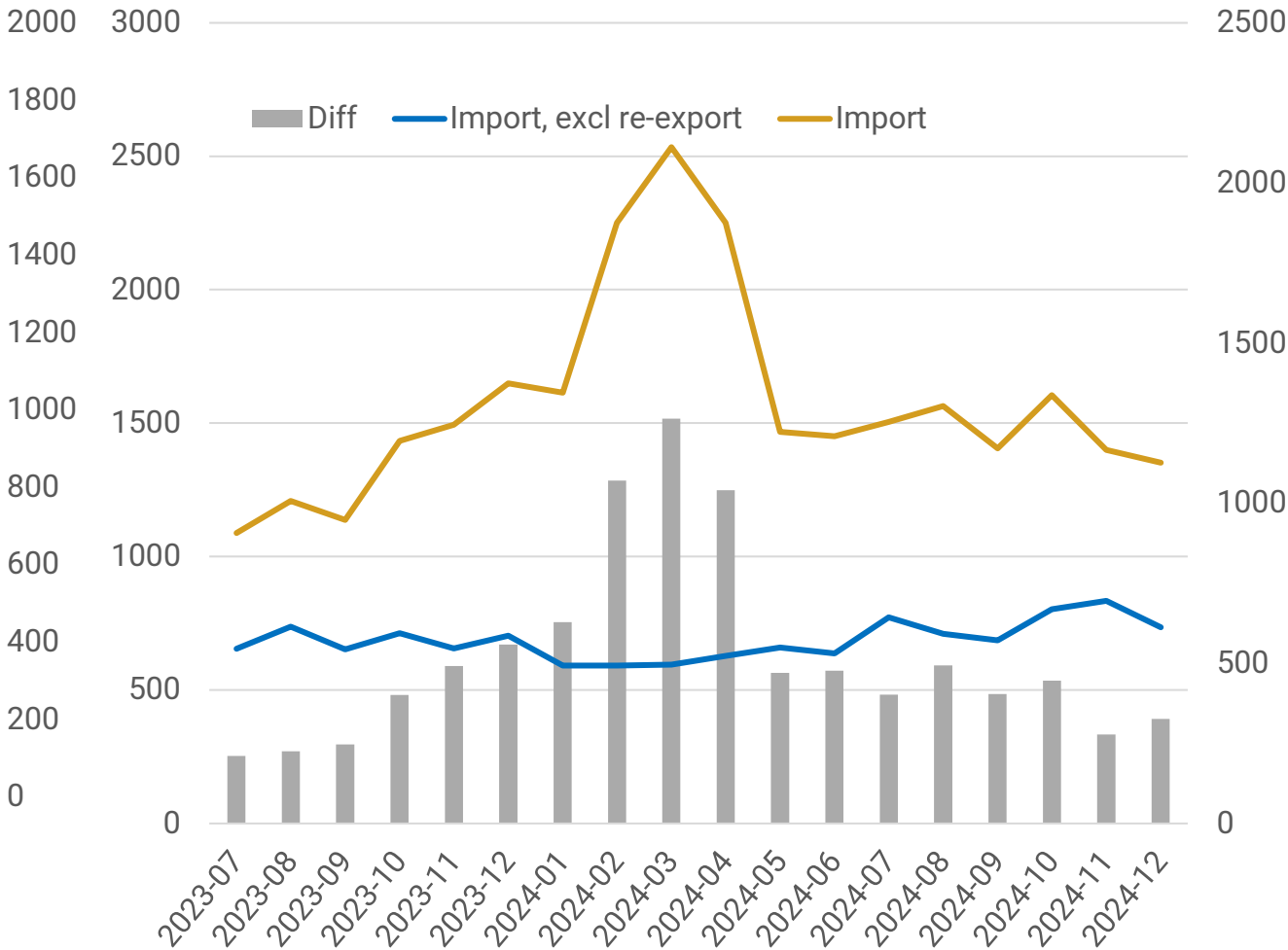


Exports, million dollars



Source: National Statistical Committee of Armenia , CBA estimates

Imports, million dollars

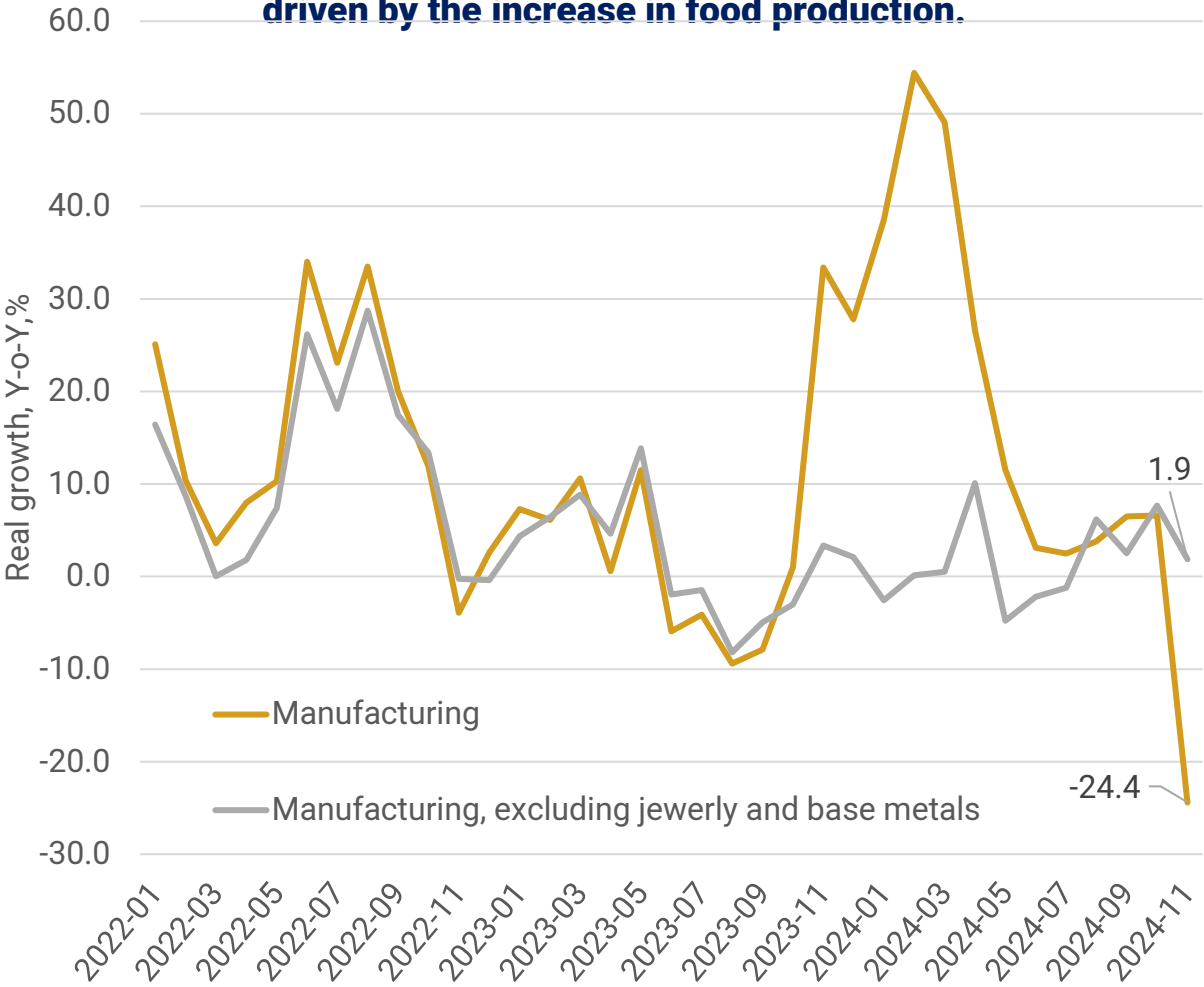


Source: National Statistical Committee of Armenia , CBA estimates

On the other hand, alongside the weakening of external trade flows, certain positive signals of recovery continue to be observed in the "traditional" sectors of the manufacturing industry.

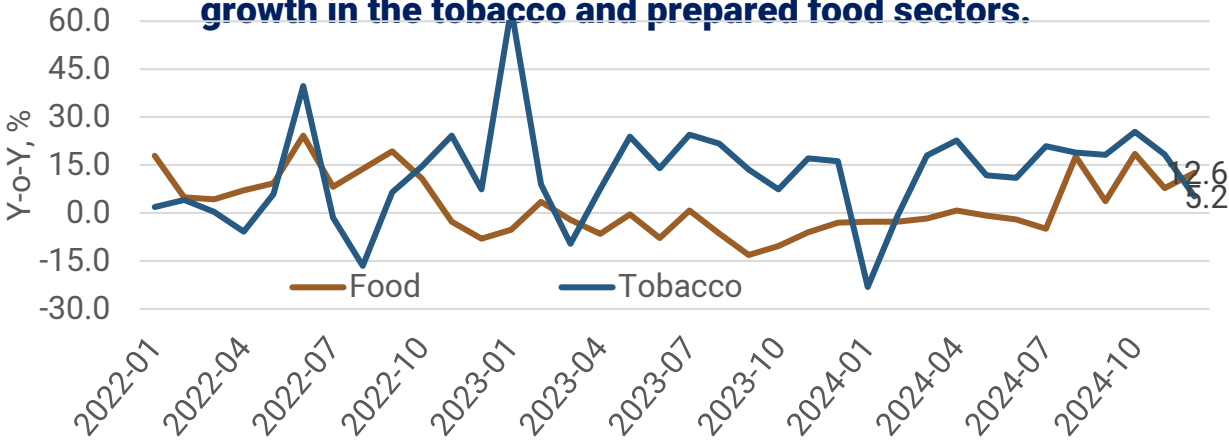


The growth of the manufacturing industry is accelerating, primarily driven by the increase in food production.



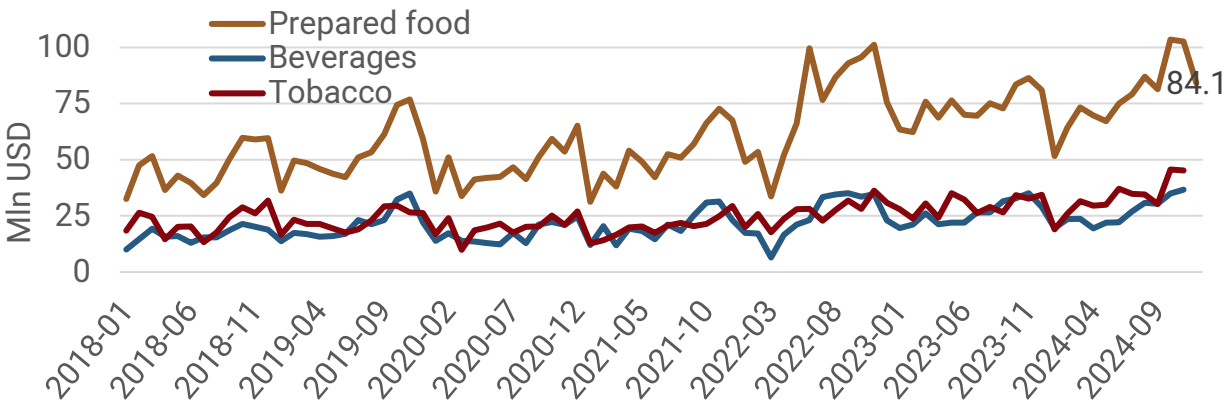
Source: National Statistical Committee of Armenia , CBA estimates

The recovery of the manufacturing industry is primarily driven by growth in the tobacco and prepared food sectors.



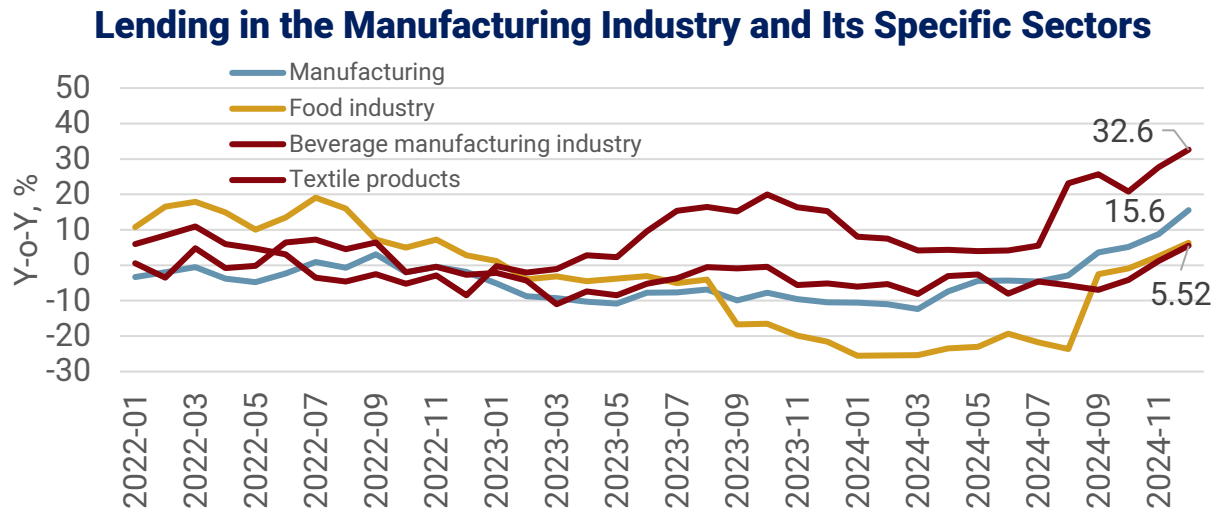
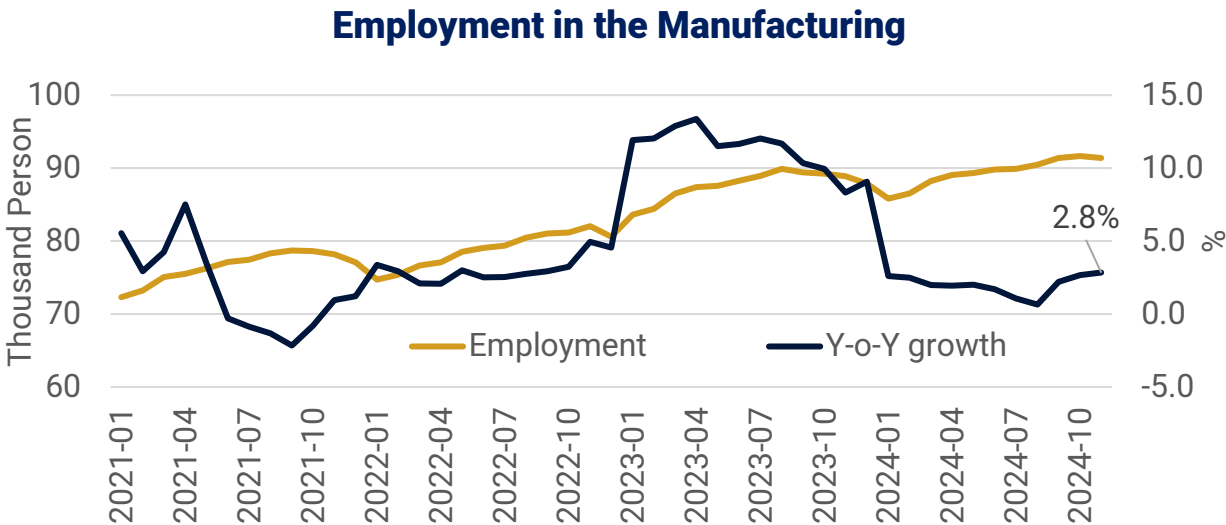
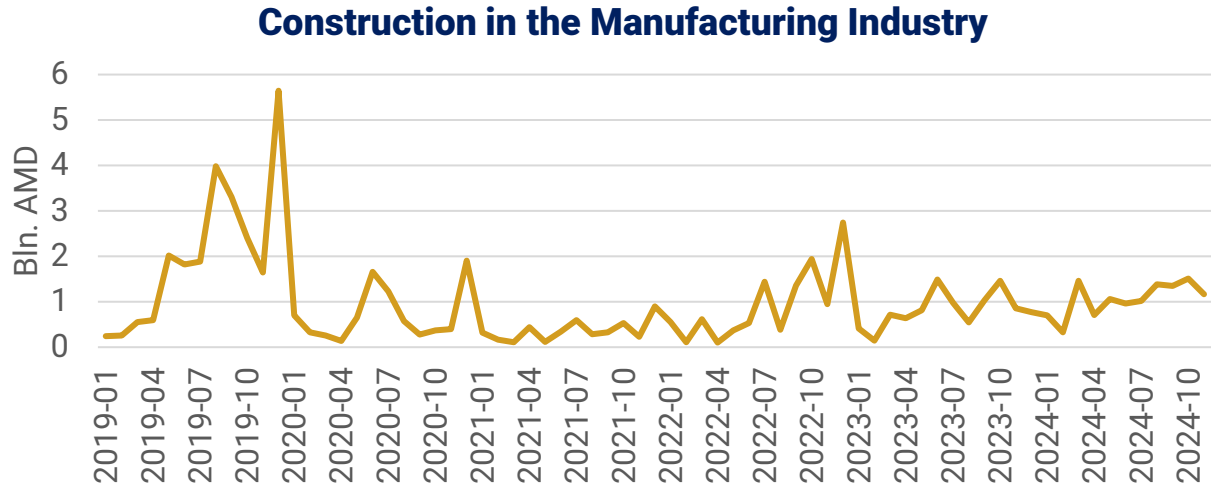
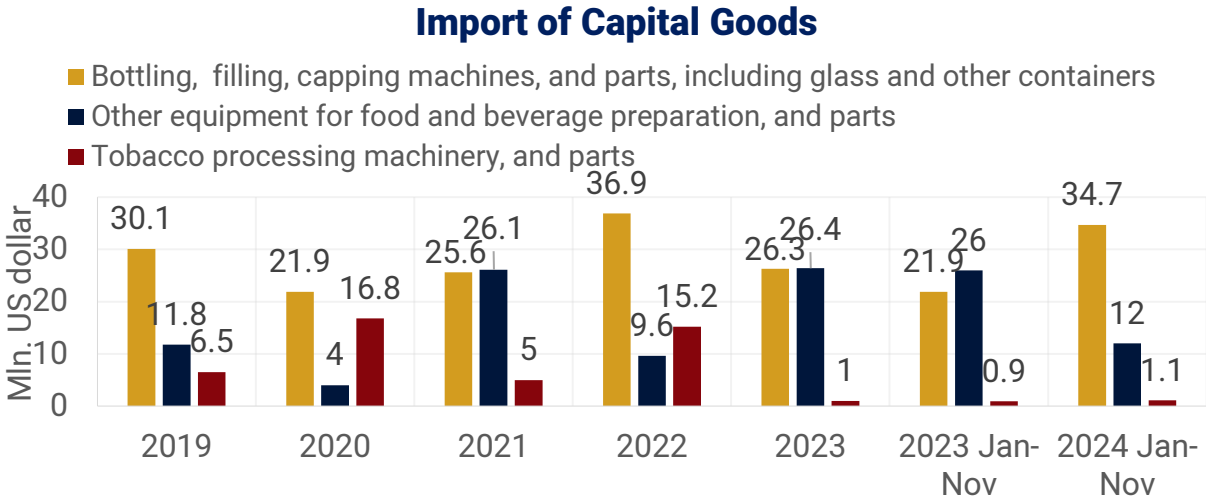
Source: National Statistical Committee of Armenia

Exports of some product groups



Source: National Statistical Committee of Armenia

Nevertheless, no strong signs of improvement in long-term potential growth are evident.



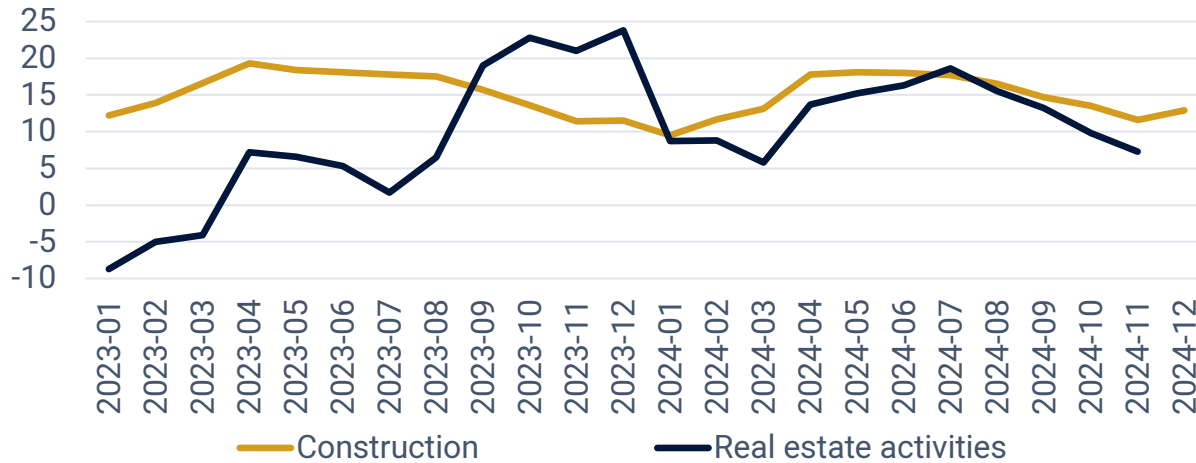
Source: National Statistical Committee of Armenia

Source: National Statistical Committee of Armenia

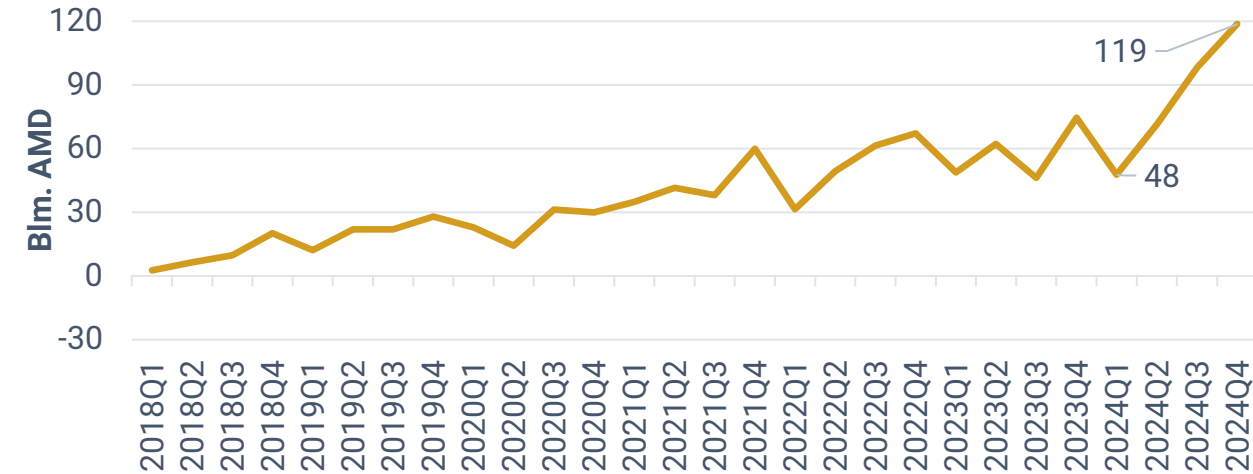
Under the conditions of gradual decline (adjustment) in construction sector activity and real estate prices, the risks of falling into weak demand environment persist.



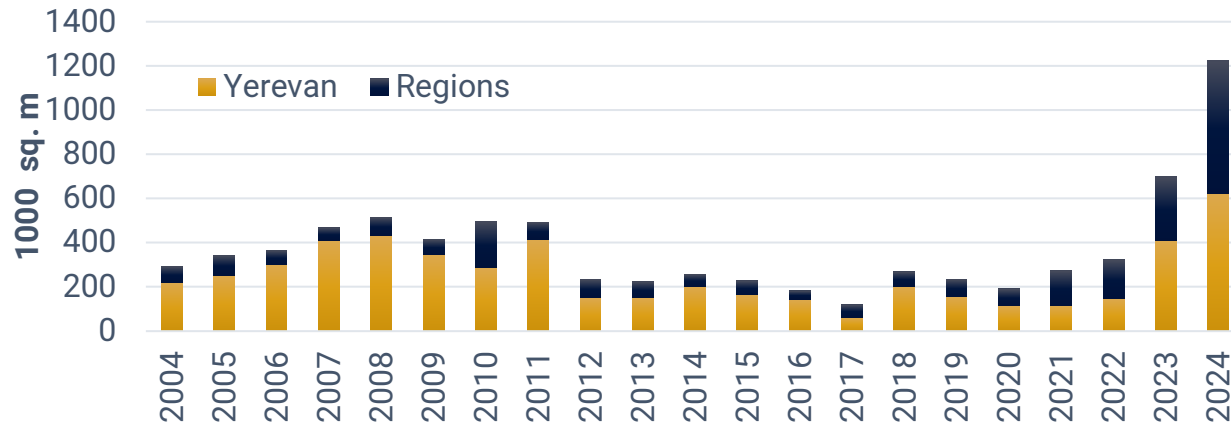
Real growth, Y-o-Y



Net mortgages extended, quarterly, bln. AMD



Residential properties commissioned for use, Yerevan and region



The growth of real estate prices in Yerevan has significantly slowed down.

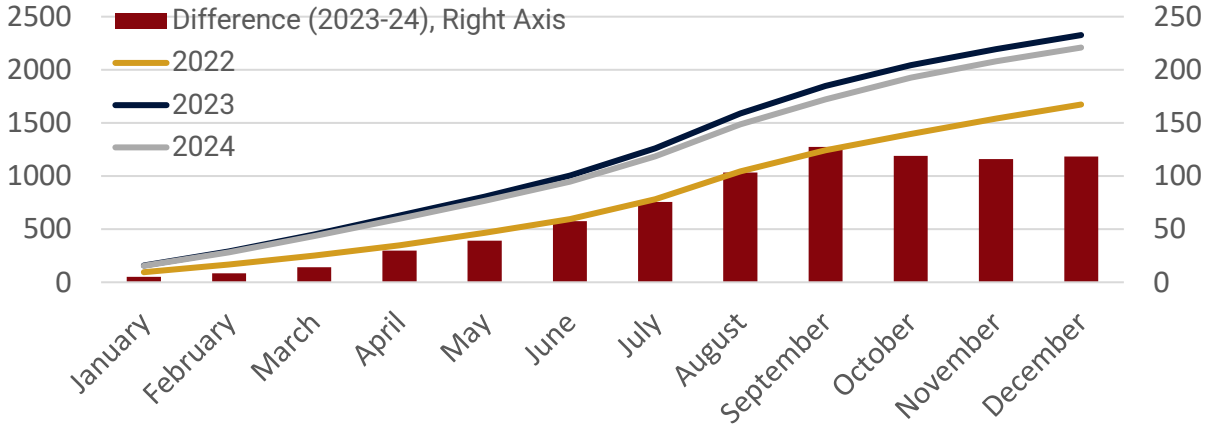


Source: Cadastre Committee of RA, National Statistical Committee of Armenia

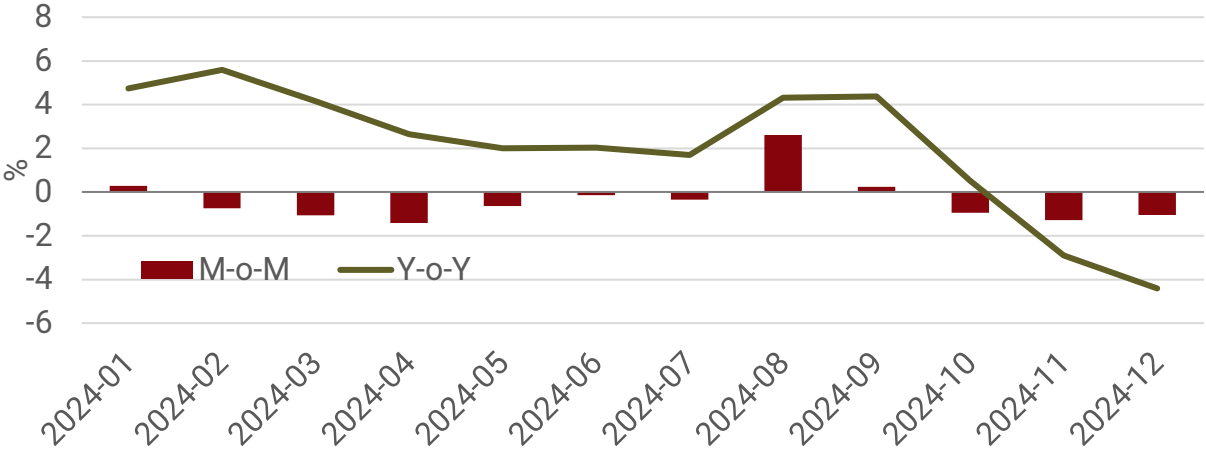
Source: Cadastre Committee of RA, National Statistical Committee of Armenia

External demand continues to normalize. On one hand, there has been a certain decrease in touristic flows to Armenia, which is also reflected in the corresponding adjustments in the prices of certain services

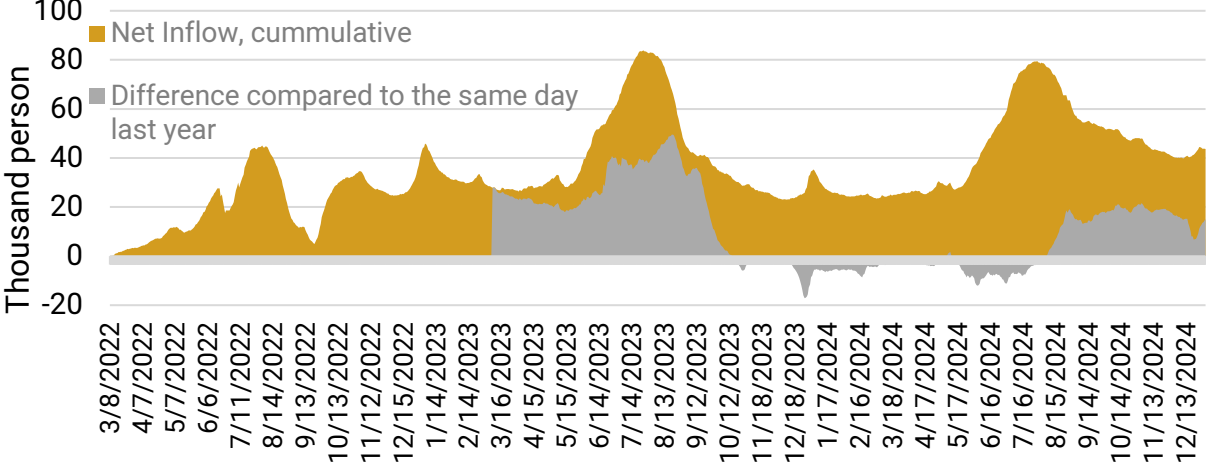
Inbound Tourists, 1000s, cummulative



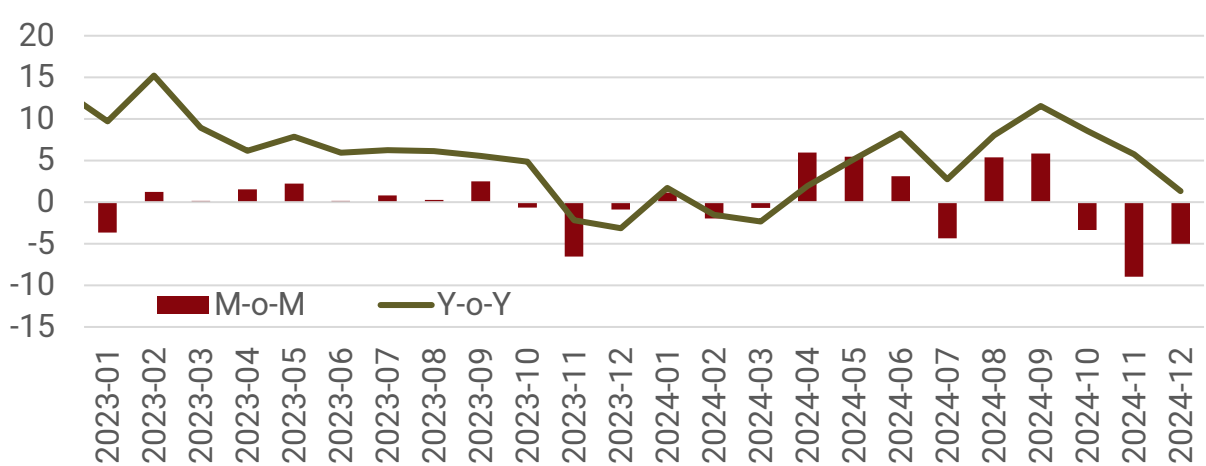
Rent Inflation, %



Border crossings, Net inflow, cummulative



Hotel services

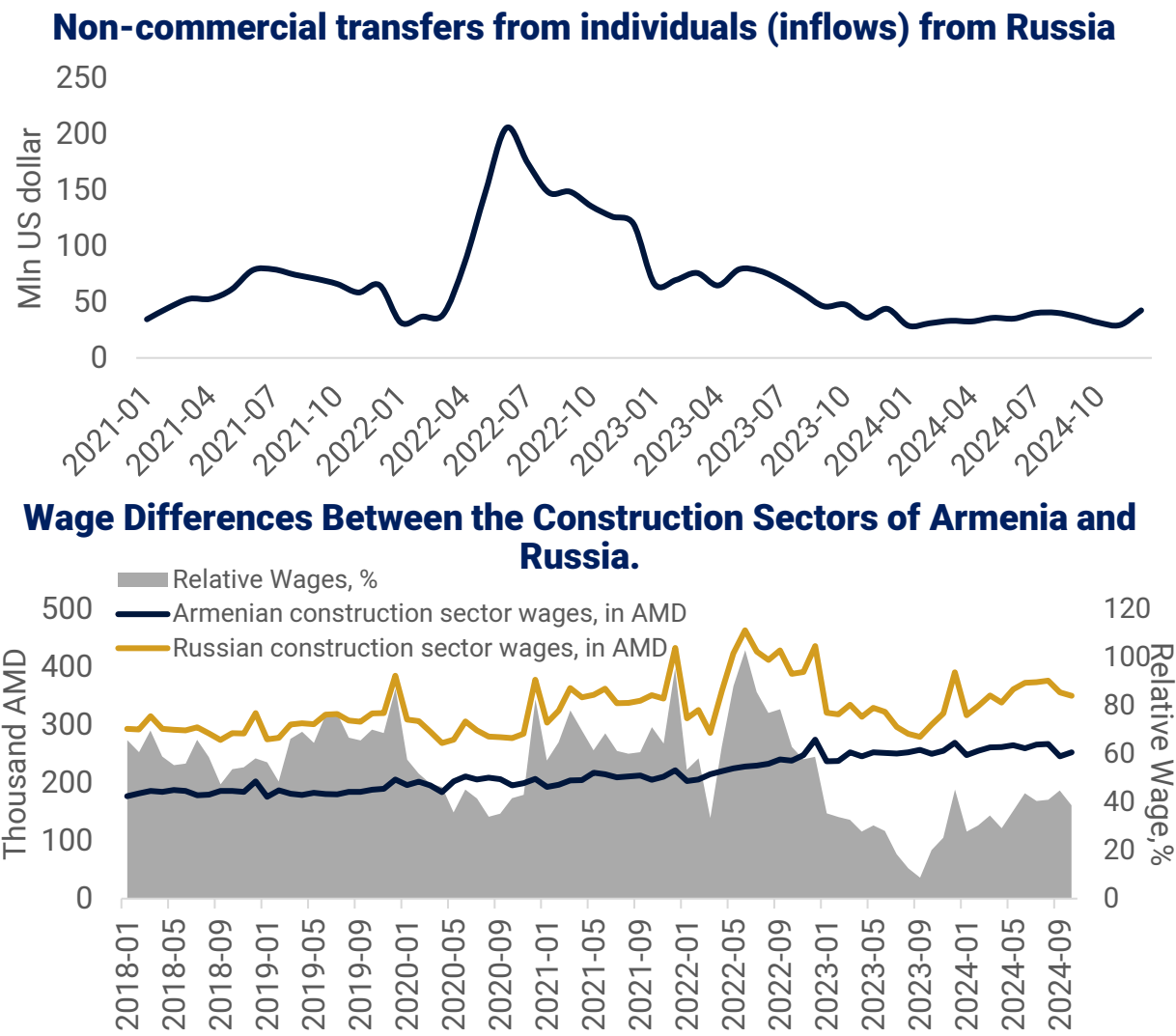


Source: State Tourism Committee

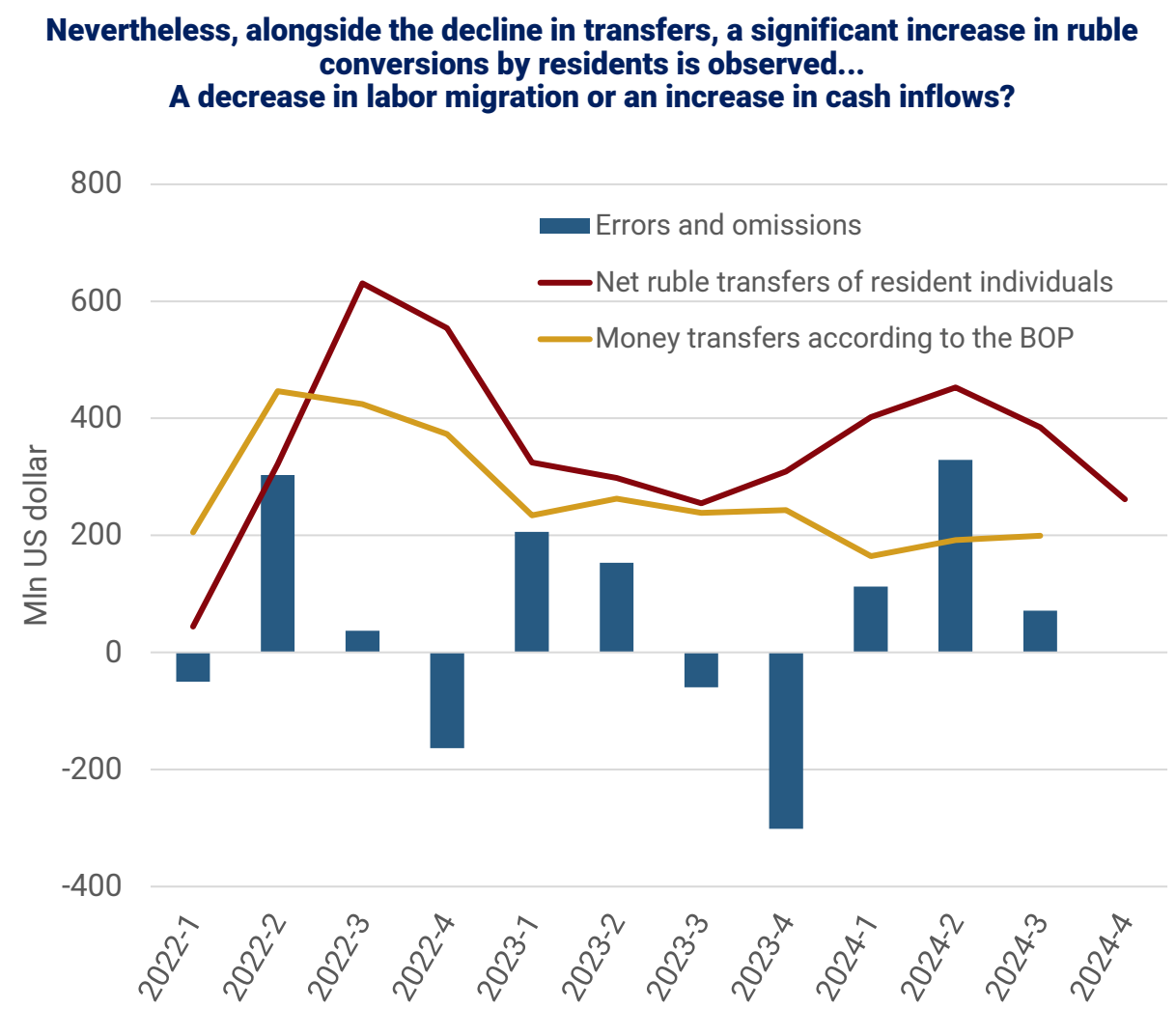
Source: National Statistical Committee of RA

On the other hand, The narrowing wage gap between Armenia and Russia, tightening of Russian migration policy, as well as the reduction in actual remittances, may be indicating a decrease in migration flows towards Russia.



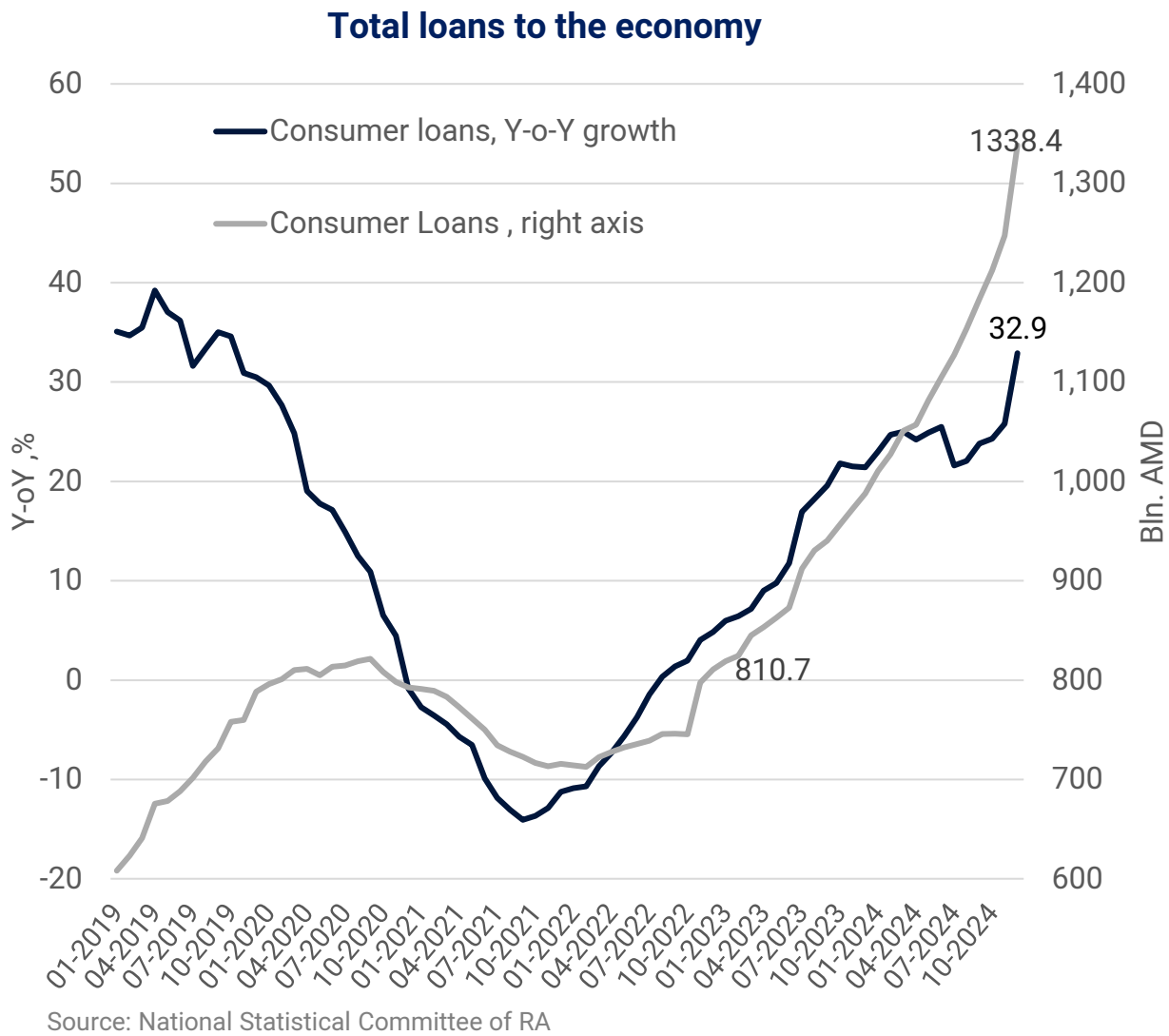


Source: Rosstat, National Statistical Committee of RA, CBA estimates



Source: CBA

Given the high liquidity of the banking system (including FX) and high demand for loans, there are risks of sustained high credit growth, further fueling the expansion of domestic demand.

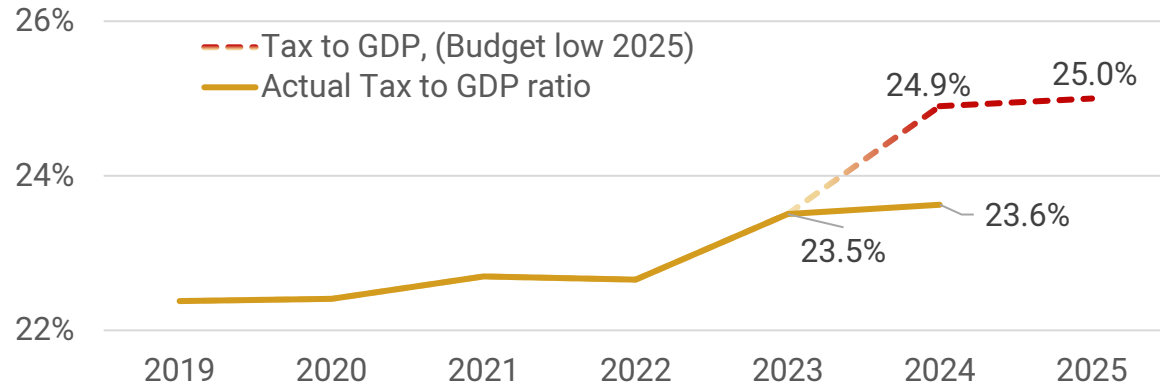


On one hand, the risks arising from underperformance of revenues, and on the other hand, the structure of expenditures (especially capital) and the capacity to implement them, create a high level of uncertainty regarding the impact of fiscal policy.

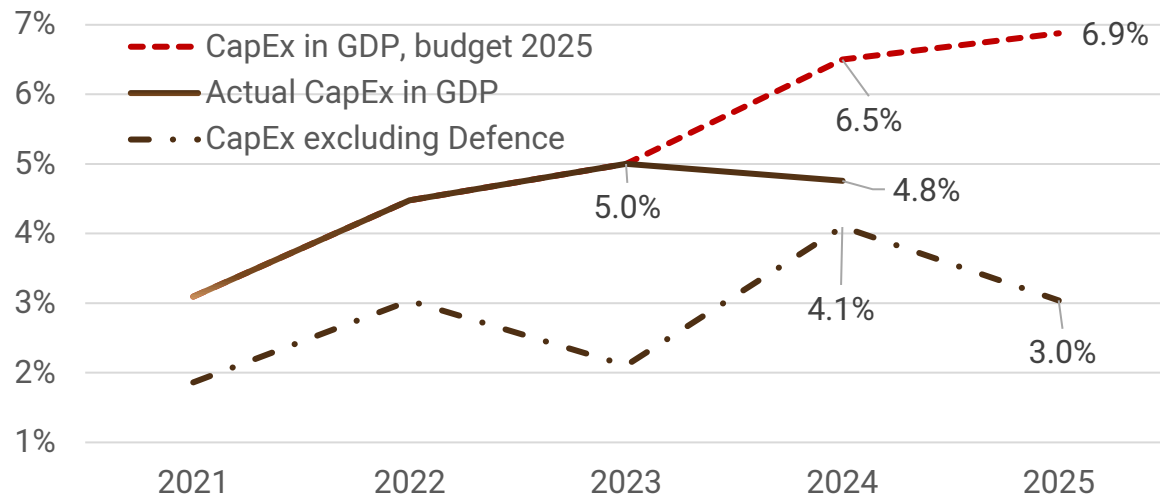


The significant underperformance of capital expenditures also carries risks from the perspective of long-term potential growth.

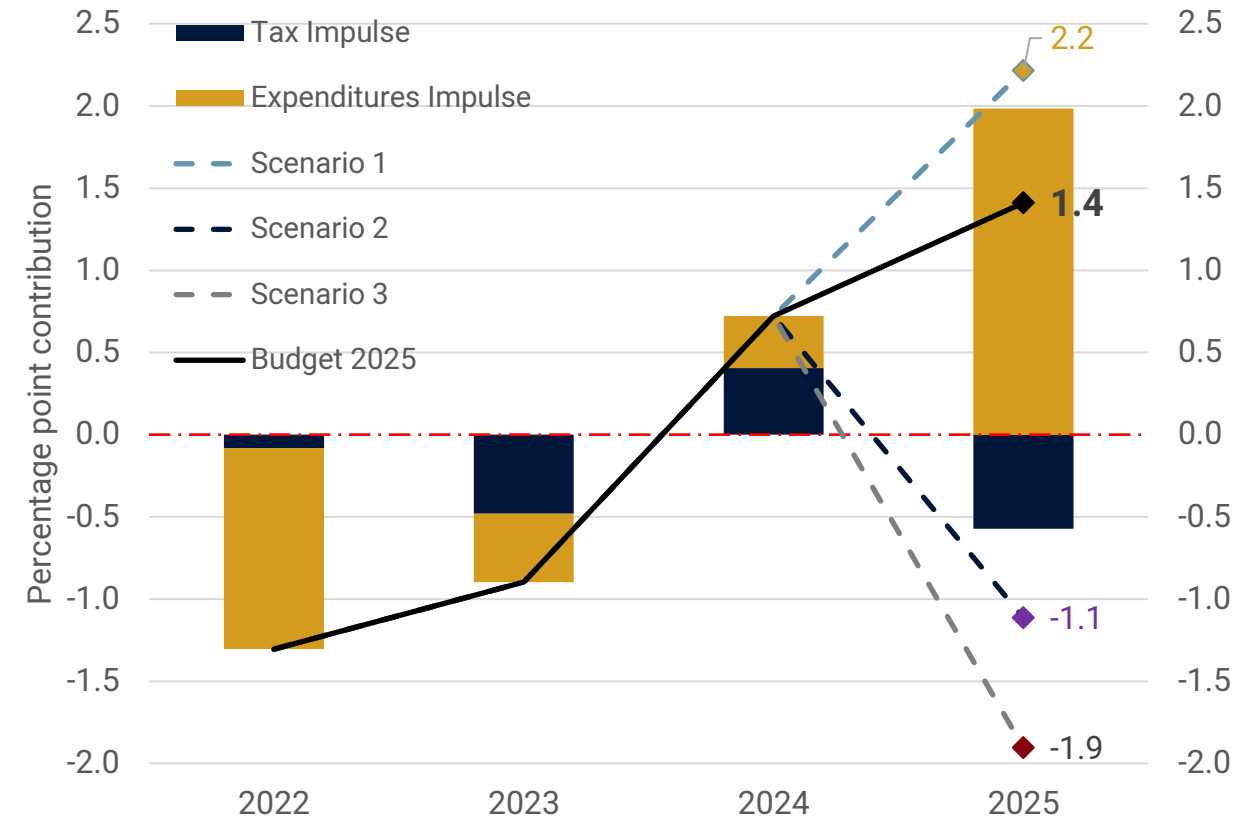
In 2024, the Tax to GDP ratio was about 1.3 percentage points lower compared to the program, also creating certain risks regarding the implementation of the 2025 program



The structure of Capital Expenditures is another source of uncertainty about Fiscal Impulse



Some scenarios for Fiscal Policy impact



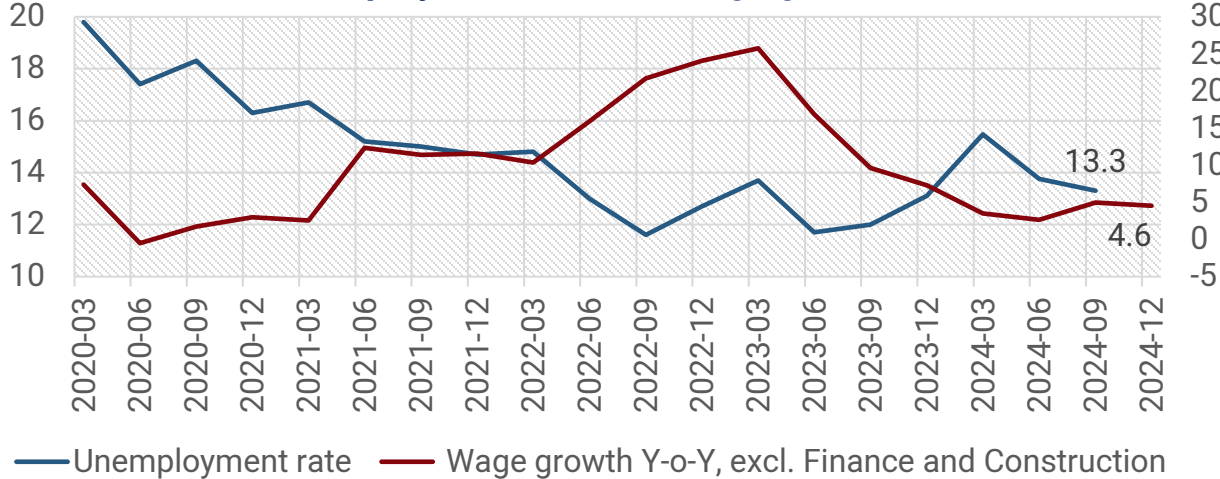
Scenario 1 – Growth of tax revenues based on the actual figures of 2024,
 Scenario 2 – Growth of expenditures based on the actual figures of 2024,
 Scenario 3 – Scenario 2 + excluding a portion of defense spending from capital expenditures (an additional approximately 100 billion dram)

Source: MinFin of RA, CBA estimates

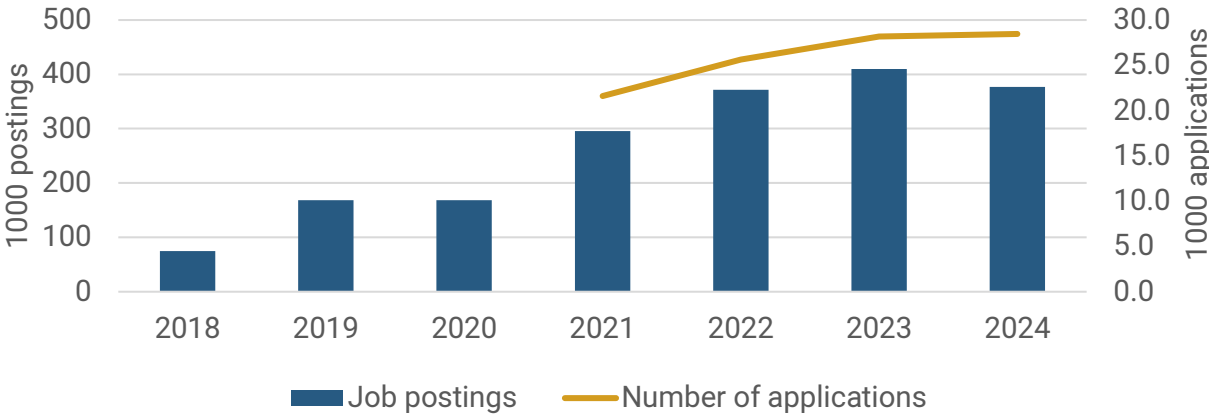
Although uncertainty regarding labor market conditions persists, several additional labor market indicators also point to a certain softening of conditions in recent times



Unemployment rate and wage growth, %

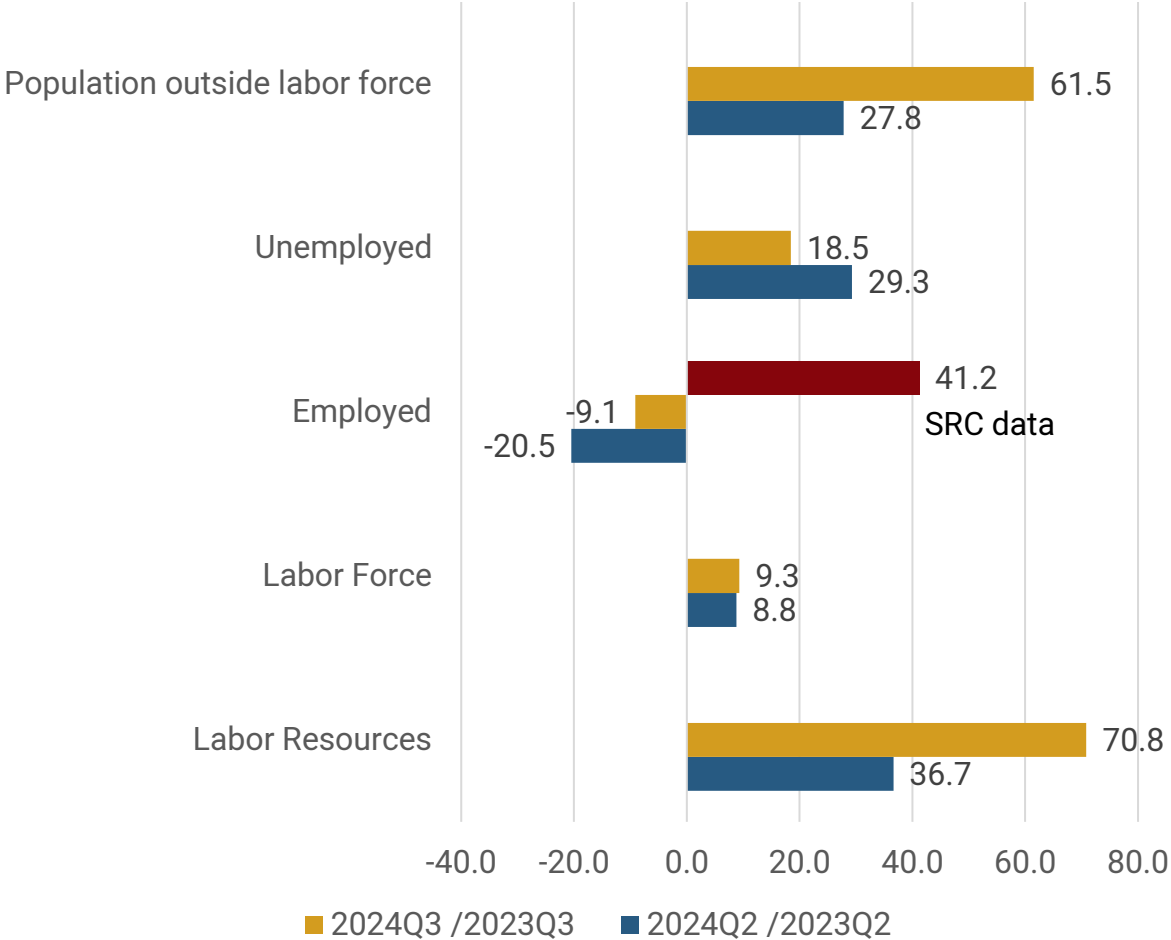


The softening of labor conditions is also reflected on online platforms, with a decrease in the number of job postings, alongside a steady increase in applications



Source` National Statistical Committee of RA, Staff.am

Change in Labor Force, 2024Q3/2023Q3, 1000s

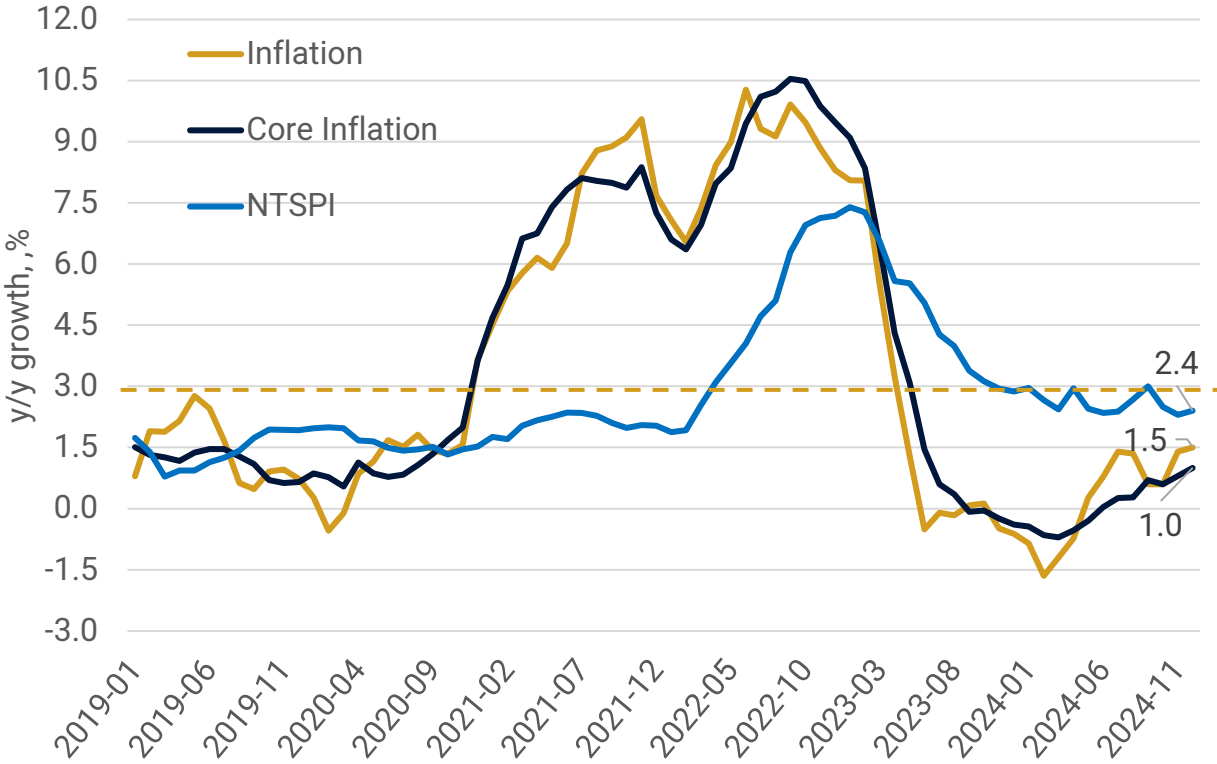


Source: National Statistical Committee of RA

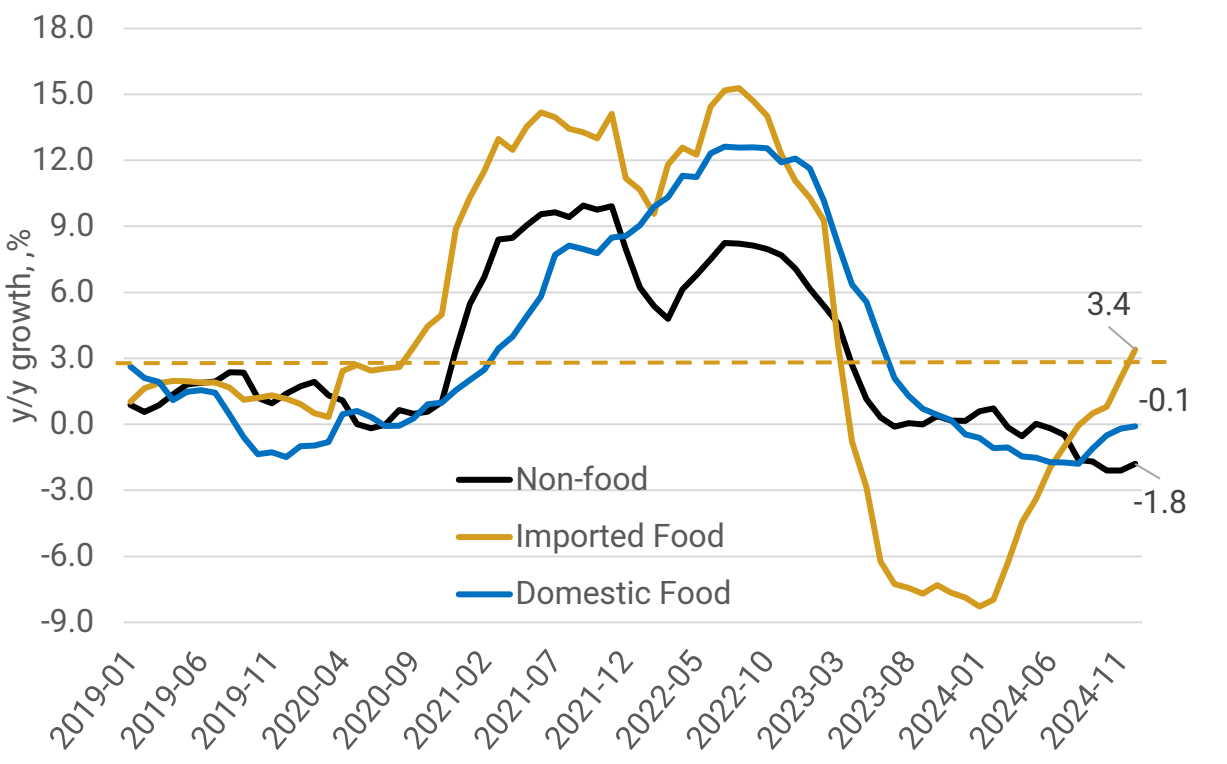
Despite the slight increase in December, the overall inflationary environment in Armenia remains weak, largely due to low imported inflation.



Inflation and core inflation



Some 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.

Inflation in domestic food products remained slightly lower than its historical seasonal patterns after the adjustments in November.

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

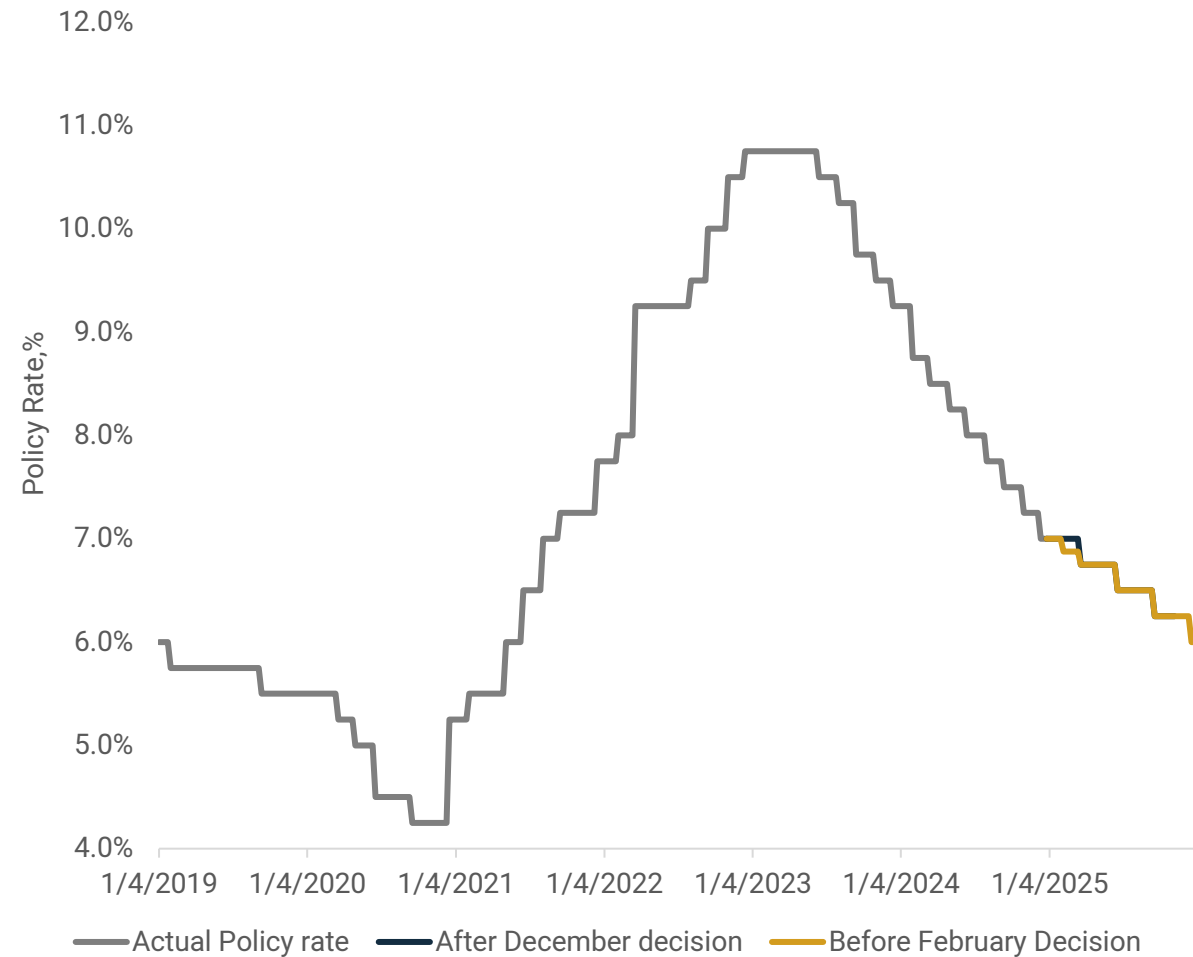


Market Expectations

The Change In Financial Market Expectations After December's Monetary Policy Decision.

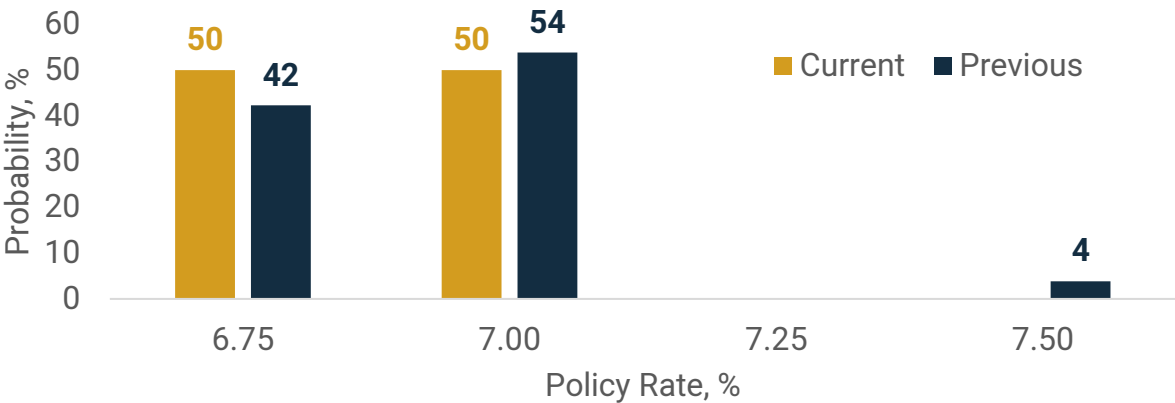


Policy rate expectations over the year ahead.

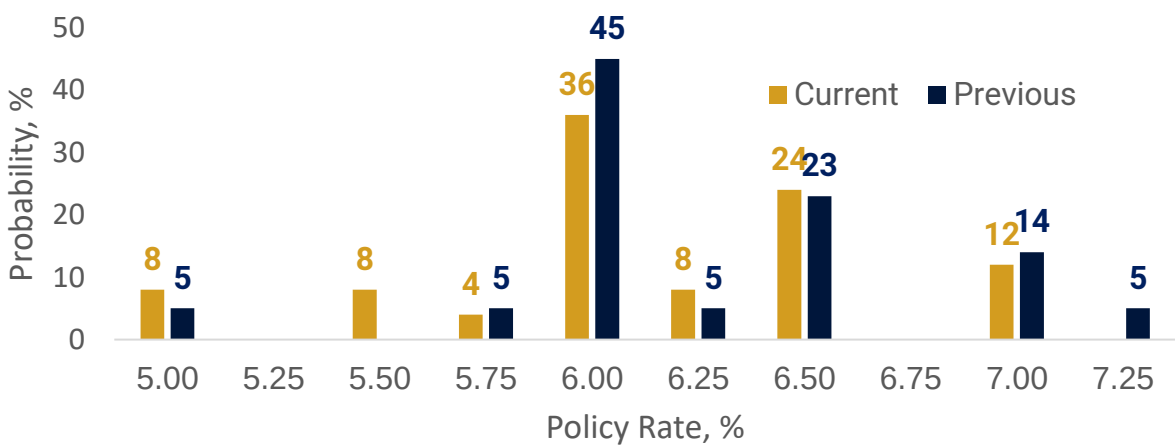


Source` CBA, survey of financial analysts

Expected policy rate change for February

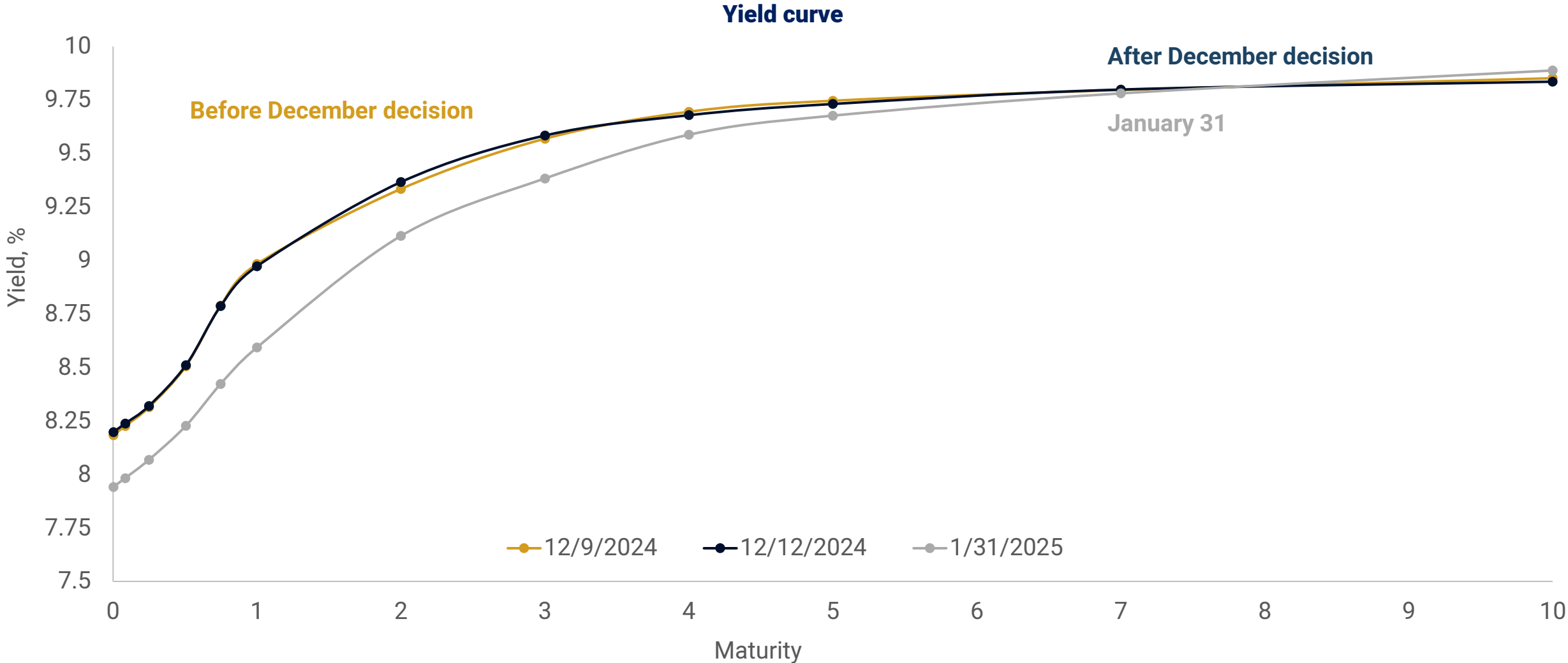


Expected policy rate level for Dec 2025



Source` CBA, survey of financial analysts

The short part of the yield curve has shifted downward after the December decision, while the long part, which primarily reflects the developments of the economy's fundamentals, has remained unchanged



Source: CBA



Policy Discussion

Policy Decision

