

## Building Scenarios: The 3R Principle

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Hello everyone, I'm **Susanna Grigoryan**, an economist at the **Central Bank of Armenia** and a **Level One student at the Global Forecasting School**. In this video, we'll explore how FPAS Mark II makes credibility and communication two sides of the same coin.

Credibility and communication are at the core of FPAS Mark II. In the modern monetary policy environment, credibility is not achieved through the illusion of precision, but through disciplined transparency and consistent communication. The Central Bank of Armenia has designed its entire decision-making process to ensure that communication is not an afterthought but a built-in element of the analytical and policy framework. In FPAS Mark II, the way the CBA communicates is an extension of how it thinks.

In FPAS Mark II, credibility is no longer measured by how accurately the central bank predicts short-term inflation outcomes. Instead, it is defined by how transparently it explains uncertainty, how consistently it applies its framework, and how responsibly it manages risks. Communication has evolved from a supporting function to a central part of the monetary policy process. This change reflects a deeper understanding: in a world defined by uncertainty, trust must be earned through clarity, not certainty.

Credibility in FPAS Mark II is dynamic — it is created, tested, and reinforced with every policy round. The CBA builds credibility through three mutually reinforcing pillars: consistency, which means maintaining coherence between the analytical framework, policy actions, and communication; transparency, which means clearly explaining uncertainty, trade-offs, and the rationale for decisions; and accountability, which means regularly evaluating past projections and decisions and reporting the results to the public. These pillars form what can be called the credibility cycle. Each policy round begins with internal consistency, proceeds through transparent communication, and ends with a public review of outcomes. The cycle then restarts, strengthened by learning and feedback. This continuous process transforms credibility from a static reputation into an evolving institutional asset.

The CBA's communication system under FPAS Mark II is designed to align perfectly with the analytical and decision-making framework. The Monetary Policy Report is the main public document through which this alignment is demonstrated. It no longer serves as a mere forecast summary; it is a narrative explaining how the Board assessed risks, evaluated scenarios, and reached its decision. Each Monetary Policy Report includes the baseline, adverse, and optimistic scenarios, accompanied by a detailed discussion of the asymmetric risks surrounding each. It explicitly states how the least-regrets principle guided the final decision and how the Board weighed the costs of alternative actions. This structure gives the public insight into the reasoning process, not just the results. Press conferences and interviews then reinforce this approach by emphasizing prudence, learning, and humility over certainty.

Credibility under FPAS Mark II is endogenous — it grows out of the central bank's behavior. When the public understands the logic behind policy decisions, expectations adjust more smoothly and with less volatility. Clear communication reduces uncertainty about the central bank's reaction function, making monetary transmission more efficient. Over time, this stability in expectations strengthens the central bank's ability to influence real and nominal variables. In contrast, when communication is inconsistent or opaque, credibility erodes. Markets and the public begin to question whether policy decisions are anchored in analysis or in discretion. By embedding structured communication within the FPAS Mark II process, the CBA has made credibility self-reinforcing — strong communication builds trust, which in turn enhances policy effectiveness.

Communication within FPAS Mark II begins inside the institution. After each policy round, the CBA conducts a credibility review, a structured meeting that assesses how forecasts performed, how markets and the public interpreted decisions, and how effectively communication conveyed the central message. This internal review process helps the institution learn continuously, identifying gaps between intention and perception. Findings from these reviews directly inform the structure of the next Monetary Policy Report and subsequent communication efforts. This disciplined approach ensures that the CBA's external communication is always grounded in self-assessment and internal coherence. It eliminates the gap between what is said publicly and what is believed internally — a gap that often undermines credibility in other institutions.

Many larger central banks still treat communication as a post-decision task. Statements are often crafted after the policy decision is made, rather than being part of the process itself. The Federal Reserve, the Bank of England, and the European Central Bank, for example, have faced criticism for inconsistent messaging and unclear guidance, particularly during periods of high uncertainty. The CBA's approach under FPAS Mark II

stands in contrast — it integrates communication from the beginning of the policy round and aligns it with every analytical step. This proactive approach reflects a culture of transparency and institutional humility. It recognizes that credibility is not built by claiming omniscience but by demonstrating the capacity to manage uncertainty with discipline and openness.

The essence of communication under FPAS Mark II is to make uncertainty credible. By explaining how it manages risks and trade-offs, rather than pretending to eliminate them, the CBA strengthens both transparency and accountability. Credibility in this framework is not a static trait but a continuously earned outcome of prudent and consistent communication. Through this system, the CBA demonstrates how small, agile central banks can lead the global conversation on what credible monetary policy means in an age of uncertainty.

In the past, credibility was often defined by how accurately a central bank could predict inflation. Today, in a world of deep uncertainty, credibility is about something much more important — being transparent about how decisions are made. It's not about showing that we know the future, but that we are managing uncertainty in a disciplined and responsible way. At the CBA, communication is part of the analytical process itself. Every policy round ends with a clear explanation of what we've learned, what we expect, and how we've weighed the risks. This isn't just about publishing a forecast. It's about showing the public how we make decisions and why they can trust the process.

Each Monetary Policy Report includes three scenarios — a baseline, an upside, and a downside. For each one, we explain what could happen to inflation and output, and how the Board evaluated those possibilities. This gives readers a clear view of how uncertainty shapes our choices. It turns complexity into clarity. We call this transparency through structure. When people understand the structure, they understand the decision — even if the outcome changes later. That's what builds lasting credibility. It's about being consistent, transparent, and accountable.

Inside the Bank, we also hold what we call a credibility review after each policy round. We look at how our forecasts performed, how the markets reacted, and whether our messages were clear. That feedback becomes part of the next round. It's how we keep improving. Other central banks are starting to move in this direction, but Armenia is already there. FPAS Mark II makes communication a living part of the policy process. It's proactive, structured, and honest about uncertainty. That's why it works — because people can see the reasoning behind every decision.

In FPAS Mark II, credibility and communication are inseparable. Transparency builds understanding, understanding builds trust, and trust is what anchors expectations — the ultimate goal of monetary policy. Independence gives us the authority to act. Credibility ensures that we act wisely. And clear communication is what ties it all together.

Thank you for watching, and I would like to acknowledge **Douglas Laxton, Jared Laxton, Asya Kostanyan, and Sophio Mkervolidze** at the **Global Forecasting School** for their guidance and support in producing this video.

**See you there.**

### **Literature & Further Reading**

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