CENTRAL BANK OF ARMENIA

THE BETTER POLICY PROJECT
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Scenario-Based Forward Guidance

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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 go inside FPAS Mark II to understand how the anatomy of a policy round works and how it has made the Central Bank of Armenia a global benchmark in operationalizing the principles of FPAS Mark II.

Unlike many institutions that treat forecasting, policy formulation, and communication as separate activities, the Central Bank of Armenia integrates them into a unified and disciplined process known as the policy round. This cyclical process ensures that each stage—from data assessment to communication—feeds back into the next, creating a continuous loop of analysis, decision, and learning. The policy round is not simply a meeting schedule; it is the institutional architecture through which prudence, transparency, and accountability are embedded into every monetary policy decision.

At its core, a policy round under FPAS Mark II is a structured decision-making cycle linking four essential stages: assessment, scenario development, policy simulation, and communication. Each stage involves collaboration across departments—Research, Statistics, Financial Stability, and Communication—and each contributes uniquely to the final decision. This process ensures that the central bank acts with coherence, internal accountability, and clear alignment between its analytical framework and policy objectives. The CBA's innovation lies in treating the policy round as a continuous loop rather than a linear sequence. After each decision, the process transitions immediately into evaluation and feedback, preparing the institution for the next round. This dynamic structure transforms the central bank from a forecasting institution into a learning organization—one that refines its models, judgment, and communication strategy with every iteration.

The first stage of a policy round focuses on diagnosing the current economic environment. The CBA's Research Department maintains a comprehensive set of high-frequency

indicators that cover inflation, labor markets, credit, and external conditions. These are complemented by survey-based measures of expectations and risk assessments drawn from financial market data. Advanced nowcasting tools and mixed-frequency models help generate real-time estimates of key variables such as output and core inflation. The goal of the assessment phase is not just to describe recent data, but to understand the forces driving it. Staff presentations emphasize identifying temporary versus persistent shocks, quantifying their sources, and interpreting how these shocks interact with domestic and external demand. This diagnostic exercise answers the first essential question in any analytical framework: where is the economy today?

Once the current position of the economy is established, attention shifts to the future. In this stage, staff build a set of internally consistent macroeconomic scenarios that capture a range of plausible paths for inflation and output. Typically, three scenarios are prepared—a central or baseline projection, an adverse scenario that incorporates downside risks, and an optimistic scenario that captures potential upside surprises. Each scenario is constructed using the CBA's structural forecasting model, complemented by expert judgment and sectoral analysis. Scenario narratives describe the shocks driving each path—such as changes in commodity prices, external demand, or financial conditions—and quantify their effects. The key innovation of Mark II is that these scenarios are not treated as alternatives to be chosen among but as tools to evaluate risk distributions. The Board's discussion focuses on the shape of these distributions, asking where the balance of risks lies and how it might evolve.

The third stage of the policy round is where analysis becomes decision. Here, the CBA's staff simulate the policy paths required to stabilize inflation and output in each scenario. The emphasis is on robustness rather than optimization. Each potential policy action—whether a rate hike, cut, or hold—is evaluated in terms of the regrets it might generate under different scenarios. This process quantifies the trade-offs between acting too aggressively and acting too cautiously. A key tool used in this stage is the decision table. This table summarizes, for each policy choice, the projected outcomes for inflation, output, and credibility across all scenarios. By comparing these results side by side, policymakers can visualize the risks associated with each action. The Board then discusses which policy path would minimize the risk of large future regrets—those situations where, in hindsight, inaction or excessive action would have caused unnecessary instability. This stage exemplifies the least-regrets mindset that defines FPAS Mark II. It accepts that uncertainty cannot be eliminated and instead focuses on managing it transparently. By embedding structured risk evaluation into the core of the decision process, the CBA ensures that prudence is not just a principle but a measurable practice.

The final stage of the policy round translates complex internal deliberations into clear public communication. The Monetary Policy Report serves as the main vehicle for this transparency. Its narrative explains the economic context, the reasoning behind the decision, and the risks considered. Unlike traditional reports that focus on a single forecast, the CBA's Monetary Policy Report highlights scenario analysis and conveys how the Board weighed competing risks. This approach fosters accountability by allowing external observers—markets, academics, and the public—to evaluate the coherence between the central bank's stated framework and its actions. The clarity of this communication also enhances the effectiveness of policy transmission, as market participants adjust expectations in response to the central bank's explanation of how uncertainty is managed.

What distinguishes FPAS Mark II from previous generations is the feedback loop embedded into the policy process. After each round, staff conduct a detailed evaluation comparing realized outcomes with previous projections. Forecast errors are analyzed not as failures but as sources of information about evolving relationships in the economy. This discipline strengthens institutional memory and ensures that each new policy round begins with improved knowledge and refined judgment. This iterative process creates a living analytical framework—one that continuously adapts to structural changes, measurement challenges, and new forms of risk. It is through this mechanism that the Central Bank of Armenia has become recognized globally for advancing the frontier of monetary policy analysis.

The policy round is the operational heartbeat of FPAS Mark II. It institutionalizes prudence through structure, integrates transparency into every step of the process, and transforms uncertainty from a vulnerability into a manageable feature of policy. The CBA's approach demonstrates that credibility does not come from claiming certainty but from building systems that handle uncertainty systematically. In this way, Armenia has set a new global standard for how small, agile institutions can lead the next generation of inflation-targeting frameworks.

In FPAS Mark II, a policy round is the heartbeat of our central bank. It's a structured process that links data, analysis, decisions, and communication in a continuous loop. In this system, the goal isn't to eliminate uncertainty—it's to manage it systematically. The first stage is assessment. Teams across the bank monitor a wide range of indicators—inflation, labor markets, credit, global conditions, and expectations. We use mixed-frequency models and high-frequency data to understand where the economy stands right now. But we don't stop at describing the data—we dig deeper to identify what's

driving it. Are the shocks temporary or structural? Domestic or global? That diagnosis shapes everything that follows.

The second stage is scenario development. Here, we construct a set of futures—market, Case A and Case B. Each scenario tells a different story about how the economy might evolve. We quantify these narratives using our structural model and combine them with expert judgment. This helps us map the full range of risks and ensures that our discussions aren't limited to a single view of the future.

The third stage is policy simulation. This is where the least-regrets mindset comes to life. We simulate different policy paths and examine how each would perform under our scenarios. Decision tables summarize the outcomes—what happens to inflation, output, and credibility under each possible decision. The Board's job is to ask: which option would we least regret if the world turns out differently than expected? That question anchors the entire discussion.

The fourth stage is communication. Once the decision is made, we explain it transparently in the Monetary Policy Report. Instead of focusing on a single forecast, we show how we weighed the risks and reached our decision. This kind of transparency builds trust—it tells the public not that we know the future, but that we're ready for whatever future unfolds.

And then the process begins again. After each round, we analyze what worked, what didn't, and how we can improve. We compare forecasts to outcomes, learn from our mistakes, and update our framework. That's what makes FPAS Mark II a living system—it learns, adapts, and grows with every decision.

This disciplined process has made Armenia a model for how small, agile central banks can lead global innovation in monetary policy. Independence gives us the authority to act. The policy round gives us the structure to act wisely. Together, they define what credibility looks like in the modern era of central banking.

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

See you there.

Literature & Further Reading

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