# THE CENTRAL BANK OF

# THE REPUBLIC OF ARMENIA

# 

*Approved under the Central Bank Board*

*Resolution No 196A dated December 27, 2021*

## **Inflation Report/4**

## Monetary Policy Program, Q4, 2021

**🟄**

## Status Report on Implementation of the Monetary Policy Program, Q3, 2021

*The inflation targeting strategy of the Central Bank of Armenia highlights the importance of communicating of the Bank to the general public by publishing, inter alia, quarterly inflation reports.*

*«The first section of the inflation report includes the Monetary Policy Program that provides main directions of the monetary policy in the forecast horizon as well as forecasts of inflation and other macroeconomic indicators. These forecasts are based on the Bank's assessment of the current situation and future assumptions by the Bank, which also include the impact of the Bank operations.*

*The second section includes the Status Report on implementation of the monetary policy program of the previous year, which presents the results of monetary policy implementation and covers the actual developments in the domestic economy.*

*Publishing of inflation forecast and underlying assumptions in parallel to target inflation indicator makes monetary policy of the Bank more transparent, understandable and predictable, which considerably increases the public confidence in the Bank. The Bank believes that a clear and trusted monetary policy positively affects the anchoring of inflation expectations and maintaining financial stability in terms of cost reduction.*

*According to the rule of monetary policy, the policy is aimed at minimizing the deviations between the 4% target and the inflation forecasts. The path to inflation rate shaped as a result of projected policy directions is published as a Projection Probability distribution chart for the 12-quarter time horizon.*

*Projections in this report are based on the actual information available by December 14, 2021, i.e. the day on which the refinancing rate was set, the results of survey conducted by the Bank and the judgment made pursuant to the information on future developments of the macroeconomic environment.*

*All inflation reports which have been published to date are available on the Bank's website (www.cba.am) which also contains all press-releases and other monetary policy-related publications.*

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**1. EXECUTIVE SUMMARY**

***Positive developments in demand continue in the fourth quarter of 2021 amid moderate effects of the subsequent global wave of pandemic,*** ***together with the persistence of supply chain disruption and supply constraint factors. In this situation, both in the main partner countries of the Republic of Armenia and compared to the previous forecast, a higher inflationary environment has been shaped, and inflation expectations have somewhat grown.***

Monetary policy impact horizon

**Chart 1**

**Inflation (12-month) projection probability distribution for 3-year horizon**

***In the fourth quarter, 12-month inflation continued to rise, as expected, reaching 9.6% in November. According to the baseline scenario of the Central Bank of Armenia, in the context of the aforementioned factors, inflationary effects transmitted from the external sector are expected to increase, as a result of which the Central Bank has already raised the policy interest rate at this stage.***

*Source: NSS (RA National Statistical Comittee), CBA forecast*

12-month inflation will gradually decline under the current monetary policy and expected economic developments, approaching the target of 4% in the forecast medium-term horizon, and will stabilize around it.

*Current Projection*

**Chart 2**

**Real GDP growth (cumulative)1 forecast probability distribution for 3-year horizon**

***According to the Central Bank's short-term forecast scenario, the forecast for Armenia's economic growth in 2021 has been revised downwards, but will stay higher along the forecast horizon. Hence, economic growth in the medium term is estimated to be slightly above its stable level.***

*Previous Projection*

The revision of economic growth in 2021 is mainly due to the expected lower growth of industry and agriculture, which in terms of demand will be reflected in more restrained domestic demand. In the medium term, the economic growth forecast has been revised upwards compared to the previous forecast, mainly due to the implementation of capital expenditures planned in the 2022 state budget and its economic impact.[[1]](#footnote-1)

*Source: NSS, CBA forecast*

***Тhe risks of inflation deviating from the predicted trajectory in the forecast horizon, are mainly upwards, and the risks in terms of economic growth are balanced*** (details are provided in subsection 2.2.4. “Main Judgments and Risks”). The Central Bank monitors macroeconomic developments and in case of any emergence of risks the CBA stands ready to respond accordingly, ensuring the fulfilment of the price stability objective in the medium term.

2. FORECAST, FORECAST CHANGES AND RISKS

**2.1.** **External Environment Developments**

***While the spread of the pandemic continues to have a modest negative impact on the world economy, the continued recovery of demand contributes to higher economic activity. In the short term, economic recovery in the partner countries of Armenia, particularly in the USA and Russia, will continue, but at a slower than previously expected pace, and the medium-term developments will be in line with previous forecasts. The demand for the Eurozone will recover faster than previously expected across the forecast horizon. Recovery of the global economy will continue to be hampered by disruptions in supply chains, the negative impact of which, as assumed, will continue in 2022. Thus, the recovery of global demand goes hand in hand with supply constraints, which contributes to increasing inflationary pressures worldwide, having an impact on both producers and consumer prices. Inflationary pressures are also reflected in the high global energy and food prices.***

***While the spread of the pandemic continues to have a modest negative impact on the world economy, the continued recovery of demand contributes to higher economic activity.***

***Economic Developments in the United States.*** Current developments in the US economy indicate a slower-than-expected economic recovery. According to the Bureau of Economic Analysis of the US Department of Commerce, the growth of US economy in the third quarter of 2021 was 4.9% on a year-to-year basis, which is lower than previously projected by the CBA. These factors, as well as disruptions in the production chains, will continue to weigh on the slow recovery of the economy. As a result, economic growth in 2021 will be slightly lower than previously forecast, at 5.6%. The second half of 2021 saw a faster-than-expected recovery in labor market conditions (November unemployment was 4.2%), as well as a steady decline in the number of applicants for weekly unemployment benefits, reflecting positive economic recovery trends. It is projected that the pace of recovery of labor market will slow down somewhat amid the uncertainty caused by the spread of the new "Omicron" strain of coronavirus and will remain at that level, and the pre-crisis level of jobs would be restored in the second half of 2022.

In the medium term, US economic growth will slow somewhat, largely due to the tighter monetary policy needed to curb high but already persistent inflation driven mainly by supply-side factors.

In the USA, in the third quarter of 2021, the quarterly personal consumption expenditure price index[[2]](#footnote-2) continued to accelerate and reached 4.3% yoy (accelerated to 5% in October). Inflation in the USA in the third quarter was higher than expected under the previous program forecast, mainly due to higher prices for used cars because of rising demand (which will continue to have a short-term impact) and higher prices for energy, food and housing services. A relatively rapid recovery of high prices and demand for these commodities in the short run, have accelerated inflation, which is further affected by the disruption of global supply chains. Long-term inflation expectations have grown slightly, but remain around the target level (somewhat higher). According to the current forecast of the Central Bank, in these circumstances, the US Federal Reserve will keep policy interest rates at current zero level until the end of the first half of 2022, during which it will complete the purchase of assets planned under the quantitative expansion program. In the medium term, along with the gradual elimination of the impact of supply factors and the easing of monetary and fiscal policies, inflation will begin to slow down, approaching the target level at the end of the horizon.

***Economic developments in the Eurozone.*** Despite the active use of vaccination, the spread of a new type of infection and disruption of supply chains have contributed to the slow recovery of the Eurozone economy in the third quarter of 2021. According to Eurostat estimates, the economic growth of the Eurozone in the third quarter of 2021 totaled 3.7% yoy (which was close to the CBA forecasts). Subsequently, it is estimated that the negative impact of theabove mentioned factors will remain in the short run, and annual economic growth in 2021 will be close to the previously estimated level of 5.5%.

In the third quarter of 2021, inflation was 2.8% yoy, which exceeded the ECB target, and core inflation in the third quarter was 1.5% yoy. At the beginning of the fourth quarter of 2021, inflation in the Eurozone continued to accelerate, and it is expected that the high inflation environment in the short term will persist due to positive developments in demand, and high energy and food prices.

It should be noted that despite the gradual recovery of the labor market, the supply side of the economy is significantly limited, mainly because of shortages of raw materials and inputs and delays in supplies. The European producers prices (also in other partner countries) are quite high. The Central Bank estimates that the current high prices of producers are already reflected in the general price indicators, but in the short term some inflationary effects will still be observed.

Amid certain acceleration of inflation expectations, domestic demand in the EU will recover faster than previously estimated due to the more expansionary monetary conditions, but in the short-term part of the forecast horizon it will still have a restraining effect on inflation.

Subsequently, according to current forecasts, after the neutralization of temporary supply factors, inflation will significantly weaken in the medium term and will slowly approach the target level in the last segment of the horizon. In this context, the European Central Bank will keep interest rates at current low levels at least until the end of 2022, gradually reducing the scale of asset purchase programs.

***Economic developments in Russia***. According to the State Statistics Service of Russia, in the third quarter of 2021, the Russian economy observed a lower-than-expected growth of 4.3% yoy. Nevertheless, according to the forecasts of the Central Bank of Armenia, in the conditions of the growth of international oil prices and the recovery of the global economy, economic growth of 2021 will make 4.6%.

**Chart 3**

**Economic growth in trade partner countries (%)**

Current developments also indicate a faster recovery in economic demand, also reflected in inflation dynamics, which was 6.8% in the third quarter against 6.0% in the previous quarter (remaining above the target level of 4%). Food and non-food prices, acceleration of core inflation and high levels of inflation expectations continued to contribute to the acceleration of inflation and persistence of the current high level. Under the current inflationary pressures, the Central Bank of the Russian Federation raised policy rate by 1.0 percentage point in July, then by 0.25 and 0.75 percentage points in September and October, respectively, setting it at 7.5% and is expected to raise the rate by an additional 1.0 percentage point in December. Despite the faster tightening of monetary conditions, amid high spill-over effects of external inflation and significantly higher inflation expectations, inflation will decline slower than previously projected and reach the target level in the last segment of the forecast horizon.

*Source: BLS, Eurostat, Rosstat, CBA forecast*

**Chart 4**

**Inflation in trade partner countries (%)**

*Source: BLS, Eurostat, Rosstat, CBA forecast*

***Developments in commodity and food product markets. In commodity markets, amid slow growth in supply and continued recovery of demand driven by expansionary economic policies, commodity and food prices continue to rise.***

***In commodity markets, amid slow growth in supply and continued recovery of demand driven by expansionary economic policies, commodity and food prices continue to rise.***

In the third quarter of 2021, international copper prices, as expected, fell due to the Chinese government's control over copper reserves. As a result, the excess copper in market contributed to the reduction of prices. On the other hand, due to the current shortage in a number of inputs, the slowdown in the output of some products has somewhat curbed the demand for copper. As a result, during the third quarter of 2021, international copper prices fell by 3.2% on a quarterly basis, although in the short term, some growth of copper prices is expected.

According to the current forecast of the Central Bank, amid relative supply constraints along with the weakening of short-term restraint of demand, the growth rate of international copper prices in the medium term will accelerate totaling to about 11.5 thousand US dollars per ton.

International oil prices grew faster than expected in third quarter because of the slow growth in market supply and OPEC's decision to keep production growth at the same level contrary to market expectations. In the third quarter of 2021, the q/q price growth was 6.2%. Despite a certain reduction in prices due to the US decision to increase supply in the market at the expense of reserves, short-term forecasts have been revised upwards compared with the previous program. In the medium term, with proportional recovery in global oil demand and supply, at the end of the forecast horizon prices will remain high at around US$ 86 a barrel.

**Chart 5**

**International commodity and food prices**

Food prices in the third quarter of 2021 continued to rise in almost all product groups conditioned by low supply expectations. In the short run, with limited yields and high demand, prices are expected to be high. Prices in the sugar market stabilized at the beginning of the fourth quarter due to the upward revision of crop expectations in India and Thailand. In the grain market, expectations of the new crop have been revised downwards because of unfavorable weather conditions, as a result of which inflationary developments in this product group are expected to continue. No significant inflationary developments are expected in vegetable oil markets as prices will continue to fluctuate around current levels.

*Source: World Bank, FAO, CBA forecast*

As a result, international food prices will remain high in the medium term, with continued high liquidity in the global economy, positive trends in demand and limited supply.

**2.2. Forecasts**

**2.2.1. Inflation and Monetary Policy**

***Inflation has continued to rise in the current quarter. In November 2021, inflation totaled 1.7% compared with 1.3% in the same month of the previous year with the 12-month inflation at the end of the month reaching 9.6%. In November, the 12-month core inflation continued to grow, having reached 8.4%, after the stable dynamics of the previous months.*** ***Developments in both the external and internal sectors of the economy continue to exert strong inflationary pressures on prices. This is evidenced by the dynamics of the annualized rate of core quarterly inflation, which, after decreasing in the last two quarters, has grown in the fourth quarter (see Chart 6).* *The Central Bank finds that monetary conditions in the current situation must be tightened.***

***Developments in both the external and internal sectors of the economy continue to exert strong inflationary pressures on prices.***

**Chart 6**

**Dynamics of annualized quarterly core inflation**

Along with the recovery of demand, relative limitation of supply in partner countries is still observed, contributed also by the persistent disruption of global value chains. Against this background, the prices of both raw materials and agricultural products, as well as general inflation rates in the partner countries, continue to grow, significantly exceeding the previous forecasts. Accordingly, greater inflationary impacts from the external sector will be transmitted to the Armenian economy.

According to current estimates, economic growth in Armenia will be lower than expected, mainly because of the slowdown of growth in agriculture and industry. On the other hand, amid the high rates of external demand and remittances to Armenia, positive developments in terms of demand continue. The structure of the factors contributing to the latter is dominated by the acceleration of external demand, mainly due to the more positive in the tourism sector, while a certain slowdown in domestic consumption has been observed. Within the structure of factors contributing to the latter the acceleration of external demand prevails, mainly due to the more positive developments in the tourism sector, while a certain slowdown in domestic consumption has been observed. Amid relatively low rates of production capacity expansion, the above developments contribute to a positive demand gap, which exerts additional inflationary pressures on the prices of goods and services. It is estimated that in the light of significant inflationary impacts from the external sector and demand developments described above, short-term public inflation expectations have increased somewhat. ***Taking into account the aforementioned factors, the CBA Board decided to raise policy interest rate by 0.5 percentage points at this stage.*** Under the medium-term monetary policy, as well as small restraining fiscal effects, positive GDP gap will be neutralized. Subsequently, 12-month inflation will gradually decrease and will approach and stabilize around the target within the forecast medium-term horizon.

**Chart 7**

**Inflation (12-month) projection probability distribution for 3-year horizon**

*Source: NSS (RA National Statistical Comittee), CBA forecast*

Monetary policy impact horizon

According to the Central Bank estimation, the risks of inflation deviating from the planned trajectory are mainly upward.

***Table 1***

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Period** | **Inflation Interval Projection Probability Distribution** | | | | |
| **<1.0%** | **1.0-2.5%** | **2.5-5.5%** | **5.5-7.0%** | **>7.0%** |
| Q4 2021 | 0.0% | 0.0% | 0.0% | 0.5% | 99.5% |
| Q1 2022 | 0.0% | 0.0% | 4.0% | 20.3% | 75.8% |
| Q2 | 0.0% | 0.2% | 15.4% | 31.3% | 53.1% |
| Q3 | 0.3% | 2.8% | 39.6% | 31.4% | 25.9% |
| Q4 | 0.8% | 4.6% | 43.8% | 28.2% | 22.5% |
| Q1 2023 | 2.4% | 8.2% | 46.9% | 23.5% | 19.0% |
| Q2 | 3.2% | 9.8% | 48.0% | 22.0% | 17.0% |
| Q3 | 3.5% | 10.0% | 47.4% | 21.7% | 17.5% |
| Q4 | 4.4% | 10.6% | 45.6% | 20.9% | 18.5% |
| Q1 2024 | 6.9% | 12.4% | 43.7% | 18.9% | 18.2% |
| Q2 | 9.0% | 14.1% | 43.8% | 17.3% | 15.7% |
| Q3 | 10.8% | 15.2% | 43.5% | 16.3% | 14.3% |

**2.2.2. Economic Activity[[3]](#footnote-3)**

After the deep economic decline of the previous year, the economic growth in 2021 has somewhat restored, and the annual growth is projected at 4.2%. Economic growth in the first half of the year, was mainly due to the rapid recovery of domestic demand, which occurred as a result of acceleration of private consumption and reduction of private savings. Rapid recovery of domestic demand, which took place due to the acceleration of private consumption and the reduction of private savings, was the main driver for economic growth in the first half of the year. In the second half of the year, external demand contributes to the economic growth as well, due to a faster recovery of the flow of tourists visiting Armenia compared to those who left Armenia. Subsequently, net export developments are assessed more positive than in the previous forecasts, while private spending has been somewhat revised downwards, and by 2021 it is estimated to grow by 5.4%. Higher private spending will be due to a 5.5% growth of private consumption and a 4.4% growth in the accumulation of private fixed assets. The latter will start to pick up pace to some extent, but will still show a little restraint as a result of uncertainties in the private sector. Acceleration of private consumption will be facilitated by the gradual reduction of savings, which, however, will be still higher than in the pre-crisis period.[[4]](#footnote-4)

*Source: NSS, CBA forecast*

**Chart 8**

**Contribution of demand4 components to growth (percentage point)**

***After the deep economic decline of the previous year, the economic growth in 2021 has somewhat restored, and the annual growth is projected at 4.2%.***

Medium term economic activity has been revised somewhat upwards over the previous program forecast, and GDP growth is expected to be above its long-term stable level. In particular, the economic growth in 2022 is estimated at 5.3%, which will be mainly due to the growth of public capital expenditures, which in turn will lead somewhat higher private investments. The growth of investments in 2022 will be accompanied by an acceleration of the growth of imports of capital goods, which will worsen the current account to a certain degree, and the impact of investments on exports in the medium term is assessed as positive. On the other hand, tourism exports are expected to continue to recover, at the same time exports and imports of services will grow faster.

***The economic growth in 2022 is estimated at 5.3%, which will be mainly due to the growth of public capital expenditures, which in turn will lead somewhat higher private investments.***

***External Demand.*** Developments in the fourth quarter of 2021 will take place amid the ongoing recovery of the global and domestic economies, persisting high international copper prices, as well as some slowdown in remittances. At the same time, inbound tourism developments outpaced expectations. In the short term, the large tourism surplus recorded since the beginning of the year will continue. Under these developments, current account deficit/GDP ratio in 2021 will remain within the same range as in the previous forecast.

Thus, after the high growth in the third quarter, real growth of exports of goods and services in the fourth quarter will slow down somewhat, mainly caused by slightly higher uncertainty in the mining sector. Despite the spread of coronavirus, tourism exports will significantly outweigh tourism imports. This will be due to already observed more favorable trends in tourism exports indicators than expected in the previous forecast. As a result, the growth rate of real exports of goods and services for the year will be in the range of 12.0-14.0%.

Amid the slow growth and recovery of domestic demand, real imports of goods and services will slow down a bit with the growth in 2021 in the range of 8.0-10.0%[[5]](#footnote-5). It should be noted that in contrast to tourism exports, the recovery of tourism imports will still be limited because of the relatively low rate of vaccination in Armenia compared to the world, which will be reflected in cautious policy towards tourists from Armenia by other countries (especially the European Union).

Weakening of the Russian economic activity during the fourth quarter associated with an increase in the spread of the coronavirus will be reflected in the slowdown in remittances of seasonal workers compared to previous forecasts. At the same time remittances from the United States are also expected to be at a lower level in the fourth quarter than in previous forecasts, which is already observed in the actual developments. Under these forecasts, given the higher than projected growth of total transfers in the first half of the year, their net inflow in 2021 will grow by about 23-26%.

According to above forecasts, current account deficit/GDP ratio in 2021 will remain in the range of 1.0-3.0% as mentioned in the previous forecast.

Growth of real exports of goods and services in 2022 will slow down compared to 2021 as a result of the slowdown in the growth of the mining industry, as well as the reduction of textile exports to the European Union caused by the termination of application of the EU “Generalized System of Preferences” (GSP+) (see Box 1).

**Chart 9**

**Change in real export and import of goods and services in the medium term (%)**

Concerning real imports of goods and services, under the scenario of recovery of domestic demand and import of tourism, growth rates will accelerate compared to the previous year.

Due to the gradual easing of measures to overcome the pandemic, remittances, especially from the United States, will decrease in 2022. Incomes of seasonal workers will continue to recover in line with the developments in the Russian economy. As a result, current account deficit will grow in 2022, and will be in the range of 3.0-4.0%.

In the medium term, in the event of projected global economic developments, domestic demand recovery trends, relatively stable international prices and gradual recovery of tourism, current account deficit to GDP ratio will gradually approach and stabilize at the estimated equilibrium level of 4.0-6.0%.

*Source: NSS, CBA forecast*

***Box 1****[[6]](#footnote-6)*

***Assessment of the Impact of Armenia’s graduation from the “Generalized System of Preferences” (GSP+) of the EU on Armenia's Total Exports and Exports to the European Union***

*The Generalized System of Preferences of the European Union (GSP +) is a system of customs privileges that allows low- and middle-income countries to export more than 6,200 products to the EU market with zero or reduced tariffs. Since 1 January 2009, the Republic of Armenia has been using the EU's Generalized Scheme of Preferences (GSP +) for sustainable development and good governance. According to the provisions of the EU regulation, a country is excluded from the list of beneficiaries of the system if it has been classified as a high-income or upper middle incomecountry by the World Bank for 3 consecutive years. At the same time, according to the regulation, the country is given a one-year transition period, during which it continues to enjoy a preferential trade regime. In 2018, 2019 and 2020, the Republic of Armenia was classified by the World Bank as an upper middle income per capita country.* *According to current World Bank standards (as of July 1, 2021), a country is considered as an upper middle incomeif the country's gross national income per capita is in the range of USD 4,096-12,695 (calculated by the Atlas method). According to the World Bank, the gross national income per capita of the Republic of Armenia for the last three years has been USD 4,240, USD 4,660 and USD 4,220, respectively. 2021 was a transition period for Armenia, and from January 1, 2022, Armenia will no longer benefit from the “GSP +” preferential trade regime.*

**Chart 10**

**The weight of Armenia's exports to EU countries**

*Armenia's exports to the European Union in January-October 2021 amounted to about USD 551 million or about 23% of total exports. At the same time, it should be noted that in Armenia's exports to EU countries raw materials, in particular metals, predominate, whereas under GSP + scheme, exports of base metals (except for copper concentrate) prevail (see Table 3). It should be noted that the share of exports of goods subject to export under the GSP + scheme to the EU in recent years has fluctuated in the range of 40.0-50.0% (see Table 1).*

***Table 1***

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Armenia exports to EU, million USD** | **2018** | **2019** | **2020** | **2018, weight %** | **2019, weight, %** | **2020, weight, %** |
| MFN | 388 | 265 | 194 | 48.2 | 45.5 | 44.7 |
| GSP+ | 268 | 286 | 214 | 39.2 | 49.1 | 49.3 |
| Other\* | 27 | 32 | 26 | 12.6 | 5.5 | 6.0 |
| Total | 683 | 583 | 434 |  |  |  |
| *\* Includes commodity groups eligible for MFN and GSP+ trade regimes.* | | | | | | | |

*To assess the impact of the termination of the EU's Generalized System of Preferences (GSP +) on exports, let us first look at which product groups the tariff changes apply to and provide some estimates of the size of the tariff margins. It is noteworthy that exports eligible for GSP+ regime and realised exports are different for different product groups: utilization rate for metals is quite high, about 100%, while for example, for textiles, it ranges between 30-70%[[7]](#footnote-7). There are some fixed costs for textiles, such as licensing costs for the country of origin, the existence of which may discourage exporters from the use of the GSP + system in case of small volumes of exports, so they may prefer regular Most-Favoured\_Nation (MFN) trade regime. In general, copper concentrate (Table 2) predominates in MFN eligible exports, while ferromolybdenum, clothing and aluminum foil predominate in GSP + eligible exports (Table 3).*

***Table 2***

***Estimates of exports of goods to the EU eligible for MFN regime [[8]](#footnote-8)***

***(products*** ***with*** ***small weight were not considered)***

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Product name, million USD** | **2018** | **2019** | **2020** | **Weight in 2018 exports to the EU, %** | **Weight in 2019 exports to the EU, %** | **Weight in 2020 exports to the EU, %** |
| Copper ore, concentrate and unrefined copper | 269 | 206 | 150 | 39.3% | 35.3% | 34.5% |
| Diamonds | 21 | 19 | 17 | 3.1% | 3.2% | 3.9% |
| Zinc ore, concentrate | 20 | 16 | 13 | 3.0% | 2.8% | 3.0% |
| Cognac, rum, gin, liqueur | 7 | 8 | 9 | 1.0% | 1.3% | 2.0% |
| Molybdenum ore, concentrate | 7 | 7 | 5 | 1.0% | 1.3% | 1.2% |
| Raw or semi-finished gold, powder | 6 | 8 | 0 | 0.8% | 1.4% | 0.1% |

***Table 3***

***Estimates of exports to the EU*** ***eligible for*** ***GSP +[[9]](#footnote-9) regime (products with small weight are not considered), million USD***

|  |  |  |  |
| --- | --- | --- | --- |
| Product name | **2018** | **2019** | **2020** |
| Ferromolybdenum | 124 | 141 | 86 |
| Clothing | 73 | 75 | 62 |
| Aluminum foil | 69 | 67 | 62 |
| Cigarettes | 1 | 2 | 2 |
| Drinks | 1 | 1 | 2 |
| Total | 268 | 286 | 214 |

*Referring to the comparison of the tariff rates of the two trading regimes (see Table 4), it can be concluded that for certain product groups, such as aluminum foil, clothing, cigarettes and beverages, changes in tariff rates can have a significant impact. However, there will be no impact on copper for example, which is the main export item.*

***Table 4***

***Tariffs under Trading Regimes***

|  |  |  |
| --- | --- | --- |
| **Tariff [[10]](#footnote-10)** | **MFN** | **GSP+** |
| Copper concentrate | 0% | 0% |
| Ferromolybdenum | 2.7% | 0% |
| Aluminum foil | 7.5% | 0% |
| Clothing | 12% | 0% |
| Diamond | 0% | 0% |
| Zinc | 0% | 0% |
| Cigarettes | 26% | 0% |
| Drinks | Average tariff: 15.06% | 0% |

*Impact assessments for individual product groups will depend on the size of changes in tariff rates and export opportunities to other countries. In particular, tariff change for ferromolybdenum is estimated to be small (MFN tariff - 2.7%), and export opportunities to other countries less likely. Therefore, under other equal conditions, the maximum possible decrease in exports to the European Union under unit elasticity assumption is estimated at USD 4.8 million, (in 2021, the export of ferromolybdenum to the EU is estimated at about USD 178 million). The potential impact on total exports is also estimated at USD 4.8 million, given the estimated low reorientation opportunities to other countries.*

*The impact on the export of "Knitwear and machine-made or hand-knitted garments" (double-digit product code 61) is estimated to be almost zero, as exports under this product code to the EU are quite small, estimated at USD 1.9 million in 2021.* *The decrease in exports to the European Union is estimated at USD 1.9 million, and the impact on overall exports is zero, as the possibility of reorganizing exports to Russia is estimated to be high.*

*The estimated significant impact on the product group 62 "Textile clothing and clothing accessories (except knitted or crocheted)" is notable. The tariff change is estimated to be significant: MFN tariff rate is 11.8%. As for the eligibility opportunity for the preferential regime, as already mentioned, the utilisation rate is relatively low for textile products. Estimates of the 50% utilization rate (GSP + utilization rate) will be used as a basis for estimates of textile exports to the EU. According to estimates from various sources, this product market is quite segmented, and export opportunities to other countries are limited. As a result, the maximum possible decline in exports to the EU,* *as well as the maximum possible impact on overall exports is estimated at about USD 50.0 million (in 2021, exports to the EU under this product code is estimated to about $ 100 million).*

***Table 5***

***Summary of the possible effects of the graduation from the preferential trade regime of the EU, million USD***

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **EU exports, 2021 estimate** | **Opportunity to export to another country or probability to stay in the same market** | **Possible decline in exports to the EU** | **Possible decline in total exports** |
| Ferromolybdenum | 177.4 | Less likely | -4.8 | -4.8 |
| Clothing (61) | 1.9 | likely | -1.9 | 0 |
| Clothing (62) | 100 | unlikely | -50 | -50 |
| Aluminum foil | 98 | likely stay in EU market | 0 | 0 |
| Total impact |  |  | -56.8 | -54.8 |

*Further to the graduation from GSP + on aluminum foil exports, raise of tariffs by the United States is expected[[11]](#footnote-11). Here, the EU tariff change is also estimated to be large (MFN tariff rate - 7.5%). In case of tightening of trade terms in the mentioned two main markets, the probability of the decline of exports grows up to 110.0 million US dollars. However, according to various estimates, there are opportunities for exports to other countries, as well as a certain neutralizing of the impact on the export of aluminum foil to the EU in light of high international aluminum prices due to certain profit adjustment.*

*In conclusion, it can be stated that the effects of the graduation from the "Generalized Scheme of Preferences" (GSP +) on the total export of Armenia are small, and are manifested solely in terms of textile exports (see Table 5).*

***Fiscal Policy.*** The impact of fiscal policy on aggregate demand for 2021 is assessed as contractionary[[12]](#footnote-12), with a slight expansion in the first quarter and restraining in the other quarters of the year. Amid the economic downturn in 2020 caused by the pandemic and the war, a significantly expansionary policy was implemented, in terms of which 2021 policy can be described as aimed at ensuring fiscal stability.

***The impact of fiscal policy on aggregate demand for 2021 is assessed as contractionary.***

Along with the recovery of the economy, tax revenues in the third quarter of 2021 like in the second quarter tended to accelerate. The over-fulfillment of tax revenues compared to the adjusted program of the state budget for 9 months made 3.5% or 38.1 billion drams. It should be noted that along with the revision of the economic growth target by the Government, the annual tax program indicators have also been adjusted upwards. The annual tax/GDP ratio estimate is 23%, i.e. 0.6 percentage points higher than in 2020. According to the Central Bank estimates, public expenditures will total 97.3% of the annual program adjusted in line with the Government decisions. Тhe low level of expenditures is conditioned, in particular, by expectations of only partial disbursement of external financing against incurred capital expenditures and the resulting co-financing savings. Thus, in 9 months of 2021, capital expenditures on externally financed programs amounted to only 58.6% of the nine-month plan. According to the Central Bank, in 2021 expenditures/GDP ratio will total 28.4%, decreasing by 2.2 percentage points compared to the previous year.

As a result, deficit/GDP ratio in 2021 will total 4.1%, decreasing by 1.3 percentage points compared to 2020, but still above the historical average. However, adjusting government expenditures and revenues from non-aggregate demand flows in 2021 versus 2020 (when fiscal policy expanded significantly), 1.6 percentage point fiscal impulse contractionary effect is estimated.

It is noteworthy that from the point of view of the implementation of the current fiscal policy, as the debt of the Government in 2021 will still be higher than 60% of GDP[[13]](#footnote-13), the Government in 2021 will still stay in the framework of an exceptional case defined by the current fiscal rule.

According to the indicators of the 2022 Law on the State Budget of the Republic of Armenia, compared to 2021, in 2022, 0.3 percentage point growth of taxes/GDP ratio and about 1 percentage point decline of deficit/GDP ratio are expected, as result of which fiscal policy will be somewhat contractionary, creating grounds for reducing the debt of the Government in the medium term and ensuring fiscal stability.

In the medium term, based on the 2022-2024 draft MTEFP, it is expected that, in parallel with the recovery of the economy, the Government will proceed to fiscal consolidation ensuring a gradual reduction of the budget deficit and debt burden due to the higher tax revenues and the improvement of the expenditure structure. Accordingly, ***mainly a neutral fiscal policy is planned in 2023-2024***.

***Labor Market.*** In 2021, nominal salaries in private sector are projected to grow by about 8.1%. The growth rate of nominal wages in the private sector in the medium term, will be in line with the developments of economic growth and inflation which are its fundamental measures. As a result, in 2022, along with the acceleration of economic growth, nominal wages in the private sector are projected to grow by 8.5%, and by the end of the projected horizon they will stabilize at around 6.9%.

**Chart 11**

**Nominal wage growth in private sector, y/y (%)**

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Despite the downward revision of economic growth in 2021, unemployment will remain low, mainly due to the lower labor supply as a result of migration observed since the beginning of the year. Although the latter is in line with previous estimates and has a negative impact on economic growth potential, it is still accompanied by a reduction in the number of unemployed, so in 2021 lower unemployment rate of 15.7% is expected. In the medium term, the unemployment rate will remain in the range of 15-16%.

**Chart 12**

**Unemployment level (%)**

*Source: NSS, CBA forecast*

In 2021, the growth of unit labor costs of enterprises will accelerate because of higher growth in private sector wages relative to productivity, and at the end of the forecast horizon will stabilize around its fundamental measure, i.e. target inflation rate of 4%. In the short run, inflationary effects from the labor market will be maintained and gradually neutralized in the medium term, as economic growth accelerates and productivity recovers.

**Chart 13**

**Unit labor costs growth, y/y (%)**

*Source: NSS, CBA forecast*

**2.2.3. Comparison with the Previous Projection**

***Successful developments in vaccination processes, as well as the experience gained during the previous waves, allows economies to overcome every next outbreak of the virus with milder restrictions. In this context, despite the emergence of new coronavirus stains and some increase in short-term uncertainties, the current medium-term forecast for economic growth in partner countries are broadly in line with previous one.***

**Chart 14**

**US economic growth forecast (%)**

*Source: NSS, CBA forecast*

As a result of the slightly deeper impact of the pandemic in the USA in the short term and tighter medium-term monetary policy than previously expected, economic growth will be somewhat lower than previously forecast.

Due to the above factors, domestic demand in the US will be somewhat softened, but will still have a positive impact on inflation over almost the entire forecast horizon.

*Source: BEA, CBA forecast*

In the Eurozone, amid certain acceleration of inflation expectations resulting from more expansionary stance of monetary policy, the recovery of domestic demand (and subsequently economic growth) will proceed at a faster pace. The supply side of the economy is significantly limited by the shortage of inputs and raw materials resulting from the disruption of international value chains or delays in supplies. In the context of these factors, as well as significant inflationary pressures from the international food and raw materials markets, inflation in the Eurozone has accelerated significantly in recent months and in the medium term will be higher than previously projected.

**Chart 15**

**EU economic growth forecast (%)**

In Russia, in the face of greater damage from the pandemic (certain local restrictions) and tighter monetary policy, economic growth has been revised downwards in the short term, while for the medium term, in parallel with the mitigation of restraining factors mentioned above and amid higher levels of international oil prices compared to the previous forecasts, the growth was revised upwards.

**Chart 16**

**Russia economic growth forecast (%)**

*Source: Eurostat, CBA forecast*

Under the impact of both spillover effects from high inflationary pressures in international food and commodity markets and quick recovery of domestic demand, as well as significant acceleration of inflationary expectations, inflation in Russia will be higher than previously projected. In the medium term, as the impact of supply factors phases out, and under tighter monetary conditions, inflation will slow down, stabilizing around the target at the end of the horizon.

International food prices have been affected by the downwards revision in expected harvest, as well as rising prices of inputs (fuel, fertilizers, feed) for food production, and with high global liquidity, they will remain high in the medium term.

**Chart 17**

**International food price forecast**

*Source: RosStat, CBA forecast*

Due to a smoother overcoming of new pandemic waves, and the streamlined execution of the agreement on limiting oil production, oil prices have formed and in the medium term will be at a higher level than previously projected.

Conditioned by the disruption of international value chains, global demand for copper in the short term has slowed (e.g. manufacturing of vehicles/electric cars has slowed as a result of a shortage of chips), but this will be neutralized in the last part of the forecast horizon after these factors phase out. Therefore, international copper prices, in conditions of relative stability of supply, will be shaped in line with previous forecast.

It should be noted that developments in the international commodity markets will have a significantly higher inflationary impact on the economies of key partner countries than previously expected.

*Source: FAO, CBA forecast*

***Armenia's economic growth estimates for 2021 have been revised downwards, and are expected to be somewhat higher along the forecast horizon.***

Given lower domestic demand expectations, economic growth for 2021 has been revised downwards and, compared to the previous 5.4%, is currently estimated at around 4.2%. The main factor for the downward revision in terms of sectors of economy is the smaller level of economic growth expected in industry and agriculture. At the same time, economic growth in 2022 has been revised upwards, mainly due to the expected increase in capital expenditures in the draft state budget.

**Chart 18**

**International oil price projections**

***Given lower domestic demand expectations, economic growth for 2021 has been revised downwards and, compared to the previous 5.4%, is currently estimated at around 4.2%.***

Compared to the previous forecast, the growth of the industrial sector has been revised downwards. In manufacturing sector, mostly the output of beverages and pharmaceuticals is growing, furthermore, it is expected that investment activity in the sector will remain weak. Output in the mining industry has been declining since the middle of the year. Accordingly, the performance indicators of the industrial sector have been revised downwards because of both the decline in the mining industry and weaker developments in the manufacturing industry. In addition, as a result of the uncertainties in the sector, it is expected that in the medium term the output of the industry will remain at the same level and no significant growth will be observed.

**Chart 19**

**International copper price forecast**

*Source: World Bank, CBA forecast*

***Economic growth in 2022 has been revised upwards, mainly due to the expected increase in capital expenditures in the draft state budget.***

The forecasts of the construction sector compared to the previous program, both in 2021 and in the forecast horizon, have been revised upwards, mainly due to the implementation of capital expenditures envisaged by the state budget and certain stir up of private investments.

The growth of the agricultural sector has been revised downwards, mainly because of lower growth expected under the existing trends of unfavorable weather conditions. It is expected that current decline will continue until the end of the year, and there will be no significant positive changes in this sector.

**Chart 20**

**Real GDP growth (cumulative)14 forecast probability distribution for 3-year horizon**

*Source: World Bank, CBA forecast*

The more positive developments than expected in international tourism have neutralized some of the slowdown in private consumption, as a result of which the growth of the services sector has not been significantly revised compared to the previous forecast and remains the main driver of economic growth.

*Current Projection*

The economic growth forecast for the forecast medium-term horizon has been revised upwards compared to the previous forecast, mainly due to the implementation of capital expenditures envisaged by the 2022 state budget and its economic impacts (see Box 2). As a result, economic growth in the medium-term horizon is estimated to be slightly above its steady state (Chart 18). [[14]](#footnote-14)

*Previous Projection*

*Source: NSS, CBA forecast*

***Table 2***

|  |  |  |
| --- | --- | --- |
| ***Probability Distribution of Real GDP Growth (Cumulative) Projection*** | | |
| Period | 30% Probability Interval | 90% Probability Interval |
| January-December 2021 / January-December 2020 | 4.0 – 4.4 | 3.5 – 4.9 |
| January-December 2022 / January-December 2021 | 4.3 - 6.0 | 1.4 - 8.6 |
| January-December 2023 / January-December 2022 | 3.3 – 5.3 | (-0.3) – 8.5 |
| January-September 2024 / January-September 2023 | 3.0 – 5.0 | (-0.4) – 8.4 |

***Box 2[[15]](#footnote-15)***

**Chart 21**

**Change in economic growth and private investment compared to a stable level under the scenario of additional public investments, according to the GIMF model calibrated for the Armenian economy**

***The Impact of Public Capital Investments in 2022 on Economic Growth and GDP Potential***

**Public Investments**

*The RA Law on the State Budget of the Republic of Armenia for 2022 envisages a rather high level of expenditures in terms of non-financial assets (capital expenditures), aimed at investments in both infrastructure and social spheres. The structure of financing expenditures on non-financial assets envisages an increase in the volume of external and domestic sources. At the same time, the increase in the volume of financing of domestic sources is higher.*

*Expenditures on non-financial assets of the RA state budget in 2010-2020 averaged 3.5% of GDP. In general, in 2020 there was a sharp increase in state budget expenditures as a result of the need for additional expenditures planned by the state budget, as well as anti-crisis measures and military conflict. In particular, transactions with non-financial assets accounted for 3.7% of GDP, growing by 0.7 percentage points (including additional military expenditures as a consequence of military conflict in Artsakh). In 2021, a certain shortfall of expenditures on non-financial assets stipulated by law will take place, amounting to 2.6% of GDP[[16]](#footnote-16). About AMD 350.0 billion capital expenditures are envisaged in 2022 (4.4% of GDP - estimated by law), the increase of which over the amount planned by law in 2021 is about AMD 134.0 billion or 1.8 percentage points within GDP. The main areas of expenditure on non-financial assets include ongoing programs aimed at improving infrastructure, ensuring the country's security, and new measures aimed at strengthening human and physical capital.*

**Economic growth**

**Weight of Private Investments in GDP**

*According to the Central Bank, ensuring the performance and efficiency of the public capital expenditure indicators in 2022 is one of the pillars of economic growth, as well as a guarantee of long-term economic development. Using structural GIMF model (which incorporates monetary and fiscal blocks calibrated for the Armenian economy) analysis was carried out to assess the impact of public capital investment on economic growth. Research shows that the full implementation of expenditures on non-financial assets in 2022 will have a positive impact on the economic growth of that year by 1.4 percentage points, and that the positive contribution will be maintained in the long run as well. In particular, the increase of public investment in GDP by 1.22 percentage points in 2022, in turn, according to estimates, will have a positive impact on private investment, and in the long run, the share of the latter in GDP will grow by 0.3-0.4 percentage points. The increase of capital investments, in turn, will provide a positive contribution in terms of medium-term potential growth, which, according to the Central Bank, will be 0.3-0.4% higher in the medium term due to effective implementation of this policy.*

*It should be noted that there are certain risks in the positive and negative directions concerning non-financial asset expenditure scenario, provided by law, in case of materialization of which economic growth estimates for both the short-term and the forecast medium-term horizon will change.*

**Chart 22**

**Current account/GDP medium-term forecasts (%)**

In 2021, the current account deficit / GDP ratio will be at the level of the previous forecast. Moreover, the high growth of the services balance surplus will exceed the increase of the goods balance deficit.

***Compared to the previous projection, fiscal impulse estimate is almost unchanged:*** revenue-expansionary and expenditure contractionary effects are estimated under assumption of full implementation of adjusted tax program and 97.3% (CBA assessment) adjusted expenditure program.

According to the current forecast, while general inflation dynamics in the short run will be in line with the forecast, core inflation will be somewhat higher than previously forecast. In the short run, high levels of inflation and core inflation will continue to be driven by rising inflation in international commodity markets and pressures on the domestic economy. At the same time, inflationary pressure from international markets is expected to be longer-term than previously estimated. Accordingly, in the short run, inflation will have a higher trajectory than than projected in the previous program, and in the medium term, it will gradually decrease and stabilize around the target level in the forecast horizon (see Chart 1. Inflation Projection Probability Distribution).

*Source: CBA estimate*

**Chart 23**

**Fiscal impulse forecast (percentage point**

*Source: NSS, CBA forecast*

***Short-term inflation expectations will be somewhat higher than the previous forecasts as a result of current developments of core inflation and spill-over inflationary effects transmitted from the external sector to the Armenian economy.***

**Chart 24**

**Short-term inflation expectation estimates (%)**

*Source: CBA estimate*

**2.2.4. Main Assumptions and Risks**

This section presents the main assumptions underlying the Monetary Policy Program for the fourth quarter of 2021, and the risks to implementation of the program coming from external sector developments, fiscal policy, emerging trends and short-term projections.

***Box 3***

**Chart 25**

**Household inflation expectation surveys**

***The results of survey on expectations of households and the financial system***

*According to a survey conducted by the Central Bank on households and financial sector organizations' expectations for a number of macroeconomic indicators in QIII 2021, inflation expectations for the second quarter in terms of general trends have risen somewhat. Specifically, the share of households expecting high and very high inflation rates for a one-year horizon has grown to a certain degree among total respondents. In addition, results of the survey reflect higher level of uncertainty of households about the expected inflation in the third quarter.*

*Source: CBA*

**Projection Judgements**

***Table 3***

|  |  |
| --- | --- |
| **Main Judgements and Assumptions** | **Possible developments if these assumptions prove to be correct** |
| Despite the faster spread of the new type of coronavirus, Omicron, and the uncertainty about its possible consequences, extensive economic restrictions are not expected to be imposed.  As a result of supply chain disruptions, delays in the supply of goods and shortages of certain goods will be observed throughout 2022 as well.  Expansionary economic policies in advanced economies will gradually ease.  The recovery of oil extraction within the framework of the OPEC + agreement will be gradual, in line with the established schedule. | * The economic impact of further spread of coronavirus on the global economy and, in particular, on the main partner economies of the Republic of Armenia will be modest. * While acceleration of inflation in partner economies continues to be largely determined by supply factors, high inflation will persist. * Medium-term inflation expectations in all partner economies have accelerated. In the USA and the EU, they will continue to be at a level close to the target as a result of a slight tightening of policy. * Prices in the international commodity markets will remain at high levels. |
| In the context of persisting high liquidity in international financial markets, country risk premium of Armenia in the forecast horizon will still stay below the long-term sustainable levels. | * As a result of expected tightening of the US monetary policy, country risk premium for Armenia in the fourth quarter grew slightly and is in line with previous forecasts. In the medium term, with the slow decline in global financial liquidity, it will grow, approaching a long-term sustainable level. |
| Rising inflation expectations | * The assessment shows that conditioned by persisting inflationary developments in the international markets, public short-term inflation expectations have somewhat grown amid some acceleration of the actual inflation and recovery of demand. The growth of inflation expectations was subsequently reflected in the level of the neutral interest rate. |
| Expanding revenue and restraining expenditure effects of fiscal policy for 2021, and moderate restraining effects of fiscal policy in 2022. | * In 2021, 0.8 revenue-enhancing expansionary and 2.5 expenditure-restraining impacts are estimated at full execution of the adjusted state budget revenue program and 97.3% execution of the adjusted expenditure program (CBA estimate). According to projections based on the main indicators of the 2022-2024 MTEFP, in the medium term, particularly in 2022, a restraining fiscal policy impact, and in 2023 a neutral impact is expected. * Full implementation of public capital expenditures planned in the 2022 budget will presumably have a positive impact on the GDP potential. |
| The impact of new outbreaks of pandemic on the Armenian economy will be weak. | * There will be no significant economic consequences for the spread of the new type of the virus, and the likelihood of restrictions is low. * With the gradual lifting of travel restrictions, the recovery of inbound tourism in Armenia in 2021 will be within 61% of the 2019 level, but the outbound tourism, in view of current pandemic trends and new restrictions on international passenger traffic in partner countries, will recover at a slower pace, reaching around 47% of the 2019 level. given current worldwide trends of the pandemic, the low level of vaccination in Armenia and the cautious policies implemented by other countries regarding international passenger flows. |
| There is some negative contribution from the extractive industries to the growth of the level of GDP potential. | * Monetary policy scenario does not incorporate operation of Amulsar mines and Alaverdi copper-molybdenum plant. Their potential impact is reflected in the projected risks. * As a result of the logistical problems related to the operation of the Sotk mine, only about 30-35% of the previous capacity of the entire economic chain of gold mining, processing and export will be realized throughout the forecast horizon. * Due to current uncertainties in the sector low output of the other mining companies is still expected. |
| Changes in excise and customs rates by 2023 deriving from the requirement to apply common rates in the EEU. | * The annual impact of the excise tax change expected in 2021-2023 is estimated at about 0․4 percentage point, and the impact of the change in customs rates at 0․3 percentage point for each year. |
| The impact of termination of GSP + preferences on the Armenian economy will be moderately weak. | * The impact of termination of preferences will be mainly on the textile industry, in which case the maximum impact on the overall industry is estimated at 0.7%, and 1.0-2.0 percentage points on real exports. |
| Savings that grew significantly in 2020 amid economic uncertainty, during 2022 will gradually decline. | * The decline of savings will have positive effects on the total demand, however, in the forecast horizon they will still remain above the pre-crisis level because of the availability of precautionary savings amid persisting uncertainties. |
| Rise in prices for regulated services in early 2022. | * In the first quarter of 2022, regulated services, in particular, rents for water supply and electricity, are expected to increase, with the impact on inflation estimated at up to 1.0 percentage points. |

**Forecast Risks**

Coronavirus pandemic is globally manifested by the spread of new transformations and new waves. Various restrictions and requirements applied in the framework of the control measures against them still contain certain risks in terms of both supply and demand restraint, but their consequences are assessed as limited. Concerning the Armenian economy, high uncertainties remain, especially in terms of the investment environment and economic prospects, reflected in the ongoing relatively broad ranges of uncertainty over inflation and other macroeconomic data projections (See Chart 1. Inflation Projection Probability Distribution and Chart 2. GDP Real Growth Projection Probability Distribution). Accordingly, amid high uncertainties, the most significant quantitative risks that exist around the baseline scenario are presented below.

**In terms of aggregate demand, the following risks stand out:**

* External demand risks are mainly related to the prevalence and risk of new type of coronavirus (Omicron), as well as the effectiveness of vaccinations against it. The likelihood and severity of this and the resulting economic constraints will determine the risks associated with the corresponding economic impacts.
* The impact of fiscal policy on aggregate demand in 2022 largely depends on the state budget execution process: there are risks associated to both shortfall of tax collection and tax collection above the planned level (surplus), which may change the expected constraining effect on revenue. In the event of public spending savings or smaller than planned disbursements from external funding sources, expenditures may have a less expansionary or neutral effect. If capital expenditures continue to be underperformed as in recent years, the expanding impact of expenditures will diminish, as well as risks will emerge to economic growth and boosting potential. Therefore, implementation of capital expenditures envisaged by the program is crucial, especially in terms of ensuring long-term economic growth.

**In terms of supply, the following inflationary risks stand out:**

* In case of possible disproportionate tightening of expansionary policies in advanced economies developed countries, there are risks of capital outflows from developing countries and Armenia’s higher country risk premium.
* Commodity price risks are associated with the pace of recovery of the global economy, as well as actual performance of supply factors in commodity markets (e.g. crop volumes, value chain disruptions, etc.).

As a result, the risks to the inflation deviation from the forecast in the medium term are estimated to be upward and, in general, quantitatively still high (see Chart 1. Inflation Projection Probability Distribution).

In addition to the above-mentioned inflation risks, there are additional potential medium-term risks to economic growth, which are bilateral, but upward risks prevail. In particular, risks are related to the following internal factors:

* Uncertainties related to the development of the Amulsar mine and Alaverdi copper smelter, which pose an upward risk.
* Implementation of projects within the framework of € 2.6 billion EU Eastern Partnership assistance package, which is an upward risk.
* The likelihood of a new outbreak as a result of the rapid spread of a new type of disease, which is a negative risk for the economic outlook.
* In case of possible persistence of economic and political uncertainties in Armenia and on-going tension on the border, additional risks of investment reduction will emerge.
* Probability of a decrease of labor resources as a result of possible emigration, which is a downward risk.

Given the low performance of capital expenditures in relation to the adjusted state budget programs of previous years, there are downside risks in terms of the implementation of the corresponding expenditures in 2022 and in terms of investment absorption by the economy. On the other hand, if capital expenditures are effectively implemented, additional effects in the form of increased private investment are possible, which can be considered as a positive risk.

In general, as some uncertainties remain regarding further politico- military and economic developments, the Central Bank seeks to reduce the potential risks arising from these uncertainties by modeling and evaluating different scenarios of further developments and considering the alternatives of policy response, which will allow to react accordingly at the first reasonable signs of emergence of those risks.

**3. ACTUAL DEVELOPMENTS IN Q3,2021**

**3.1. Inflation**

**3.1.1. Fulfillment of the Inflation Target**

The monetary policy to be implemented at the beginning of the reporting period was based on a number of assumptions described below. In particular, amid the growing uncertainties against the background of martial law, quickly spreading second wave of the coronavirus, in the fourth quarter of 2020, low economic activity and weak demand were expected. Starting from 2021, some negative factors, such as the expected slowdown in financial intermediation, as well as the projected weak restraining effect of fiscal policy, would to some extent curb overall demand. However, under the influence of inflationary pressures from foreign commodity markets on domestic prices and the actual depreciation of dram, inflation was expected to accelerate in the next year. Given the expected expansion of the inflationary environment and the increase of country risk premium under the declared martial law, the Central Bank tended to gradually reduce monetary expansionary position in order to achieve the goal of inflation.

During the reporting period, macroeconomic developments both in the external sector and in the Armenian economy were more positive than expected. Thus, as a result of the widespread use of coronavirus vaccination and the avoidance of severe restrictions to a possible extent, a faster recovery of global economic activity and external demand has been observed. Under the influence of a number of supply factors manifested against the background of positive demand developments (forecasts of low supply of new crops, increase in freight costs, disruption of production chains), significant inflationary developments were observed in the international commodity markets. This was also reflected in the formation of a high inflationary environment in the main partner countries of the Republic of Armenia, under which inflationary pressures were transmitted to the economy of the Republic of Armenia through a number of imported food products. In the second quarter of 2021, demand factors were added to supply factors of the impact of international food prices inflation on domestic prices, conditioned by the progressive growth in private consumption over the output capacity expansion opportunities. The latter was mainly due to the sharp increase in household consumption expenditures at the expense of the accumulated savings, as well as the large inflow of remittances. At the same time, amid martial law and economic-political uncertainties, depreciation of the Armenian dram was observed in the foreign exchange market at the beginning of the reporting period, which, in the conditions of fundamental improvement of the external balance, was mostly offset by further dram appreciation. Under the impact of these factors, in the reporting period, as expected, 12-month inflation showed an upward trend, reaching from 1.4% in September 2020 to 8.9% in September this year. Great uncertainty over the economic outlook has also raised inflation expectations to some extent. All this was also reflected in the core inflation performance: during the aforementioned period, the 12-month core inflation also grew significantly, making 8.0% in September. It is noteworthy that the quarterly annual core inflation mainly grew in the first two quarters of the reporting period, and then, until the third quarter of 2021, significantly dropped to 3%.

**Chart 26**

**12-month inflation forecast for the reporting period was periodically revised upwards**

In light of these developments, the projected short-term inflation trajectory to reach the target in each subsequent quarter of the reporting year was adjusted upwards.

Due to the uncertainties arising from the declared martial law during the reporting period, there was a high demand for monetary liquidity in the Armenian financial market, which the Central Bank fully satisfied mainly through its main instrument (7-day repo agreements). Subsequently, short-term market interest rates were mainly shaped around policy interest rate. During the reporting period of 12 months, the Central Bank, adhering to the floating exchange rate policy, took a situational participation in the foreign exchange market in order to ensure the normal functioning of the financial market.

*Source: NSS, CBA*

Taking into account inflationary effects in the external sector and the Armenian economy, and, parallel to it, certain increase of inflation expectations, during the reporting period, the Central Bank, as planned, pursued a policy of tightening monetary conditions, gradually reducing and offsetting expansionary monetary position. To this end, the Central Bank through comparatively big steps raised the refinancing rate setting it at 7.25% in September. It is estimated that such a persistent tightening of monetary conditions has a sufficient impact on the regulation of progressive demand, curbing inflation and ensuring the inflation target in the medium term.

**3.1.2. Prices**

Inflation has accelerated since the end of 2020, and, as projected, inflation environment in the reporting period remained high.

***Inflation has accelerated since the end of 2020, and, as projected, inflation environment in the reporting period remained high.***

The growth of inflation by the year-end was mainly conditioned by the acceleration of core inflation, which was strongly driven by the rise in prices for imported food and non-food products. The latter has been affected by changes of food prices in international markets and devaluation of dram. Thus, spill-over effects from international markets resulted in a sharp growth in the prices of "Bakery and Cereals", "Oils and Fats" and "Sugar" commodity groups in the domestic economy. The growth of international energy prices affected fuel prices. As a result of the rise of fuel prices, as well as the easing of air communication restrictions introduced by some countries in order to prevent the pandemic, air transport tariffs have also grown significantly. As a result of the increase in fuel prices, as well as the easing of air communication restrictions used by some countries to prevent the epidemic, air transport tariffs have also increased significantly. The sharp growth of international freight prices is also notable as it had a direct impact on inflation of imported goods (in particular, electrical appliances, clothing and footwear, as well as personal care items).

In the first half of 2021, inflationary trends continued in the main international commodity markets because of the positive expectations of demand recovery and a number of observed supply factors, which also had a direct impact on the increase in inflation of imported food. At the same time, along with the faster-than-expected recovery of demand in the Armenian economy, inflation in the mentioned period accelerated for locally produced goods and services as well, leading to the adjustment of tariffs for a number of services with rigid prices (medical, hairdressing, legal and postal services).

**Chart 27**

**Since the end of 2020 rapid growth of both 12-month general and core inflation was observed**

In addition to the above-mentioned factors, the acceleration of inflation was significantly fueled by the weaker deflation of seasonal food products in the third quarter of 2021, which is not usual for the season. In particular, the lower-than-usual deflation of vegetables was the result of bad weather conditions, as well as the reduction of arable crops and the growth of exports.

During the year, tariffs for regulated services endured moderate inflationary fluctuations, with 0.6% year-over-year growth in the third quarter of 2021.

*Source: NSS*

Growth of prices of "Tobacco " and "Alcoholic Beverages" product groups, in line with the estimates, continued to be affected by inflationary impact of the change of excise tax rates at the beginning of the year.

***Table 4***

|  |  |  |  |
| --- | --- | --- | --- |
| **Consumer price inflation by commodity items as key contributors** | | | |
| ***Designation*** | **Weight** | **12-month inflation in June 2021** | **Contribution to y/y inflation** |
| **Core inflation** | **74.4** | **8.0** | **5.9** |
| Bread and cereals | 7.7 | 9.5 | 0.7 |
| Meat | 9.7 | 9.0 | 0.9 |
| Oils and fats | 2.3 | 27.1 | 0.6 |
| Sugar | 0.4 | 31.1 | 0.1 |
| Alcoholic beverage | 2.9 | 8.6 | 0.2 |
| Tobacco | 1.6 | 10.4 | 0.2 |
| Clothing | 2.5 | 12.9 | 0.3 |
| Footwear | 1.6 | 11.7 | 0.2 |
| Medicines and health products | 0.5 | 12.4 | 0.1 |
| Fuel | 4.0 | 9.5 | 0.4 |
| Air passenger transportation services | 6.0 | 10․3 | 0.6 |
| Education | 0.6 | 22.2 | 0.1 |
| Hospital services | 2.9 | 2.3 | 0.1 |
| **Seasonal food products** | **9.6** | **28.3** | **2.7** |
| Eggs | 1.3 | 27.4 | 0.4 |
| Fruits | 3.7 | -3.0 | -0.1 |
| Vegetables | 4.7 | 64.5 | 3.0 |
| **Regulated services** | **16.0** | **0.6** | **0.1** |

**Chart 28**

**Compared to the same quarter of the previous year, USD prices on imports of goods and services in the third quarter of 2021 remained at a high level**

***Import prices.*** During the third quarter of 2021, the growth of food prices in global economy was reflected in the acceleration of the growth of import prices in USD terms in Armenia. The latter are higher than the level of the same quarter of the previous year. During the third quarter, import prices in USD terms grew by 0.8% as compared to the previous quarter, with subsequent growth of by 7.2% yoy over the previous year. During the third quarter, growth was mainly observed in the dollar prices of intermediate goods.

As for the developments compared to the same period of the previous year, 7.2% yoy growth was mainly the result of the growth of oil, wheat and sugar prices. Furthermore, growth was observed on almost all imported intermediate goods. Growth in consumer goods prices compared to the previous year was mainly the result of higher dollar prices of consumer goods from Europe, China and Russia.

*Source: NSS*

**3.2. Economic Developments**

**3.2.1. Economy Position**

***GDP gap narrowed somewhat during the reporting period, but remained in the positive range.*** In the third quarter of 2021, economic growth totaled 2.7% (see section 3.2.3), which is lower than the previous forecast of the Central Bank and was mainly the result of lower-than-expected levels of agriculture and industry under the influence of temporary supply factors (unfavorable weather conditions and uncertainties in industry, as well as expected changes in the tax system) Gross demand was also lower than previous estimates, furthermore, structure of demand has changed significantly. In contrast to the prevailing role of domestic demand in the first half of the year, economic growth in the reporting quarter was mainly driven by external demand. Subsequently, the GDP gap narrowed somewhat, but remained in the positive range, which is in line also with the high inflationary environment in the consumer market.

***In the third quarter of 2021, economic growth totaled 2.7%.***

**3.2.2. Expenditure Aspect of the Economy**

Economic growth in the second quarter of 2021 was 2.7%, which is below previous estimates. Economic growth was largely driven by relatively high government spending and net exports, while domestic demand was relatively weak. The downward shift in demand was the result of the decline in private consumption (compared to the previous program, decline totaled 4.4%, although it was expected that private consumption would remain the main driving force in terms of demand, previously restrained demand would restore faster, and private savings would reduce faster). The growth of private investments, on the other hand, was higher than expected (13.6%), which, however, did not have a significant positive contribution to the increase in private spending. Accordingly, private spending fell by 1.8% in the third quarter.

**Chart 29**

**Private spending structure *(y/y growth)***

During the third quarter of 2021, under the expected developments of the global and domestic economies, growth rates of exports of goods and services, far outpaced those of imports of goods and services.

*Source: NSS, CBA estimates*

Growth rates of export of services, in particular, export of tourism, were higher than projected by the Central Bank. At the same time, it should be noted that weak domestic demand was reflected in a lower-than-expected growth of imports of goods and services.

Growth of real exports of goods and services in the third quarter of 2021 was 29.6% yoy, and growth of real imports of goods and services 10.6% yoy. The low level of tourism imports was mainly due to the cautious policies by other countries.

To sum up, net real export contribution to GDP in the third quarter was more positive than expected.

**Chart 30**

**Net export position improved in the third quarter of 2021 (net real export, y/y, %, positive sign means improvement)**

According to estimates, the dollar value of net remittances of individuals (includes seasonal workers income and private transfers) in the third quarter of 2021 will grow by about 10.0%, which is nearly in line with the Central Bank forecast in the previous quarterly program.

As a result of the above developments, in the third quarter of 2021, according to estimates, a current account surplus was formed, mainly due to a larger than expected surplus of net export of services.

***Fiscal Policy[[17]](#footnote-17).*** Actual budget revenues in the third quarter of 2021 were higher than the Central Bank projections[[18]](#footnote-18), and expenditures and loans to economy were within the projections. Compared to the previous quarter, according to the calculated impulse[[19]](#footnote-19), both revenues and expenditures had a restraining effect on aggregate demand of 0.6 and 1.6 percentage point, respectively. At the same time, compared to the forecast, revenues had a more restraining effect, and the impulses of expenditures was in line with the programmed.

**Chart 31**

**The restraining effect of fiscal policy in the third quarter of 2021 is mainly due to the restraining effect of expenditures**

*Source: NSS*

Actual budget revenues in the third quarter of 2021 totaled 103.3% of the CBA estimate[[20]](#footnote-20), due to both surplus of tax revenue collection and high inflows of other revenues. The annual growth of taxes and duties was about 15%, which is mainly due to the increase of value added tax, customs duties, stamp duties and export duties.

Revenue impulse in the third quarter of 2021 against the second quarter was 0.6 percentage points restraining.

State budget expenditures and net lending to the economy in the third quarter were in line with the Central Bank projections. Quarterly yoy growth of government expenditures amounted to 4.4%. Within the structure of state budget expenditures, ***government consumption and actual expenditures on acquisition of non-financial assets*** were in line with the Central Bank's projection.

**Chart 32**

**Main indicators of the consolidated budget *(AMD billion)***

*Source: CBA estimates*

As a result, government spending had a restraining effect of 1.6 percentage points on the aggregate demand over the previous quarter.

Under the above-mentioned developments in revenues and expenditures, in the third quarter the state budget had AMD 72.1 billion deficit, slightly deviating downwards from the deficit figure estimated by the Central Bank. Consolidated budget deficit amounted to around AMD 70.3 billion.

*Source: NSS*

***In terms of the impact on demand and inflation, fiscal impulse in the third quarter of 2021 was restraining.***

The deficit was financed exclusively from internal sources, in particular, net income from the placement of government securities totaled AMD 72.1 billion.

**Chart 33**

**In the third quarter of 2021, state budget had deficit, which was financed by domestic sources (AMD billion)**

Summing up, in terms of the impact on demand and inflation, fiscal impulse in the third quarter of 2021 was restraining.

According to the results of the nine months of 2021, state budget revenues totaled AMD 1,201.5 billion, growing by 11.8% as compared to the same period of the previous year. Taxes and duties totaled AMD 1,137.3 billion, growing by 11.9% compared to the same period previous year, mainly due to the increase in customs duties, stamp duties and export duties. State budget expenditures totaled AMD 1,349.1 billion with a growth of 9.7% over the same period of the previous year. Subsequently, a state budget deficit of AMD 147.5 billion was observed. The impact of fiscal policy on aggregate demand in the nine months of 2021 is estimated to be restraining.

**Chart 34**

**GDP Sectoral Structure (y/y growth, %)**

*Source: RA MoF*

**3.2.3. Output Aspect of the Economy**

GDP growth in the third quarter of 2021 totaled 2․7%, which was well below the Central Bank projection. Decline in the agricultural sector was deeper than expected and was mainly conditioned by huge decline in plant growing as a result of unfavorable weather conditions. The industrial sector in turn provided a large negative contribution to economic growth, mainly as a result of continuing decline in the mining sector conditioned by the existing policy and investment uncertainties in the sector. A smaller-than-expected decline was recorded in the construction sector. It should be noted that in recent months, due to corporate and household funding construction begun to intensify, which is also reflected in the relatively higher investment rate in the quarter under review. The services sector continued to have the largest positive contribution to economic growth, which grew at 8.6% in line with the Central Bank's expectations.

**Chart 35**

**Private nominal salaries (y/y growth, %)**

*Source NSS, CBA estimates*

**3.2.4. Labor Market**

In the third quarter of 2021, the growth rate of nominal salaries of the private sector was close to the previous projections of the Central Bank and amounted to 10.1%, mainly driven by the growth of the services sector. Particularly high growth was observed in the sectors of transportation and inventories, housing and public catering, as well as information and communication. The growth rate of real wages of the private sector in the third quarter was about 3.7%. Unemployment rate in the third quarter of 2021, is estimated at 15.6%, which is in line with previous projections of the Central Bank. The high growth of private wages and the low unemployment rate indicate a certain activation of the labor market, which is in line with the estimated positive GDP gap in the economy and also reflects the decline in labor supply due to migration trends observed since the beginning of 2021.

*Source: NSS, CBA estimate*

**Chart 36**

**Unit labor costs (y/y growth, %)**

During the reporting period, the growth of unit labor costs of enterprises accelerated to 6.5% and reflects higher growth of private wages relative to output growth per unit labor. As a result, inflationary pressures from the labor market persisted and increased somewhat in the reporting quarter.

*Source: NSS, CBA estimate*

**Chart 37**

**During the quarter short-term interest rates continued to stay around the CBA policy interest rate**

**3.3. Financial Market Developments**

***In the third quarter of 2021, the Central Bank Board raised the refinancing rate by 0.75 percentage point setting it to 7.25%.***

Given inflationary effects expected from the global and domestic economies amid high inflation, and, at the same time, emphasizing the importance of neutralizing the expansionary monetary stance, the CBA Board decided to increase the refinancing rate in August (by 0.5 percentage points) and in September (by 0.25 percentage points). The CBA Board also signaled to respond adequately in case of risks of deviation from the forecast, to ensure fulfillment of the goal of price stability.

*Source: CBA*

**Chart 38**

**USD/AMD exchange rate dynamics, October 2020 – September 2021**

***Table 5***

*Source: CBA*

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Average quarterly interest rates in Armenia’s financial market** | | | | | | | | | | | | | | |
| **Indicators** | | **16.09.20-27.10.20** | | **28.10.20-15.12.20** | | **16.12.20-02.02.21** | | **03.02.21-16.03.21** | | **17.03.21-04.05.21** | | **05.05.21-15.06.21** | **16.06.21-03.08.21** | **15.09.21-02.11.21** |
| Central Bank refinancing rate (end of quarter) | | 4.25 | | 4.25 | | 5.25 | | 5.5 | | 5.5 | | 6.0 | 6.5 | 7.00 |
| Central Bank repo rate | | 4.33 | | 4.31 | | 5.47 | | 5.61 | | 5.67 | | 6.7 | 6.97 | 7.34 |
| Interbank repo rate (up to 7-day) | | 4.25 | | 4.29 | | 5.49 | | 5.54 | | 5.62 | | 6.59 | 6.9 | 7.14 |
| Yield of government securities on a yield curve (as of end-quarter) | | | | | | | | | | | | | | |
| Short-term treasury bill (1 year) | 5.59 | | 5.94 | | 6.6 | | 6.83 | | 6.81 | | 7.15 | | 7.59 | 8.18 |
| Medium term notes (5 year) | 6.92 | | 7.36 | | 8.18 | | 8.19 | | 8.24 | | 8.37 | | 8.75 | 9.37 |
| Long-term bonds (30-year) | 8.71 | | 8.98 | | 9.32 | | 9.17 | | 9.25 | | 9.45 | | 9.55 | 10.03 |

**Chart 39**

**Liquidity absorbed and injected through CBA transactions (average monthly stock, AMD million)**

During the third quarter of 2021, again there was a high level of demand for short-term liquidity in the financial market, which was partly due to the change in the reserve requirement ratio during the previous quarter. In these circumstances, the Central Bank has fully covered liquidity demand of the banks, keeping market interest rates close to the CBA policy interest rate.

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In FX market, during the quarter, AMD/USD exchange rate continued to appreciate. Compared to the previous quarter, quarterly average exchange rate appreciated by 6.07. With the view to ensuring sustainability of the financial market, in the third quarter, the Central Bank carried out a small net purchase of USD 10.0 million in foreign exchange market in order to address the situational problems and temporary disruptions in foreign exchange market.

**Chart 40**

**In the third quarter of 2021, government bond yields grew along the entire curve**

 .

*Source: CBA*

*Source: CBA*

Refinancing rate hikes have affected all segments of the government bond market. At the end of September, interest rate growth along the entire yield curve averaged 0.8 percentage points over the end of the previous quarter.

The impact of the CBA policy is also noticeable in the dynamics of the funds attracted by banks in Armenian drams, especially interest rates with a maturity of up to 1 year.

*Source: CBA*

**Chart 42**

**In the third quarter of 2021, interest rates of deposits with a maturity of up to 1 year grew**

 .

*Source: CBA*

**Chart 41**

**Dynamics of the CBA refinancing rate and government bond yields**

 .

Amid the economic and political uncertainties and low investment activity and conditioned by completion of the public support programs in 2020, there is a tendency of decreasing lending by banks and credit organizations in 2021, except for mortgage loans. In September 2021, total volume of lending for the 12-month period dropped by 3.1%.

**Chart 43**

**In the third quarter of 2021, lending rates grew almost for all types of loans**

 .

Continued slowdown in lending growth in the third quarter of 2021 concurred with some increase in interest rates resulting from the increase of the relative assessment of economic risks and the increase of interest rates of the Central Bank policy, the impact was reflected in almost all types of loans: due to an upward revision in the relative assessment of economic risks and an increase in policy interest rates, this impact was reflected in almost all types of loans.

*Source: CBA*

**Chart 44**

**12-month growth flow of lending by banks**

 .

*Source: CBA*

**4. SUMMING UP**

***According to the monetary policy program of the Central Bank of Armenia for the fourth quarter of 2021, 12-month inflation will start to decrease in the near future and in the medium term will approach and stabilize around the target.***

Inflation in the short run will be conditioned by inflationary effects transmitted from the external sector, positive developments in demand, as well as a certain increase in public inflation expectations. In this situation, the Central Bank continues to neutralize expansionary monetary stance by raising policy rate. Inflation will gradually decrease in the medium term ***and will stabilize around the target of 4% at the end of the forecast horizon***.

***The risks of deviating from the projected inflation trajectory in the projected forecast horizon are mainly upwards,*** and in case of their emergence the Central Bank stands ready to respond adequately, in order to ensure the achievement of the price stability objective.

# BOARD MEETING OF THE CBA

**MINUTES (14.12.2021)**

**On the Refinancing Rate**

**The CBA Board Meeting of December 14, 2021 attended by CBA Governor M. Galstyan, Deputy Governors N. Yeritsyan and V. Abrahamyan, and Board Members A Stepanyan, H. Ghahramanyan, H. Khachatryan, D. Nahapetyan and A. Manukyan**

The Board meeting opened with a report of the situation as of December 14. It addressed the developments on inflation, external environment, and real, fiscal, financial and monetary sectors of the economy.

As noted, in November 2021, 1.7% inflation was recorded, as opposed to inflation of 1.3% in the same month of the previous year, as a result of which ***12-month inflation grew, reaching 9.6% by the end of the month***. The monthly inflation was contributed by 3.3% growth in “Food, Beverages and Tobacco” product group, in the structure of which the price growth of *fruit* and *vegetable* subgroups prevailed (4.8% and 16.4%, respectively. In November, prices for non-food products grew by 0.8%, and prices for services, by 0.4%. After the stable dynamics of the previous months, ***12-month core inflation*** during November grew as well, totaling ***8.4%.***

Current developments in the foreign sector were presented, according to which quick recovery of economic activity and aggregate demand in Armenia's key partner countries continues. At the same time, the new strain of coronavirus is rapidly spreading worldwide, leading to additional uncertainties and risks. At the same time, it was stated that, in light of the disruptions in the global economy, which go hand-in-hand with the rapid recovery of external demand, as well as limited supply in a number of commodity markets, prices in the international commodity markets are projected to rise to high levels over the whole forecast horizon. In such a situation, higher inflation developments and acceleration of inflation expectations are observed in the partner countries of Armenia. In order to mitigate them and ensure fulfillment of the inflation target in the medium term, central banks of partner countries continue to tighten monetary policy.

The Board reviewed current developments of the RA economy, and it was noted that the growth of economic activity falls short of the expectations of the Central Bank, mostly because of slowdown in the growth of agriculture and industry sectors. At the same time, aggregate demand remains positive, which, in contrast to the previous quarters, is currently greatly facilitated by the high external demand due to the higher-than-expected growth rates of tourism. While domestic demand is still sluggish, in view of some slowdown in the export of goods, it is expected that by the end of the year there will be some deterioration of the balance of goods, which will be partially offset by the impact of more positive developments in net tourism exports. According to current estimates, both in 2021 and in the medium term, fiscal consolidation implemented pursuant to the principle of debt stability will have a certain restraining effect on domestic demand. However, due to large-scale capital expenditures in 2022, the restraining effect will be significantly mitigated, which will in turn positively contribute to the restoration of economic potential.

The Board reviewed the developments in financial market of the Republic of Armenia and noted that in the reporting period, short-term market interest rates were formed around policy rate of the Central Bank. It was noted that in line with the recent decision to leave the policy rate unchanged, market interest rates in November were relatively stable.

Inflation developments and estimates of inflation expectations were presented to the Board. It was noted that the acceleration of inflation this time was mainly deriving from high external inflation. At the same time, the high inflation in the international markets, according to both foreign analysts and the Central Bank, would gradually decrease in 2022, provided factors disrupting the supply were neutralized. However, current assessments show that value chain disturbances will persist for a longer period of time, as a result of which the central banks of the advanced economies are already reviewing their monetary policy approaches. In such a situation, inflationary spillover effects transmitted from the external sector and positive developments in demand lead to acceleration of quarterly headline inflation, which, according to estimates, also contributes to a certain augmentation of household inflation expectations.

Following a discussion of the situation report and external and domestic macroeconomic developments, the Board proceeded to addressing the monetary policy directions and making decision on the policy rate. Taking into account the substantial spill-over inflationary effects transmitted from foreign economy, as well as the projected developments of inflation expectations, ***the forecasting team suggested to the Board increasing the refinancing rate by 0.75 percentage points***. Despite all Board members approved the baseline forecast scenario and key judgments presented, other policy responses were also reviewed. In particular, some members of the Board believed that in the face of rising inflation and expectations, it was necessary to raise the policy rate, but not with the proposed big step, given the accumulated uncertainties. Some Board members felt that in the face of the spread of new global pandemics, domestic demand developments and global supply constraints, as well as a number of geopolitical uncertainties, it was feasible to refrain from revision of monetary policies at that time, with the view to consider tightening monetary policy in the near future. Finally, ***the CBA Board decided with a majority of voices to raise the refinancing rate by 0.5 percentage point***. Under such conditions, it was projected that the 12-month inflation would gradually decrease and in the forecast medium-term horizon would approach the target of 4% and stabilize around it.

The Board of the Central Bank noted that the risks of inflation deviation from the projected medium-term trend amid the still uncertain economic prospects are mostly upwards, deriving from the ongoing value chain disruptions and supply constraints in international markets, possible pandemic developments and uncertainties arising from geopolitical developments in the region and growing financial market volatility. In case of their materialization the Central Bank stands ready to respond accordingly in fulfilment of the price stability objective.

The Board approved interest rates of monetary instruments of the Central Bank and the proposed press release, which are attached.

**THE CENTRAL BANK OF THE REPUBLIC OF ARMENIA**

**BOARD DECISION**

**On establishment of interest rates of the central bank of monetary policy instruments and press release on refinancing interest rate**

By virtue of Article 2(3), Article 20 “c” and “e” points of the Republic of Armenia law “On the Central Bank”, and provisions of the Republic of Armenia law “On Normative Legal Acts”, the Board of the Republic of Armenia Central Bank, herewith enacts:

1. Set the refinancing rate of the Central Bank of the Republic of Armenia at 7.75%.

2. Set the lombard repo facility rate offered by the Central Bank of the Republic of Armenia at 9.25%.

3. Set the deposit facility rate offered by the Central Bank of the Republic of Armenia at 6.25%.

4. Approve the press release on the refinancing rate of the Central Bank of the Republic of Armenia (attached).

5. This decision shall enter into force on the day following the day of its publication on the website of the Central Bank of the Republic of Armenia.

Martin Galstyan,

Governor of the Central Bank

*December 14, 2021*

**PRESS RELEASE**

**14.12.2021**

At December 14, 2021 meeting, the CBA Board decided to raise refinancing rate by 0.5 percentage points, setting it at 7.75%.

Inflation in November 2021 totaled 1.7%, compared to 1.3% in the same month of the previous year, as a result of which the 12-month inflation grew to 9.6%. After stable performance in recent months, the 12-month core inflation increased in November, reaching 8.4%.

Strong recovery of economic activity and aggregate demand in the main partner countries of Armenia continues. In such a situation, amid remaining supply bottlenecks, a significant expansion of the inflationary environment is observed in international commodity and food markets. The latter is further reflected in the substantial acceleration of domestic inflation in partner countries as compared to previous projections. In order to mitigate high inflation expectations and to achieve the inflation target, Central Banks of partner countries continue to tighten monetary conditions. Altogether, it is expected an increase in inflationary impact from the external sector on the Armenian economy.

The current economic activity in Armenia is estimated to be lower than expected, mainly because of the slowdown of growth in agriculture and industry. Still, positive demand developments carry on, which is currently supported by external demand due to higher-than-expected growth rates of tourism. Against the background of inflationary effects from the external sector and positive demand conditions, certain acceleration of quarterly core inflation and inflation expectations is estimated.

In view of the upsurge of inflationary impacts from the external sector, as well as the estimated developments in inflation expectations, the Board judges appropriate to increase the refinancing rate.

The 12-month inflation is projected to gradually decrease, approaching the target of 4% in the medium-term forecast horizon, and stabilize around it.

The CBA Board assesses that amid the still uncertain economic outlook, the risks of inflation deviating from the projected medium-term path are mainly upward, and should they materialize, the Board stands ready to respond accordingly in fulfilment of the price stability objective.

*Press Service of the Central Bank of Armenia*

**ARMENIA: SELECTED MACROECONOMIC INDICATORS**

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Indicators** | **2014** | **2015** | **2016** | **2017** | **2018** | **2019** | **2020** | **2021** | **2022** | **2023** | **2024** |
| **actual** | **actual** | **actual** | **actual** | **actual** | **actual** | **actual** | **program** | **program** | **program** | **program** |
| **External sector** | | | | | | | | | | | |
| USA economic growth *(%, real growth*) | 2.3 | 2.7 | 1.7 | 2.3 | 2.9 | 2.3 | -3.4 | 5.4 | 3.0 | 2.0 | 2.0 |
| Eurozone economic growth *(%, real growth*) | 1.4 | 1.9 | 1.8 | 2.7 | 1.9 | 1.3 | -6.5 | 5.2 | 4.4 | 2.3 | 0.9 |
| Russia economic growth *(%, real growth*) | 0.7 | -1.9 | 0.2 | 1.8 | 2.8 | 2.0 | -2.9 | 4.4 | 1.9 | 1.5 | 2.3 |
| USA inflation *(average, %)* | 1.6 | 0.1 | 1.3 | 2.1 | 2.4 | 1.8 | 1.2 | 4.4 | 3.7 | 2.2 | 2.4 |
| Eurozone inflation (average, %) | 0.4 | 0.0 | 0.2 | 1.5 | 1.7 | 1.2 | 0.3 | 2.4 | 2.5 | 1.7 | 1.8 |
| Russia inflation (average, %) | 7.5 | 14.4 | 6.8 | 3.6 | 2.8 | 4.4 | 3.3 | 6.4 | 6.1 | 4.2 | 4.0 |
| Oil price *(US$/barrel)* | 115.0 | 53.5 | 45.0 | 54.6 | 71.4 | 64.1 | 42.5 | 71.0 | 80.1 | 83.2 | 85.7 |
| Copper price *(US$/barrel)* | 6825.9 | 5497.4 | 4867.6 | 6201.5 | 6544.7 | 6024.1 | 6191.2 | 9314.7 | 10293.8 | 10871.4 | 11457.5 |
| FAO index | 99.3 | 93.0 | 91.9 | 98.0 | 95.9 | 95.0 | 98.0 | 125.7 | 136.4 | 138.5 | 141.4 |
| **Domestic economy** | | | | | | | | | | | |
| **Prices** | | | | | | | | | | | |
| Inflation *(y/y, end of period, %)* | 4.6 | -0.1 | -1.1 | 2.6 | 1.8 | 0.7 | 3.7 | 8.4 | 5.5 | 4.7 | 4.0 |
| Consumer price index *(y/y, average, %)* | 3.0 | 3.7 | -1.4 | 1.0 | 2.5 | 1.5 | 1.2 | 7.2 | 6.7 | 4.8 | 4.4 |
| Core inflation *(y/y, average, %)* | 1.9 | 5.1 | -2.0 | 0.8 | 4.0 | 1.2 | 1.3 | 7.2 | 6.1 | 5.3 | 4.3 |
| **Gross product** | | | | | | | | | | | |
| GDP *(billion Armenian dram)* | 4828.6 | 5043.6 | 5067.3 | 5568.9 | 6017.0 | 6543.3 | 6181.7 | 6885.4 | 7562.1 | 8210.6 | 8846.5 |
| GDP *(%, real growth)* | 3.6 | 3.2 | 0.2 | 7.5 | 5.2 | 7.6 | -7.4 | 4.2 | 5.3 | 4.4 | 3.6 |
| **Supply** | | | | | | | | | | | |
| Industry *(%, real growth)* | -0.9 | 6.2 | 7.7 | 11.7 | 4.9 | 12.0 | -1.7 | 0.3 | 1.6 | 3.9 | 3.5 |
| Agriculture *(%, real growth)* | 6.1 | 13.2 | -5.0 | -5.1 | -6.9 | -5.8 | -4.1 | -2.2 | 3.3 | 3.1 | 3.0 |
| Construction *(%, real growth)* | -4.5 | -3.1 | -14.1 | 2.8 | 0.6 | 6.5 | -6.7 | -3.2 | 16.8 | 4.9 | 3.4 |
| Services *(%, real growth)* | 6.7 | 1.6 | 3.2 | 10.6 | 9.1 | 10.0 | -9.7 | 7.8 | 5.9 | 4.8 | 3.7 |
| Taxes, net *(%, real growth)* | 1.8 | -5.1 | -3.7 | 9.7 | 8.0 | 7.1 | -10.0 | 5.9 | 4.4 | 4.0 | 3.9 |
| **Demand** | | | | | | | | | | | |
| **Consumption** *(%, real growth)* | 1.2 | -6.0 | -2.1 | 11.6 | 3.8 | 11.7 | -10.1 | 4.6 | 3.9 | 4.0 | 3.8 |
| Public consumption *(%, real growth)* | -1.2 | 4.7 | -2.4 | -2.1 | -3.0 | 12.9 | 15.2 | 0.4 | -4.8 | 2.4 | 5.6 |
| Private consumption *(%, real growth)* | 1.6 | -7.5 | -2.1 | 14.0 | 4.8 | 11.5 | -13.9 | 5.5 | 5.7 | 4.4 | 3.4 |
| **Gross accumulation of fixed assets\*** *(%, real growth)* | -2.2 | 2.5 | -11.4 | 9.7 | 4.8 | 4.4 | -8.6 | -2.1 | 15.7 | 5.4 | 4.3 |
| Public investment\*\* *(%, real growth)* | 10.0 | 13.6 | 5.0 | 31.7 | -37.4 | 31.1 | 15.6 | -21.9 | 58.0 | 7.5 | 6.7 |
| Gross accumulation of private fixed assets *(%, real growth)* | -3.4 | 1.2 | -13.9 | 6.2 | 19.6 | -0.5 | -14.5 | 4.4 | 5.3 | 4.9 | 3.8 |
| **Export of goods and services** *(%, real growth)* | 6.4 | 4.9 | 21.3 | 19.3 | 5.0 | 16.0 | -33.4 | 12.4 | 5.6 | 12.0 | 5.5 |
| **Import of goods and services** *(%, real growth)* | -2.7 | -15.3 | 6.3 | 24.6 | 13.3 | 11.6 | -31.4 | 9.0 | 10.3 | 10.7 | 5.1 |
| **Current account** | | | | | | | | | | | |
| Balance of trade *((million US dollar))* | -2055.4 | -1186.4 | -976.9 | -1400.9 | -1724.4 | -1727.9 | -1356.2 | -1468.1 | -1550.6 | -1652.5 | -1724.3 |
| Balance of services *((million US dollar))* | -113.0 | -96.4 | 70.4 | 159.4 | 24.7 | -66.9 | 100.1 | 371.4 | 224.3 | 199.6 | 187.7 |
| Remittances *((million US dollar))* | 1616.1 | 1098.3 | 1009.4 | 1179.3 | 1136.2 | 1143.8 | 1040.2 | 1310.7 | 1254.5 | 1150.8 | 1103.9 |
| Current account *((million US dollar))* | -883.1 | -284.7 | -107.9 | -173.9 | -875.9 | -1002.3 | -478.7 | -243.8 | -519.6 | -749.9 | -880.4 |
| Balance of trade *(share in GDP, %)* | -17.8 | -12.2 | -8.6 | -10.8 | -13.7 | -13.1 | -9.9 | -8.2 | -8.7 | -9.0 | -9.0 |
| Balance of services *share in GDP, %)* | -1.0 | -0.9 | 0.7 | 1.4 | 0.2 | -0.5 | 0.8 | 2.8 | 1.5 | 1.2 | 1.1 |
| Remittances *(share in GDP, %)* | 14.0 | 10.4 | 9.5 | 10.2 | 9.1 | 8.4 | 8.2 | 9.9 | 8.2 | 7.1 | 6.5 |
| Current account *(share in GDP, %)* | -7.6 | -2.7 | -1.0 | -1.5 | -7.0 | -7.3 | -3.8 | -1.8 | -3.4 | -4.7 | -5.2 |
| **Items** | **2014** | **2015** | **2016** | **2017** | **2018** | **2019** | **2020** | **2021** | **2022** | **2023** | **2024** |
| **actual** | **actual** | **actual** | **actual** | **actual** | **actual** | **actual** | **program** | **program** | **program** | **program** |
| **Public sector\*\*\*** | | | | | | | | | | | |
| Revenues and grants *(billion Armenian dram)* | 1144.8 | 1167.7 | 1171.1 | 1237.8 | 1341.7 | 1559.1 | 1560.4 | 1677.0 | 1947.7 | 1966.7 | 2148.3 |
| Tax revenues *(billion Armenian dram)* | 1064.1 | 1067.9 | 1079.7 | 1158.0 | 1258.1 | 1464.3 | 1385.2 | 1582.0 | 1843.2 | 1889.9 | 2084.0 |
| Expenditures *(billion Armenian dram)* | 1235.1 | 1409.0 | 1449.1 | 1504.8 | 1447.1 | 1623.0 | 1894.3 | 1957.6 | 2184.0 | 2135.5 | 2312.0 |
| Deficit *(billion Armenian dram)* | -90.3 | -241.3 | -278.0 | -267.0 | -105.4 | -63.9 | -333.9 | -280.6 | -236.3 | -168.8 | -163.7 |
| Revenues and grants *(share in GDP, %)* | 23.7 | 23.2 | 23.1 | 22.2 | 22.3 | 23.8 | 25.2 | 24.4 | 25.8 | 24.0 | 24.3 |
| Tax revenues *(share in GDP, %)* | 22.0 | 21.2 | 21.3 | 20.8 | 20.9 | 22.4 | 22.4 | 23.0 | 24.4 | 23.0 | 23.6 |
| Expenditures *(share in GDP, %)* | 25.6 | 28.0 | 28.6 | 27.0 | 24.1 | 24.8 | 30.6 | 28.4 | 28.9 | 26.0 | 26.1 |
| Deficit *(share in GDP, %)* | -1.9 | -4.8 | -5.5 | -4.8 | -1.8 | -1.0 | -5.4 | -4.1 | -3.1 | -2.1 | -1.9 |
| **Monetary sector** | | | | | | | | | | | |
| Broad money *(y/y, end of period, %)* | 8.3 | 10.8 | 17.5 | 18.5 | 7.5 | 11.2 | 9.0 | - | - | - | - |
| Dram broad money *(y/y, end of period, %)* | -3.5 | 5.2 | 24.8 | 28.9 | 13.2 | 21.5 | 14.8 | - | - | - | - |
| Loans to economy *(y/y, end of period, %)* | 20.8 | -3.3 | 6.0 | 16.5 | 17.2 | 18.5 | 14.3 | - | - | - | - |
| USD/AMD *(Armenian dram for one US dollar)* | 415.9 | 477.9 | 480.5 | 482.7 | 483.0 | 480.4 | 489.0 | - | - | - | - |
| *\* Hereinafter, the Central Bank will only present the indicator of the aggregate fixed asset accumulation instead of the aggregate accumulation, since the change in tangible working capital inventories is considered by Armenia’s Statistics Committee as a balancing item and it does not show the true level of the aggregate accumulation. See https://www.armstat.am/file/article/sv\_04\_19a\_112.pdf:*  *\*\* Actual indicators of public investment are capital expenditures of the consolidated budget, and the forecasts are based on the currently revised macro framework for 2022-2024.*  *\*\*\* indicators of the 2021 budget are those of the law "On 2021 State Budget of the Republic of Armenia". The indicators for 2022-2023 are presented from the revised macro framework.* | | | | | | | | | | | |

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1. *The growth rate of each quarter is calculated as the cumulative growth rate for the last four quarters.* [↑](#footnote-ref-1)
2. *The personal consumption expenditure price index target is 2%, which on average is commensurate with headline inflation of 2.3%.* [↑](#footnote-ref-2)
3. *For a detailed economic growth forecasts, see the “GDP Projection Probability Distribution”, Chart 18, Table 2.* [↑](#footnote-ref-3)
4. *Demand does not take into account changes in inventories* *of tangible assets, as it is calculated by the CBA as a balance sheet item and does not reflect the real level of investment. Therefore, growth calculated by supply and demand factors can variate. See: https://www.armstat.am/file/article/sv\_04\_19a\_112.pdf* [↑](#footnote-ref-4)
5. *The real growth rates of exports and imports of goods and services in the first half of 2021 have been revised by the RA NSS․* [↑](#footnote-ref-5)
6. *Prepared by Harutyun Sargsyan (Monetary Policy Department).* [↑](#footnote-ref-6)
7. *See GSP STATISTICS (1 DECEMBER 2020), European Commission tps://trade.ec.europa.eu/doclib/docs/2020/february/tradoc\_158640.pdf* [↑](#footnote-ref-7)
8. *The assessments are the author's estimates.* [↑](#footnote-ref-8)
9. *The assessments are the author's calculations. Exports of goods eligible for GSP + and actually realized exports may differ depending on the opportunity to use the preferential trade regime.*  [↑](#footnote-ref-9)
10. *Source https://ec.europa.eu/taxation\_customs/dds2/taric/taric\_consultation.jsp?Lang=en* [↑](#footnote-ref-10)
11. *See https://www.trade.gov/faq/final-determinations-antidumping-and-countervailing-duty-investigations-aluminum-foil-armenia* [↑](#footnote-ref-11)
12. *Based on the indicators of the RA Law on the State Budget of the Republic of Armenia for 2021, the adjusted budget program, expected estimates, current developments, and the Central Bank's relevant assessments. The adjusted program is the current quarterly and annual program adjusted in line with the Government decisions.* [↑](#footnote-ref-12)
13. *Assessment of the Ministry of Finance given in the 2022 Law on the State Budget of the Republic of Armenia.*  [↑](#footnote-ref-13)
14. *The growth rate of each quarter is calculated as the cumulative growth rate of the last 4 quarters.* [↑](#footnote-ref-14)
15. *Prepared by Hayk Karapetyan, Angela Karapetyan (Monetary Policy Department), Gevorg Minasyan (Department of Economic Research).* [↑](#footnote-ref-15)
16. *2021 GDP is the CBA estimate.*  [↑](#footnote-ref-16)
17. *The review of the fiscal sector used actual consolidated budget indicators at the fourth quarter.*  [↑](#footnote-ref-17)
18. *The estimate of quartelry revenue program is based on the actual revenue collection trends and operative monthly programs of the Finance Ministry. Expenditure projection is the Central Bank estimate.*  [↑](#footnote-ref-18)
19. *Fiscal impulse is calculated against the previous quarter.*  [↑](#footnote-ref-19)
20. *The annual revenue program of the Central Bank coincides with the current annual adjusted program of the Government, which also includes changes made in accordance with the legislation during the reporting period. However, the quarterly revenue projections are the Central Bank's assessment, which is based on current developments. and monthly programs provided by the Ministry of Finance.*  [↑](#footnote-ref-20)