Determinants of Monetary Transmission in Armenia

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Description of the policy problem under investigation

A well-functioning monetary policy transmission mechanism is a guarantee for a successful monetary policy, therefore examination of the impacts of its main determinants in Armenia was of a great interest, and served as an inspiration for the given research. The final goal of this research is to identify the main disturbing factors for the monetary policy transmission to CPI inflation in Armenia, and measure the influence of those factors on the effectiveness of monetary pass-through. Following the research objectives, first of all we were required to find a proxy variable which described the effectiveness of monetary policy transmission (hereafter MTS) in Armenia, and then this variable was used as an outcome variable in the final regression analyses.

The results and policy recommendations arising from the research

This was the first attempt to estimate the historical developments of the monetary policy pass-through in Armenia, and get time series for it. This is a valuable contribution to the literature which not only makes it possible to use the resulted time series in the second stage of the analyses, but also helps to understand the developments of monetary policy pass-through in Armenia during different periods, and finally, the results can be used in the further research projects as an explanatory variable in different empirical studies.

During the second stage the estimated MTS variable was used to evaluate the relationships of monetary transmission and its main determinants. The final results provide the long-run and short-run effects of financial dollarization, financial developments, and other factors on the monetary policy pass-through in Armenia. We got strong empirical results, which were supported by the theory and correspond to our initial beliefs. Therefore, the results of this research are

considered realistic and provide an opportunity for monetary policy authorities in Armenia to think about monetary policy transmission mechanism and the ways of its improvements.

Directions for further policy analysis

However, we understand that the research also faces some limitations and should be improved during the future researches. The main limitations of the research are the short history of the time series, which may generate some bias during the estimation. The complications of choosing appropriate priors for the TVP_VAR model while estimating the monetary pass-through coefficient. It is crucial, to give such a priors to the model, which will not create distortions while estimating the coefficients. Another issue of the research is connected with the second stage. Literature suggests other factors, for example financial system competition and health, or excess liquidity, which theoretically affect the strength of monetary transmission. The inclusion of these variables was not possible first of all because of their short history, and also these variables for Armenia do not have explanatory power because of the lack of vulnerability. It is also reasonable, to think about the existence of many country specific factors, which may have significant influences on the monetary transmission.