

BOARD MEETING OF THE CBA

MINUTES

(02.02.2021)

On the Refinancing Rate

The CBA Board Meeting of February 2, 2021 attended by Governor M. Galstyan, Deputy Governors N. Yeritsyan and V. Abrahamyan, and Board Members H. Ghahramanyan, A. Stepanyan, O. Aghasyan, H. Khachatryan, and D. Nahapetyan

The Board meeting opened with presentation of the Situation Report as of February 2, 2021. The inflation, external environment, and real, fiscal, financial and monetary sector developments were addressed in the context of the impact of uncertainties about the persisting pandemic and the economic outlook in the world.

It was recorded that inflation in December of 2020 stood at 3.4% compared to that of 1.3% registered in the same month last year, in which case the **12-month inflation rate has increased considerably to 3.7% at the end of the year**, getting as close to the target as possible. The month's inflation mainly owed to a 7.2% rise in prices of item "Food products and non-alcoholic beverage", in which the prices of imported food products grew the fastest. In December, prices of non-food products increased by 2.3% and service tariffs, by 0.3%. Alongside a headline inflation, the **12-month core inflation rate** has increased as well, amounting to **3.6%** in end December.

The external sector developments for January 2021 were addressed, stating that these unfolded mostly in line with the scenario outlined in Q4 2020 MP program of the Central Bank of Armenia, according to which signs of rebounding global economic activity and demand are observed. Among key partner countries to Armenia, this has been noticeable in the United States and Russia, whereas recovery in the Eurozone is taking place slower than expected as the restrictions imposed to overcome the pandemic were extended. At the same time, inflationary trends continued to be seen in main commodity markets, responding to the expectations for world demand recovery and a number of supply factors. Such trends were transmitted and reflected also through shaping of higher-than-expected inflationary environment in partner countries. However, as inflation in the US and Eurozone is still below the target, there the central banks will continue conducting a stimulative monetary policy, while the Central Bank of Russia will reduce the size of monetary policy stimulus during the year in order to contain inflationary expectations deriving from accelerating inflation, according to the CBA estimates.

As to the economic situation in Armenia, the developments of the fourth quarter were discussed and annual results of the economic activity summed up. It was recorded that economic activity proved lower-than-anticipated and domestic demand remained weak in the fourth quarter amid a new wave of pandemic outbreak and the martial law declared in Armenia, coupled with increased uncertainty over the economic development outlook. As a result, the 2020 economic activity indicator has decreased by 7.5% mainly due to large declines reported in services and construction during the year. The weakening of domestic demand was primarily caused by a significant decline in private consumption, which in turn was due to cautious behavior of people in the face of current uncertainties, as well as the slowing in lending growth noticeable in recent months. With uncertainties and risks persisting, the aforementioned trends are estimated to carry on and have a negative impact on the domestic demand in the beginning of 2021, according to the results of monitoring. Meanwhile, in the fourth quarter the Government continued implementing a stimulative fiscal policy, and the inflow of remittances from abroad proved larger than expected, which somehow mitigated the negative impact of the above factors. In such a situation, it was noted, considerable risks to long-term economic growth potential had emerged, and, in that context, the Board underscored the importance of having an appropriate fiscal policy spending strategy in place, which, along with other structural reforms to be undertaken by the Government, would be steered to restoring the economic potential.

The Board looked to the possible developments of inflationary expectations in the Armenian economy in the fourth quarter. It stated that high inflation had been fueled mainly by supply factors and, in particular, by a rise in prices of a number of imported food products. At the same time, inflationary expectations somehow increasing in line with price inflation are estimated as manageable and are mainly anchored.

Talking about the situation in Armenia's financial market in January, the Board noted that the short-term market rates had reacted accordingly to a policy rate rise by the Central Bank of Armenia late in the previous year, shaping mainly around it. An increase in interest rates was also observable in the government bond market, where yields have grown along the entire curve. At the same time, reduced country risk premium in the international financial markets has been admitted as a positive result, supported also by rather a low yield on the Republic of Armenia Eurobonds allocated in January. The discussion showed that, without underrating the aspect of a generally favorable market environment, low yield also reflects the trust of international investors in the country's macroeconomic stability and in the institutions that are in charge of securing such stability, as a long-term fundamental factor. It is therefore estimated that the reduction in risk premium is not going to be short-term. In the fourth quarter, it was noted, interest rates on loans and deposits in the banking system were still not reacting to the change in interest rates in the interbank and securities markets, demonstrating mainly a

steady behavior, whereas growth rates of bank lending to the economy have slowed to a certain extent, driven mostly by a decrease in consumer loans.

Following the presentation of the Situation Report and discussion on macroeconomic developments in external and domestic sectors, the Board began addressing the monetary policy directions and making decision on the policy interest rate. In view of the inflationary effects transmitted from the external sector and somehow accelerated inflationary expectations in the Armenian economy on the one hand, and persisted weak demand and reduced country risk premium, on the other, a **scenario of leaving the refinancing rate unchanged was proposed to the Board's consideration**. Though unanimous in acknowledging the above factors, the Board members' votes went divided over how these developments would further unfold and to which extent they would affect inflation. Some members believed that notwithstanding a persistently weak demand and high inflation driven by supply-side factors, inflationary expectations are accelerating to some extent, and the CBA should express its position by raising the interest rate in a small step. Others suggested raising the interest rate in a bigger step, supporting a judgment for an expected increase in prices of food products from the external sector in the coming year, hence acceleration in inflationary expectations in Armenia, the short-term nature of decrease in the country's risk premium in the international market and significant reduction of the domestic economic potential. As a result, the **CBA Board decided by a majority of votes to raise the refinancing rate by 0.25 pp**, and stated that it will be consistent in taking appropriate action to absorb any risks to unanchored inflationary expectations. In such conditions, according to the CBA estimates, inflation will somewhat increase in the near future and then will gradually decrease, stabilizing around the 4% target in the forecast horizon.

The Board admitted that under high uncertainty about economic outlooks, risks to inflation deviating from the mid-term projection path are balanced. Should such risks emerge, the Central Bank stands ready to respond accordingly, while fulfilling the objective of price stability.

The Board approved the decision on interest rates of the CBA monetary instruments and the proposed press release, which are attached hereto.

Deciding on the interest rate

Code

050.0008 L. 02.02.21

02 February 2021

Interest Rates of Monetary Policy Instruments of the Central Bank of Armenia

By virtue of Article 2 (3), Article 20 “c” and “e” of the Republic of Armenia Law on the Central Bank, and clauses of the Republic of Armenia Law on Normative Regulations, the Board of the Central Bank of the Republic of Armenia **enacts:**

1. Set the Refinancing rate of the Central Bank of the Republic of Armenia to be 5.5%.
2. Set the Lombard facility rate offered by the Central Bank of the Republic of Armenia to be 7.0%.
3. Set the Deposit facility rate offered by the Central Bank of the Republic of Armenia to be 4.0%.
4. This decision takes force on the day following its publishing on Internet homepage of the Central Bank of the Republic of Armenia.

Martin Galstyan,

Governor of the Central Bank

February 2, 2021

c. Yerevan

Press release

02.02.2021

At the February 2, 2021 meeting, the Board of the Central Bank of Armenia decided to raise the refinancing rate by 0.25 pp, setting it at 5.5%.

Inflation in December 2020 amounted to 3.4%, mainly due to the rise in prices of imported food products, in which case the 12-month inflation has increased significantly and nearly approached the target level, reaching 3.7% at the end of the year. In December, the 12-month core inflation also increased, making up 3.6% at the end of the month.

Early in 2021, in line with the scenario outlined in the monetary policy program of the CBA, signs of reviving economic activity and demand recovery are observed in the United States and Russia, among the key partner countries to Armenia, while trends in the Eurozone are slower than anticipated due to the restrictions imposed under the spreading pandemic. At the same time, driven by expectations of global demand recovery and influenced by a number of supply factors, inflationary developments continue to persist in the global commodity and food markets, which is also reflected in the higher-than-expected inflationary environment in key partner countries. Under such circumstances, the CBA Board estimates that mostly inflationary impact on the Armenian economy from the external sector is persisting.

Economic activity in the fourth quarter proved lower than expected in the context of the announced martial law in Armenia, the spread of coronavirus pandemic and high uncertainty over the economic growth outlooks. The economic downturn was largely due to the decline in the services sector, reflecting also weak demand. The projected slowdown in lending to the economy is predicted to have an additional negative impact on domestic demand. Along with these developments, in recent months there has been some improvement in the country's risk premium estimates in the international financial markets. Nonetheless, the Board is of the opinion that, in the current situation, it is important to implement potential growth-enhancing structural reforms, including through the adoption of an appropriate fiscal spending strategy.

Despite a sluggish demand and primarily a supply-side driven inflation, there is some acceleration in inflation expectations as a result of the latter, and the CBA Board therefore considers it appropriate to increase the refinancing rate. The Board will also stay committed in taking appropriate actions to neutralize any risks of inflation expectations destabilization. Under such conditions, inflation in the forecast horizon will be around the 4% target.

The CBA Board finds that the risks of inflation deviating from mid-term projection path amid high uncertainty over economic outlooks are balanced, and should they emerge, the Central Bank stands ready to react accordingly, in fulfilment of the goal of price stability.

Detailed information that underlies the decision on setting of the interest rate will be available in Press Release (Minutes on Interest Rate) to be published by February 16, 2021.

You can read detailed information underlying the decision on the level of interest rate in Press Release (Minutes on Interest Rate) to be published by February 16, 2021.

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