THE CENTRAL BANK OF THE REPUBLIC OF ARMENIA

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STATUS REPORT ON IMPLEMENTATION OF THE MONETARY POLICY PROGRAM

(Inflation Report)

Q3, 2010

YEREVAN
2010

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1. SUMMARY

Q3 2010 ACTUAL INDICATORS AND DEVELOPMENTS

The main macroeconomic developments in the third quarter of 2010 were characterized by deepening inflationary environment and slowing recovery rates in world and domestic economies. A high inflationary environment was mostly attributable to the downfall in agriculture and steep price rise in food products, wheat in particular, in global markets. Also, the tightening of monetary policy since the beginning of the year, including the developments in the foreign exchange market, as well as still slowly recovering domestic demand further contributed to somewhat mitigate inflationary pressures.

Inflation in the third quarter was 0.2 percent whereas the 12-month inflation indicator has been 8.6 percent, growing by 2.8 pp in relation to the respective indicator of the previous quarter. Price increases in items "fruit" and "vegetable and potato" contributed 3.3 pp and item "bread products" 1.5 pp to the 8.6 percent of the 12-month inflation. Under such a circumstance, the 12-month core inflation reduced by 0.5 pp in relation to the respective indicator of the previous quarter to reach around 4.9 percent.

Over the quarter, food prices fell by 0.2 percent (with -0.1 pp contribution to headline inflation), non-food prices remained almost unchanged, while service tariffs rose by 1.1 percent (with 0.3 pp contribution to headline inflation). Whereas in recent years change in prices in items "vegetable and potato" and "fruit" made an average -2.6 pp contribution to the quarter's inflation, these items in the third quarter of 2010 contributed a mere 0.1 pp, that is 2.7 pp higher, and which is why the actual indicator deviated from the Q3 projection almost to the same extent.

In the third quarter of 2010 economic growth rates further slowed down, posting as low as 2.8 percent y-o-y[*] growth indicator for the period January-September. Relative to the second quarter, the slowdown has been driven largely by the downfall in agriculture due to unfavorable weather conditions.

In the third quarter industry and services reported, respectively, 13.4 percent and 4.5 percent y-o-y growth of value added, whereas construction and agriculture reported, respectively, 13.4 percent and 4.5 percent y-o-y decline of value added.

Notwithstanding the slowing of economic growth rates, there was an improvement in the labor market indicators in the third quarter. Average quarterly unemployment reduced, reflecting the growing demand for labor. Average nominal wages grew, too, reflecting the increase of wages in firms in the private sector and in several budget-supported organizations. In spite of the growth of nominal wages labor productivity has somewhat decreased, due to the severe decline recorded in agriculture, thus pushing unit labor costs to increase to some extent. As a result, inflationary pressures in the economy have been estimated in the range of zero to slightly inflationary, up to 0.5 percent.

In the third quarter of 2010 the growth of domestic demand slowed against the previous quarters to 1 percent y-o-y, due to the slowdown in economic growth rates and reduced government expenditures. In the structure of domestic demand, private spending grew by around 4 percent y-o-y, with private consumption increased by nearly 1 percent y-o-y and private investment, by 12 percent y-o-y. In the third quarter too, private spending remained placing a restrictive impact on inflation. According to Central Bank estimations, private sector expenditures in real terms have

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[*] *Y-o-y = year-on-year, in relation to the same period of the previous year.*

been 1-2 percent below the equilibrium, thus creating some 0.4-0.6 percent deflationary pressures in consumer market.

In the third quarter of 2010 too, fiscal policy's expansionary impact further diminished. As a result, the impact of the fiscal sector on aggregate demand and inflation has been less expansionary, according to the fiscal impulse indicator, and amounted to 0.8 pp. As such, the revenues impulse made up 2.6 percent restrictive while the expenditures impulse made up 3.4 percent expansionary.

With the above developments in domestic demand and labor market, slight inflationary pressures were observed during the third quarter, which, according to the Central Bank estimates, were in the range of 0 - 0.3 percent.

In the times of slowing recovery rates in global and domestic economies in the third quarter of 2010 current account deficit somewhat improved y-o-y, running at a high level, however. In the meantime, considerable was the decline in dollar growth rates in export and import, which has been attributable mainly to the developments in the domestic economy as well as reduced y-o-y growth rates in international metals prices. The aforementioned developments were reflected primarily in the declines of growth rates of import volumes. At the same time, the y-o-y growth rates of remittances have recovered after the slowing in the previous quarter. In the outcome, in the third quarter current account deficit reduced by USD 13.2 million y-o-y to amount to USD 270.7 million.

The above-mentioned trends determined the attainment of the inflation target and monetary policy directions over the quarter. The Central Bank withheld from tightening monetary conditions, in consideration that inflation reached a high level influenced primarily by supply shocks and that its rate would gradually slow down as the above shocks are expected to come to an end in a one-year horizon and when transmitted impact from tightened monetary conditions is showed up. Under such a circumstance, the refinancing rate over the previous three quarters remained unchanged, at a 7.25 percent level.

Given the actual environment of the first half of the year and planned measures to fight dollarization, the third quarter monetary policy program envisaged a modest growth of monetary aggregates and faster growth rates in dram deposits over those of foreign currency deposits. The expectations were justified inasmuch as the monetary environment stated a weakened dollarization, reducing as much as by 4.1 percent and reflecting 1.2 percent reduction in foreign currency deposits (a mere 0.5 percent growth, when the exchange rate change is excluded) and 12.9 percent increase in dram deposits. At the same time, foreign currency loans continued growing during the quarter, at 10.3 percent (12.1 percent growth, when the impact of exchange rate change is excluded), owing mainly to excess funds on correspondent accounts in foreign currency. Over the quarter, the lending in dram has grown merely by 2.4 percent, and the increase of the volume of economy lending has increased by 6.5 percent and 22.4 percent y-o-y, as a result.

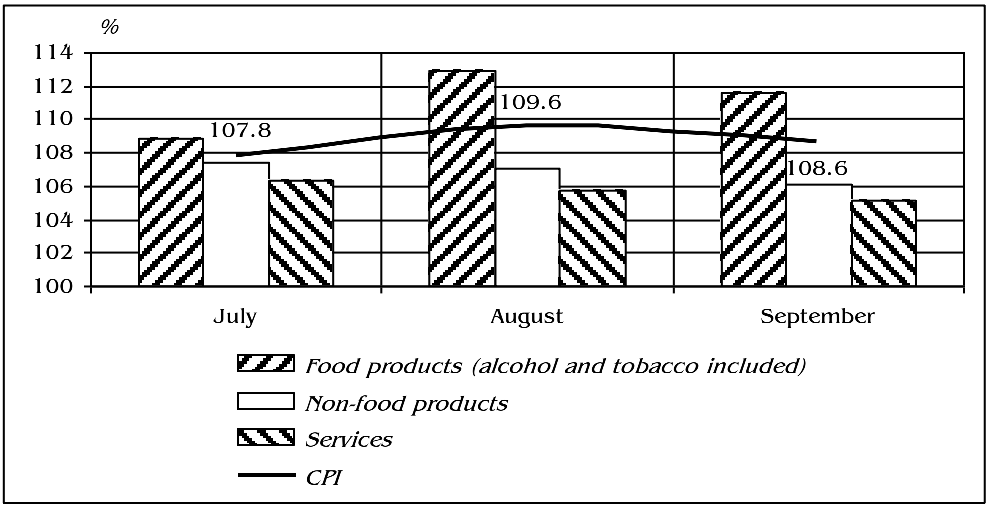
2. INFLATION DEVELOPMENTS

2.1. INFLATION BY GOODS AND SERVICES; CORE INFLATION

In September 2010, relative to September 2009, inflation was 8.6 percent. Prices have increased as follows: food products (alcohol and tobacco included) – 11.6 percent; non-food products – 6.1 percent; and service tariffs – 5.2 percent, all having contributed to inflation by 6.1, 1.0 and 1.5 pp, respectively.

Contribution to inflation, pp	Commodity groups	Price change, %
6.1	**Food products**	**11.6**
2.7	Vegetable and potato	58.0
1.6	Meat products	16.3
1.5	Bread products	10.0
0.5	Fruit	21.2
0.4	Fats and oils	8.9
0.2	Confectionery	8.2
0.1	Sugar	6.6
0.1	Tobacco	1.4
-0.2	Egg	-13.4
1.0	**Non-food products**	**6.1**
0.2	Personal car and fuel	7.0
0.2	Footwear	13.3
0.2	Garment and knitwear	8.4
0.1	Medicament	3.4
0.1	Fuel	8.7
1.5	**Services**	**5.2**
0.7	Residential and public utilities	9.3
0.5	Medical services	5.6
0.2	Educational services	5.1
0.1	Other household services	14.2
s.1	Public catering	6.8
-0.1	Transport services	-3.5

CPI in Q3 2010 based on 12-month results, by main commodities and services

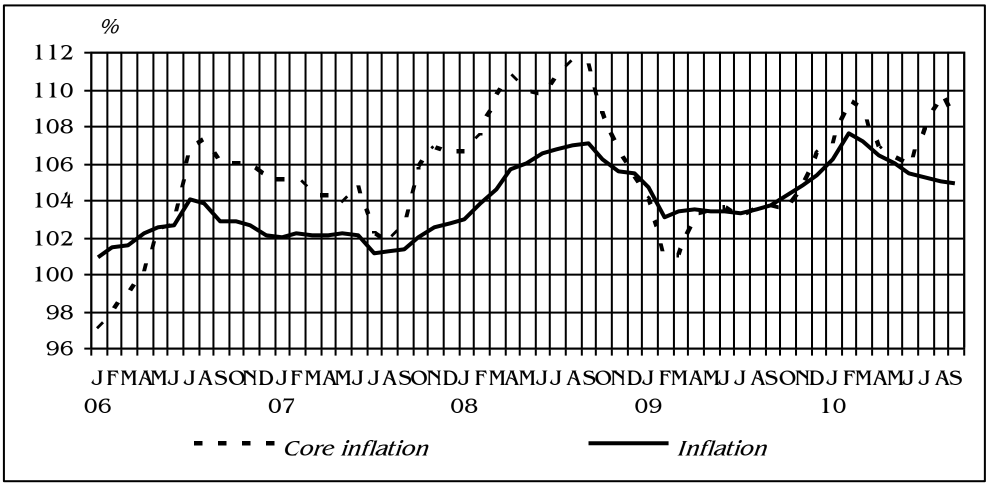


In the third quarter inflation was 0.2 percent compared to the end of the previous quarter. Prices of food products fell by 0.2 percent (with -0.1 pp contribution to inflation), non-food prices remained almost unchanged, while service tariffs rose by 1.1 percent (with 0.3 pp contribution to inflation). In September 2010, relative to December 2009, inflation was 4.7 percent. Prices of food products increased by 5.4 percent (with 2.9 pp contribution to inflation), non-food prices, by 3.1 percent (with 0.5 pp contribution to inflation) and service tariffs, by 4.4 percent (with 1.3 pp contribution to inflation).

In the period January-September of 2010, relative to January-September of 2009, inflation has been 7.8 percent. This was fuelled by 7.0 percent price increase of food products, 11.1 percent price increase of non-food products and 7.5 percent rise in service tariffs, all having contributed to headline inflation by 3.8 pp, 1.8 pp and 2.2 pp, respectively.

The 12-month core inflation in the third quarter of 2010 reduced by 0.5 pp and amounted to 4.9 percent at the end-September. The largest contribution upside came from items "beef", "services at hospitals", "butter", "vegetable oil", "sugar", amounting to 1.2 pp, 0.4 pp, 0.3 pp, 0.1 pp and 0.1 pp, respectively. Such items as "egg" and "transport fare" made downside contribution to inflation, amounting to -0.3 pp and -0.2 pp, respectively[1].

Inflation and core inflation in 2006 - 2010 (% against the same month of previous year)



Statistical review of inflation fluctuations

In order to review the changes in Consumer Price Index and in price indexes of individual items included in consumer basket, as well as to discover the factors determining their fluctuations, the influence of three components (trend, seasonal and irregular components) used in Statistics theory has been identified and assessed for the time period from October 2007 to September 2010*.

Calculations show that in the period from October 2007 to September 2010 the influence of seasonal component on CPI has been 60.05 percent; the influence of irregular component, 35.34 percent; and the influence of trend component, a mere 4.62 percent. In comparison with the period from October 2006 to September 2009, influence of seasonal component has decreased by 7.9 percent, whereas influence of trend component and irregular component has increased by 2.9 pp and 5.1 pp, respectively.

For the time period from October 2007 to September 2010, the influence of the three components has changed as follows:

- the impact of seasonality component on **price index of food products** was 63.29 percent, although this component's impact

[1] *The detailed methodology of calculation of core inflation is provided in the periodical paper "CBA Review" (Q1, 2008) and an analytical paper "Inflation in the Republic of Armenia: 'Seasonal exclude and external shock adjustment' method.*

has decreased by 13.5 percent compared to the period from October 2006 to September 2009;

- the irregularity component had the largest impact, 68.00 percent, on **price index of non-food products**, in the period between October 2006 and September 2009; this component's impact has increased by 14.3 percent compared to the period from October 2006 to September 2009;
- the seasonality component had 60.7 percent impact on **service tariffs**; the irregularity component's impact was 33.0 percent. Relative to the period between October 2006 and September 2009, the seasonality component's impact has increased by 18.4 percent while the irregularity component's decreased by 12.5 percent.

For the time period from October 2007 to September 2010, **the seasonality component** had the strongest impact on such items as "educational services" (84.3 percent), "vegetable and potato" (78.9 percent), "fruit" (78.7 percent), "egg" (71.9 percent), "residential and utility services" (53.2 percent), "items of culture" (52.2 percent); **the irregularity component** had the strongest impact on such items as "meat products" (81.0 percent), "home appliances" (79.8 percent), "kitchen utensils" (78.1 percent), "beauty and apparel" (77.8 percent), "public catering" (74.1 percent), "carpet" (73.7 percent), "jewelry items" (72.6 percent), "confectionery" (72.2 percent). The trend component's impact has been weak on all commodity groups, yet it affected items such as "alcohol and tobacco" (19.7 percent), "non-alcoholic beverage" (19.7 percent), "coffee, tea, cocoa" (13.1 percent), "medical services" (8.4 percent).

Share of components causing fluctuations in monthly price indexes (October 2007 – September 2010), %

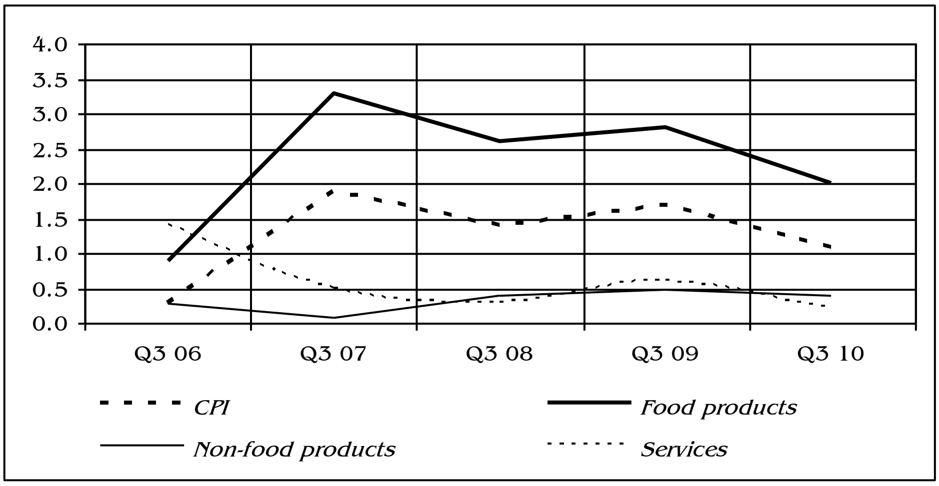
:m	Trend	Seasonality	Irregularity	Total
CPI (relative to previous month)	*4.62*	*60.05*	*35.34*	*100.0*
Food products (alcohol and tobacco included)	*4.20*	*63.29*	*32.52*	*100.0*
Bread products	4.5	33.7	61.8	100.0
Meat products	2.7	16.3	81.0	100.0
Fish products	0.7	35.8	63.5	100.0
Dairy products	7.4	35.5	57.1	100.0
Egg	3.3	71.9	24.8	100.0
Fats and oils	6.1	47.5	46.4	100.0
Fruit	1.6	78.7	19.7	100.0
Vegetable and potato	1.0	78.9	20.1	100.0
Sugar	1.2	47.7	51.0	100.0
Coffee, tea, cocoa	13.1	49.5	37.4	100.0
Confectionery	0.2	27.5	72.2	100.0
Other products	6.7	27.7	65.6	100.0
Non-alcoholic beverage	19.7	30.1	50.3	100.0
Alcohol and tobacco	19.7	30.1	50.3	100.0
Non-food products	*0.0*	*32.0*	*68.0*	*100.0*
Garment and knitwear	0.0	43.8	56.2	100.0
Footwear	0.6	51.4	48.0	100.0
Fuel	6.7	30.2	63.1	100.0
Furniture	0.8	43.6	55.6	100.0
Carpets	0.2	26.2	73.7	100.0
Textiles	6.2	27.2	66.6	100.0
Home appliances	3.6	16.6	79.8	100.0
Kitchen utensils	5.6	16.3	78.1	100.0
Detergents	0.7	43.3	56.0	100.0
Building materials	0.3	38.4	61.4	100.0

Items of gardening	1.6	48.5	50.0	100.0
Medicament	0.7	29.1	70.1	100.0
Personal cars and fuel	0.0	36.0	64.0	100.0
Items of culture	0.3	52.5	47.2	100.0
Stationery	5.7	26.4	68.0	100.0
Beauty and apparel	0.0	22.2	77.8	100.0
Items of jewelry	0.0	27.4	72.6	100.0
Items of personal use	2.3	32.8	64.9	100.0
Services	***6.3***	***60.7***	***33.0***	***100.0***
Household services	0.1	32.8	67.0	100.0
Other services for household	0.3	32.9	66.8	100.0
Residential and public utility services	0.1	53.2	46.7	100.0
Healthcare services	8.4	31.4	60.1	100.0
Transport services	3.3	40.2	56.5	100.0
Communications services	3.9	34.1	62.0	100.0
Culture services	2.6	32.0	65.4	100.0
Educational services	3.1	84.3	12.6	100.0
Leisure and rest services	2.5	37.7	59.8	100.0
Public catering	2.2	23.8	74.1	100.0
Legal and banking services	5.8	29.2	64.9	100.0

The consumer price index volatility has been reviewed also by means of monthly price index variation coefficients defined for each commodity group.

The chart below shows that the CPI and food price index volatility dynamics are very similar.

CPI, foods, non-food products and services price index variation coefficients in third quarters of 2006-2010



The table below shows that in Q3 2010, relative to Q3 2009, the CPI variation coefficient has dropped from 1.7 percent to 1.1 percent. *Food products, non-food products* and *services price index variation coefficients* have also fallen, respectively, from 2.8 percent to 2.0 percent, from 0.5 percent to .04 percent, and from 0.6 percent to 0.2 percent, respectively.

Volatility has been relatively high in such items as "vegetable and potato" (13.9 percent), "egg" (9.8 percent), "bread products" (3.0 percent), "fruit" (2.8 percent), and "sugar (2.4 percent).

Monthly price index variation coefficients in Q3 of 2006, 2007, 2008, 2009 and 2010, %

Item	Q3 06	Q3 07	Q3 08	Q3 09	Q3 10
CPI (relative to previous month)	**0.3**	**1.9**	**1.4**	**1.7**	**1.1**
Food products (alcohol and tobacco included)	**0.9**	**3.3**	**2.6**	**2.8**	**2.0**
Bread products	0.2	1.4	0.3	0.3	3.0
Meat products	0.5	1.1	1.1	0.6	0.2
Fish products	10.9	1.7	21.4	0.1	0.4
Dairy products	0.3	0.4	0.0	0.5	0.4
Egg	3.1	3.8	1.7	7.0	9.8
Fats and oils	0.3	4.1	0.2	0.9	1.2
Fruit	3.7	4.5	10.1	17.6	2.8
Vegetable and potato	6.0	20.2	19.4	18.2	13.9
Sugar	0.2	0.6	1.3	3.8	2.4
Coffee, tea, cocoa	0.1	0.0	0.3	0.4	0.2
Confectionery	0.0	0.0	0.3	0.1	0.1
Other products	0.2	0.1	0.7	0.2	0.0
Non-alcoholic beverage	0.6	0.0	0.0	0.1	0.0
Alcohol and tobacco	0.0	0.0	0.0	0.1	0.0
Non-food products	**0.3**	**0.1**	**0.4**	**0.5**	**0.4**
Garment and knitwear	0.6	0.2	0.4	1.0	1.1
Footwear	1.1	0.2	0.1	4.7	1.4
Fuel	1.0	0.3	0.7	1.1	0.1
Furniture	0.4	0.1	0.1	0.2	0.3
Carpets	3.1	0.0	0.0	0.1	0.5
Textiles	1.8	1.0	0.1	0.4	0.2
Home appliances	0.0	0.7	0.3	0.8	0.3
Kitchen utensils	1.5	0.0	0.8	1.1	0.1
Detergents	0.3	0.1	0.6	2.3	0.1
Building materials	0.2	0.1	0.6	1.5	0.1
Items of gardening	2.1	0.7	0.5	0.0	0.3
Medicament	0.1	1.1	0.1	0.0	0.2
Personal cars and fuel	1.8	0.8	2.0	1.0	0.8
Items of culture	0.2	0.8	1.5	0.2	1.5
Stationery	1.0	0.1	0.2	2.2	0.6
Beauty and apparel	1.1	0.3	0.1	0.4	0.1
Items of jewelry	2.6	0.4	4.1	0.5	0.2
Items of personal use	0.5	0.1	1.2	1.9	0.7
Services	**1.4**	**0.5**	**0.3**	**0.6**	**0.2**
Household services	0.3	2.0	0.1	0.7	0.1
Other services for household	0.3	2.5	0.1	0.8	0.1
Residential and public utility services	1.1	0.0	0.0	0.1	0.0
Healthcare services	3.5	0.3	0.7	0.8	0.1
Transport services	1.7	0.2	0.4	1.2	1.1
Communications services	0.1	0.0	1.0	0.0	0.0
Culture services	0.5	3.5	2.2	3.6	2.3
Educational services	2.3	2.9	1.7	3.9	2.8
Leisure and rest services	0.7	1.1	0.3	1.4	0.3
Public catering	0.0	0.1	0.5	0.1	1.0
Legal and banking services	0.0	0.0	0.2	0.0	0.0

[*] The methodology of calculation is provided in the paper "Inflation in the Republic of Armenia, 2nd half of 1999".

2.2. FULFILLMENT OF INFLATION TARGET

According to the results of the third quarter of 2010, the 12-month inflation has grown by 2.8 percent q-o-q[*] to amount to 8.6 percent, which exceeded the upper border of the target by 3.1 pp. Such a surge in the third quarter is explained absolutely by inflationary impact from a severe decline

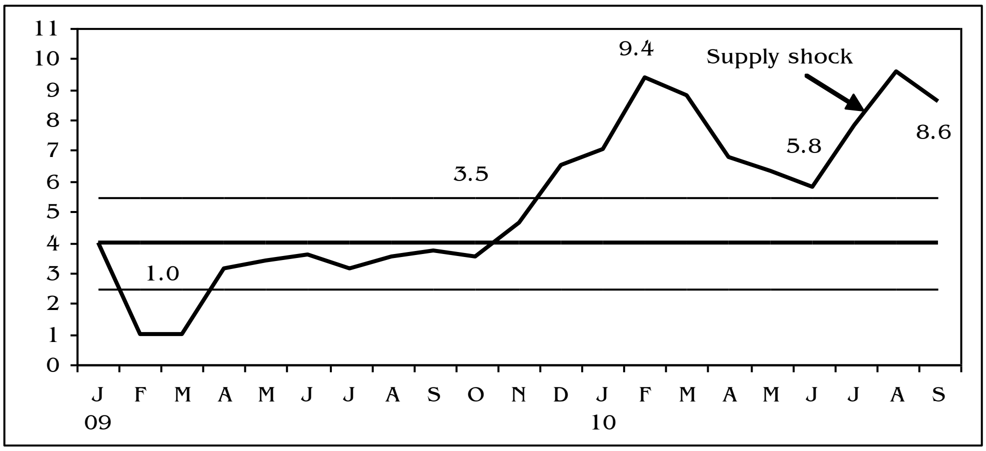
[*] *q-o-q = quarter-on-quarter, in relation to the previous quarter.*

in agriculture and steep wheat price increases in international markets, fuelled by supply shocks.

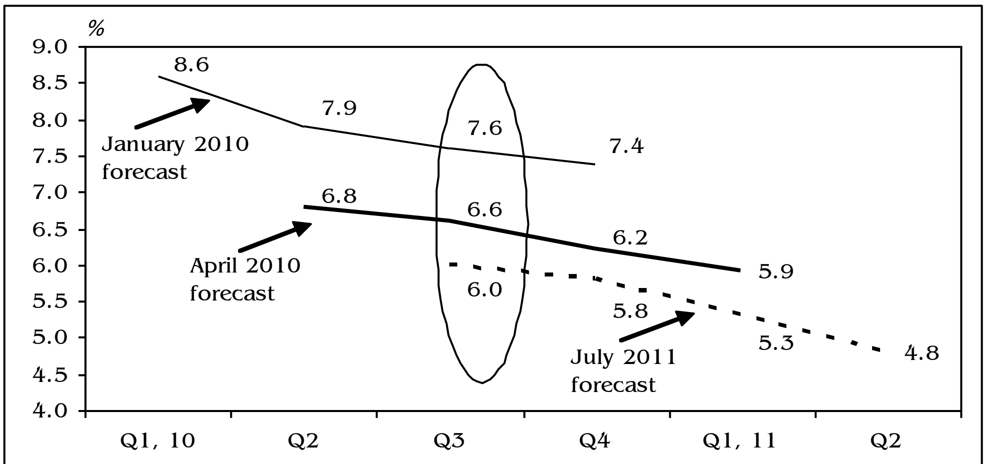
The inflationary environment and monetary policy directions in the preceding 12-month period were characterized by the following developments. Prior to October of 2009, in the time of worsening global economic crisis and sharply slackened domestic demand, inflationary environment has been in a low phase, where the 12-month inflation (just 3.5 percent in end-October) was within the target. Bearing this in mind, the Central Bank continued implementing an extremely expansionary monetary policy in the fourth quarter too, in order to effectively coordinate stimulation of economic activity and price stability issues.

From December of 2009 however, the 12-month inflation started accelerating sharply and reached its peak (9.4 percent y-o-y) in February of 2010. In the period mentioned, the main inflation factors were the impact transmitted from extremely expansionary fiscal and monetary policies implemented by the Government and the Central Bank since the second half of 2009 as well as the dram depreciation pressures furnished primarily by negative expectations.

12-month inflation behavior



12-month inflation indicator forecast



Central values of forecast inflation, when refinancing rate is left unchanged

In January of 2010, in expectation of inflationary pressures in external and domestic environment, the Central Bank made an upside revision to inflation forecasts for an upcoming one-year horizon. Nonetheless, because it has a diminishing behavior, inflation were to reach a 7.6 percent level in the third quarter.

At the same time, tasked to eliminate an accelerating potential of inflation and to bring inflation back to the target, the Central Bank had altered, since the beginning of the year, the direction of monetary policy by tightening monetary conditions. Thus, in order to minimize deviation of inflation from the target, the Central Bank had raised the refinancing rate a total 2.25 pp over the first five months of the year while sharply restricting quantitative easing. Concurrent with this, the Government took an action to restrain inflation, which meant cutting back budget expenditures and increasing tax collection. At the same time, the Government and the Central Bank took further measures to fight dollarization of the economy. In the outcome, the Central Bank succeeded in lowering the 12-month inflation to 5.8 percent at the end of the second quarter.

Based on the above mentioned developments in inflation, the Central Bank again revised its forecasts in April and July, this time in a downside direction, projecting 6.6 percent and 6.0 percent levels, respectively, for the 12-month inflation for the third quarter of 2010.

In fact, in the third quarter too, one would anticipate an influence of factors to ease inflation, under which circumstance a diminishing behavior of inflation would have been maintained. What happened in the third quarter, however, was the surge of the 12-month inflation affected mostly by supply shocks, price increases on bread products, fruit and vegetable (with a total 4.4 pp contribution to inflation) in particular. As a result, the third quarter (which is a deflationary period as a rule since in recent years the respective deflation indicator has been an average 3.0 percent) reported 0.2 percent inflation, while the 12-month inflation reached 8.6 percent in end-September.

However, in view of the situation whereby an inflationary environment has been driven primarily by supply shocks as well as some other factors (i.e. tightened monetary conditions since the start of the year, developments in the foreign exchange market in the third quarter, slowly recovering domestic demand still aversive to creating inflationary pressures), the Central Bank found it reasonable to withheld, starting from the third quarter, from changing monetary conditions. At the same time, the level of refinancing rate of the third quarter was considered appropriate to neutralize auxiliary impacts of inflation and inflation expectations in the forecast time horizon. In the outcome, in the period June-September the refinancing rate was left unchanged, at 7.25 percent level, while not forgetting about the possibility to further revision.

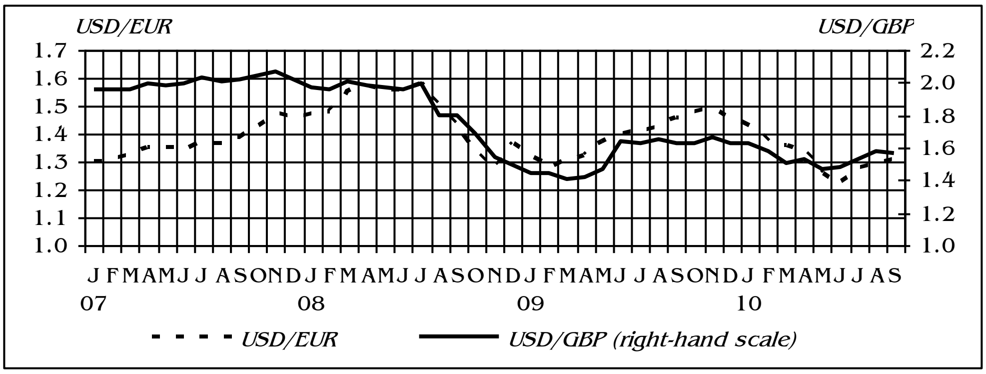
3. INFLATION FACTORS

3.1. EXTERNAL ENVIRONMENT

In the third quarter of 2010 world output growth has somewhat slowed down. Yet, given higher-than-anticipated recovery of the global economy in the first six months of the year, the IMF raised its projections of world output growth in October. According to new projections, in 2010 world output will grow at 4.8 percent instead of the previous forecast (in July) of 4.6 percent. This figure is about 1.3 pp higher from the previous five years' average, although it still is behind growth rates of the economic upsurge in the period 2004-2007. Nevertheless, the IMF predicted mainly downside risks in terms of the 2010-2011 world growth outlooks. This is largely attributable to financial instability risks spreading farther and to the lack of consistent economic policies to enhance domestic and external redistributions of world aggregate demand. Despite somewhat a slowing global demand, in the third quarter international commodities markets were prominent with substantial inflation developments attributable mostly to food markets (grain markets in particular), fuelled by concerns over expected crops, as well as some depreciation of the dollar exchange rate. Meanwhile, driven by some slowing of global economic growth rates under somewhat limited fiscal stimuli, most countries (especially most advanced countries) continued implementing expansionary monetary policy.

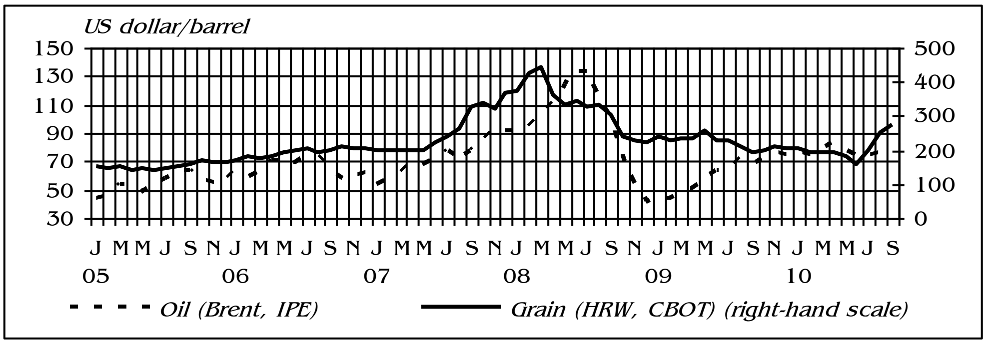
Amid pessimistic expectations about the developments of the US economy as well as announcements by the US Federal Reserve System on applying of quantitative easing, in the third quarter the USDEUR depreciated by 1.5 percent q-o-q, with the dollar averaging around 1.29 per Euro (the US dollar still remains appreciated vis-a-vis Euro by around 10.7 percent y-o-y).

In Q3 2010 the US dollar depreciated versus euro



In the third quarter of 2010 international oil prices fell by 3.2 percent q-o-q, with 'Brent' averaging around USD 76.4 a barrel, which however is 11.8 percent higher in relation to the relevant indicator of the third quarter of the previous year. Prices of both base metals and precious metals have grown. The copper price at the London Metal Exchange has increased by 3.1 percent, averaging around USD 7279 per ton (24.0 percent growth y-o-y). Average quarterly price of gold has grown by 2.7 percent against the previous quarter to reach USD 1228 per troy oz. (27.9 percent y-o-y).

Third quarter was prominent for an inflationary environment in international commodity markets



In the third quarter prices of grains in international markets were driven by notable reduction in volumes of expected harvest in the light of unfavorable weather conditions in Russia, Euro-area and Canada. This has resulted in an infltionary environemnt. In the third quarter, compared to the previous quarter, grain prices have risen by around 34.1 percent, making up USD 6.5 a bushel on average (14.6 percent growth y-o-y). As estimated by the US Department of Agriculture, in the 2010/2011 marketing year some 643 million tons of crops of grain are expected instead of the previous year's 680 million. Under such conditions, the world grain stock would reduce by about 20 million tons to 178 million tons. The price of rice has reduced by 5.2 percent in relation to the previous quarter, to USD 11.2 per short hundredweight (45.3 kg) (with 17.3 percent decline y-o-y). The price of sugar has grown by 30.9 percent, averaging around USD 26.5 per cent/pound, which is 24.5 percent higher from the third quarter's indicator of the previous year.

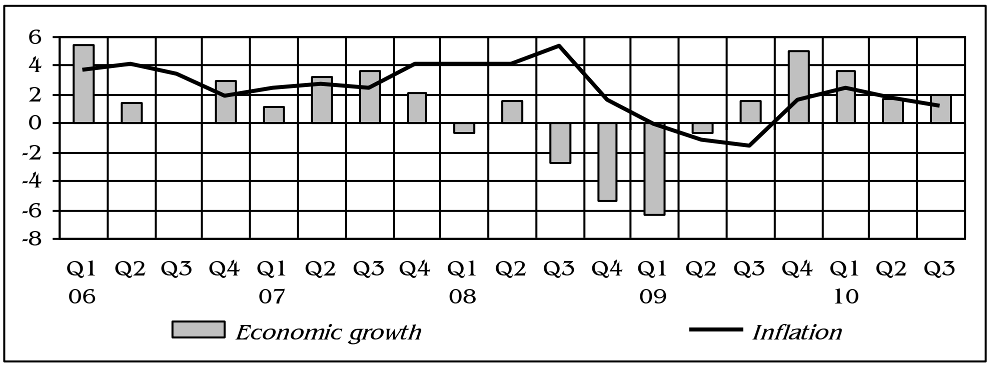
Below is the review of economic developments in the USA, Euro-zone and Russia, which make the largest share in the global economy and which are the main partners to Armenia. The review of economic developments of countries neighboring Armenia will follow.

In the third quarter of 2010 economic recovery in the **United States of America** slowed down. Preliminary estimates by Economic Analyses Bureau of the US Department of Commerce show that in the third quarter the US economy posted an annualized 2.5 percent growth q-o-q against 1.7 percent growth recorded in the previous quarter. The growth has been fuelled primarily by consumer expenditures (with 2.0 pp contribution), private investments (with 2.5 pp contribution) and public sector (with 0.8 pp contribution). However, contribution from net exports remained negative, as was in the second quarter, making up -1.8 pp.

In the third quarter the deficit of net exports in GDP further widened, amounting to 3.7 percent compared to 2.9 percent recorded for the same period of the previous year and to 3.7 percent recorded for the previous quarter. This was determined mostly by faster growing imports over exports in terms of both value and volume.

In the third quarter some 1.1 percent y-o-y inflation was recorded in the USA (1.7 percent in the previous quarter). The inflationary environment has been attributable to the price increases on fuel, energy and food products. Amid still high unemployment figures, insignificant inflationary pressures as well as uncertainty over economic recovery the US Federal Reserve System kept its prime lending rate in the corridor 0-0.25 percent while announcing about the possibility to return to the quantitative easing.

In Q3 2010 economic growth in USA shrank

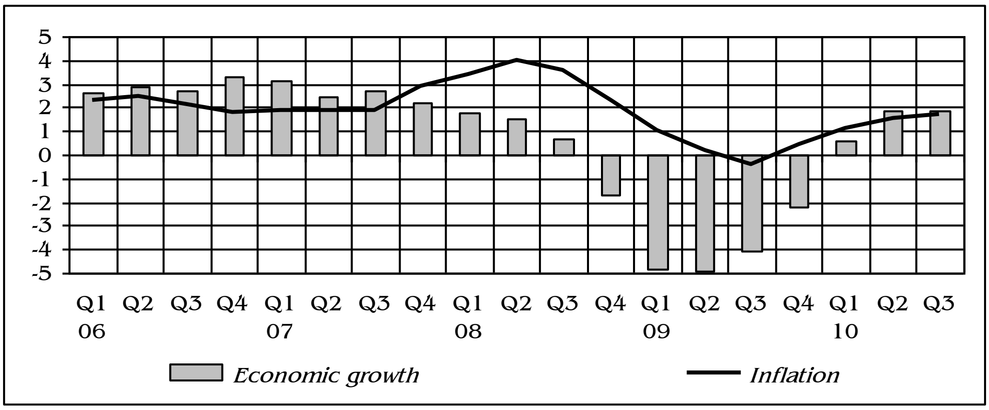


According to preliminary estimates of EuroStat, a 0.4 percent economic growth was posted in **Euro-area** in the third quarter of 2010. In the meantime, a relatively stable y-o-y recovery rate persisted, reaching 1.9

percent (against 1.0 percent and 1.9 percent q-o-q and y-o-y, respectively, in the previous quarter).

In the third quarter the consumer price index rose by an average 1.7 percent y-o-y against 1.5 percent inflation recorded in the previous quarter. During the quarter the European Central Bank kept interest rates at the same level, 1.0 percent, in the light of slowly recovering rates of the economy.

Euro-area posted y-o-y economic growth



In the third quarter of 2010 **Russia** posted 2.2 percent real economic growth y-o-y, slowing down enough when compared to the second quarter's 5.2 percent growth. The declining of growth rates was driven by 18.6 percent y-o-y decline in agriculture that suffered adverse weather conditions. In the period January-September the economic growth reached 3.4 percent, while an official forecast of the Russian Government for 2010 is 4.0 percent.

Growth in industry in the third quarter was 6.4 percent y-o-y against 10.9 percent y-o-y growth in the previous quarter. Retail trade sector posted 5.9 percent growth y-o-y, and construction, 2.1 percent growth y-o-y.

In view of the domestic developments as well as continued recovery of the world economy, the IMF estimated a 4.0 percent economic growth for Russia for 2010 instead of the previous forecast of 4.3 percent. The 2011 forecasts have been revised upside, to reach 4.3 percent instead of the previously forecast 4.1 percent.

With the global economy somewhat slowed down as well as oil prices rising, current account surplus decreased y-o-y by USD 6.7 billion to amount to USD 8.7 billion. This was driven by reduced trade balance surplus. Unlike huge net inflow of capital recorded in the second quarter, net outflow of USD 4.4 billion was observed in the third quarter (in the third quarter of the previous year net outflow amounted to USD 27.0 billion). Net foreign assets of banks have reduced by USD 8.3 billion whereas net foreign assets of other private sector have increased by USD 10.8 billion. As a result of balance of payments flows, in the third quarter foreign currency reserves of the Central Bank of Russia have increased by USD 2.7 billion and amounted to USD 490.0 billion as of October 1, 2010.

In the face of balance of payment flows as well as developments in international financial markets, the ruble exchange rate showed an appreciation trend at the beginning of the quarter. In September, however, appreciation changed into depreciation. Under such a circumstance Russian Central Bank acted as a net seller of foreign currency, in contrast to the previous quarter when the Bank was a net purchaser. As a result, during the third quarter the average RURUSD depreciated by 1.3 percent q-o-q. Further, on a yearly basis, the average ruble exchange rate is still below the third quarter average of 2009: the y-o-y appreciation reached 2.2 percent.

In the third quarter of 2010 the rate of inflation accelerated again following some deceleration trends observed in the previous quarter. Inflation in the third quarter reached 6.3 percent y-o-y from 5.9 percent recorded in the previous quarter. The rate of inflation demonstrated acceleration in September, mostly on food products. Food prices grew twice as fast in relation to the average growth of the previous months. Growth of non-food prices also accelerated at the end of the quarter. During the third quarter Russian Central Bank withheld from raising policy rates, keeping the refinancing rate at a 7.75 percent level set on June 1. The decision was made in consideration of the main macroeconomic indicators and the situation in the domestic financial markets. As well as the Bank considers that inflation risks driven by monetary factors are in the tolerance band and the monetary policy is steered to further buoy up credit markets and support a sustainable economic growth.

Macroeconomic Situation in Neighboring Countries [2]

Turkey: *in the second quarter of 2010 the Turkish economy kept on recovering fast, and the country posted a 10.3 percent real growth of GDP*[3]*, in part in the light of a severe decline which was recorded in the same quarter of the previous year. However, q-o-q growth rates were faster in the second quarter, reaching up to 3.7 percent (when seasonality excluded). Growth rates of domestic demand (free of stocks) accelerated in the second quarter, and the resultant positive contribution to the economic growth made up 10.8 pp. Private consumption grew by 6.2 percent and investments posted as high as 29.0 percent growth. The latter is a key impulse which helps one suppose that economic growth indicator for 2010 will exceed expectations.*

Preliminary figures tracking out growth of tax revenues suggest that in the third quarter the growth rates would not slow down much (taking base effect into account). It should be noted, however, that risks to an added current account deficit are growing as domestic demand keeps on evolving positively.

In the second quarter the highest growth was recorded in construction and processing industry, making up, respectively, 21.9 percent and 15.4 percent y-o-y; and in wholesale & retail trade and agriculture sectors growth of 13.9 percent and 0.6 percent y-o-y, respectively, was recorded.

Driven by deteriorated trade balance deficit, in the period July-August large current account deficit persisted at the level of USD 6.6 billion against USD 1.1 billion recorded for the same period of the previous year. In the period July-August export of goods has grown by 4.3 percent y-o-y, and import of goods, by 21.3 percent y-o-y. The increase of imports with regard to almost all sub-items persisted. Net inflow via capital and financial account in July-August amounted to USD 9.4 billion compared to USD 2.1 billion-worth net inflow recorded for the same period of the previous year.

In the period July-August net inflow of foreign direct investment has been USD 1.8 billion, representing 17.8 percent increase. Some USD 6.9 billion-worth net inflow was reported for portfolio investment against net inflow of USD 2.0 billion recorded for the same period of the previous year. Item 'Other investment' posted net inflow of USD 0.61 billion. Net foreign assets of the banking sector have reduced by USD 0.06 billion in contrast to USD 0.35 billion increase of net foreign assets of other private sector (excluding banks). As a result of the balance

[2] *Review of the macroeconomic situation in neighboring countries is important in a sense that, being under the influence of similar economic turbulences, developments in these countries may indirectly influence the Armenian economy. Crises of 1990s showed that indirect influence channels, including common export markets, lending organizations or countries, investors, etc, from the regional standpoint are becoming increasingly influential on economic developments of countries. Therefore countries periodically monitor macroeconomic developments not only in neighboring countries but also partner countries in the Region. Note that Iran is not included in the selection because numerical data of this country are not complete and are issued in such delays when they lose relevance.*

[3] *Official GDP figures for Q3 2010 are lacking.*

of payments flows in the period July-August, official reserves of the Central Bank of Turkey have increased by USD 4.3 billion (item 'Errors and omissions' posted net inflow of USD 1.46 billion).

In the third quarter the Turkish lira appreciated versus the US dollar by 1.4 percent on average, in comparison with the second quarter average. However, the average nominal exchange rate of the third quarter is still above the third quarter average of the previous year.

In the third quarter of 2010 consumer prices grew by 1.15 percent (September to June) whereas the annual inflation in September reached 9.24 percent. As a result, in the third quarter average y-o-y inflation amounted to 8.4 percent against 9.2 percent recorded in the previous quarter. Price growth has been largely attributable to a steep increase of prices of unprocessed food while contribution of prices of processed food to inflation has been 4.2 pp. On the other hand, inflation in other sub-groups (exclusive of food) was very low when compared with the previous year's average. Core inflation kept on moving downward fuelled by appreciating lira and lower-than-expected inflation in services. During the third quarter Central Bank of Turkey left the policy rate unchanged, keeping one-week repo rates in the corridor of 7.0 percent. According to the September 16 decision, repo rate remained at the same level while overnight repo rates for borrowing and lending were lowered from 6.5 percent to 6.25 percent and from 9.0 percent to 8.75 percent, respectively. As stated by the monetary committee, in the short-run prices will go up temporarily but will start falling from the fourth quarter.

***Azerbaijan:** economy of this country maintained real GDP growth rates in the course of the first nine months of 2010, which made up 4.1 percent, and 5.2 percent in the non-oil sector[4]. Nominal GDP has grown by 20.4 percent in relation to the same period of the previous year and GDP deflator amounted to 15.6 percent against -31.3 percent in the same period of the previous year. Industry's contribution to the GDP growth was 54.4 percent; agriculture – 5.1 percent; construction – 7.1 percent; transport and telecommunications – 8.2 percent; wholesale and retail trade – 6.8 percent; social services – 10.7 percent[5].*

In the period January-September of 2010 inflation was 3.5 percent relative to December of the previous year and 5.2 percent relative to January-September of the previous year. Average annual inflation was fuelled by price increases on food products (5.7 percent), non-food products (2.0 percent), and service tariffs (5.8 percent)[6].

Over the first nine months of 2010 trade balance of Azerbaijan has run with surplus, reaching USD 11.1 billion. Export has increased in relation to the same period of the previous year by 56.8 percent and totaled USD 15.6 billion; import has increased by 3.81 percent and reached USD 4.5 billion[7]. Crude oil accounted for 86.6 percent of value of Azerbaijani exports in the period January-September of 2010[8].

In January-September of 2010, relative to the same period of the previous year, gross inflow of foreign direct investment has increased by around 48.7 percent to reach USD 1.4 billion[9].

In 2010 too, the Central Bank of Azerbaijan implemented a policy to maintain stability of manat exchange rate. As a result, in the period January-September manat appreciated vis-a-vis US dollar by a mere 0.05 percent, while the January-September average exchange rate appreciation has been 0.08 percent y-o-y[10].

In the period January-September of 2010 foreign exchange reserves of the Central Bank of Azerbaijan have increased by 17.4 percent and amounted to USD 6.1 billion, as of September 30, 2010[11].

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[4] Source: Azerbaijan Central Bank Statistics Bulletin, January-September, 2010, Table 1.1, http://abc.az/rus/news/48887.html.
[5] Source: http://www.abc.az/rus/news_21_10_2010_48884.html.
[6] Source: Azerbaijan Statistics Committee, http://www.azstat.org/sdds/en/P_I/I_C_P.shtml, Azerbaijan Central Bank Statistics Bulletin, January-September, 2010, Table 1.2.
[7] Source: http://www.abc.az/rus/news_16_10_2010_48744.html.
[8] Source: http://www.abc.az/rus/news_18_10_2010_48752.html.
[9] Source: http://www.abc.az/rus/news_22_10_2010_48902.html.
[10] Source: http://www.cbar.az/other/azn-rates.
[11] Source: http://www.cbar.az/infoblocks/money_reserve_usd.

In September of 2010, relative to the end-December of 2009, economy lending has grown by 6.3 percent, whereas non-performing loans have increased by 48.8 percent[12]. There was a notable increase of deposits in local currency: total amount of bank deposits grew by 4.6 percent in which deposits in local currency, by 13.3 percent. The share of foreign currency deposits declined to 49.7 percent, as of end-September 2010[13].

Georgia: *in a phase of economic downturn since the second half of 2008, the Georgian economy posted some 6.6 percent real GDP growth in the first half of 2010. In the period January-September the largest contribution to GDP growth has come from industry (11.2 percent), agriculture (8.0 percent), construction (4.9 percent), transport (7.5 percent), trade (12.6 percent), and public administration (11.7 percent). Net taxes on manufacture and import amounted to 13.9 percent of GDP[14].*

In the period January-September of 2010 average inflation in Georgia was 5.2 percent in relation to the same period of the previous year, and 7.4 percent in relation to December of the previous year. Moreover, compared to the previous December, some 3.6 percent deflation was reported for semi-durable goods but inflation was reported for durable and non-durable goods and services, amounting to 10.6 percent, 6.1 percent and 0.7 percent, respectively[15]. For the period 2010-2012 the National Bank of Georgia set an inflation target of 6 percent.

In January-September export volumes (FOB) have increased by 33.6 percent or USD 276.3 million, and import volumes (CIF) have increased by 12.7 percent or USD 395.3 million. As a result of export-import transactions carried out in the period January-September of 2010 Georgia's trade balance deficit deteriorated by 5.2 percent in relation to the same period of the previous year and reached USD 2413 million.

Notwithstanding signs of recovery of the Georgian economy, gross inflow of foreign direct investment is further narrowing. In the first six months of 2010 inflow of FDI reached USD 271.1 million, which is a 4.3 percent y-o-y decrease. Unlike direct investment inflows, there has been about 13.1 percent growth of inflow of money transfers from abroad in relation to January-September of 2009. In the first nine months of 2010 this figure was USD 670.6 million.

With foreign currency inflow reducing, in the period January-September the average exchange rate of Lari depreciated vis-a-vis the US dollar by 6.6 percent y-o-y. Relative to the end-December of 2009, depreciation of Lari was 6.7 percent. To restrain depreciation pressures, the National Bank sold (net) USD 248.2 million in the domestic foreign exchange market in the period January-September.

As of September 30, 2010, foreign exchange reserves of the National Bank of Georgia amounted to USD 2.11 billion, which was in line with the end-2009 levels. In the same period of time, Georgia's foreign debt (excluding government guaranty) has increased by around USD 375.0 million to reach USD 3.75 billion, as of September 30, 2010, compared to USD 3.375 billion recorded as of December 30, 2009.

In the period January-September of 2010 bank lending has grown. The volumes of loans in local currency have increased by 35.3 percent and loans in foreign currency, by 5.2 percent. The largest share in lending to resident economic agents comes from trade (49.3 percent), industry (21.3 percent) and construction (11.2 percent). Under such a circumstance, the amount of bad loans has reduced by around Lari 12.9 million (USD 7.1 million). The share of deposits attracted by banks has increased, with deposits in local currency, by 40.3 percent and deposits in foreign currency, by 53.4 percent. Dollarization in the Georgian economy has increased as in the period July-August alone foreign currency deposits reported an abrupt increase of 22.3 percent. While foreign currency deposits constituted 71.7 percent in total as of June 30, 2010, their share increased to 74.6 percent as of September 30, 2010.

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[12] Source: Azerbaijan Central Bank Statistics Bulletin, January-September, 2010, Table 2.8.
[13] Source: Azerbaijan Central Bank Statistics Bulletin, January-September, 2010, Table 2.4.
[14] Source: http://www.nbg.gov.ge/uploads/gdpinglisurad/nominal_gdp_qucurrenteng.xls.
[15] Source (here and henceforth): National Bank of Georgia's Monetary and Banking Statistics Bulletin, January-September, 2010.

3.2. BALANCE OF PAYMENTS [16]

3.2.1. Current account

With the world and domestic economies growing at somewhat a slower pace in the third quarter of 2010 current account deficit tended to improve y-o-y, running at a high level, however. At the same time, growth rates of export and import in dollar terms weakened notably, which was driven mainly by the developments in domestic economy as well as reduced y-o-y growth rates of international prices of metals. The aforementioned developments were reflected primarily in the declines of growth rates of import volumes. The y-o-y growth rates of transfers bounced back after the slowdown in the previous quarter. As a result, the deficit of current account has reduced by USD 13.2 million y-o-y and amounted to USD 270.7 million.

In the third quarter export and import values have increased by USD 50.3 million (23.1 percent) and USD 78.1 million (10.6 percent) y-o-y, respectively. As a result, the deficit of trade balance increased by USD 27.8 million y-o-y to amount to USD 548.8 million.

Growth of export was largely attributable to the global demand which is recovering (although recovery rates have decelerated) and persistently high international prices of metals. In the third quarter export of goods and services in real terms[17] has increased by 8.5 percent y-o-y. Growth of export in dollar terms[18] was driven mainly by positive contributions from such items as "mineral production", "base metals and articles thereof", "products of prepared food" by 18.8 pp, 5.7 pp and 4.1 pp, respectively[19].

Growth rates of import slowed down considerably as growth rates of domestic demand became sluggish. Growth of import was driven mainly by positive contributions from such items as "transport means", "mineral production" and "products of prepared food" by 4.8 pp, 3.0 pp, and 1.8 pp, respectively. Growth of import of these items offset y-o-y declines in such items as "base metals and articles thereof" and "machinery an equipment", negative contributions of which were, respectively, 2.9 pp and 0.7 pp. Import of goods and services in real terms has increased by 3.6 percent y-o-y.

In terms of geographic distribution of external trade, the main development was the deficit of trade balance with China, which has grown by USD 30.5 million y-o-y, whereas y-o-y trade balance deficit with the CIS and EU states remained at the same levels. In the meantime, trade balance surplus with the Netherlands has increased by USD 12.5 million y-o-y while trade balance deficit with Germany has increased by USD 18.9 million y-o-y.

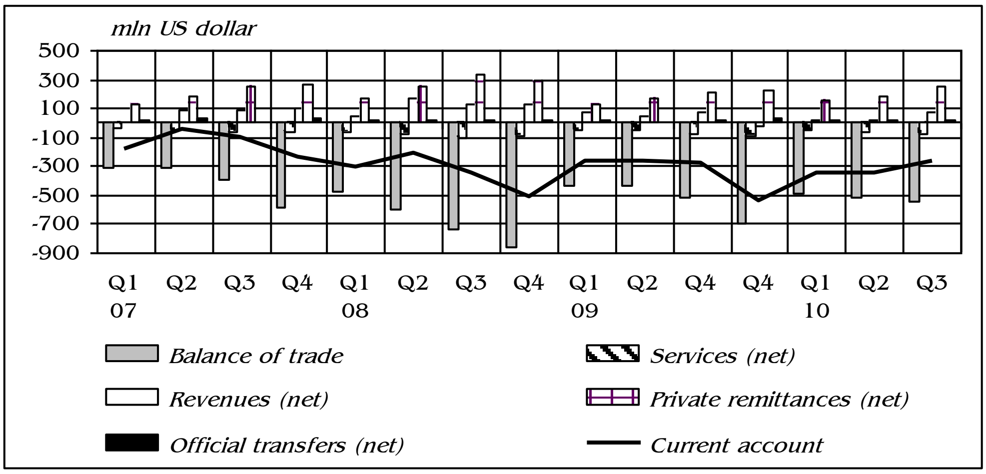
In the third quarter the balance of services deficit remained almost at the respective level of the previous year, making up USD 70.6 million. The third quarter was prominent for dramatic y-o-y growth of inbound and outbound travel. As a result, there has been a surplus of balance of travel, which exceeded the previous year's respective figure for the third quarter. This somehow offset the deficit of transport services which was broadened because of increased balance of trade deficit. In the third quarter export of services has increased by 19.3 percent y-o-y and import of services, by 13.5 percent y-o-y.

In the third quarter of 2010 the y-o-y growth of private remittances recovered after some slowdown observed in the previous quarter[20]. This is largely explained by the developments in the Russian economy. According

[16] Q3 2010 indicators are the Central Bank estimations.
[17] Export and import of goods in real terms are the Central Bank estimations.
[18] Decreases were reported for export of some items which are negligible by weight.
[19] Export and import breakdown by sector and geography is presented, respectively, in FOB and CIF prices.
[20] In the third quarter of 2010 net non-commercial transfers via the banking system have grown by 18.7 percent y-o-y. As such, inflow of non-commercial transfers has increased by 16.8 percent y-o-y and outflow of non-commercial transfers, by 6.3 percent y-o-y.

to most recent forecasts by the IMF, economic growth indicator in Russia in 2011 is estimated to reach 4.3 percent, which is above the figure forecast earlier. In the third quarter net inflow of seasonal worker income has grown by 8.2 percent y-o-y and amounted to USD 171.9 million. This offset net outflow in item "income on investment". As a result, item "Income" posted net inflow of USD 79.6 million. In the third quarter private transfers have grown by 17.2 percent y-o-y and totaled USD 250.5 million.

In Q3 2010 current account deficit shrank slightly y-o-y

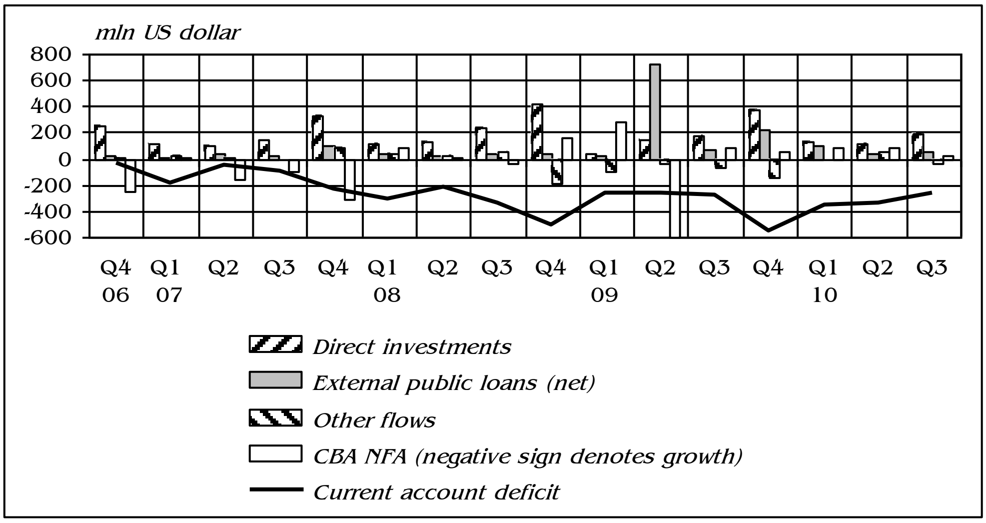


3.2.2. Capital and financial account[21]

In the third quarter of 2010 the capital and financial account reported net inflow of USD 250.1 million. All items, except item "Other investment", posted net inflow of funds, which was not enough however to finance current account deficit. In the outcome, net foreign assets of the Central Bank have reduced by USD 20.6 million due to reduction in excess liquidity on foreign currency accounts of commercial banks with the Central Bank, which went to the domestic lending.

Items of the capital and financial account reported the following flows: inflow of capital transfers reached USD 32.6 million (USD 24.6 million in the third quarter of the previous year).

In Q3 2010 current account deficit outweighed net inflow on capital and financial account



[21] *All indicators pertaining to the capital and financial account are the Central Bank estimates.*

Net inflow of foreign direct investment reached USD 188.3 million compared to USD 171.2 million recorded in the third quarter of the previous year. Net inflow of public loans amounted to USD 58.8 million against USD 70.3 million recorded in the third quarter of the previous year.

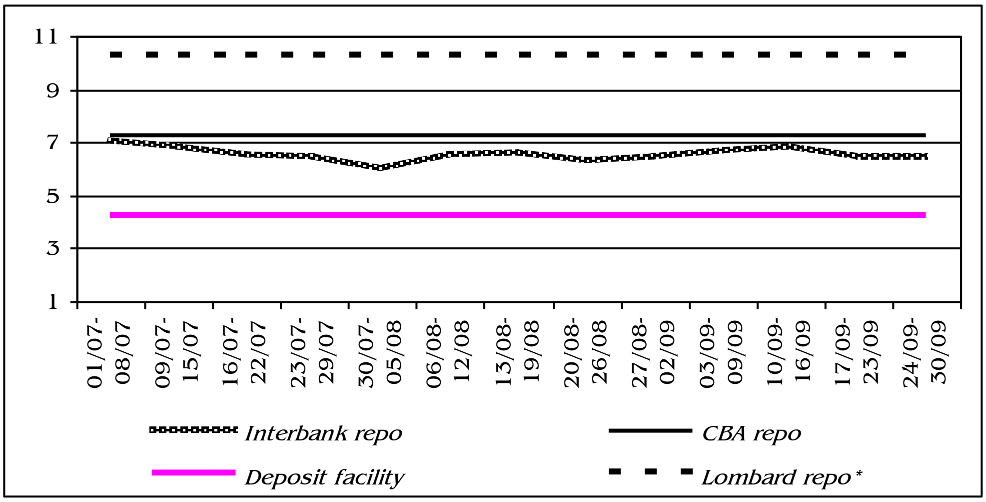
Net foreign assets of private sector have grown by USD 29.6 million. Net foreign assets of private sector (commercial banks excluded) have grown by USD 140.4 million in contrast to USD 110.8 million reduction of net foreign assets of the banking sector.

3.3. INTEREST RATES, EXCHANGE RATE AND MONETARY DEVELOPMENTS

3.3.1. Interest rates

In the third quarter too, the Central Bank left refinancing rate of repo agreement unchanged, at 7.25 percent, under which condition lombard repo rate was maintained at the level of 10.25 percent and the deposit facility rate, 4.25 percent. In September the Central Bank carried on introducing a change to the reserve requirement mechanism, whereby reserve requirement against another 25 percent of foreign currency funds attracted shall be kept in dram. These actions somewhat affected operations executed by the Central Bank as well as interest rates of funds attracted and allocated by the banking sector.

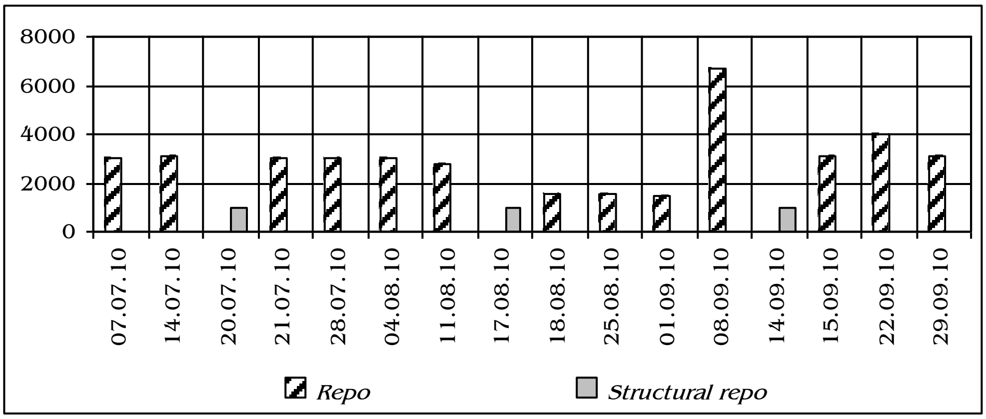
CBA refinancing rate, standing facility rate and interbank repo rate



** Before February of 2010 this instrument was called Lombard facility.*

In the third quarter the Central Bank continued offering, each Wednesday, repo transactions to commercial banks. Average reported weekly volumes of repo operations performed reached AMD 3.0 billion, with an average interest rate of 7.37 percent. In the meantime, the Central Bank further applied an instrument of long-term repos, with a total volume of around AMD 3.0 billion, with an average interest rate of 8.38 percent.

CBA repo operations in Q3 2010 (mln AMD)



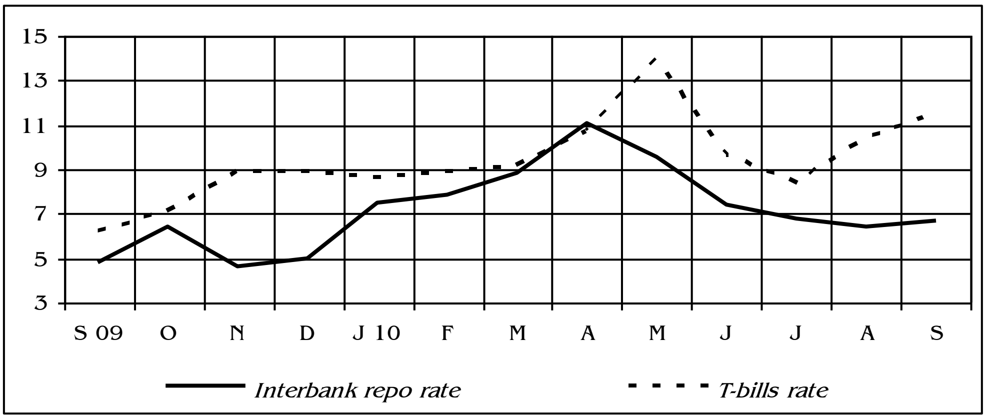
In the third quarter liquidity in the banking system has increased. Effectiveness of liquidity management with commercial banks has risen as well, which was boosted up by an Overnight Bџrse set up back in April this year. In the third quarter the volume of interbank loans reached AMD 127.5 billion, growing by nearly AMD 26.0 billion against the previous quarter, with an average interest rate fallen by 2.40 pp to 4.24 percent. This was the reason why no lombard repo operations were executed between commercial banks and the Central Bank, whereas the average daily volume of commercial bank deposit with the Central Bank amounted to AMD 12.0 billion compared to AMD 5.9 billion in the previous quarter.

In the third quarter the volume of operations performed in the interbank and intrabank repo market amounted to AMD 210.2 billion, growing AMD 46.4 billion compared to the previous quarter. In September average interbank and intrabank market repo rate was 7.33 percent against 8.49 percent recorded in June. The share of operations between commercial banks in total constituted 38.87 percent against 35.81 percent recorded in the previous quarter. In September average interbank market repo rate was 6.63 percent against 7.41 percent recorded in June.

In the third quarter the issue volumes of short-term treasury bills amounted to AMD 21.0 billion against AMD 13.0 billion recorded in the previous quarter. The total volume of short-term treasury bills allocated reached AMD 18.2 billion compared to AMD 11.0 billion recorded in the previous quarter.

In the third quarter interest rates tended to rise in the primary market of short-term treasury bills driven by both the supply of these securities and mounting inflation. In particular, at the beginning of the quarter interest rates dropped but started going up in August-September. As a result, in September average yield on short-, medium- and long-term treasury bills reached 11.49 percent, 14.13 percent and 15.95 percent, growing against June indicator by 1.9 pp, 1.2 pp and 0.8 pp, respectively.

Interbank repo and T-bills rates

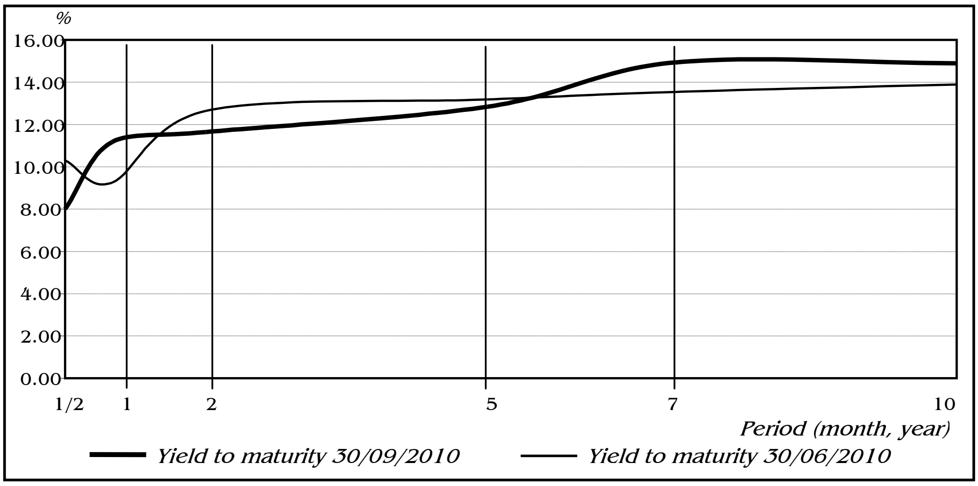


The yield curve analysis shows that in the secondary market of government securities yields have grown mostly in short-term (6 months to 1 year) and long-term segments. Most transposition of the curve (approximately 90 percent) is driven by a parallel shift in the curve line, which amounted to 0.11 pp, owing to increased yields. Convexity of the curve has changed too, from 0.21 to 0.31, which points to the widened spread between interest rates of long-term and short-term treasury bills.

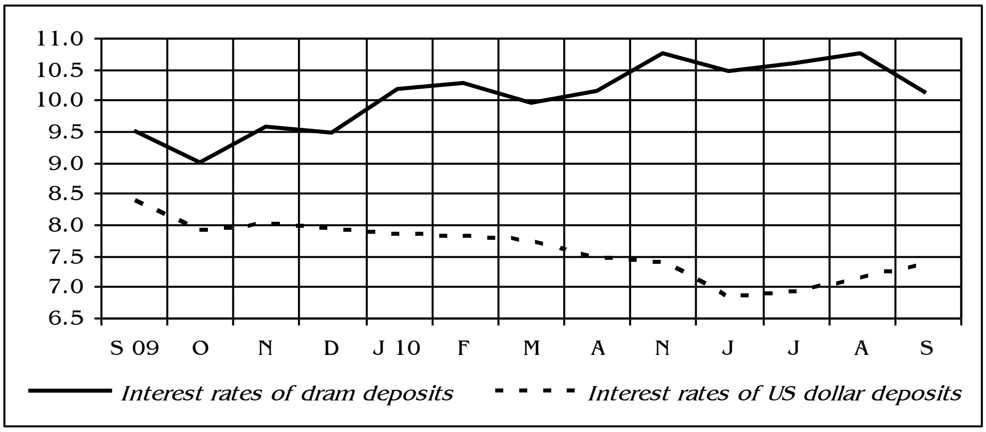
In the third quarter interest rates of loans and deposits in Armenian dram and US dollar trended as follows: average interest rates of dram and dollar deposits were 10.46 percent and 7.16 percent, respectively. Relative to the second quarter, average interest rate of dram deposits remained largely the same, while interest rates of dollar deposits fell by 0.1 percent.

As a result, the spread of interest rates of dram and dollar deposits amounted to 3.3 pp against 3.22 pp recorded in the second quarter.

Secondary market posted an interest rate rise in short- and long term and a fall in medium term

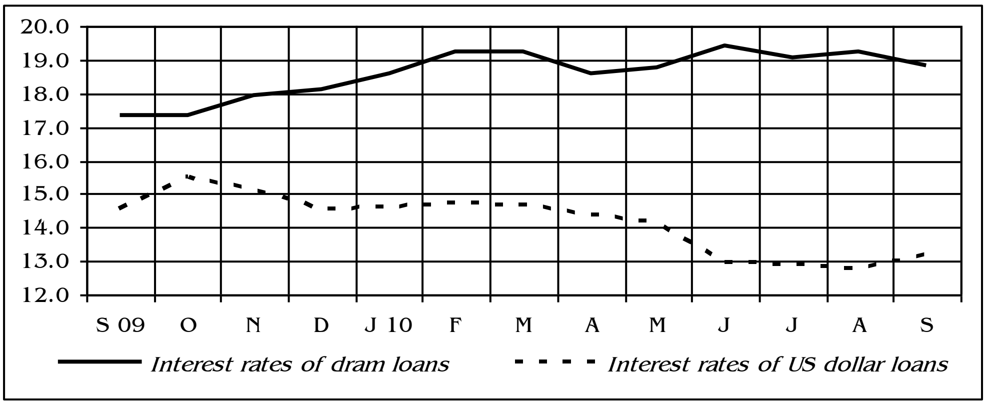


Interest rates of deposits attracted by banking sector



Average interest rates of dram loans and dollar loans were 19.02 percent and 12.91 percent, respectively. Relative to the second quarter, average interest rate of dram loans rose by 0.11 pp whereas interest rate of dollar loans fell by 0.8 pp. As a result, in June the spread of interest rates of dram and dollar loans amounted to 6.11 pp compared to 5.2 pp recorded in the second quarter.

Interest rates of loans provided by banking sector

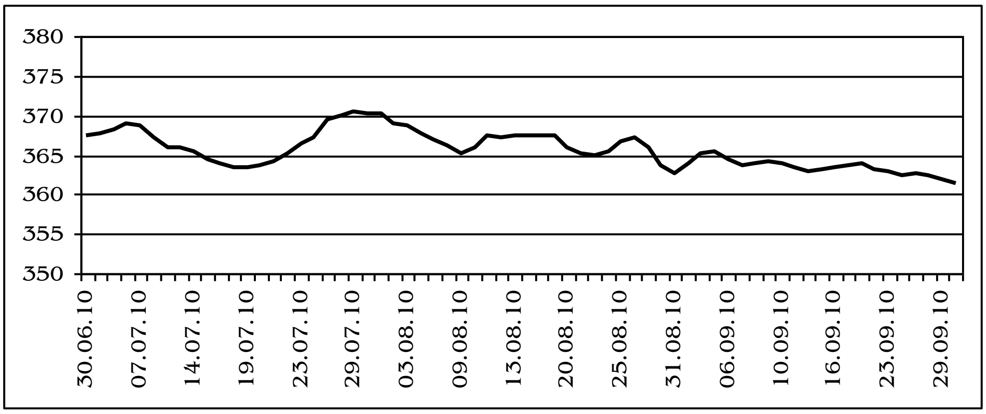


The interest rate spread of loans and deposits in Armenian dram made up 8.56 pp, (8.45 pp in the second quarter) and the interest rate spread of loans and deposits in US dollar reached 5.75 pp (6.48 pp in the second quarter).

3.3.2. Exchange rate

At the end of the third quarter of 2010, relative to the end of the previous quarter, the average AMDUSD appreciated by 1.71 percent to dram 361.31 from 367.5 for one dollar. Relative to the third quarter of the previous year, average appreciation has been 6.36 percent. Average quarterly exchange rate appreciated by 5.15 percent relative to the previous quarter, and by 1.95 percent, relative to the third quarter of the previous year.

AMD/USD in Q3 2010



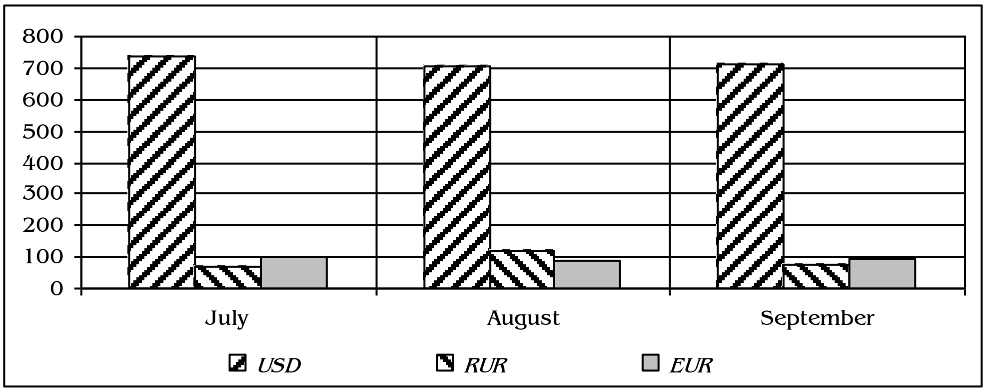
The aggregate volume of interbank market transactions carried out during the third quarter amounted to USD 2156.4 million[22] (AMD 786110.42 million) which represents 16.29 percent increase in relation to the respective indicator of USD 1854.4 million recorded in the third quarter of the previous year.

Volumes of ruble/dram exchange transactions have increased abruptly, reaching AMD 95074.91 million (RUR 8013.21 million), which represents 53.26 percent increase in relation to the previous year's figure. In the intrabank ruble/dram market bank purchases prevailed all the time. Volumes of euro/dram exchange transactions amounted to AMD 103646.94 million (EUR 219.50 million), which represents 18.22 percent decrease in relation to the respective indicator recorded in the previous year.

As a result, the aggregate volume of foreign exchange transactions executed in dollar, ruble and euro (in dollar terms) totaled USD 2701.83 million, of which USD 1,384.52 million as purchase and USD 1,317.31 as sale. These transactions executed in the foreign exchange market determined the behavior of nominal exchange rate.

To handle the dram supply and prevent the dram exchange rate from sharp fluctuations, the Central Bank purchased a total of USD 31.35 million from commercial banks and sold a total of USD 14.35 million to commercial banks.

Gross volumes of foreign exchange operations in Armenia (mln USD)



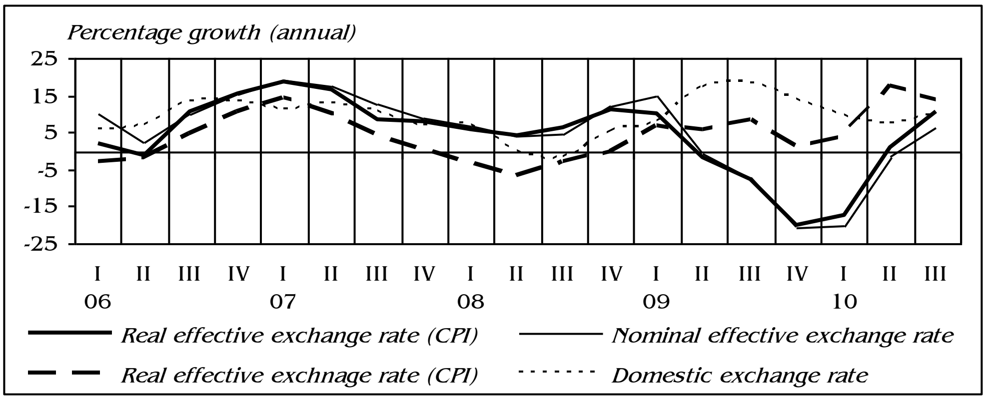
[22] *This figure includes trades executed at the stock exchange, totaling USD 179.92 million.*

In the third quarter nominal effective exchange rate of the dram appreciated by 4.3 percent q-o-q primarily due to about 5.15 percent appreciation of average quarterly AMDUSD q-o-q, whereas partner countries' currencies have appreciated versus the US dollar by a mere 0.7 percent. Relative to the same period of the previous year nominal effective exchange rate of the dram has appreciated by around 6.0 percent. This was mostly driven by an average 4.1 percent y-o-y depreciation of exchange rate in partner countries, with the euro depreciation having played the greatest role (with 3.9 pp contribution).

During the third quarter real external exchange rates calculated by CPI and PPI appreciated, whereas real domestic exchange rate depreciated in relation to the previous quarter. Still, both external and domestic real exchanges rates reported y-o-y appreciation.

In the third quarter of 2010 average quarterly inflation was 8.7 percent y-o-y in Armenia and average weighted inflation was 4.2 percent y-o-y in partner countries. Weighted average inflation in partner countries was most influenced by inflation in Russia (6.3 percent y-o-y), Ukraine (9.0 percent y-o-y) and Iran (9.3 percent y-o-y), with contributions of 1.3 pp, 0.7 pp and 0.5 pp, respectively, as well as by 0.6 pp contribution from Euro-area, which is determined by a large weight of the latter. So, in the third quarter the CPI-calculated real effective exchange rate has appreciated notably, 10.5 percent y-o-y, against 0.6 percent y-o-y appreciation in the previous quarter. At the same time, the PPI-calculated real effective exchange rate has appreciated by 13.7 percent against 17.6 percent appreciation in the previous quarter. This was mainly driven by considerable y-o-y increase of producer prices in dram in Armenia.

In Q3 2010 real and nominal exchange rates kept on appreciating



In the third quarter the domestic real exchange rate appreciated by 9.9 percent y-o-y, against the previous quarter's 7.0 percent appreciation, as prices of non-tradable goods grew faster than prices of tradable goods[23]. Prices of non-tradable goods and services have increased by 18.6 percent y-o-y, and prices of tradable goods, by 8.0 percent, compared to 14.7 percent and 7.6 percent, respectively, recorded in the previous quarter. The y-o-y growth of prices of tradable goods was attributable to a notable growth of international prices. The growth of prices in non-tradable sector was mainly determined by y-o-y increase in gas and water supply fees in the second quarter of 2010.

3.3.3. Monetary developments

The first half of 2010 results pointed to a relatively stable macroeconomic environment and a diminishing 12-month inflation behavior. Somewhat a subdued dollarization was observable as well, in part

[23] *Prices of non-tradable and tradable goods have been calculated based on expert judgment over prices of a consumer basket, taking goods and services into relevant categories.*

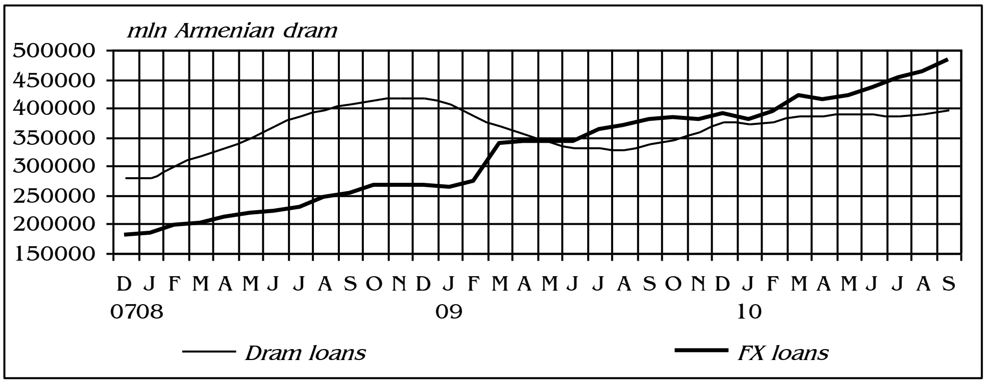
thanks to the change in reserve requirement mechanism effective from September 2010 (whereby reserve requirement against 25 percent of foreign currency funds attracted shall be kept in dram). In view of these tendencies and that a new reserve requirement mechanism was introduced, effective September, to provide for another 25 percent portion of foreign currency funds to be kept in dram, the Q3 2010 monetary policy program envisaged a moderate growth of monetary aggregates and faster growth rates in dram deposits over foreign currency deposits.

In the third quarter expectations were mainly justified in a sense that the level of dollarization declined by 4.1 percent due to 1.2 percent reduction in the volume of foreign currency deposits (a mere 0.5 percent increase, when a change in exchange rate is excluded) and 12.9 percent increase in dram deposits.

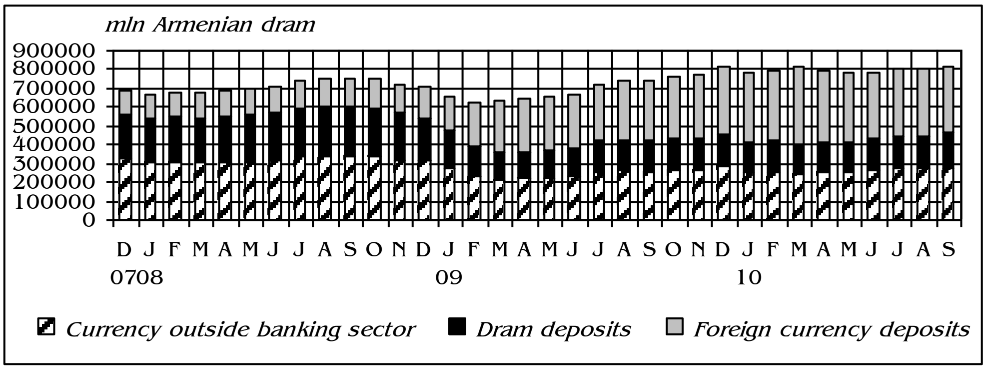
Meanwhile, foreign currency loans kept on growing by 10.3 percent (or 12.1 percent, when a change in exchange rate is excluded), primarily owing to excess funds on correspondent accounts in foreign currency. Over the quarter the dram lending has grown merely by 2.4 percent, and the growth indicator of economy lending made up 6.5 percent, as a result.

The above structural shifts in broad money explained an outpacing pattern of dram broad money: in the third quarter broad money grew by 3.0 percent, whereas the growth of dram broad money has been twice as much, making up 6.5 percent.

FX lending persisted despite continued efforts to minimize dollarization



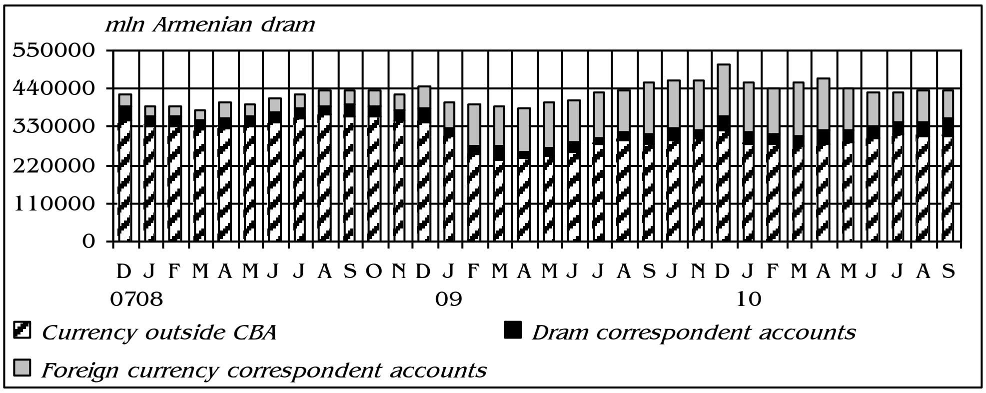
In Q3 2010 dram components of broad money continued to grow



Following substantial declines in early periods of time, in the third quarter monetary base stayed much the same, growing merely by 1.0 percent due totally to the growth of dram components, and the dram portion of monetary base has increased, as a result.

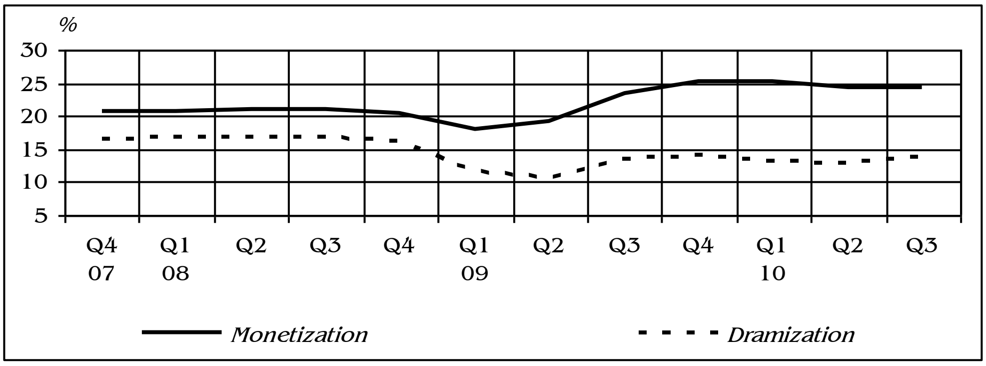
The above indicators demonstrated the following behavior over the quarter, based on the 12-month period: broad money grew by 9.0 percent, dram broad money, by 8.7 percent, currency in circulation, by 7.0 percent, dram deposits, by 11.4 percent, foreign currency deposits, by 9.3 percent, and economy lending, by 22.4 percent. Instead, monetary base declined by 5.5 percent y-o-y.

Monetary base by components



At the end of the third quarter dollarization of the economy (measured as a ratio of foreign currency deposits to broad money) was 43.5 percent, which is more than 4 percent below the respective indicator of the previous quarter and which is mostly in line with the figure recorded for the same quarter of the previous year.

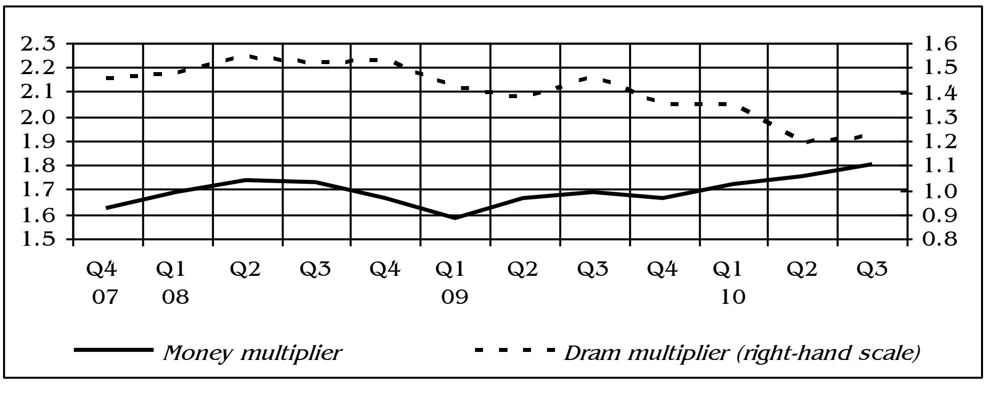
Monetization and dramization ratios



The monetization and dramization ratios, which are measures of financial intermediation, made up 24.4 percent and 13.6 percent, according to the third quarter results, rising by 4.1 percent and 1.3 percent, respectively, in relation to the previous year's indicators.

Other indicators of financial intermediation, i.e. money and dram multipliers, behaved as follows: money multiplier has increased by 3.1 percent, with y-o-y growth making up 6.8 percent, and dram multiplier has increased by 3.2 percent q-o-q but decreased by 16.3 percent y-o-y. The quarterly growth of dram multiplier was restrained to a certain extent associated with an alteration to reserve requirement mechanism as part of Central Bank and Government action to reduce the level of dollarization in the economy. As a result, foreign currency funds on correspondent accounts of commercial banks with the Central Bank have decreased and dram funds have increased.

Money and dram multipliers



3.4. AGGREGATE DEMAND AND AGGREGATE SUPPLY

3.4.1. Aggregate demand

Domestic demand

Private consumption and investments[24]***:*** In the third quarter of 2010 some slowing of domestic demand relative to the previous two quarters of the year was observed in the economy under the slowdown of economic growth rates and reduced public expenditures.

In the third quarter domestic demand has grown by around 1 percent in real terms. Public expenditures have reduced in real terms by 26.2 percent[25], reflecting diminishing expansionary fiscal policy as part of anti-crisis measures taken up in the previous year.

Private investments have grown by around 12 percent due to slowly yet steadily recovering domestic and external demand, increased remittances and optimistic expectations among economic agents about future macroeconomic environment. Private consumption has grown by nearly 1 percent in real terms, which is a result of some increase of private disposable income and restored consumer confidence. The growth of private consumption and investment reflects 0.4 percent increase of retail trade as well as growth of organization-supported construction and wholesale trade volumes, by 32.6 percent and 12.4 percent, respectively.

Composite economic indexes calculated by the Central Bank for the third quarter of 2010 point to the aforementioned developments[26]. In the third quarter, consumer confidence index, CCI, rose by 2.3 percent, present conditions index, PCI, by 1.3 percent and future conditions index, FCI, by 3 percent. Economic activity and business activity indexes rose by 5.8 percent and 4.5 percent, respectively. In the third quarter enterprise willingness to invest has increased. These indicators, however, stay behind the respective indicators recorded in the previous quarter, reflecting the slowing of growth rates of private spending due to the slowdown of economic growth.

With a reported increase in the third quarter, private spending, however, had a restrictive impact on inflation amid slow growth rates. According to the Central Bank, the estimated level of real private expenditures has been below its equilibrium by 1-2 percent, which exerted deflationary pressures in the consumer market reducing inflation by 0.4 - 0.6 pp.

Public consumption and investments[27]: In the third quarter of 2010 expansionary impact of the fiscal policy kept on reducing. According to estimated fiscal impulse, the fiscal policy's impact on aggregate demand and inflation was 0.8 percent expansionary, much lesser than anticipated, which was created under a 2.6 pp restrictive impact of the revenues impulse and a 3.4 pp expansionary impact of the expenditures impulse. The revenues impulse was less restrictive than forecast, due to sluggish collection of revenues, whereas the expenditures impulse was less expansionary thanks to some savings on expenditures.

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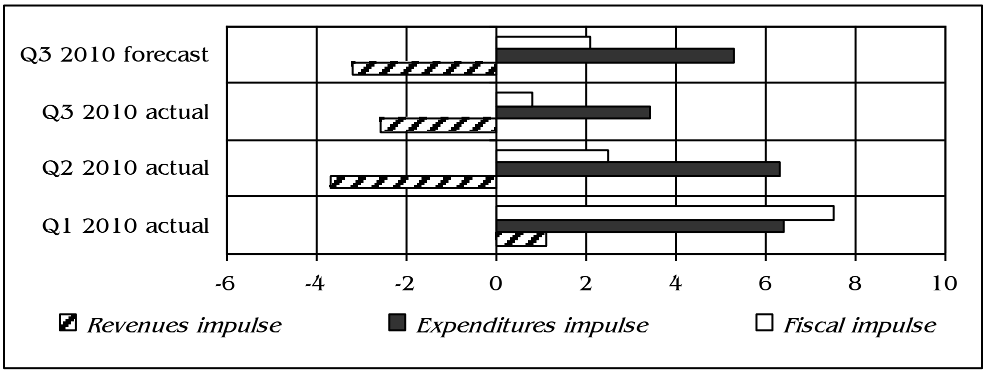
[24] The real growth indicators of private consumption and investments for the third quarter are the Central Bank estimations. The actual figures of these indicators are as of the second quarter of 2010. Estimations of real growth presented in this section are relative to the same quarter of the previous year, unless otherwise stated.

[25] Substantial decline in public expenditures in real terms has been under a high level of public expenditures deflator.

[26] See http://www.cba.am/CBA_SITE/statistics/complex_index.html?__locale=hy.

[27] Consolidated budget indicators prepared based on preliminary actual data of the third quarter of 2010 (including PIU funds) have been used for the review of the fiscal sector. The 2010 fiscal impulse indicators have been estimated against 2008 consolidated budget indicators (with 2008 treated as a base year), since the fiscal policy in 2009 has been prominent as anti-crisis measures were taken up that year. The impact of revenues has been calculated against an actual nominal GDP indicator and the impact of expenditures has been calculated against an estimated potential GDP indicator.

In Q3 2010 fiscal impulse was less expansionary than had been forecast

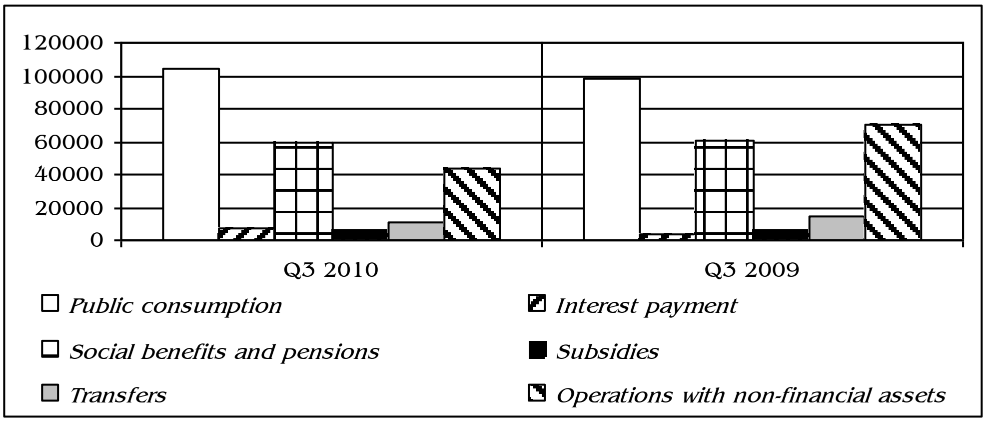


Positive developments with the economic recovery observable since the start of the year affected the process of collection of budget revenues, which resulted in a notable overperformance on revenues. In the third quarter, however, in the face of the slowing of economic activity, some sluggishness in collection of revenues was observed. This led the revenues impulse to have a lesser restrictive impact than forecast.

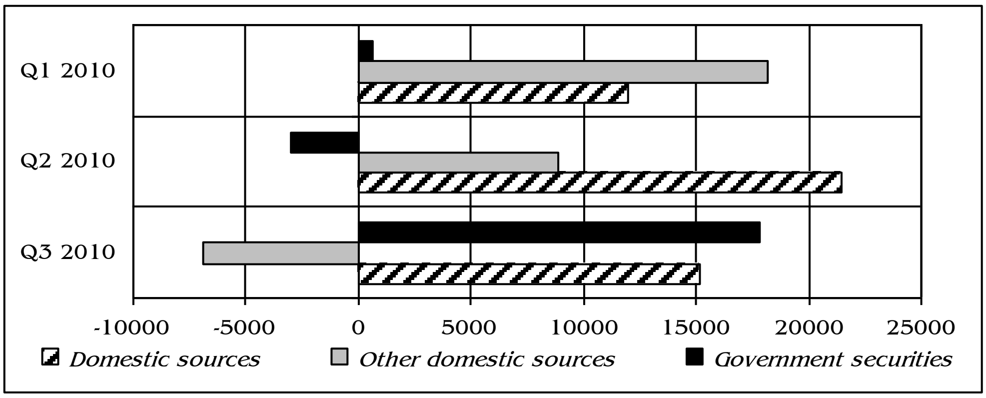
The y-o-y growth of tax revenues and social security charges was 12.3 percent. Growth of indirect taxes was 13.6 percent y-o-y which is largely due to increased value added tax. Direct taxes grew by 7.1 percent y-o-y. In the structure of direct taxes, a decrease was observed in respect of profit tax only, by 11.2 percent, while income tax increased by 27 percent. Growth of 18.2 percent was posted with regard to other revenues.

Over the third quarter budget expenditures have decreased by about 9.2 percent y-o-y. Current expenditures have grown by 2.3 percent y-o-y, in which public consumption has increased by 6.3 percent y-o-y. Expenditures on item *transactions with non-financial assets* have reduced by 39 percent. This was attributable to the Government having implemented an expansionary fiscal policy since the second half of the previous year, which led to a notable increase especially on the part of capital expenditures.

In Q3 2010 budget expenditures posted cutbacks on capital expenditures



In Q3 2010 net proceeds on government securities prevailed in sources of budget deficit financing



In the third quarter of 2010 budget deficit amounted to AMD 26.1 billion, 58 percent of which has been financed from external sources and 42 percent, from domestic sources. In the structure of external sources AMD 10.2 billion was the portion of IMF's loan for budget support and AMD 17.8 billion was net proceeds from government securities.

To sum up the results of the first nine months of the year, a considerable increase has been reported for state budget revenues in relation to the same period of the previous year. In particular, tax revenues and social security charges have grown by 18 percent and public expenditures (including PIU funds) have grown by around 3 percent.

Based on the results of the first nine months of 2010, state budget deficit has totaled AMD 84.2 billion or about 43.6 percent of annual projection.

Main macroeconomic indicators in Q3, 2009 and Q3, 2010 (in real terms)

Indicator	Q3, 2009-Q3, 2008	Q3, 2010-Q3, 2009
Real GDP	-19.8	-1.2
Domestic demand	-20.5	0.8
Consumption	-2.5	0..3
Public	-6.3	-6..9
Private	-2.0	1.0
Capital investment	-43.7	1.7
Public	15.7	-52.2
Private	-48.6	11.7
Export[28]	-5.9	8.5
Import[28]	-19.6	3.6

3.4.2. Aggregate supply[29]

During the third quarter economic growth rates continued to slow down, whereas economic growth indicator in the period January-September has been merely 2.8 percent y-o-y. The slowdown in relation to the previous quarter was driven mainly by the downfall in agriculture due to unfavorable weather conditions.

Industry reported about 13.4 percent y-o-y growth in value added in the third quarter, whereas growth over the first nine months of the year has been 9.7 percent y-o-y.

The first nine-month growth results of mining, processing, and water supply sub-industries were, respectively, 28.9 percent, 10.8 percent and 6.8 percent growth, while electricity and gas production and supply sub-industry reported 5 percent decline. In the latter's structure, when expressed in kind, about 19.4 percent y-o-y growth was recorded for electricity production, which has been determined by considerable increase of export volumes of electricity, whereas production of gas shrank by around 13.7 percent y-o-y[30], explained by reduced gas consumption by households.

Contribution to the growth in industry came mainly from *metal ore mining* (29.8 percent), *food production*[31] (8.7 percent), *beverage production*[32] (21.7 percent), *items of jewelry* (30.4 percent), *building materials production* (17.4 percent), *finished articles of metal* (7.3 percent),

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[28] This is to mean export/import of goods and services.
[29] Indicators of the branches of the economy are for the period January-September of 2010 in relation to the same period of the previous year.
[30] Source: ArmRosGazProm CJSC.
[31] Growth in this sub-branch has been fuelled by increased production volumes of sugar ($15^1/_2$ times), grains (90.8 percent), flour (18.2 percent), confectionery (13.1 percent), macaroni (4.9 percent), ice-cream (13.6 percent), sour-cream (6.9 percent), mountain yoghurt (8.3 percent) and vegetable oil (9.6 percent).
[32] Growth in this sub-branch has been fuelled by increased production volumes of brandy (17.5 percent), wine (30.4 percent), beer (49.7 percent), champagne (56.2 percent), mineral water (25.7 percent), spring water (44.3 percent), and natural juice (39.3 percent).

and *chemical production* (27.8 percent), driven by gradually recovering world economy and domestic economy.

Construction reported about 1.2 percent y-o-y decrease in value added, whereas growth over the first nine months of the year has been 2.7 percent y-o-y. The growth was fuelled mainly by increased volumes of construction in *agriculture* (4.6-fold), *processing industry* (97.8 percent), *transport* (64.7 percent), *information and communications* (19.3 percent), and *public administration* (2.1-fold). *Residential housing* with reported slowing of decline rates, however, continued decreasing, (24 percent).

Further, increased volumes of construction financed by *state budget funds* (5-fold), *local budgets* (2.7-fold), *humanitarian aid* (5.1-fold), and *private organizations* (32.6 percent) have totally neutralized reduced volumes of construction to the expense of *international loans* (36 percent decrease), and *household funds* (48.1 percent decrease).

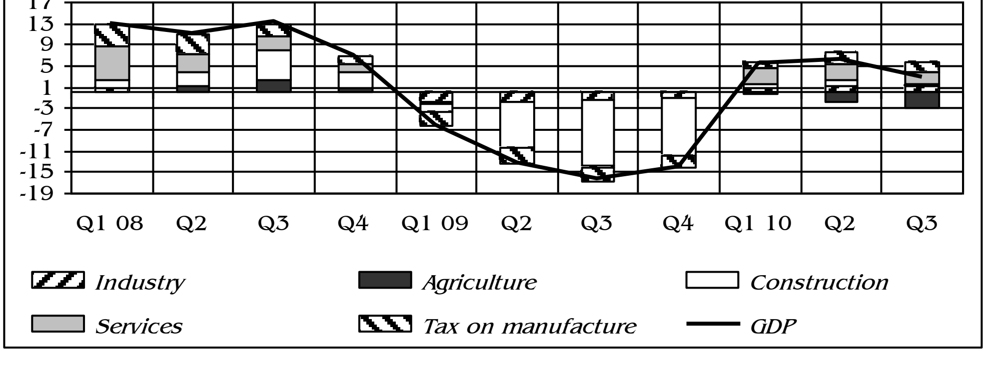
Funds of organizations financed about half of construction volumes, in the period January-September.

So in the structure of construction financing, construction funded by organizations was once again among leading positions in the period January-June, like in the same period of the previous year. Even more so, this indicator exceeded the indicator of construction funded by international loans, which held the largest share in the structure of financing in the previous quarter.

Agriculture reported around 19 percent y-o-y decline in value added in the third quarter, whereas over the first nine months of the year the decline has been 17.8 percent y-o-y. The decline was determined by decreases in *plant growing* (25.6 percent) and *animal growing* (2.4 percent). Further, the decline in production volumes of animal growing was totally due to decreases in *slaughter animal and poultry* (10.9 percent) and *milk production* (2.9 percent) which were, however, offset in part by 23.5 percent increase in egg production volumes. The decline in *plant growing* is consequence of decreased spring sowing, less harvests and reduced arable land due to adverse weather conditions. In the outcome, demand for agricultural products in domestic market was satisfied mostly from hothouse products and imports.

Services reported about 4.5 percent y-o-y growth in value added for the second quarter, whereas over the first nine months of the year the growth has been 5.4 percent y-o-y. This was driven by *retail trade* (0.4 percent) (this was completely a result of increased turnover of shops, agro-product markets and trade stalls), and *wholesale trade* (12.4 percent). In the meantime the volume of services rendered has increased by 7.4 percent. Save for services in *healthcare* and *social public services*, growth was reported for services in all other areas. Such areas as *information and communications, transport* and *financial and insurance activities* added contributions to overall service growth, by 3 percent, 2.9 percent and 17.5 percent, respectively.

Real GDP growth rate and sector contributions (cumulative)



3.5 LABOR MARKET [33]

In the third quarter of 2010 there has been some growth in nominal wages observed in the labor market, which was fostered by wage increases in the private sector and a number of budget-supported organizations, as a result of recovering economic activity. Demand for labor further increased, reaching 22.7 percent, despite a slowing of economic growth rates to 6.9 percent in relation to the respective indicator of the previous year. This brought the level of unemployed slightly down.

According to the Central Bank estimates, average growth of nominal wages in the economy over the third quarter has been around 7 percent. The highest rise was reported in industry, construction and services while relatively a modest growth, in healthcare and education areas.

The number of employed increased by 17 percent during the quarter, with an average employment growth figure of 1.1 percent.

Over the quarter labor productivity indicator reported around 1 percent decline. As a result of these developments, unit labor costs have increased by around 8 percent which created minor inflationary pressures of 0 - 0.5 percent in the economy[34].

3.6. IMPORT PRICES AND PRODUCER PRICES

3.6.1. Import prices

In world commodities markets in the third quarter prices further tended to grow. Although this was mainly attributable to significant growth of food prices, prices of main intermediate goods also posted some growth. According to the Central Bank estimations, dollar prices of imports have increased by 7.5 percent y-o-y (about 7.3 percent y-o-y increase was recorded in the previous quarter).

Indicator	Q3, 09	Q4, 09	Q1, 10	Q2, 10	Q3, 10
Import (total)	-8.3	5.4	13.4	7.3	7.5
Import (services)	-9.1	3.1	10.7	4.9	4.7
Import (goods)	-8.0	6.1	14.3	8.1	8.4
Capital goods[35]	0.0	0.0	0.0	0.0	0.0
Consumption goods	-9.1	3.1	10.7	4.9	4.7
Intermediate goods	-15.1	-3.7	8.4	7.5	13.6
Diamond[35]	0.0	0.0	0.0	0.0	0.0
Oil products	-40.9	34.2	70.4	33.5	11.8
Natural gas	40.0	40.0	40.0	16.9	16.9

The y-o-y growth in dollar prices has been attributable to very low prices recorded in the same period of the previous year but a notable growth of prices of intermediate goods and food products, which was 7.0 percent q-o-q (in the previous quarter - 0.9 percent).

Prices of intermediate goods and food products have increased by 13.6 percent y-o-y compared to 7.5 percent y-o-y increase recorded in the previous quarter. While price rise was reported for all intermediate goods, the most prominent were increased prices of grain and sugar which determined high y-o-y growth of prices of such goods. The impact of prices of intermediate goods on total import was 3.7 pp.

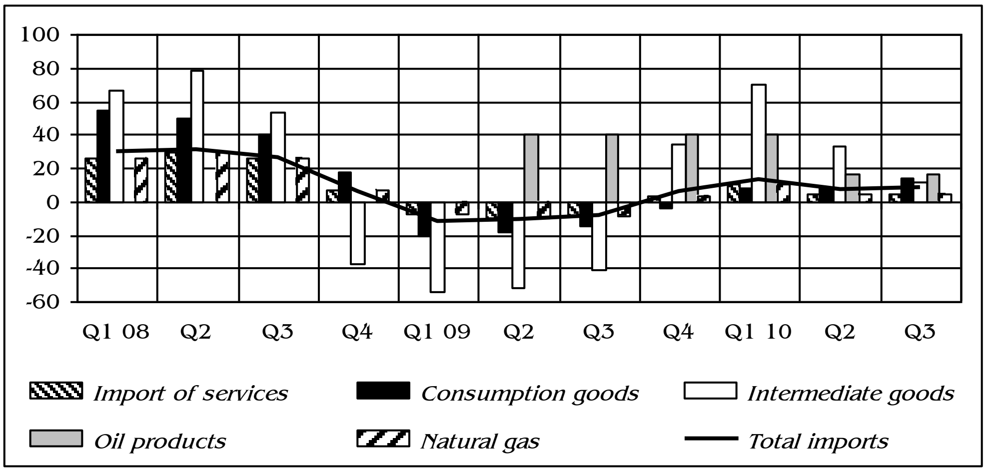
[33] Labor market indicators of the third quarter are the Central Bank estimations based on actual figures of July and August and estimated figures of September of 2010. Growth estimations presented in this section are relative to the same quarter of the previous year, unless otherwise specified.

[34] Because unit labor costs have increased in the light of slackened productivity as a result of deep decline in agriculture, and that paid workforce in agriculture makes only a small share in total employment in the branch, the labor market's impact on inflation in the third quarter is likely to have been weak if not neutral at all.

[35] The lack of estimates on prices of capital goods and diamond is due to their sharp volatility. Therefore a change in these prices is estimated to be zero.

In the third quarter dollar prices of oil products reported about 3.2 percent fall, whereas dollar prices of oil products have grown by about 11.8 percent y-o-y (33.5 percent in the previous quarter). As a result, prices of oil products had only 0.8 pp of impact on general import prices.

In Q3 2010 y-o-y prices of imported goods kept on rising



In the third quarter prices of imported consumption goods have increased by 4.7 percent y-o-y, creating merely 0.9 pp of impact on general import prices. On the whole, growth of prices of consumption goods was driven by high inflation (6.8 pp) in partner countries. The latter's huge impact on dollar prices of import goods could not be offset even when partner countries' exchange rates had depreciated by 2.1 pp on average. High inflation recorded in China and the yuan appreciation was the strongest contribution, among main partner countries, to general import prices, making up 0.5 pp. Second strongest contribution, 0.4 pp, came from Russia, largely driven by inflation in this country. The impact of positive contributions from inflation in Russia and other partner countries has been in part neutralized by around -0.4 pp contribution from Euro-area due to high y-o-y depreciation of the euro exchange rate.

Given 7.5 percent y-o-y rise in international prices (dollar import prices) and 1.9 percent y-o-y depreciation of the average nominal AMDUSD exchange rate, dram prices of import goods included in the consumer basket have increased by 5.9 percent y-o-y during the third quarter.

3.6.2. Producer prices [36]

In the third quarter of 2010 all branches of the economy reported an increase of price indexes, and in the period January-September the GDP deflator reached 109.8 y-o-y, exceeding the previous year's respective indicator by 10.2 pp.

The largest price increase has been in ***Agriculture.*** Over the quarter prices have risen by 32.3 percent y-o-y[37], whereas the growth in the period January-September has been 26 percent y-o-y. Plant growing suffered by short supply of crops and reduced sowing because of unfavorable weather conditions reported 37.6 percent price increase which was fuelled by price increases in grains (22.1 percent), potato and gourd plants (39.3 percent), and fruit and berries (29.4 percent). Price increase of 18.9 percent in animal growing was fuelled mainly by price increases in meat (31.5 percent) and milk and dairy products (5.6 percent).

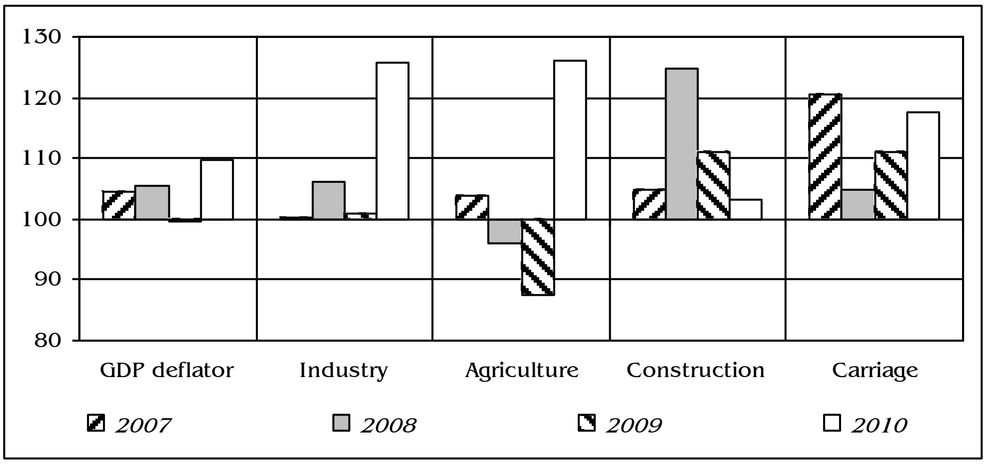
[36] Price index change in the period January-September of 2010 is relative to the same period of the previous year, unless otherwise specified. Price indexes in branches of the economy represent output price indexes.
[37] Sales prices of producers of agricultural product are presented.

Industry reported an increase of prices by 14.4 percent y-o-y, whereas the January-September growth has been 25.9 percent y-o-y due to growths in *mineral production* (39.7 percent), *processing industry* (20.6 percent), and *electricity, gas and water production and supply* (25.2 percent). In the period January-September of 2010, relative to January-September of the previous year, these increases were associated with high prices of nonferrous metals, gradual recovery of world and domestic demand and gas tariff rise since April of 2010.

Construction reported 6.8 percent y-o-y growth of prices in the third quarter, whereas in the period January-September there has been 3.1 percent rise y-o-y, mostly driven by increased prices of building materials.

Prices in carriage costs have increased by 9.8 percent y-o-y, whereas the growth in January-September has been 17.7 percent y-o-y, determined by increases in *railway carriage costs* (7.9 percent), *auto carriage costs* (3.7 percent), *air transportation fare* (10 percent), and *pipeline transportation fare* (31.2 percent). The pipeline transportation fare has risen as a result of gas tariffs increased from USD 154 to USD 180 per cubic meter.

In January-September 2010 highest price increases were reported in agriculture and industry



3.7 INFLATION EXPECTATIONS

The Central Bank carried out the third quarter of 2010 survey of inflation expectations of financial organizations, households, and non-financial organizations of real sector.

Based on the results of survey in the financial sector, expectations of high inflation for the upcoming 12-month horizon persisted. The choice of the 5.5-8.5 percent range for the 12-month inflation was still prevailing at banks, reaching 71.4 percent, inflation expectations at credit organizations were somewhat moderated and stretched between the 5.5-8.5 percent and 2.5-5.5 percent ranges and came as a ratio of 54/46 percent. So, despite a diminishing behavior of the 12-month inflation in the previous period (save for an episode of abrupt rise in the third quarter, which was affected by supply shocks) and expected downward trends in the upcoming one-year period, the financial sector has been, in principle, reluctant to ascertain its inflation expectations.

High inflation in the third quarter, naturally, triggered sentiment and affected expectations of households. Based on the survey results, 62.0 percent of respondents expect price increases on food products versus 47.5 percent in the previous quarter, and 45.4 percent of respondents expect consumer price increases compared to 37.3 percent in the previous quarter.

According to the results, on the whole banks and credit organizations stick to expectations of stable market interest rates for the upcoming one-year horizon. Banks, however, expect a slight drop in interest rates of loans in foreign currency.

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