

THE CENTRAL BANK OF THE REPUBLIC OF ARMENIA

*Approved under
the Central Bank Board Resolution No. 313-A,
on 22.11.2011*

**STATUS REPORT
ON IMPLEMENTATION OF
THE MONETARY POLICY
PROGRAM**

(Inflation Report)

Q3, 2011



Table of Contents

1. Summary	3
2. Inflation developments	5
2.1. Inflation by goods and services, Core inflation	5
<i>Statistical review of inflation fluctuations</i>	<i>6</i>
2.2. Fulfillment of inflation target	9
3. Inflation factors	12
3.1. External environment	12
3.2. Balance of payments	19
<i>3.2.1 Current account</i>	<i>19</i>
<i>3.2.2 Capital and financial account</i>	<i>21</i>
3.3. Interest rates, exchange rate and monetary developments	21
<i>3.3.1. Interest rates</i>	<i>21</i>
<i>3.3.2. Exchange rate</i>	<i>24</i>
<i>3.3.3. Monetary developments</i>	<i>26</i>
3.4. Aggregate demand and aggregate supply	28
<i>3.4.1. Aggregate demand</i>	<i>28</i>
<i>3.4.2. Aggregate supply</i>	<i>31</i>
3.5. Labor market	32
3.6. Import prices and producer prices	33
<i>3.6.1. Import prices</i>	<i>33</i>
<i>3.6.2. Producer prices</i>	<i>34</i>
3.7. Inflation expectations	35

ACTUAL INDICATORS AND DEVELOPMENTS IN Q3, 2011

1. SUMMARY

In the third quarter of 2011 the inflation environment further eased, driven by both domestic and external macroeconomic developments. Prices of food products and raw materials in world markets behaved stably and prices of some commodities even went down. In the meantime, conditioned by slowly recovering domestic demand, influence of implemented contractionary fiscal and monetary policies and increased supply of agricultural products, no inflationary pressures from domestic environment were shown up. Yet, because of tightened tax administration in sugar market and some food and non-food product markets, at the end of the quarter the 12-month inflation was still above the confidence band.

At the end of the third quarter the 12-month inflation was 6.2 percent, reducing by around 2.3 pp relative to the previous quarter's indicator. Price increase in food products made 5 pp contribution to headline inflation, of which 3.4 pp alone fuelled by price increases in sugar, meat, dairy and egg. Price increases in non-food products and service tariffs made, respectively, 0.5 pp and 0.7 pp contribution to headline inflation.

The Central Bank estimations based on y-o-y economic growth indicator for the period January-September 2011 are in line with previous forecasts. The decline in construction was totally offset by higher-than-expected growths in industry and agriculture as a result of materialization of upside risks in industry and agriculture and downside risks in construction, as were outlined in previous forecasts.

Economic growth in this period of time was determined mainly by estimated y-o-y growth of 14.8 percent, 15 percent and 3.7 percent in industry, agriculture and services, respectively.

In the third quarter the average quarterly unemployment rate reduced, reflecting the growing demand for labor. At the same time, the growth of average nominal wages was consistent with the growth of labor productivity. As a result, no significant changes in unit labor costs were seen, so one may affirm that the impact of the change in unit labor costs on inflation in the third quarter was almost neutral.

In the third quarter private sector expenditures grew by around 6 percent relative to the previous year. Public expenditures in real terms grew by nearly 1 percent, while domestic demand increased by 5 percent relative to the same period of the previous year. Private consumption grew by around 6 percent and private investment by roughly 4 percent relative to the previous year.

In the third quarter the gap between private spending and their potential was still negative although it further narrowed as a result of continuously growing private spending. In the light of the aforementioned developments, the private sector spending did not have a significant impact on inflation in the third quarter.

The fiscal policy in the third quarter was further driven to maintain macroeconomic stability and ensured congruence with collection of revenues and savings on public expenditures. As a result, the fiscal policy's impact on aggregate demand, hence, inflation was 0.5 pp contractionary instead of the forecast 0.8 pp expansionary. This was driven by almost neutral impulse from revenues and -0.5 pp contractionary impulse from expenditures.

In general, in the course of nine months the fiscal policy's impact on aggregate demand has again been neutral.

In light of the above-mentioned developments in domestic demand and labor market, some deflationary pressures were observed in the economy during the third quarter of 2011, which were in the range of 1.5 - 2 pp y-o-y, according to the Central Bank estimates.

In the third quarter current account performed on the background of slowing world economic growth rates and increasing uncertainties associated, particularly, with Euro-area debt crisis. So, current account tended to improve in line with the developments in world and domestic economies. With sustained high levels of metals prices in global markets and reported high growth in industry in the third quarter, the growth of export of goods remained strong. Grown economic activity led to increased volumes of import of goods in both dollar terms and real terms, which topped the expectations. The developments in world economy, the tightness in the banking sector in Russia in particular, was especially noticeable in September when growth rates of inflow of non-commercial remittances of individuals via the banking system slowed down. High growth of transfers however remained strong in the third quarter due to reported high growth in July and August. As a result of the aforementioned developments, in the third quarter the current account deficit reduced by USD 65.1 million y-o-y and amounted to USD 204.8 million. In the period January-September 2011 the share of current account deficit in GDP has improved by 3.7 pp.

The above-mentioned trends determined the attainment of the inflation target and monetary policy directions for the third quarter. Despite easing of the inflation environment, in July and August the Central Bank withheld from changing the interest rate in the face of escalated debt problems in world economy as well as higher-than-expected prices of some food products and non-food products. However, given the prevailing influence of key factors pushing inflation down, at the end of the quarter monetary conditions were loosened to some extent with the aim to bring the inflation indicator possibly closer to the central value in confidence band in the 12-month horizon subsequent to the third quarter. This could create additional stimuli to shore up economic activity.

In the third quarter monetary policy developments were again mainly consistent with the scenario. Broad money grew by 4.7 percent, dram broad money, by 8.0 percent, and monetary base, by 9.7 percent. The level of dollarization further tended to subdue in the third quarter by 1.7 pp relative to the previous quarter and by 1.5 pp against the same period of the previous year. Despite some sluggishness in growth rates in relation to the first two quarters of the year, growth of lending volumes remained strong this quarter too, 6.2 percent.

2. INFLATION DEVELOPMENTS

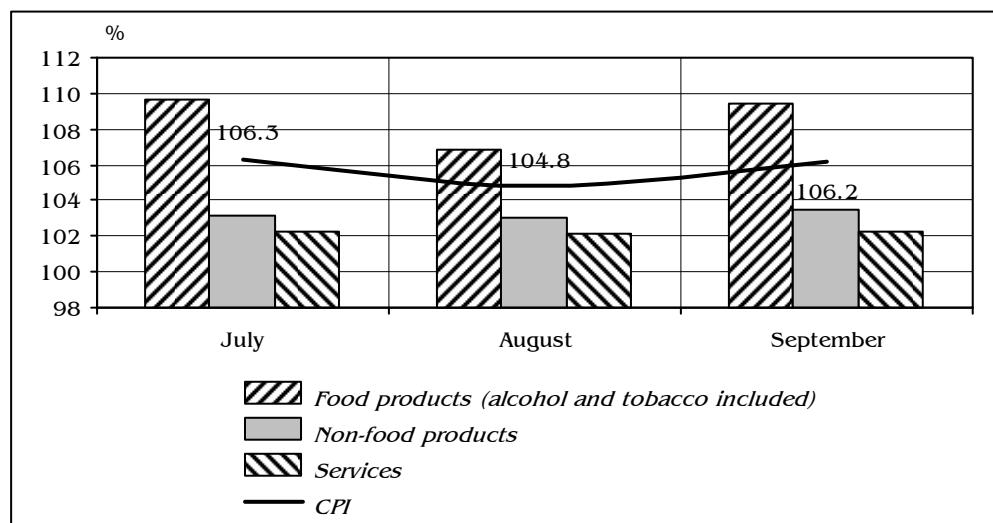
2.1. INFLATION BY GOODS AND SERVICES; CORE INFLATION

In September 2011, relative to September 2010, inflation was 6.2 percent. Prices rose as follows: food products (alcohol and tobacco included) by 9.4 percent; non-food products by 3.5 percent; and service tariffs by 2.2 percent, all having contributed to inflation by 5.06 pp, 0.55 pp and 0.67 pp, respectively.

Main contributions to inflation

Commodity groups	Price change, %	Contribution to inflation, pp
Food products		
Meat products	14.0	1.42
Dairy products	22.7	0.96
Fats and oils	19.8	0.64
Egg	39.9	0.55
Bread products	5.1	0.54
Coffee, tea, cocoa	14.3	0.51
Sugar	46.4	0.50
Fruit	2.4	0.09
Vegetable	-8.6	-0.54
Non-food products		
Personal car and fuel	11.9	0.29
Garment and knitwear	3.8	0.11
Jewelry items	34.1	0.06
Services		
Medical services	13.2	0.49
Transport services	8.2	0.27
Public catering	6.2	0.11
Household services	4.1	0.05
Residential and public utilities	-1.0	-0.14

CPI in Q3 2011 based on the 12-month results, by main commodities and services



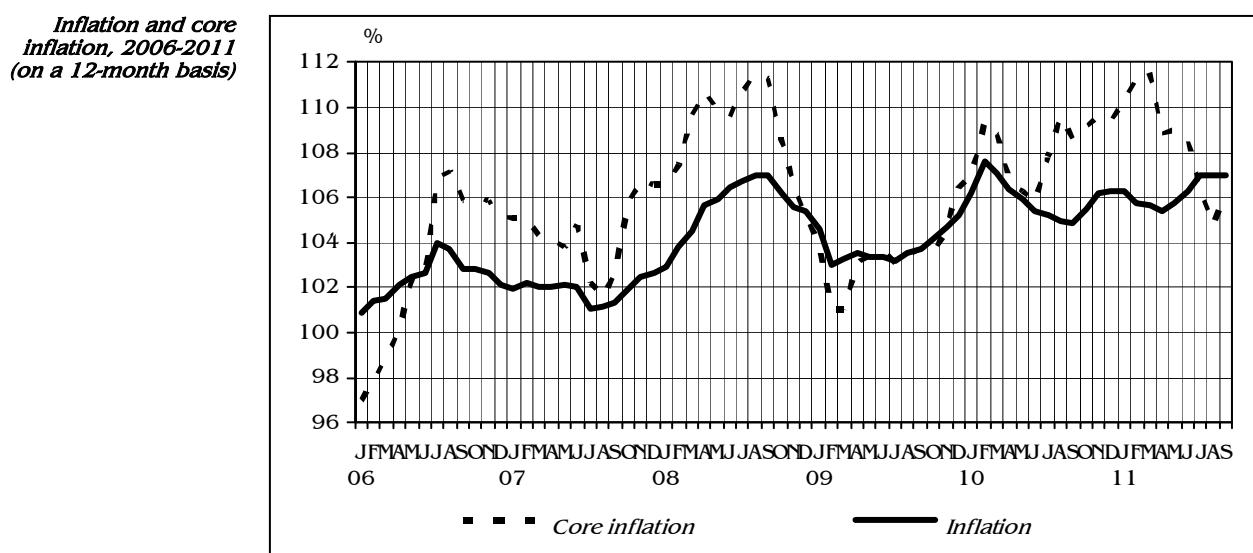
In the third quarter consumer price index reduced by 2.8 percent compared to the end of the previous quarter; prices of food products decreased by 5.2 percent (with -2.77 pp contribution to inflation), service tariffs by 0.04 percent, while non-food product prices rose by 0.4 percent.

In the period January-September of 2011, relative to January-September of 2010, inflation has been 8.5 percent (it was 7.8 percent and 2.9 percent in 2010 and 2009, respectively). This figure of 8.5 percent was

due to 12.8 percent price increase of food products, 3.1 percent price increase of non-food products and 4.0 percent rise in service tariffs, all having contributed to headline inflation by 6.8 pp, 0.5 pp and 1.2 pp, respectively.

In September of 2011, relative to December of 2010, prices of consumer goods have risen by 0.6 percent as a result of 0.9 percent deflation on food products and 2.5 percent inflation on non-food products and 2.4 percent inflation on service tariffs (with -0.5 pp 0.4 pp and 0.7 pp contribution to inflation).

In the third quarter the 12-month core inflation was 7.01 percent. The largest contribution to it came from such items as "beef" (contribution – 1.0 pp), "egg" (0.7 pp), "homemade cheese from cow milk" (0.7 pp), "petrol" (0.4 pp), "surgery services at hospitals" (0.4 pp), "butter" (0.4 pp), "pork" (0.3 pp), "sugar" (0.3 pp), "air transport fare" (0.3 pp), "Chanakh cheese" (0.3 pp) and "chopped meat" (0.2 pp)¹.



Statistical review of inflation fluctuations

In order to review the changes in Consumer Price Index and in price indexes of individual commodity groups included in consumer basket, as well as to discover the factors determining their fluctuations, the influence of three components (trend, seasonality and irregularity components) used in Statistics theory has been identified and assessed for the time period from October 2008 to September 2011².

Calculations show that in the period from October 2008 to September 2011 the influence of seasonality component on CPI has been 61.8 percent; the influence of irregularity component, 37.1 percent; and the influence of trend component, 1.1 percent. In comparison with the period from October 2007 to September 2010, the influence of seasonality component and irregularity component has increased by 1.7 percent and 1.8 percent, respectively, whereas the influence of trend component has decreased by 3.5 percent.

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".

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

For the time period from October 2008 to September 2011, the influence of the three components has changed as follows:

- the influence of seasonality component on *price index of food products* was 70.56 percent, up by 7.3 percent compared to the period from October 2007 to September 2010; in the meantime the influence of irregularity component and trend component has decreased by 3.3 percent and 4.0 percent, respectively;
- the irregularity component had 62.34 percent impact on *price index of non-food products* in the period from October 2008 to September 2011 (this component's impact has decreased by 5.7 percent compared to the period from October 2007 to September 2010); the impact of seasonality component has increased by 5.7 percent and reached 37.66 percent;
- the seasonality component and irregularity component had roughly the same amount of impact on *service tariffs*, making up 43.2 percent and 43.9 percent, respectively; the seasonality component's impact has decreased by 17.5 percent, while the irregularity's and trend's has grown by 10.9 percent and 6.6 percent, respectively, in comparison with the period between October 2007 and September 2010.

For the period from October 2008 to September 2011, the *seasonality component* had the strongest impact on such items as "education services" (75.26 percent), "vegetable and potato" (72.74 percent), "fruit" (70.32 percent), "footwear" (63.59 percent), "items of culture" (57.03 percent), "Residential and public utility services" (56.55 percent), "fats and oils" (54.18 percent) and "egg" (53.37 percent); the *irregularity component* had the strongest impact on such items as "jewelry items" (83.47 percent), "alcohol beverage" (75.98 percent), "textiles" (75.74 percent), "kitchen utensils" (75.51 percent), "communication services" (70.30 percent), "other services for household" (69.75 percent), "household services" (69.70 percent) and "bread products" (69.27 percent); and the *trend component's* impact has been relatively strong on such items as "gardening items" (18.74 percent), "beauty and apparel" (16.77 percent), "personal cleanliness items" (12.53 percent), "stationery" (11.79 percent), "detergents" (11.02 percent), "bread products" (10.81 percent) and "medicament" (9.71 percent).

*Share of components causing fluctuations in monthly price indexes
(October 2008 – September 2011), %*

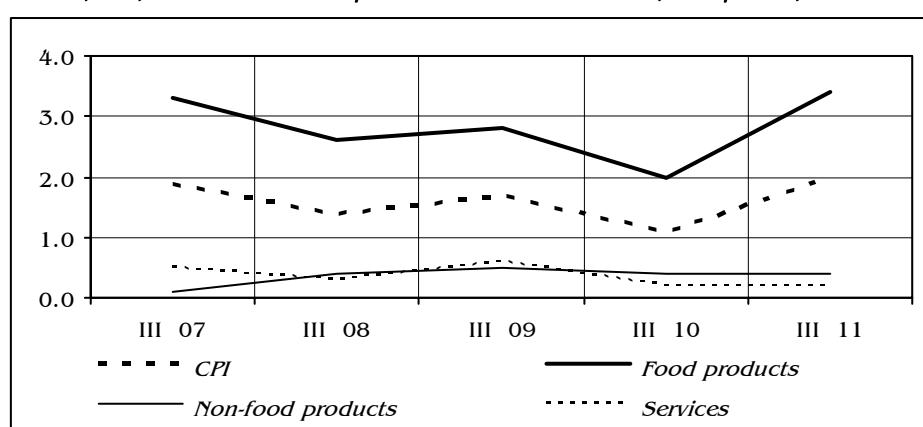
Item	Trend	Seasonality	Irregularity	Total
CPI (relative to previous month)				
Food products (alcohol and tobacco included)	1.1	61.8	37.1	100.0
Bread products	0.2	70.6	29.2	100.0
Meat products	10.8	19.9	69.3	100.0
Fish products	8.6	29.6	61.8	100.0
Dairy products	5.0	32.1	62.9	100.0
Egg	2.5	42.4	55.1	100.0
Fats and oils	1.1	53.4	45.5	100.0
Fruit	3.7	70.3	26.0	100.0
Vegetable and potato	5.3	72.7	21.9	100.0
Sugar	2.0	50.8	47.2	100.0
Coffee, tea, cocoa	4.0	32.9	63.1	100.0
Confectionery	1.3	35.9	62.8	100.0
Other products	5.7	35.6	58.7	100.0
Non-alcoholic beverage	0.0	35.1	64.9	100.0
Alcohol and tobacco	0.9	23.1	76.0	100.0

Non-food products	0.0	37.7	62.3	100.0
Garment and knitwear	7.4	50.5	42.1	100.0
Footwear	0.9	63.6	35.5	100.0
Fuel	8.5	46.5	45.0	100.0
Furniture	5.6	51.8	42.6	100.0
Carpets	1.5	41.0	57.5	100.0
Textiles	0.0	24.3	75.7	100.0
Home appliances	4.8	31.6	63.6	100.0
Kitchen utensils	2.4	22.1	75.5	100.0
Detergents	11.0	31.7	57.3	100.0
Building materials	8.8	29.2	62.0	100.0
Items of gardening	18.7	46.9	34.4	100.0
Medicament	9.7	27.0	63.3	100.0
Personal cars and fuel	6.4	28.2	65.4	100.0
Items of culture	0.3	57.0	42.7	100.0
Stationery	11.8	42.7	45.5	100.0
Beauty and apparel	16.7	14.6	68.7	100.0
Items of jewelry	1.0	15.5	83.5	100.0
Personal cleanliness items	12.5	37.8	49.7	100.0
Services	12.9	43.2	43.9	100.0
Household services	1.1	29.2	69.7	100.0
Other services for household	0.9	29.3	69.8	100.0
Residential and public utility services	3.7	56.6	39.7	100.0
Healthcare services	0.1	34.1	65.8	100.0
Transport services	0.1	31.6	68.3	100.0
Communications services	0.5	29.2	70.3	100.0
Culture services	7.9	29.5	62.6	100.0
Educational services	0.5	75.3	24.2	100.0
Leisure and rest services	1.4	43.4	55.2	100.0
Public catering	5.3	29.7	65.0	100.0
Legal and banking services	0.0	31.8	68.2	100.0

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

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

CPI, food, non-food and service price index variation coefficients, third quarters, 2007-2011



In the third quarter of 2011, relative to the third quarter of 2010, the CPI variation coefficient has risen to 2.0 percent from 1.1 percent, driven by 1.4 pp increase of food product price index variation coefficient. Such increase was a result of price index variation coefficients risen in such items as "vegetable and potato" (24.3 percent), "fruit" (12.2 percent) and "sugar" (11.3 percent). The non-food product price index and service tariff index variation coefficients remained mainly unchanged, with coefficients risen in such items as "footwear" (2.8 percent), "items of culture" (4.0 percent), "jewelry items" (3.4 percent) and "leisure and rest services" (4.8 percent).

Monthly price index variation coefficients in third quarters, 2007-2011, %					
Item	Q3 2007	Q3 2008	Q3 2009	Q3 2010	Q3 2011
CPI (relative to previous month)	1.9	1.4	1.7	1.1	2.0
Food products (alcohol and tobacco included)	3.3	2.6	2.8	2.0	3.4
Bread products	1.4	0.3	0.3	3.0	0.6
Meat products	1.1	1.1	0.6	0.2	1.0
Fish products	1.7	21.4	0.1	0.4	0.6
Dairy products	0.4	0.0	0.5	0.4	1.6
Egg	3.8	1.7	7.0	9.8	2.3
Fats and oils	4.1	0.2	0.9	1.2	0.1
Fruit	4.5	10.1	17.6	2.8	12.2
Vegetable and potato	20.2	19.4	18.2	13.9	24.3
Sugar	0.6	1.3	3.8	2.4	11.3
Coffee, tea, cocoa	0.0	0.3	0.4	0.2	0.4
Confectionery	0.0	0.3	0.1	0.1	0.2
Other products	0.1	0.7	0.2	0.0	0.1
Non-alcoholic beverage	0.0	0.0	0.1	0.0	0.1
Alcohol and tobacco	0.0	0.0	0.1	0.0	0.3
Non-food products	0.1	0.4	0.5	0.4	0.4
Garment and knitwear	0.2	0.4	1.0	1.1	1.2
Footwear	0.2	0.1	4.7	1.4	2.8
Fuel	0.3	0.7	1.1	0.1	0.6
Furniture	0.1	0.1	0.2	0.3	0.3
Carpets	0.0	0.0	0.1	0.5	0.1
Textiles	1.0	0.1	0.4	0.2	0.1
Home appliances	0.7	0.3	0.8	0.3	0.2
Kitchen utensils	0.0	0.8	1.1	0.1	0.1
Detergents	0.1	0.6	2.3	0.1	0.1
Building materials	0.1	0.6	1.5	0.1	0.5
Items of gardening	0.7	0.5	0.0	0.3	0.6
Medicament	1.1	0.1	0.0	0.2	0.3
Personal cars and fuel	0.8	2.0	1.0	0.8	0.8
Items of culture	0.8	1.5	0.2	1.5	4.0
Stationery	0.1	0.2	2.2	0.6	0.7
Beauty and apparel	0.3	0.1	0.4	0.1	0.3
Items of jewelry	0.4	4.1	0.5	0.2	3.4
Personal cleanliness items	0.1	1.2	1.9	0.7	0.3
Services	0.5	0.3	0.6	0.2	0.2
Household services	2.0	0.1	0.7	0.1	0.0
Other services for household	2.5	0.1	0.8	0.1	0.0
Residential and public utility services	0.0	0.0	0.1	0.0	0.2
Healthcare services	0.3	0.7	0.8	0.1	0.3
Transport services	0.2	0.4	1.2	1.1	0.7
Communications services	0.0	1.0	0.0	0.0	0.4
Culture services	3.5	2.2	3.6	2.3	0.1
Educational services	2.9	1.7	3.9	2.8	2.2
Leisure and rest services	1.1	0.5	1.4	0.5	4.8
Public catering	0.1	0.5	0.1	1.0	0.6
Legal and banking services	0.0	0.2	0.0	0.0	0.3

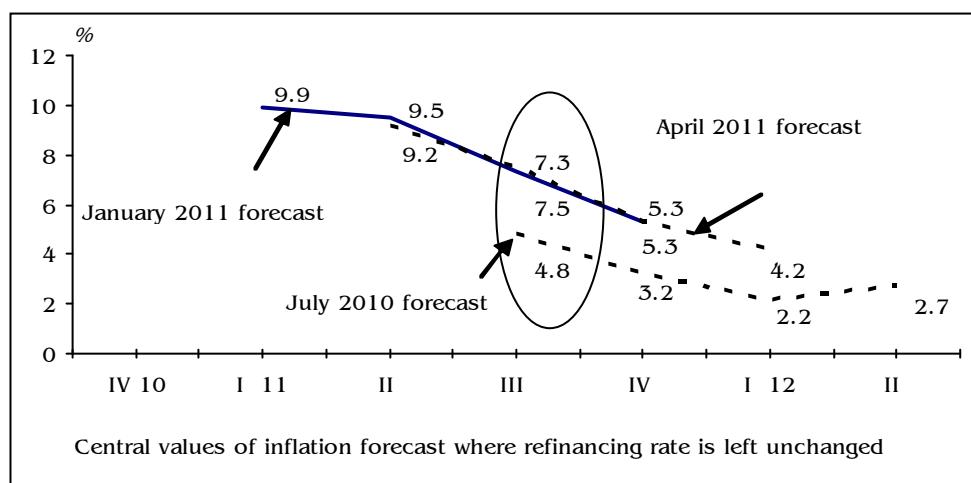
2.2. FULFILLMENT OF INFLATION TARGET

The inflation environment further tended to ease in the third quarter of 2011 due to lagged impact of monetary conditions which were tightened since the start of the year, some stabilization in prices of food products and raw materials in foreign markets, implemented contractionary fiscal policy and price falls in agriculture amid increasing output volumes of domestic products in that sector compared with the previous year. There was 2.8 percent deflation recorded during the third quarter, and the 12-month inflation made up 6.2 percent. In August it was as low as 4.8 percent but

rose again in September due to tightened tax administration in sugar market and some food product and non-food product markets. However, external and internal macroeconomic developments projected for the upcoming one-year horizon and expected influence from monetary policy point out that the 12-month inflation will again trace a diminishing trajectory and in the meantime it will be within the confidence band.

The inflation environment and monetary policy directions during the previous 12-month horizon prior to the third quarter of 2011 were characterized by the following trends. Given the up-scaling behavior of inflation in the second half of 2010, the inflation environment further intensified in the course of the first half of 2011, since second-round effects and inflationary expectations were added to existing inflation factors. As a consequence, 4.4 percent inflation was recorded in the fourth quarter (3.4 percent is average indicator in the last five years) and 5.2 percent in the first quarter of 2011 (2.5 percent is average indicator in the last five years). Under this circumstance, the 12-month inflation amounted to 11.5 percent in end-March, exceeding the upper border of the confidence band by 6.0 pp.

The 12-month inflation indicator forecast



Notwithstanding high inflationary environment, in the fourth quarter of 2010 the Central Bank found it reasonable to withhold from changing monetary conditions in the times when the inflationary environment was driven primarily by supply-side factors. As well as some other factors to ease inflation (i.e. tightened monetary conditions since the start of the year, developments in the foreign exchange market, slowly recovering domestic demand still aversive to creating inflationary pressures) were considered. As a result, in the period October-December the Central Bank left the refinancing rate unchanged, at the 7.25 percent level. However, in the face of intensifying inflationary environment, in the last months of the year the Central Bank made it clear in its statements that tightening the monetary conditions might be necessary.

In early 2011 high inflationary environment persisted, and the Central Bank made another upside revision to its January and April 2011 forecasts for the third half of 2011, to an estimated 7.5 percent and 7.3 percent, respectively. Also, taking into account the impact of supply shock gradually faded off during the previous year and completely eliminated in the second half of the year as well as the lagged impact of tightened monetary conditions in the first six months of the year, the forecasts however hold the fastest declining trajectory for a one-year horizon, when compared with projections of previous quarters. These forecasts were also based on the World Bank Food Index having soared to 25.3 percent in end-December

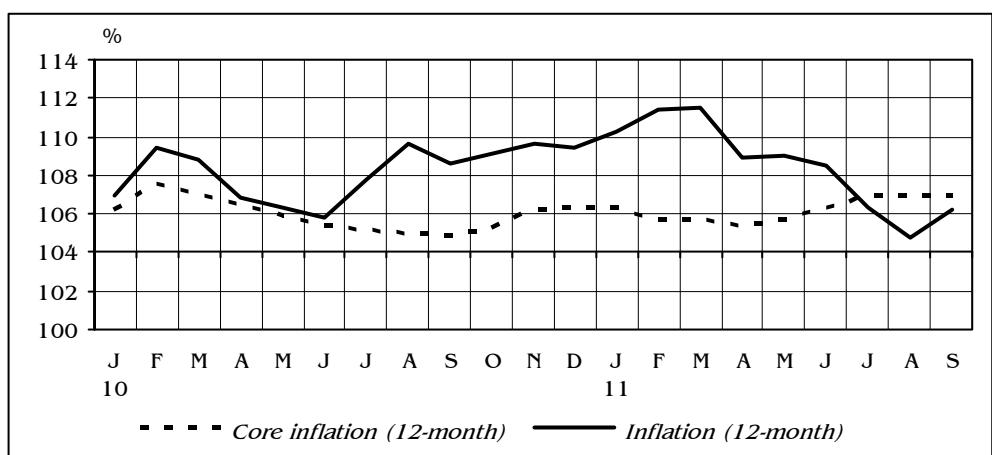
(and about 35.0 percent in March of 2011) from 14.0 percent recorded in September.

In such a situation, the Central Bank gradually tightened monetary conditions, from the start of the year, by raising the refinancing rate in January-April by 1.25 pp to set it at the 8.5 percent level.

In the second and third quarters the inflation environment somewhat moderated as prices in global commodities and raw materials markets were relatively stable. This was concomitant with non-inflationary developments in the domestic economy, reflecting neutral impact of labor market and private expenditures on prices and a contractionary nature of the fiscal policy. As a result, the second and third quarters saw 1.6 percent and 2.8 percent deflation, with the 12-month inflation having subdued to 6.2 percent in end-September from 11.5 percent in end-March. Price increases on food products remained the main contribution to the 12-month inflation (5.0 pp), driven primarily by price increases in items such as "meat products", "dairy products" as well as egg and sugar prices.

However, the 12-month core inflation remained high, 7.0 percent, again driven by the aforementioned inflation factors.

The 12-month core inflation and headline inflation dynamics



In view of actual moderation of the inflationary environment and in anticipation of price falls in domestic agricultural products due to their increased supply in the sector compared with the previous year, the Central Bank estimated, already in April, that the 12-month inflation in the forecast time horizon would most likely be in the range of $4\% \pm 1.5$ pp and that the likelihood of further expansion of the inflationary environment was very low, meaning that interest rates in financial market were high enough to restrain existing inflationary environment. So, in the period May-August the refinancing rate has been left unchanged, while in September it was lowered by 0.5 pp to amount to 8.0 percent.

3. INFLATION FACTORS

3.1. EXTERNAL ENVIRONMENT

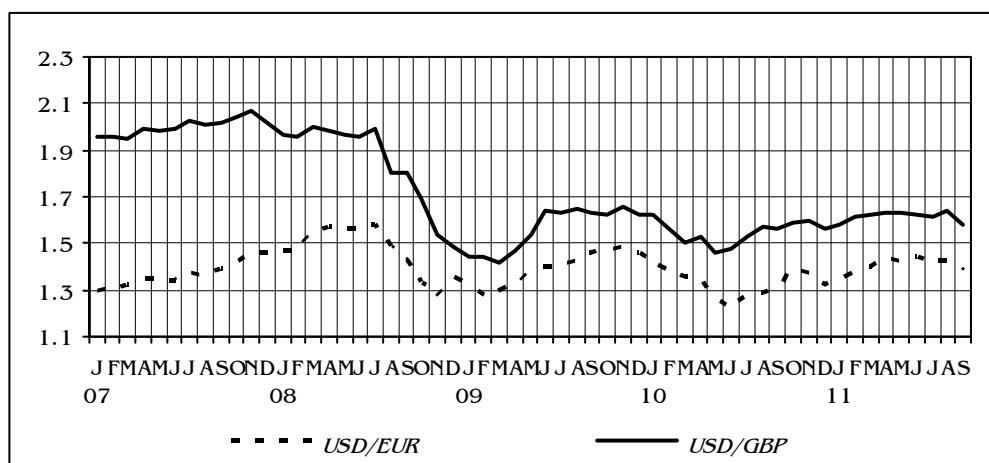
In the third quarter of 2011 world economic growth outlook further deteriorated amid persisting reluctance to resolution of debt problems in developed countries. Based on the IMF forecasts made in September 2011, world output growth in 2011 is expected to make up 4 percent (0.3 pp lower from previous forecasts)³. The revision downside is determined mainly by the slowing of economic growth in developed countries (estimation with 0.6 pp lower for 2011) and 0.2 pp reduction in economic growth forecasts for emerging countries. For 2011, inflation was estimated to be 2.6 percent in developed countries and 7.5 percent in emerging countries.

Risks remain downwards amidst world economic growth projected downside, which is associated with debt crisis and necessity for fiscal consolidation in developed countries on the one hand and possible influences from declining external demand in emerging countries on the other.

The third quarter was remarkable with price falls and stabilization trends in world commodities markets due mainly to some slowing of world economic activity. During the quarter, stabilization trends of prices were seen in both raw materials and food products markets.

In the third quarter financial markets were very volatile amid tensed political debate over debt problems in U.S. and Euro-area. The third quarter was prominent with some events associated with economic developments and political decisions in developed countries, which prompted the U.S. Congress to raise, in August, the debt ceiling and to decide on cutting the U.S. budget deficit by reducing public expenditures. Also, the S&P downgraded the U.S. Government's rating to AA+ from AAA, and debt problems in Euro-area further escalated. As a result of these developments, the US dollar appreciated versus Euro by an average 1.9 percent q-o-q and reached 1.41 dollar for one Euro in the third quarter (dollar's y-o-y depreciation was 8.5 percent).

The U.S. dollar in Q3 2011



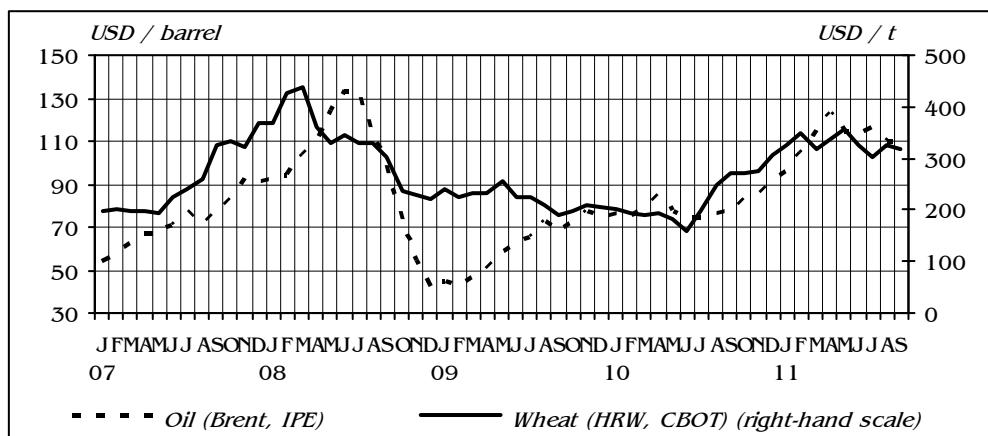
In the third quarter oil prices decreased by 3.9 percent q-o-q, with 'Brent' averaging around USD 112 a barrel (y-o-y growth was 47.2 percent).

Prices of base metals trended down on the whole, reflecting some slowing of the world economic growth rates, whereas prices of precious metals hit new historic highs. In the third quarter the copper price at the London Metal Exchange fell by 1.8 percent q-o-q and averaged around USD

³ "World Economic Outlook Update", IMF, September, 2011.

9003 per ton (y-o-y growth was 24 percent). Average quarterly gold price rose by 13 percent against the previous quarter to reach USD 1703 per troy oz. (y-o-y growth was 38.9 percent).

In world commodity markets in Q3 2011 prices tended to stabilize



Prices of food products generally stabilized during the third quarter, with the FAO-released food price index having fallen by an average 1.95 percent against the previous quarter. Average quarterly wheat price at the Chicago Board of Trade reached USD 8.6 a bushel, down by 6.9 percent against the previous quarter's average (the y-o-y growth was 32.7 percent in the third quarter and 91.1 percent in the second quarter). According to November estimates by the US Department of Agriculture, in the 2011/2012 marketing year some 683 million tons of crops of wheat are expected against the previous year's 648 million (increase by 5.4 percent). Given a projected world demand of 676.8 million tons, the world wheat stock is predicted to increase to amount to 202.6 million tons, so no inflationary pressures will be observed in wheat market.

In the third quarter the price of rice grew by 13.9 percent q-o-q and reached USD 17.1 per short hundredweight (45.4 kg), which exceeded the previous period's indicator by 52 percent.

Following a sharp decrease in the previous quarter, the price of sugar grew in the third quarter by 17 percent q-o-q, with the y-o-y growth of its price, however, having slowed down to 42 percent, compared with the previous quarter.

Below is the review of economic developments in the USA, Euro-area 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.

Though in the **United States of America** in the third quarter economic growth rates notably recovered, the economy is yet to enter the territory of sustainable growth while in the medium term the downside risks remain. Preliminary estimates by Economic Analyses Bureau of the US Department of Commerce suggest that in the third quarter the US economy posted an annualized 2.5 percent growth q-o-q compared to 1.3 percent growth recorded in the previous quarter. The growth was fuelled primarily by consumer spending (with 1.72 pp contribution), gross private investment (with 0.52 pp contribution) and net exports (with 0.22 pp contribution). In the meantime, the impact of reduced public sector expenditures and investment on the economic growth has been neutral.

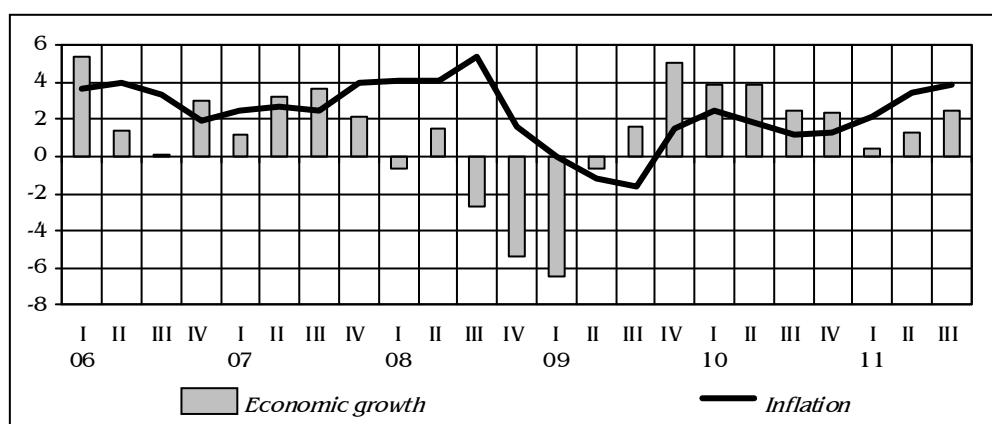
In the third quarter the deficit of net exports in GDP reduced slightly, amounting to 3.8 percent against 4 percent recorded in the previous quarter. This indicator is nonetheless higher from the 3.7 percent value

recorded for the same period of the previous year. The reduction was determined by higher growth rate of export, both in value and real terms, over imports.

In the third quarter average quarterly inflation in the U.S. economy was 3.8 percent y-o-y versus 3.4 percent y-o-y recorded in the previous quarter. The inflationary environment was driven mainly by price increases on fuel, vehicles, food products and some services.

In the third quarter the US Federal Reserve System maintained its policy target in the range of 0 - 0.25 percent while announced a *maturity extension program* (the program will be carried out until June of 2012 planning to buy long-term bonds and to sell short-term bonds at the same amount to keep long-term interest rates low and thus stimulate the economic growth) instead of carrying out QE3 which the markets were expectant of.

In the U.S.A. in Q3 2011 inflation further accelerated

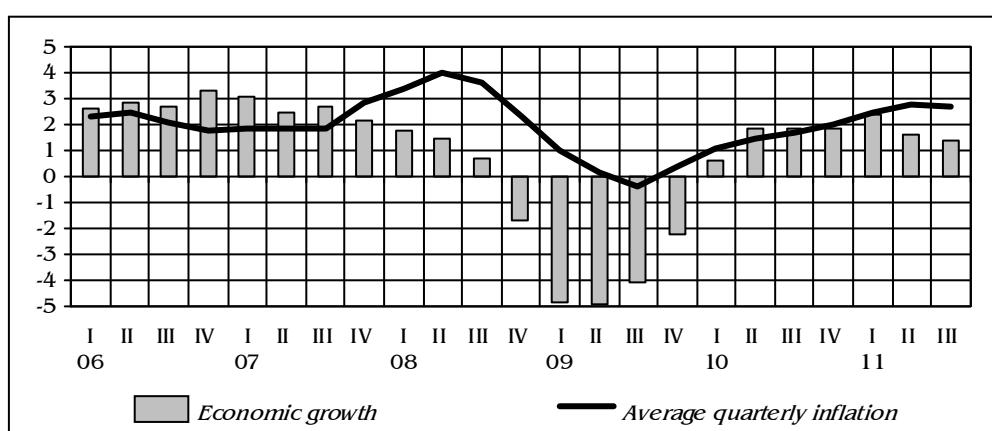


According to preliminary estimates of the EuroStat, economic growth of 0.2 percent was posted in **Euro-area** in the third quarter of 2011. In the meantime, the y-o-y economic growth rates slowed down amounting to 1.4 percent (compared with 0.2 percent and 1.6 percent q-o-q and y-o-y, respectively, in the previous quarter).

In the third quarter the consumer price index rose by an average 2.7 percent y-o-y against 2.8 percent inflation recorded in the previous quarter. Inflation was driven mainly by price increases on fuel and electricity, whereas price falls on communications, rental services and garment made a little downward impact on inflation.

To have inflationary expectations anchored, at the beginning of the quarter the European Central Bank raised the interest rate by 0.25 pp to 1.5 percent. In the next three months the interest rate was left unchanged.

In Euro-area in Q3 2011 inflation persisted at a high level



Economic recovery in **Russia** in the third quarter accelerated, with 5.1 percent y-o-y growth reported against the previous quarter's 3.7 percent growth. The growth was conditioned in part by low growth posted in the third quarter of the previous year. Economic growth in the period January-September has been 4.2 percent. As estimated by the Ministry of Economic Developments, economic growth rates in the fourth quarter will decelerate to 3.8 - 3.9 percent. On the back of this indicator, however, the growth of investments will remain strong. Economic growth rates speeded up nearly in all branches of the economy and even higher growth rates were recorded in construction (15.5 percent y-o-y) and agriculture (16.5 percent y-o-y). Retail trade posted 7.6 percent growth y-o-y and industry, 5.1 percent y-o-y.

The third quarter was prominent with near-to-zero inflation in the face of ruble depreciation, which pushed the Q2 2011 inflation indicator of 9.6 percent y-o-y down to 8.1 percent y-o-y. This was determined mainly by price falls in agricultural products. The growth of prices of non-food products and service tariffs quickened during the quarter. If these developments persist, inflation is expected to be lower than 7.0 percent up until the end of the year.

In the third quarter, in view of falling oil prices as well as developments in domestic economy, current account surplus has decreased and amounted to USD 17.3 billion against USD 25.2 billion in the previous quarter. In the third quarter of 2010 current account surplus was USD 5.5 billion. The growth of trade balance surplus (by USD 16.2 billion) more than offset the increase of net outflow of the other items. In the third quarter net capital outflow increased to USD 21.6 billion against USD 6.7 billion recorded in the third quarter of the previous year. Net outflow by banks amounted to USD 4.6 billion and net outflow by other private sector reached USD 16.8 billion. Net outflow of capital notably exceeded current account surplus. As a result, in the third quarter foreign currency reserves of the Central Bank of Russia have reduced by USD 1.8 billion and totaled USD 516.8 billion, as of end-September 2011 (net outflow on item *error and omission* was USD 2.5 billion).

In the third quarter there were even more uncertainties over the future behavior of the ruble exchange rate in the face of instabilities in global financial markets, international oil prices which fell starting from August and capital outflows starting from September. These developments added to the pressures on the ruble exchange rate thus boosting up the demand for foreign currency and weakening the ruble. Under such circumstances the Russian Central Bank sold a net of USD 2.8 billion. As a result, the average nominal exchange rate of RUB versus USD depreciated by 4.2 percent q-o-q whereas the ruble remained appreciated versus the US dollar (4.8 percent y-o-y) in relation to the third quarter of the previous year.

The Russian Central Bank implemented its third quarter monetary policy on the back of tightness in both domestic and foreign financial markets. This brought about liquidity and confidence problems in the banking sector. The above-mentioned problems escalated in September when excess reserves of banks decreased by 11.0 percent against August. In the meantime, the Central Bank, in cooperation with the Ministry of Finance, activated the refinancing. Deposits of the Ministry of Finance with credit organizations increased by RUB 0.4 trillion in September and the Central Bank's gross lending to credit organizations increased by RUB 0.2 trillion.

In its September meeting, the Board of the Russian Central Bank decided to leave the refinancing rate unchanged, to raise deposit facility rate by 0.25 pp, and to lower liquidity facility rate by 0.25 pp. The narrowing of the spread between interest rates of liquidity provision and

absorption operations should help reduce interest rate volatility in the money market as well.

Macroeconomic Situation in Neighboring Countries⁴

Turkey: in the second quarter of 2011 high economic growth⁵ persisted (8.8 percent y-o-y), exceeding expectations. Economic activity remains strong although growth rate decelerated. Private sector consumption and investment costs are the main driver to economic growth: in the second quarter of 2011 these indicators grew by 9.2 percent y-o-y and 33.5 percent y-o-y. Exports were low as they were influenced by the developments in world economy, and imports decreased significantly against previous months due to sluggish domestic demand in the light of economic policy measures. So, after a lasting period, net external demand made positive contribution.

The following developments were seen in economy's sectors: processing industry and mining industry posted, respectively, 8.0 percent and 1.2 percent y-o-y growth; growth rates in retail and wholesale trade and construction remained strong, making up, respectively, 13.0 percent and 13.2 percent y-o-y.

In the third quarter domestic demand further slowed down, reflecting lagged impact of contractionary policies. However, it reached a steady level thanks to bank regulation and supervision and tighter fiscal policy measures. In this period of time, bank lending, production and sales statistics and confidence indexes pointed out to the weakening of private sector consumption.

In the third quarter current account deficit narrowed in comparison with the previous quarter, reflecting the revision made thereto. Yet it remains at a high level. In July-August of 2011 current account deficit amounted to USD 9.25 billion as opposed to USD 6.6 billion recorded in the same quarter of the previous year. In January-August current account deficit has been nearly twice as much in comparison with the level reported for the same quarter of the previous year. The growth of export in July-August was 27.6 percent y-o-y and that of import, 36.1 percent y-o-y.

In July-August net inflow of capital decelerated and amounted to USD 4.2 billion. In the banking sector net outflow amounted to USD 1.7 billion while other private sector (excluding banks) posted net inflow of USD 2.1 billion. In July-August net inflow of 'hot money' was USD 0.5 billion compared to USD 6.1 billion net inflow recorded in the same period of the previous year. Net inflow of foreign direct investment has been USD 3.5 billion. In the period January-August net inflow of capital has been USD 51.2 billion against USD 35.7 billion recorded in the same period of the previous year. Because of the aforementioned developments with balance of payments flows in the third quarter net inflow of capital has not been sufficient enough to finance current account deficit. As a result, official reserves of the Central Bank of Turkey have decreased, for the first time since the start of the year, by USD 4.2 billion (net inflow on item error and omission was USD 0.8 billion).

In the third quarter, in view of new forecasts of global economic growth and expectations, the Turkish lira has sharply depreciated versus the US dollar (by 11.0 percent q-o-q) amidst slowing capital inflow. The y-o-y depreciation of the lira exchange rate was 14.5 percent.

The depreciation of lira was reflected in inflation developments. In the third quarter inflation rate speeded up and amounted to an average 6.4 percent y-o-y

⁴ 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, the same 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 partner countries but also neighboring 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.

⁵ Official data of the Q2, 2011 economic growth are not available.

against 5.9 percent y-o-y recorded in the previous quarter. Prices of unprocessed food, which is included in the food commodity group, reduced considerably, incurring in part the lagged influence of high growth reported in the same period of the previous year. Yet, exchange rate developments were such which led to higher-than-expected inflation.

In the third quarter the Central Bank of Turkey continued implementing monetary policy mix. On August 4, 2011, the Central Bank decided to lower the policy rate (the one-week repo rate) to 5.75 percent from 6.25 percent. In the meantime, overnight borrowing rate was raised up to 5.0 percent from 1.5 percent and overnight lending rate was left unchanged. The decision came in the light of escalated sovereign debt problems in Euro-area and deteriorated world economic growth outlooks. Aimed to constrain short-term interest rates volatility, the Monetary Policy Committee decided to narrow the spread between deposit and lending facility rates, while repo rate was lowered in order to reduce possible recession risks to the domestic economy. The MPC's September 20th decision further said that prices might go up in the short run yet second-round effects of the exchange rate were expected within limits in the face of slowing economic activity. In the third quarter the reserve requirement ratio was lowered either.

Azerbaijan: *in the period January-September 2011 real GDP growth rates further decelerated on the whole but accelerated in non-oil sector. In the meantime, real GDP has grown by 0.5 percent, and 8.2 percent in non-oil sector⁶. Nominal GDP has grown by 11.98 percent compared with the previous year. GDP deflator amounted to 11.4 percent. Industry's contribution to the GDP growth was 52.8 percent; social services' – 11.0 percent, construction's – 7.5 percent, transport and telecommunications' – 7.4 percent, wholesale and retail trade's – 7.2 percent, agriculture's – 6.6; net production and import taxes accounted for 7.6 percent of GDP⁷.*

Relative to December of the previous year, inflation in Azerbaijan in the first nine months of 2011 was 3.4 percent, with average inflation having amounted to 8.4 percent relative to the same period of the previous year. Average annual inflation was fuelled by price increases on food products (11.4 percent), non-food products (2.8 percent), and service tariffs (4.5 percent)⁸.

During the first nine months of 2011 trade balance of Azerbaijan run with surplus, reaching USD 12.8 billion. Export has increased by 26.0 percent in relation to the same period of the previous year and totaled USD 19.7 billion; import has increased by 51.1 percent and reached USD 6.9 billion⁹. In the period January-September, crude oil accounted for 86.73 percent of value of Azerbaijani exports (it accounted for 86.53 percent in 2010)¹⁰.

In January-September 2011, relative to January-September 2010, gross inflow of foreign direct investment has increased to reach USD 2245.4 million (manat 1775.4 million), with Great Britain as the largest investor (51.3 percent), U.S.A. (14.5 percent), Japan (9.0 percent), Norway (5.0 percent), and Turkey (4.2 percent)¹¹.

In the period January-September of 2011 too, the Central Bank of Azerbaijan implemented a policy to maintain stability of the manat exchange rate. As a result, in the course of nine months manat appreciated versus the US dollar by a mere 1.4 percent, and the January-September average exchange rate appreciation was 1.6 percent y-o-y¹².

In the period January-September the volumes of loans provided to the economy by banks have grown by 5.5 percent, with volumes of loans in local currency increased by 2.6 percent¹³. In the resident business loan portfolio trade & services hold the largest share (29.8 percent), followed by construction (7.6 percent), industry (5.8 percent), agriculture (4.8 percent) and transport and

⁶ Source: Azerbaijan Central Bank Statistics Bulletin, January-September, 2011, Table 1.1.

⁷ Source: <http://abc.az/rus/news/58841.html>.

⁸ Source: Azerbaijan Central Bank Statistics Bulletin, January-September, 2011, Table 1.2.

⁹ Source: http://www.azstat.org/sdds/az/F_T/x_tic01.shtml.

¹⁰ Source: <http://abc.az/rus/news/58822.html>.

¹¹ Source: <http://abc.az/rus/news/58871.html>.

¹² Source: <http://www.cbar.az/other/azn-rates>.

¹³ Source: Azerbaijan Central Bank Statistics Bulletin, January-September, 2011, Table 2.7.

communications (4.0 percent). Yet, the volumes of non-performing loans have grown by around 25.8 percent (USD 160 million) against end-2010. As of end-September 2011, non-performing loans constituted 6.4 percent of total economy lending (5.4 percent in end-2010)¹⁴.

The volumes of bank deposits have grown by 22.0 percent and the volumes of deposits in local currency, by 11.4 percent. The dollarization of the economy has grown by 4.8 percent and reached 48.8 percent as of end-September 2011, as a result of 35.5 percent increase in the share of deposits in foreign currency¹⁵.

In the period January-September 2011 foreign exchange reserves of the Central Bank of Azerbaijan have increased by USD 535.7 million (8.4 percent) and totaled USD 6.9 billion, as of September 30, 2011¹⁶. In the meantime, Azerbaijan's state oil fund assets have grown to reach USD 32.2 billion, as of September 30, 2011¹⁷.

Georgia: *in the first half of 2011 real GDP growth was 5.2 percent¹⁸. The nominal GDP has grown by 17.8 percent relative to the previous year. The GDP deflator amounted to 11.9 percent. The largest contribution to GDP growth came from industry (17.5 percent), trade (16.5 percent), transport and telecommunications (11.7 percent), public administration (11.4 percent), and agriculture (9.6 percent). Net taxes on manufacture and import constituted 14.3 percent of GDP¹⁹.*

In the period January-September 2011 average inflation in Georgia was 10.8 percent y-o-y, and 0.9 percent relative to December of the previous year. Compared to the previous December, inflation was reported for service tariffs (5.7 percent) while deflation was reported for non-durable goods (0.2 percent), semi-durable goods (4.1 percent) and durable goods (2.3 percent)²⁰.

In January-September 2011, relative to January-September 2010, export volumes (FOB) have increased by 41.7 percent and amounted to USD 1552 million, and import volumes (CIF) have increased by 38.4 percent and reached USD 4929 million. As a result of export-import transactions Georgia's trade balance deficit deteriorated by 37.0 percent, reaching USD 3377 million²¹. (In the period January-June 2011 the trade balance deficit amounted to 17.4 percent and current account deficit amounted to 12.7 percent in GDP)²².

Gross inflow of foreign direct investment started to grow, reflecting further recovery of the Georgian economy. In the first half of 2011 inflow of FDI amounted to USD 387.1 million, which represents 3.3 percent increase relative to the same period of the previous year. In the FDI inflows structure, the largest investors are: Cyprus (15.2 percent), Netherlands (11.9 percent), Turkey (9.5 percent), Great Britain (8.7 percent), Russia (7.9 percent) and British Virgin Islands (7.8 percent)²³. Moreover, in the period January-September 2011, relative to the same period of the previous year, inflow of money transfers from abroad has increased by 21.2 percent and reached USD 812.7 million²⁴.

With such foreign currency inflow dynamics, in January-September 2011 the average exchange rate of Georgian lari appreciated versus the US dollar by 5.3 percent y-o-y. Relative to end-December of 2010, lari's appreciation was 6.7 percent. In consideration of pressures from appreciation of the lari exchange rate, the National Bank purchased USD 115.0 million, net, in the domestic foreign exchange market in the course of the first nine months of 2011²⁵.

¹⁴ Source: Azerbaijan Central Bank Statistics Bulletin, January-September, 2011, Table 2.9.

¹⁵ Source: Azerbaijan Central Bank Statistics Bulletin, January-September, 2011, Table 2.4.

¹⁶ Source: http://www.cbar.az/infoblocks/money_reserve_usd.

¹⁷ Source: <http://abc.az/rus/news/main/59153.html>.

¹⁸ Official data of the Q3, 2011 economic growth are not available.

¹⁹ Source: [http://geostat.ge/cms/site_images/_files/english/nad/GDP_2011Q1\(press-release\)Eng.pdf](http://geostat.ge/cms/site_images/_files/english/nad/GDP_2011Q1(press-release)Eng.pdf).

²⁰ Source: National Bank of Georgia's Monetary and Banking Statistics Bulletin, January-September, 2011, Table 1.1.

²¹ Source: http://geostat.ge/cms/site_images/_files/english/bop/External%20Trade%20of%20Georgia%20in%20January-September%202011-Eng.pdf.

²² Source: National Bank of Georgia's Monetary and Banking Statistics Bulletin, January-September, 2011, Table 5.3.

²³ Source: http://geostat.ge/cms/site_images/_files/english/bop/FDI_2011Q2-Eng.pdf.

²⁴ Source: National Bank of Georgia's Monetary and Banking Statistics Bulletin, January-September, 2011, Table 5.8.

²⁵ Source: *Ibid*, Table 4.5.

In January-September 2011 bank lending has grown by 18.3 percent, with volumes of loans in local currency increased by 38.1 percent and loans in foreign currency, by 11.4 percent²⁶. In the total economy lending structure, resident business portfolio constituted 55.7 percent, including trade (49.0 percent), industry (19.8 percent) and construction (11.5 percent)²⁷. Non-performing loans constituted 2.34 percent of total lending volumes, as of September 30, 2011²⁸.

In January-September 2011 the volume of deposits attracted by banks has increased by 8.7 percent, with deposits in local currency grown by 22.4 percent and deposits in foreign currency, by 3.4 percent. The dollarization in the Georgian economy subdued by 1.5 percent relative to December of the previous year; as of September 30, 2011, foreign currency deposits constituted 68.6 percent in total²⁹.

In the period January-September 2011, foreign exchange reserves of the National Bank of Georgia have grown by 21.7 percent and amounted to USD 2.75 billion, as of September 30, 2011. This represented USD 491 million excess against the relevant figure recorded as of end-2010³⁰.

3.2. BALANCE OF PAYMENTS³¹

3.2.1. Current Account

In the third quarter the developments with current account of Balance of Payments were in the face of slowing growth rates of the world economy and growing uncertainties associated, specifically, with Euro-area debt crisis probability. The current account kept on improving as world and domestic economies developed further. With persistently high metals prices as well as high growth reported in industry, the growth of export of goods remained strong. In the third quarter, added economic activity resulted in an increase of import of goods in both dollar and real terms, which topped expectations. The developments in world economy and, particularly, the tightness in the Russian banking system were discernable in September when inflow of non-commercial remittances of individuals slowed down. However, high growth of transfers persisted owing to high growth reported in July-August. As a result of these developments, the deficit of current account reduced by USD 65.1 million y-o-y and amounted to USD 204.8 million in the third quarter. In the period January-September 2011 the share of current account in GDP has improved by 3.7 pp.

Export and import of goods in dollar terms have increased, respectively, by USD 102.9 million y-o-y (33.9 percent y-o-y) and USD 114.7 million y-o-y (14.1 percent y-o-y). As a result, trade balance deficit has increased by USD 11.8 million y-o-y and totaled USD 520.7 million.

The growth of export was conditioned by persisted strong growth of domestic industry as well as high international metals prices. As a result of these developments, the y-o-y growth of export of goods and services in dollar terms amounted to 23.6 percent and the growth of volumes³² of export of goods and services, 17.5 percent y-o-y. The growth of export in dollar terms³³ was driven mainly by positive contributions from such items as "precious and semiprecious stones, precious metals and articles thereof" (12.6 pp), "mineral production" (5.7 pp), "products of prepared food" (2.2 pp) and "base metals and articles thereof" (1.9 pp)³⁴.

²⁶ Source: *Ibid*, Table 3.5.

²⁷ Source: *Ibid*, Table 3.10.

²⁸ Source: *Ibid*, Table 3.5.

²⁹ Source: *Ibid*, Table 2.3.

³⁰ Source: National Bank of Georgia's Monetary and Banking Statistics Bulletin, January-September, 2011, Table 5.1.

³¹ The Q3, 2011 indicators are the Central Bank forecasts.

³² In the period January-September the growth of export (FOB) has been 33.5 percent.

³³ Volumes of export and import of goods are the Central Bank estimations.

³⁴ Export and import breakdown by sector and geography is presented, respectively, in FOB and CIF prices.

Positive developments in external and domestic economic environment reflected the dynamics with import of goods as the y-o-y growth of import of goods and services in real terms has grown by 2.4 percent y-o-y, which topped expectations. The growth of import³⁵ of goods and services in dollar terms amounted to 12.9 percent y-o-y amid persisted high imports prices.

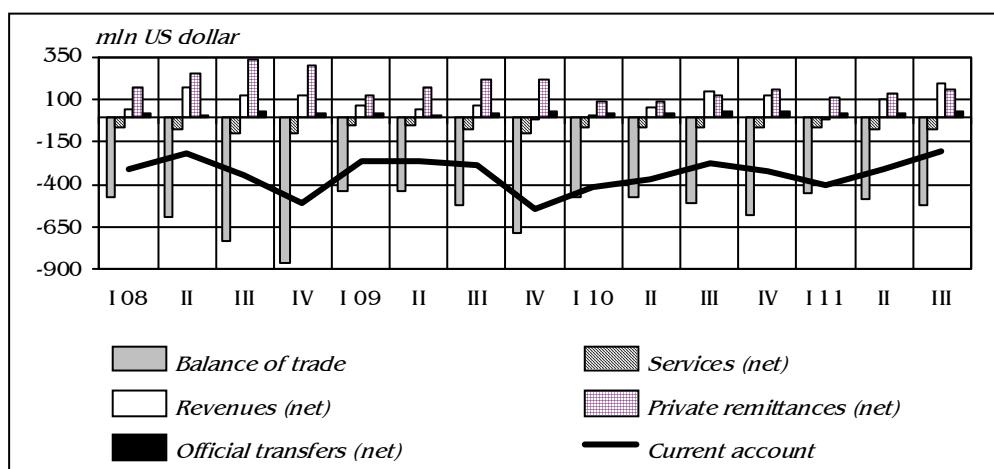
Import was driven by positive contributions mainly from such items as "precious and semiprecious stones, precious metals and articles thereof" (4.8 pp), "mineral production" (4.5 pp), "textiles" (1.4 pp) and "products of prepared food" (1.1 pp). The above-mentioned items more than offset negative contributions of such items as "base metals and articles thereof" (0.5 pp), "machinery and equipment" (0.4 pp) and "transport means" (0.2 pp).

Re: geographic distribution of external trade: trade balance deficit has increased driven by USD 74.0 million increase of trade balance deficit with the group "Other countries". This exceeded the USD 41.6 million decrease of trade balance deficit with the CIS. Trade balance deficit with the EU states remained almost at the same level recorded in the third quarter of the previous year. Notable increase of trade balance deficit was reported with Iran (USD 19.7 million) and with China (USD 16.7 million y-o-y). Increases of trade balance deficit were also reported with Turkey USD 15.1 million, Switzerland (USD 14.6 million) and Brazil (USD 141.4 million).

In the third quarter the deficit of services balance grew by USD 4.0 million y-o-y and amounted to USD 70.7.0 million. This was determined mainly by increased deficit of balance of transport services. On the contrary, balance of travel reported surplus. In the outcome, in the third quarter the y-o-y growth of export and import of services reached 11.0 percent and 9.9 percent, respectively.

In the third quarter net growth of non-commercial private remittances via banking system amounted to 20.1 percent y-o-y. The growth rates of inflow of private remittances via banking system slowed down in September due to the developments in the world economy and, particularly, in the Russian economy (tightness in the Russian banking sector because of liquidity problems). The slowing was also attributable to decreased incomes in dollar terms as a result of sharp depreciation of Russian ruble versus the U.S. dollar in September. Net inflow of seasonal worker income has grown by 21.1 percent y-o-y and amounted to USD 305.1 million. This outstripped net outflow in item "income on investment". As a result, item "income" posted net inflow of USD 189.3 million. Net inflow of private transfers has increased by 26.2 percent y-o-y and reached USD 161.7 million.

In Q3 2011 current account improved



³⁵ In the period January-September the growth of import (CIF) has been 12.0 percent.

3.2.2. Capital and Financial Account³⁶

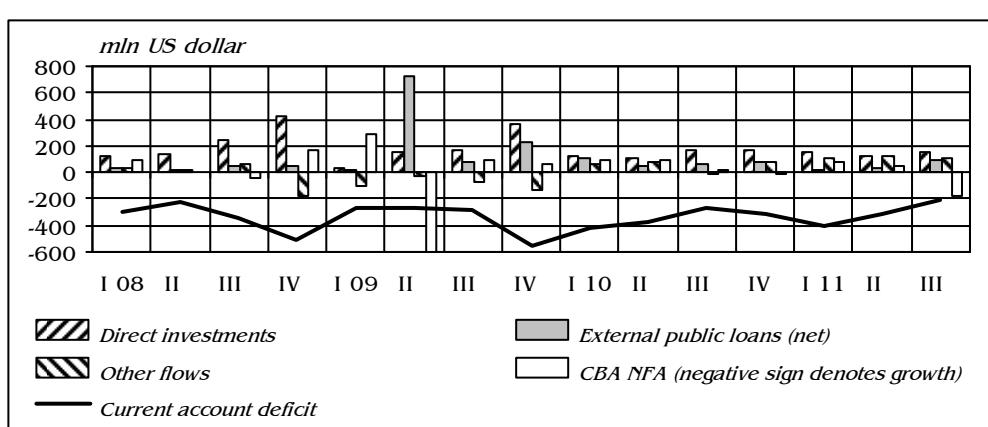
In the third quarter of 2011 the capital and financial account reported net inflow of USD 385.4 million, which is USD 132.8 million more from the relevant indicator recorded in the same period of previous year. The net inflow notably exceeded the current account deficit. As a result of balance of payment flows net foreign assets of the Central Bank have grown by USD 180.5 million mainly conditioned by the increase of foreign currency accounts of commercial banks with the Central Bank.

In the third quarter the inflow of capital transfers amounted to USD 34.7 million (USD 29.8 million in the third quarter of the previous year).

Net inflow of foreign direct investment amounted to USD 155.6 million; net inflow of public loans has grown by USD 16.4 million and amounted to USD 86.1 million.

Net foreign assets of private sector have decreased by USD 109.0 million. Net foreign assets of other private sector (commercial banks excluded) have grown by USD 50.0 million and net foreign assets of the banking sector have reduced by USD 159.0 million.

In Q3 2011 net inflow on capital and financial account outweighed current account deficit



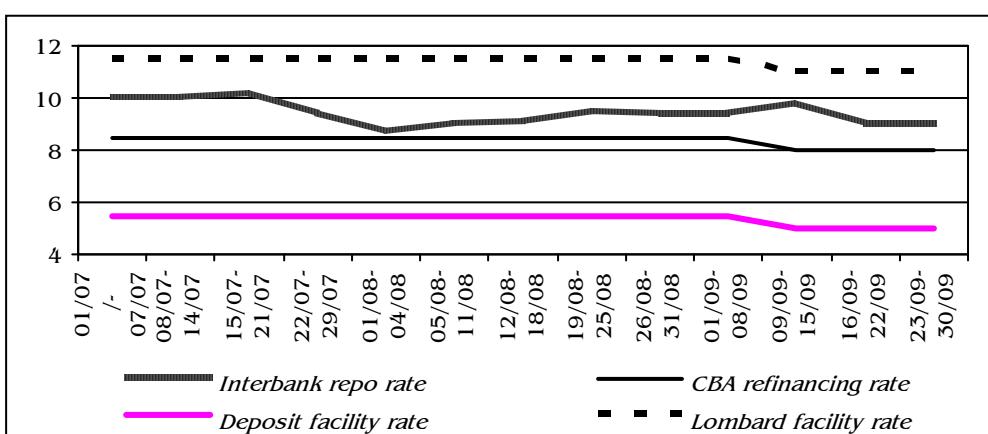
3.3. INTEREST RATES, EXCHANGE RATE, AND MONETARY DEVELOPMENTS

3.3.1. Interest Rates

In the third quarter of 2011, the Board of the Central Bank lowered the refinancing rate by 0.5 pp to 8.0 percent. Lombard repo rate and deposit facility rate were also lowered by 0.5 pp each, to 11.0 percent and 5.0 percent, respectively.

The above factors had their impact on interest rates of the Central Bank operations and interest rates of funds attracted and allocated by commercial banks.

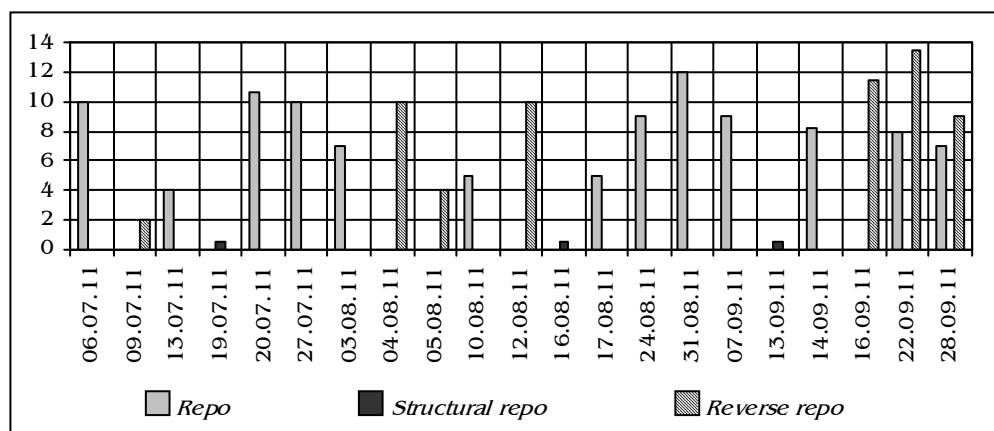
CBA Refinancing Rate, Standing Facility Rate and Interbank Repo Rate



³⁶ All indicators pertaining to the Q3 2011 capital and financial account are the Central Bank estimates.

The Central Bank continued offering, each Wednesday, repo transactions to commercial banks. Average reported weekly volumes of repo operations performed reached AMD 8.0 billion, with an average interest rate of 9.8 percent (AMD 4.5 billion and with an average interest rate of 10.63 percent in the previous quarter). In the meantime, the Central Bank further applied an instrument of long-term repo, with a total volume of nearly AMD 1.5 billion and with an average interest rate of 10.93 percent (AMD 1.5 billion and with an average interest rate of 10.11 percent in the previous quarter). In the third quarter the Central Bank entered into reverse repo transactions, with aggregate volumes of nearly AMD 60.0 billion and with an average weighted interest rate of 8.10 percent (AMD 31.3 billion and with an average interest rate of 8.46 percent in the previous quarter).

*CBA repo operations
(bln AMD)*



In the meantime, commercial banks used standing facilities. Lombard repo operations with a total volume of AMD 27.2 billion were concluded with the Central Bank, while aggregate volume of funds deposited with the Central Bank amounted to AMD 243.9 billion (AMD 122.9 billion and 253.5 billion, respectively, in the previous quarter).

The interbank loan market, i.e. the Overnight Bourse, has been active. During the quarter the volume of interbank loans was nearly AMD 740.3 billion against AMD 688.4 billion recorded in the previous quarter, with an average interest rate fallen by 0.38 pp to 7.83 percent.

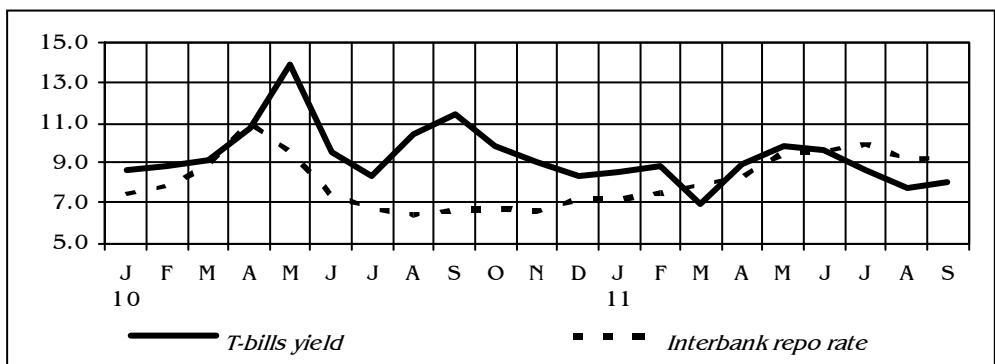
In the third quarter aggregate volume of operations performed in the interbank and intrabank repo markets amounted to AMD 276.4 billion, down by AMD 25.7 billion against the previous quarter. The average market repo rate was almost the same, 9.96 percent. The share of operations executed between commercial banks declined to make up 30 percent in total operations. Average interbank repo rate rose by 0.3 pp relative to the previous quarter and amounted to 9.48 percent.

In the third quarter total issue volume of short-term treasury bills reached AMD 12.5 billion (AMD 12.5 billion in the previous quarter). Total amount of short-term treasury bills allocated was AMD 12.5 billion compared to AMD 11.7 billion recorded in the previous quarter. In primary market of government securities interest rates tended to fall, which was more pronounced in the short-term segment. Relative to the previous quarter, average interest rate has dropped by 1.19 pp to 8.18 percent in short-term segment.

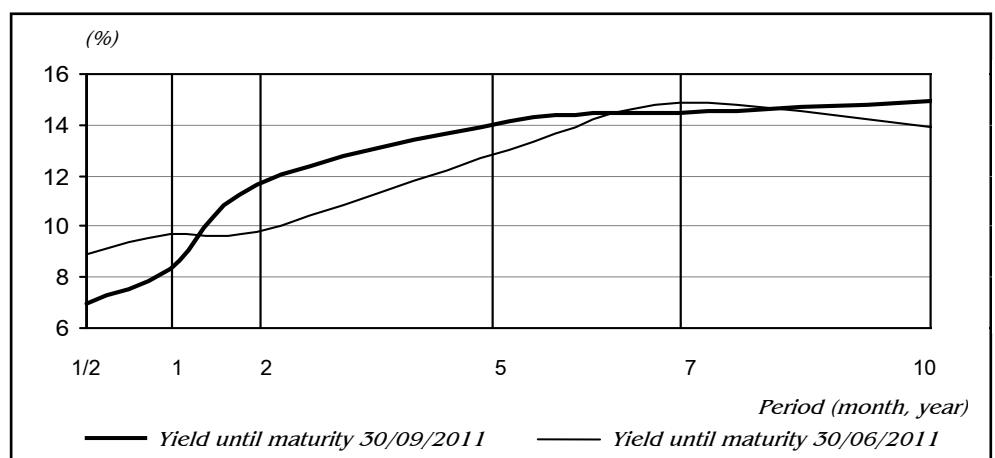
The yield curve analysis shows that in the secondary market of government securities yields have decreased by 1.62 pp in short-term segment while interest rates have risen by 0.92 pp in medium and long-term segments. As a result, convexity of the curve has changed, from 0.31

to 0.4, pointing out to the increased spread of interest rates of long-term and short-term securities.

T-bills and Interbank Repo rates

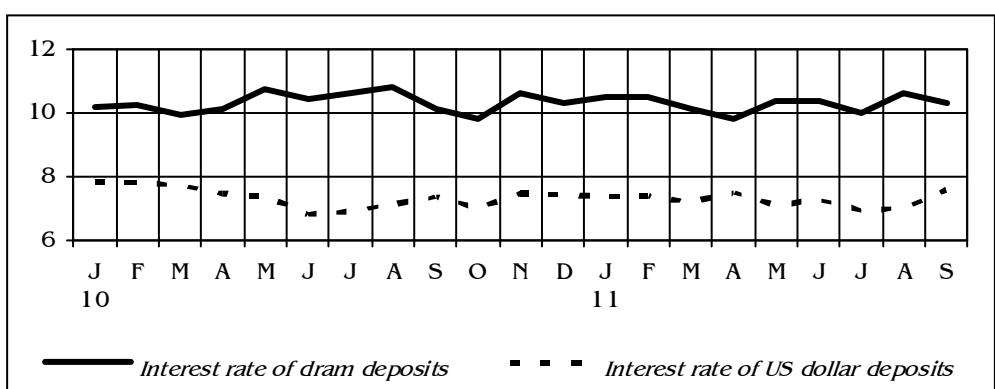


In the secondary market interest rates in short-term segments dropped



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 10.29 percent and 7.18 percent, respectively. Relative to the previous quarter, average interest rate of dram deposits has grown by 0.12 pp but interest rates of dollar deposits fell by 0.11 pp. The spread of interest rates of dram and dollar deposits made up 3.11 pp (2.88 pp in the previous quarter).

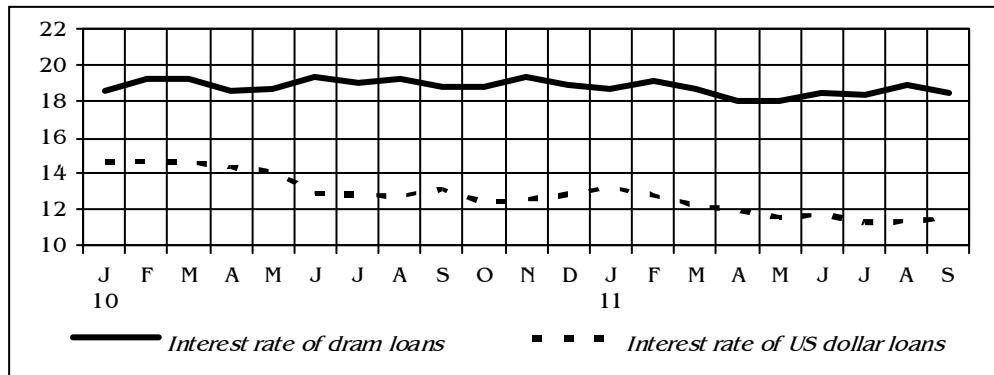
Interest rates of deposits attracted by the banking sector



In the third quarter average interest rates of dram loans and dollar loans were 18.61 percent and 11.40 percent, respectively. Relative to the previous quarter, average interest rate of dram loans has grown by 0.42 pp but interest rate of dollar loans fell by 0.37 pp. As a result, the spread of interest rates of dram and dollar loans made up 7.21 pp compared to 6.42 pp recorded in the previous quarter.

In the third quarter the interest rate spread of loans and deposits in Armenian dram made up 8.32 pp and the interest rate spread of loans and deposits in US dollar reached 4.22 pp (4.47 pp in the previous quarter).

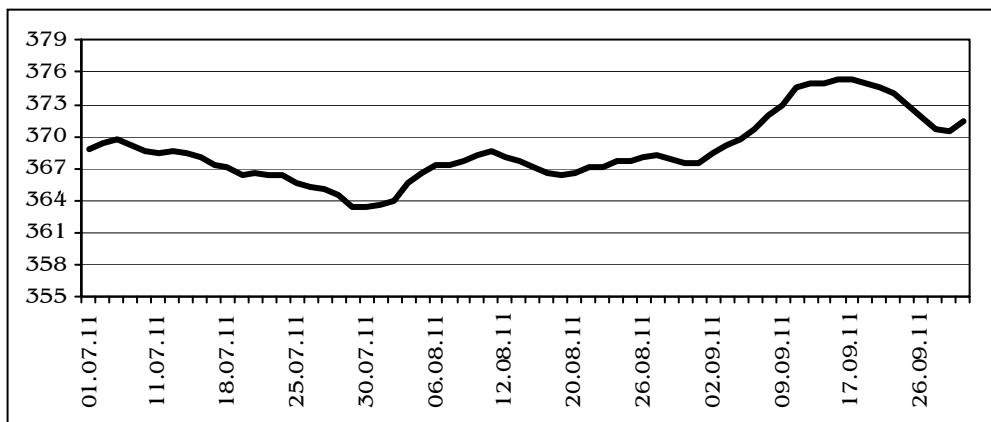
Interest rates of loans provided by the banking sector



3.3.2. Exchange rate

At the end of the third quarter of 2011, relative to the end of the previous quarter, the average AMD/USD exchange rate has depreciated by 0.86 percent and reached dram 372.05 from dram 368.86 for one dollar. Relative to the same quarter of the previous year, the average quarterly AMD/USD exchange rate has depreciated by 0.80 percent and reached dram 368.45 from dram 365.51 for one dollar.

AMD / USD exchange rate in Q3 2011



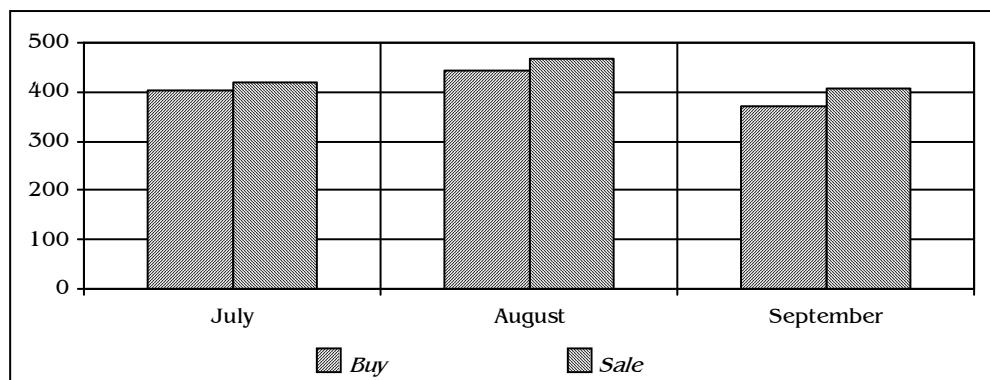
The aggregate volume of interbank market transactions executed during the third quarter amounted to USD 2.5 billion, which represents 16.35 percent increase in relation to the respective indicator of USD 2.1 million recorded in the third quarter of the previous year.

In the third quarter the aggregate volume of Euro/Dram exchange transactions amounted to EUR 219.5 million, up by 16.35 percent compared to the same quarter of the previous year.

To handle the dram supply and prevent the dram exchange rate from sharp fluctuations, the Central Bank purchased a total of USD 29.43 million from and sold a total of USD 9.54 million to commercial banks during the quarter.

In the third quarter the nominal effective exchange rate of the dram appreciated by 3.2 percent q-o-q. This was primarily due to nearly 1.4 percent q-o-q appreciation of average quarterly AMD/USD exchange rate and about 1.8 percent depreciation of partner countries' currencies versus the U.S. dollar.

Gross volumes of foreign exchange operations (mln US dollar)



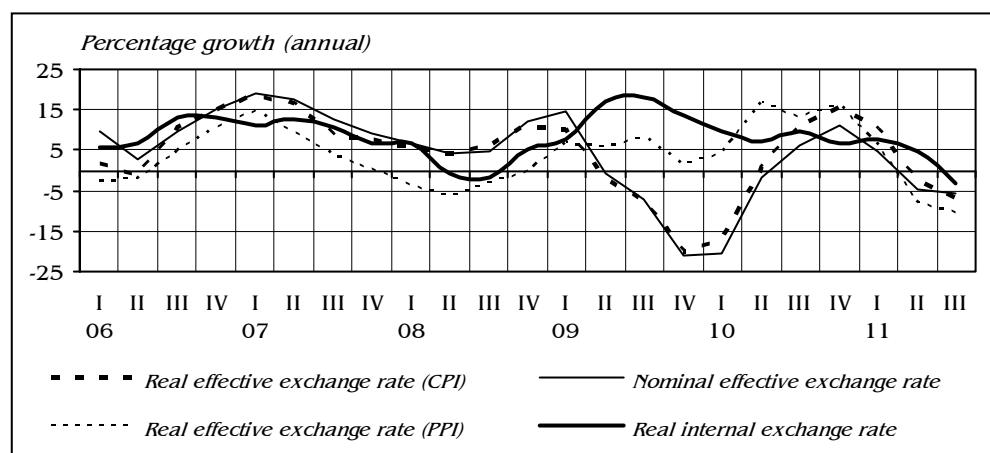
Relative to the same period of the previous year, the nominal effective exchange rate of the dram has depreciated by around 5.9 percent, which was driven by average weighted 5.1 percent appreciation of exchange rates in partner countries, mostly owing to the appreciation of Euro and Russian ruble versus the U.S. dollar. At the same time, the Armenian dram's depreciation versus the U.S. dollar has been 0.9 percent y-o-y.

During the quarter, the dram's real external exchange rate calculated by CPI (consumer price index) depreciated by 0.8 percent q-o-q amid 3.2 percent q-o-q appreciation of the dram's nominal effective exchange rate. So, 4 percent q-o-q deflation was recorded in Armenia and 0.1 percent q-o-q inflation in partner countries.

In the third quarter the dram's real effective exchange rate depreciated faster, to make up 6.6 percent y-o-y (2.6 percent depreciation in the previous quarter). This was influenced by nominal effective exchange rate's 5.9 percent y-o-y depreciation in the face of average weighted 5.5 percent y-o-y inflation in partner countries and average quarterly 5.1 percent y-o-y inflation in Armenia³⁷. Average weighted inflation in partner countries was most influenced by inflation in Russia (8.1 percent y-o-y) and Iran (19.9 percent y-o-y), with their contributions of 1.7 pp, 1.1 pp, respectively, as well as by 1.0 pp contribution from Euro-area, which is determined by a large weight of the latter.

At the same time, the PPI (producer price index)-calculated real effective exchange rate has appreciated by about 0.1 percent q-o-q. Under such circumstances the y-o-y depreciation was 10.4 percent compared with about 8 percent y-o-y depreciation in the previous quarter. This was mainly driven by high y-o-y growth of producer price in partner countries.

In Q3 2011 real exchange rate depreciated



³⁷ This indicator makes up 5.8 percent, according to official publications of the National Statistics Service of Armenia, and the difference is the variety of bases on which the indexes were calculated.

In the third quarter the internal real exchange rate³⁸ depreciated by 3.3 percent y-o-y, against the previous quarter's 4.8 percent appreciation, as prices of tradable goods grew faster than prices of non-tradable goods³⁹. The internal real exchange rate has depreciated by 9.6 percent q-o-q.

Prices of tradable goods and services have increased by 9.9 percent and prices of non-tradable goods, by 6.3 percent y-o-y, compared to 10.3 percent and 15.5 percent, respectively, recorded in the previous quarter.

3.3.3. Monetary developments

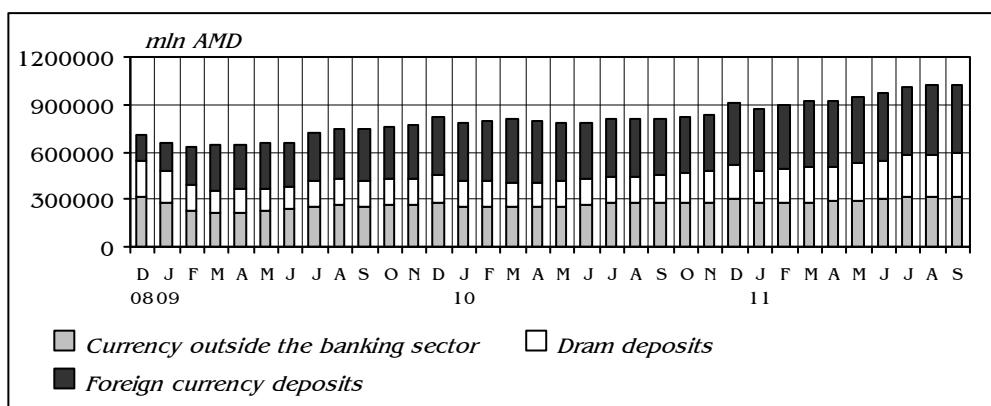
In view of some stabilization trends in external and domestic inflation environment and expectations for considerable mitigation of inflationary pressures in the upcoming one-year horizon, the forecasts for growth rates of monetary indicators were revised upside.

In consideration of the downsloping trajectory of the 12-month inflation and further forecasts for an upcoming 12-month horizon the Board of the Central Bank left the refinancing rate unchanged, 8.5 percent, for July-August, and even lowered it by 0.5 pp in September.

In the third quarter the monetary developments were mainly consistent with the scenario. Foreign currency deposits grew by 0.6 percent or AMD 2.6 billion, with term deposits making up the whole part of it – AMD 6.3 billion or 2.0 percent, whereas demand foreign currency deposits reduced by around AMD 3.7 billion or 3.2 percent. Yet, the volumes of foreign currency funds (both term and demand deposits) attracted from households have increased.

During the quarter dram deposits grew by 10.3 percent or AMD 25.3 billion, exceeding the expectations, with term deposits increased by 11.9 percent or AMD 13.2 billion and demand deposits increased by 8.9 percent or AMD 12.1 billion. Dram deposits attracted from private companies and households prevailed.

In Q3 2011 growth rates of dram deposits exceeded expectations



Over the quarter currency outside the financial system has grown by 6.1 percent or AMD 18.3 billion.

As a result of the aforementioned developments, broad money has increased by 4.7 percent and dram broad money, by 8.0 percent.

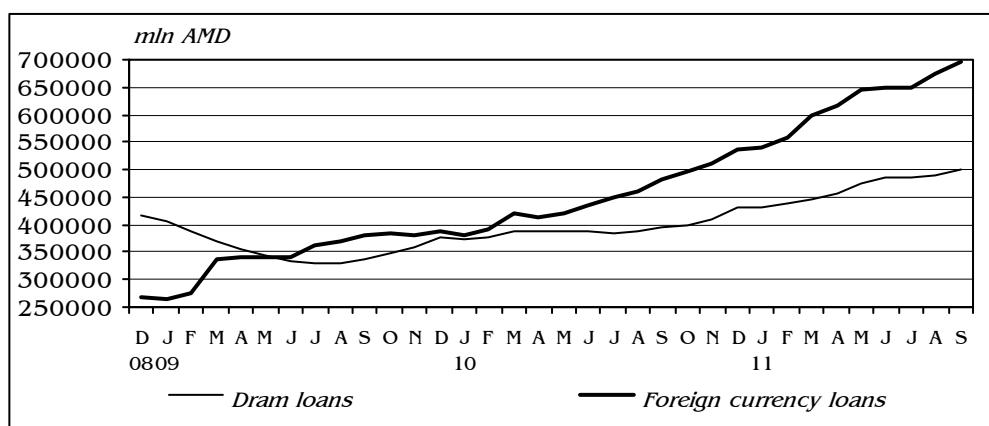
Though somewhat slowed down, lending to the economy remained strong during the third quarter, 6.2 percent or AMD 65.7 billion, with foreign currency loans again prevailing (making up AMD 47.2 billion or 7.3 percent). Credit resources attracted from abroad and excess funds of FX

³⁸ Internal real exchange rate is calculated as a ratio of prices of non-tradable goods to prices of tradable goods.

³⁹ Prices of non-tradable and tradable goods were calculated based on expert judgment over prices of a consumer basket, taking goods and services into relevant categories.

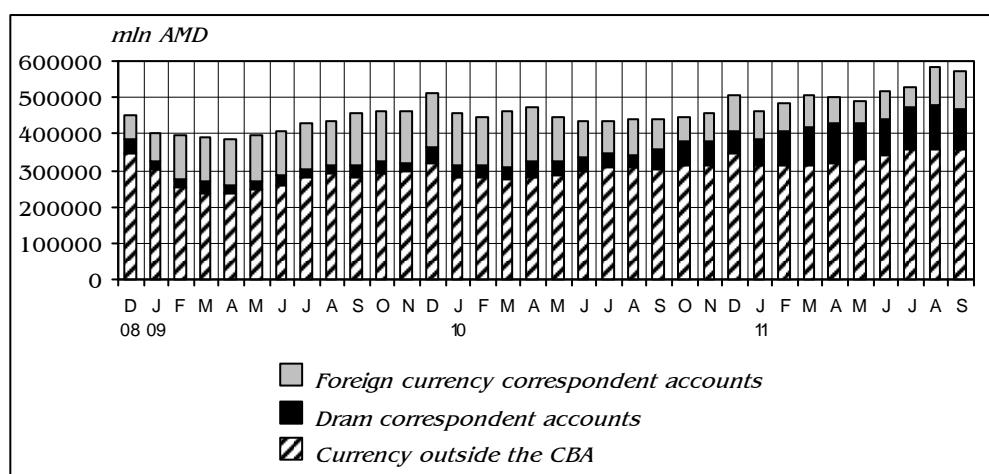
correspondent accounts remained the main source for foreign currency lending in this quarter, too. These were provided to finance SME projects. Dram loans have grown by AMD 18.5 billion or 3.8 percent, predominantly owing to consumer loans.

In Q3 2011 foreign currency lending remained strong



In the third quarter the growth of monetary base was 9.7 percent: currency outside the Central Bank grew by 6.1 percent and funds on correspondent accounts of commercial banks with the Central Bank, by 16.4 percent. This increase was determined by a large addition to FX correspondent accounts as a result of a one-time transaction performed by a commercial bank. In the outcome, the dram component of monetary base has grown at a slower pace, making up 5.9 percent.

In Q3 2011 huge increase of FX correspondent accounts with CBA notably contributed to the growth of monetary base



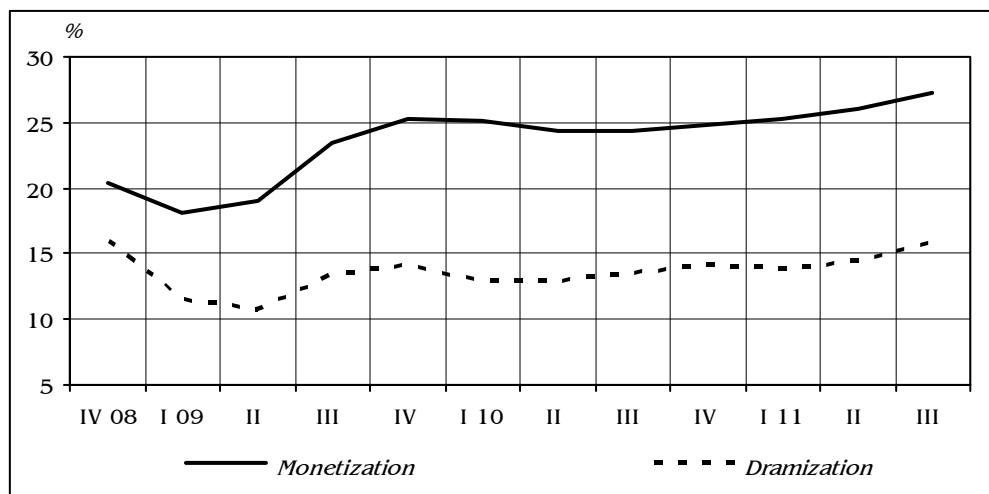
As of end-September the monetary indicators were as follows: based on the 12-month period broad money and dram broad money grew by 26.0 percent and 29.3 percent, respectively; currency in circulation increased by 17.7 percent; dram deposits and foreign currency deposits grew by 46.3 percent and 21.6 percent, respectively; monetary base and lending to the economy increased by 30.2 percent and 36.7 percent, respectively.

At the end of the third quarter dollarization of the economy (measured as a ratio of foreign currency deposits to broad money) was 42.0 percent, down by 1.7 pp relative to the same indicator of the previous quarter, which was driven by continued slowing of FX deposit growth rates. There has also been a reported 1.5 pp decrease relative to that indicator of the same quarter of the previous year.

The monetization and dramization ratios, which are measures of financial intermediation, amounted to 27.3 percent and 15.8 percent,

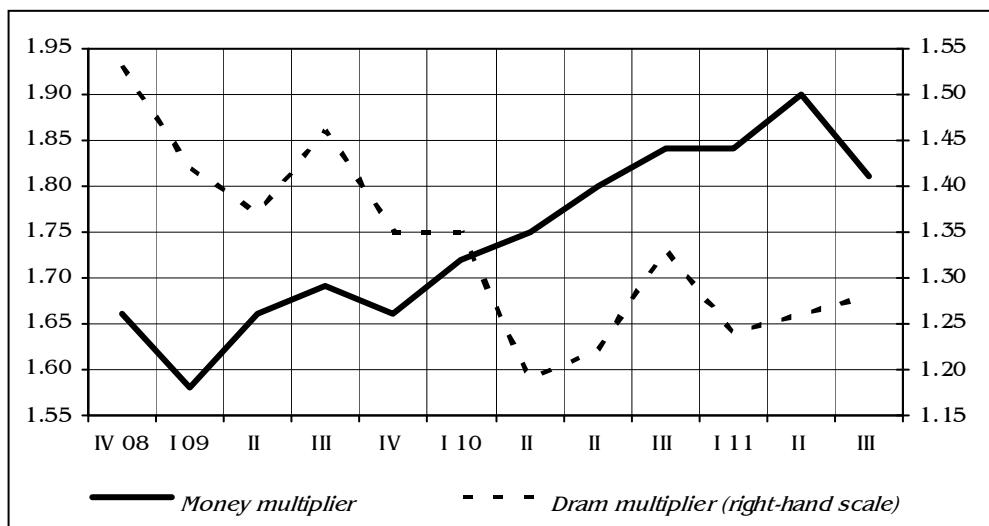
respectively, growing by 13.7 percent and 17.8 percent relative to the same indicators of the third quarter of the previous year.

Monetization and dramatization ratios



Other indicators of financial intermediation, i.e. money multiplier and dram multiplier performed as follows: money multiplier has decreased by 5.0 percent, reaching 1.8 in end-September, with its y-o-y growth making up a mere 0.2 percent, whereas dram multiplier has increased by 1.8 percent q-o-q and by 4.9 percent y-o-y, making up 1.3 percent in end-September.

Money multiplier and dram multiplier



3.4. AGGREGATE DEMAND AND AGGREGATE SUPPLY

3.4.1. Aggregate Demand

Domestic demand

*Private consumption and investments*⁴⁰: In the third quarter of 2011 growth of private spending in real terms was estimated to reach 6 percent, determined by both real increases in private investments and private consumption. In the meantime, public expenditures have grown by nearly 1 percent. In the light of the aforementioned developments, domestic demand has grown by 5 percent.

Growth of private investments was estimated to reach 4 percent, owing to increased profitability in a number of economic sectors

⁴⁰ The real growth indicators of private consumption and investments for the second quarter are the Central Bank estimates. The actual figures of these indicators are as of the second quarter of 2011. Estimations of real growth presented in this section are relative to the same quarter of the previous year, unless otherwise stated.

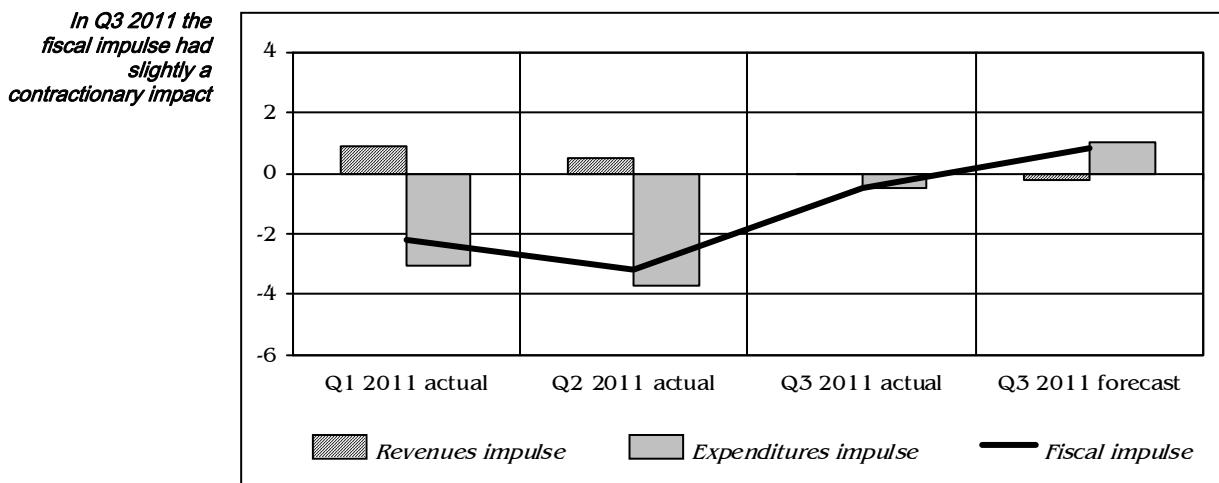
attributable to domestic and external demand growing slowly but steadily. Growing private investments were financed mainly from loans provided to the private sector and in part by own funds generated as a result of economic growth. Yet, growth rates remain below the pre-crisis levels, which is due to the situation in the construction sector⁴¹.

Private consumption in real terms has increased by nearly 6 percent, largely attributable to private sector incomes owing to increased remittances from abroad and reported domestic economic growth. Growth of lending volumes has somewhat contributed to the growth of private spending. The growth of private consumption reflects the 4.8 percent y-o-y increase of volumes of trade turnover recorded in the third quarter.

Composite economic indices⁴² as calculated and published by the Central Bank point out to the above developments with private consumption and investments. In the third quarter the consumer confidence index rose by 6.3 percent, with current conditions and business activity indices increased by 11.8 percent and 4.7 percent, respectively. The economic activity indicator is high in all sectors of the economy.

In the third quarter of 2011, the gap between private spending and their potential level is still negative despite continued narrowing. As a result of the aforementioned developments, private spending had no material impact on inflation.

Public consumption and investments⁴³: In the third quarter of 2011 the implementation of the fiscal policy was further aimed at maintaining macroeconomic stability, which reflected the collection of revenues congruent with the program and savings on expenditures⁴⁴. In the third quarter the fiscal policy had 0.5 pp of contractionary impact, instead of the projected 0.8 pp expansionary, on aggregate demand, hence, prices. The contractionary impulse was totally due to restricting influence derived from savings on expenditures.



The growth of tax revenues of the consolidated budget and social security charges has been 9.6 percent relative to the third quarter of the

⁴¹ See section Aggregate supply in this report.

⁴² See <http://www.cba.am/am/SitePages/statsscci.aspx>.

⁴³ Consolidated budget indicators which were prepared on the basis of preliminary actual data of the third quarter of 2011 (including PIU funds) were used for the review of the fiscal sector. The 2011 fiscal impulse indicators were estimated against third quarter of 2010 consolidated budget indicators. The impact of revenues has been calculated against an estimated nominal GDP indicator and the impact of expenditures has been calculated against an estimated potential GDP indicator.

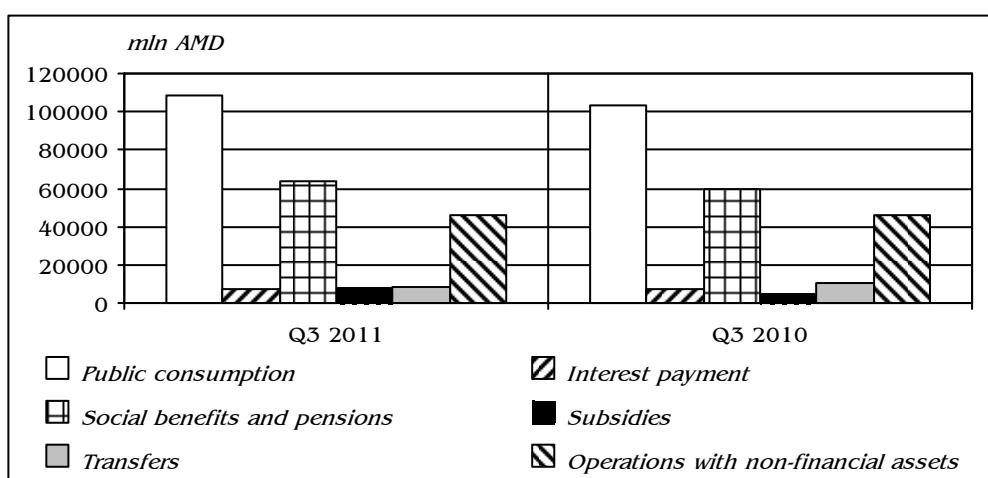
⁴⁴ Actual preliminary indicators of budget revenues, expenditures and deficit were compared with quarterly proportions set by the Government (including PIUs).

previous year. In the structure of tax revenues, the share of indirect taxes has reduced and the share of direct taxes has increased by 1.2 pp and 2.1 pp y-o-y, amounting to 62.6 percent and 26.7 percent, respectively, in total. There has been a reported decrease of 0.9 pp in other taxes, making up 10.7 percent in total. The decline in indirect taxes was mainly due to reduced share of excise duty, which amounted to 20.5 percent y-o-y. The latter was conditioned by narrowed entries on sub-excise goods imported. The y-o-y growth of value added tax and customs duty were 10.7 percent and 26.6 percent, respectively. The y-o-y growth of indirect taxes was 7.9 percent and direct taxes, 19.6 percent. In the structure of direct taxes, there has been an increase in respect of all taxes, with profit tax having grown by 33.8 percent and income tax having grown by 7.5 percent. Other revenues reported decline of 33.6 percent.

In the third quarter the state budget expenditures have grown by 4.7 percent relative to the third quarter of the previous year but were notably underperformed against the third quarter program of the state budget. Current expenditures have grown by 5.6 percent y-o-y, in which public consumption has increased by 5.1 percent y-o-y. Expenditures on item *transactions with non-financial assets* have increased by a mere 1.1 percent. It is noteworthy that in the structure of expenditures on item *transactions with non-financial assets* the share of domestic sources of financing has grown notably while the share of external sources has reduced, amounting to 72.3 percent and 27.7 percent, compared to the previous year's figures of 63.3 percent and 36.7 percent, respectively.

With revenues and expenditures indicators shown above, in the third quarter the budget deficit reached AMD 22.7 billion, making up 71.7 percent of the amount projected for the quarter. The latter was financed primarily from external sources (110.9 percent) whereas financing from domestic sources amounted to -10.9 percent due to non-disbursement of part of foreign funds on Unified Treasury Account in the Central Bank. The structure of external sources included the IMF credit tranche amounting to AMD 12.9 billion and the EU credit tranche *Micro-financial support* amounting to AMD 10.6 billion.

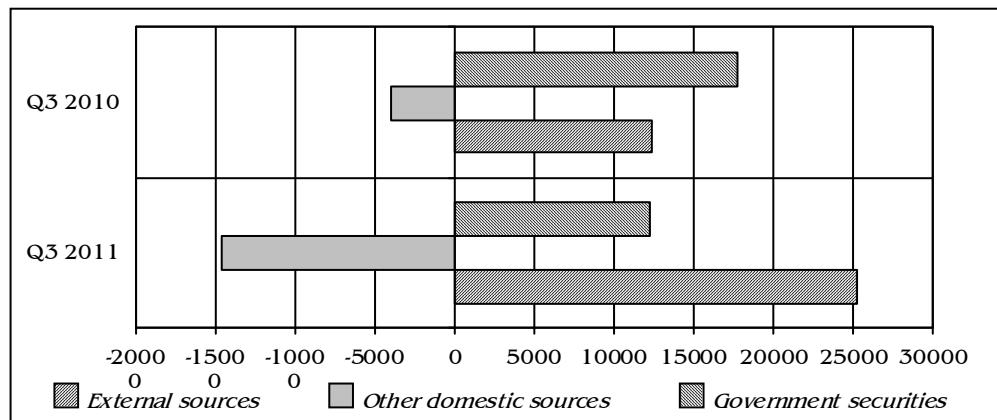
In budget expenditures in Q3 2011 transfers declined y-o-y



Based on the results of the first nine months of 2011, it should be noted that state budget revenues were performed in line with projected proportions. Relative to the same period of the previous year, revenues have grown by 10 percent or AMD 52.3 billion; public expenditures have increased by around 2.2 percent y-o-y (PIU funds included). Based on the nine months' results, the budget deficit reached AMD 41.8 billion or about

28.2 percent of annual program. The fiscal policy had an estimated 1.7 pp of contractionary impact of aggregate demand.

In Q3 2011 financing from external sources prevailed in the structure of budget deficit financing



Y-o-y growth of main macroeconomic indicators in Q3 2011, in real terms

Indicator	Q3 2011 – Q3 2010
Real GDP	5.4
Domestic demand	5.0
Consumption	5.5
Public	-0.3
Private	6.2
Capital investment	-4.0
Public	2.7
Private	4.1
Export ⁴⁵	17.5
Import	2.4

3.4.2. Aggregate supply⁴⁶

The GDP y-o-y growth in the third quarter was 3.9 percent, according to the new economic growth calculation methodology.

Looking at the y-o-y economic growth indicator of the period January-September 2011, it should be noted that the Central Bank estimates calculated on the basis of Economic Activity Indicator are in line with the scenario. Provided that risks are upside in industry and agriculture and downside in construction, as were outlined in previous forecasts, the decline in construction will be entirely offset by more-than-expected growth in industry and agriculture.

Industry: an estimated indicator of growth of value added was around 14.8 percent y-o-y mainly due to the increased volumes in *metal ore mining* (14.7 percent), *food production* (15.9 percent), *beverage production* (11.6 percent), *items of finished metal manufactures* (96.3 percent), *production of building materials* (6.2 percent) and *production of parent metals* (10.3 percent), which is a result of consistent improvement in external demand as domestic and world economies recover. Strong growth in electricity and gas production volumes (17.5 percent), driven by increased economic activity and more electricity exports to Iran, further contributed to the growth of value added.

⁴⁵ The export and import indicators include the services indicators.

⁴⁶ Indicators of sectors of the economy represent the value added which the Central Bank estimated based on sector output volumes as released by the National Statistics Service of Armenia for the period January-September of 2011. Indicators of sub-sectors of the economy denote the change in output volumes as released by the National Statistics Service of Armenia for the period January-September of 2011, relative to the same period of the previous year.

Construction: about 11 percent y-o-y contraction of value added was estimated. The reduction in construction volumes financed by *international loans* (49 percent reduction), *organizations* (23.1 percent reduction) and *households* (37.1 percent reduction) was somehow offset by increased volumes owing to *state budget* (5.5 percent growth), *local budgets* (3.8-fold growth) and *humanitarian aid* (6.4 percent growth).

The shrinkage of construction volumes financed by international loans is explained by both the accomplished projects that were financed by international organizations in the agriculture, irrigation and energy fields and a postponed major road construction project *North-South Transport Line* and supporting electricity infrastructures between Armenia and Iran and Armenia and Georgia.

Services: the growth of value added is estimated around 3.7 percent y-o-y as a result of increased volume of *services rendered*, *retail trade turnover* and *wholesale trade turnover* by 5.8 percent, 2.8 percent and 4.3 percent, respectively. The increase in the volume of services rendered was driven by growth recorded in *financial* and *insurance* (25.6 percent), *healthcare* (9.7 percent), *education* (3.1 percent) and *culture and leisure* (5.5 percent).

Agriculture: the growth of value added is estimated to reach 15 percent y-o-y, which is entirely a result of 28.9 percent growth in *plant growing* in spite of 0.7 percent reduction in *animal breeding*. The decline in animal breeding was totally due to 17.1 percent reduction in *egg production* volumes whereas *milk production* volumes and slaughter *animal and poultry* have increased by 0.7 percent and 2.6 percent, respectively. The growth in plant growing was conditioned by increased output in *wheat* (21 percent), *potato* (37 percent), *vegetables* (30.6 percent), *berries* (about 2.6-fold) and *melons and gourds* (45.7 percent). The growth in plant growing was to both improved climate conditions and government programs⁴⁷ which are implemented in this field.

3.5 LABOR MARKET⁴⁸

In the third quarter of 2011 some growth in nominal wages was 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. The growth rate of nominal wages in the economy was consistent with the growth rate of productivity amid higher economic activity. In view of the aforementioned developments, unit labor costs have not changed notably, so the changed unit labor costs had an estimated near-to-neutral impact on inflation.

In the third quarter of 2011 the growth of average nominal wages was estimated around 6.2 percent, reflecting wage increase in private sector as well as moderate increase of wages in some budget-supported organizations. It should be noted that increased productivity in industry and services, growing demand for labor as well as price increases recorded in

⁴⁷ These include programs for agricultural lending, agro-product supply chain, wheat and barley seed growing and production, development of organic agriculture and domestic production of bio-fertilizers.

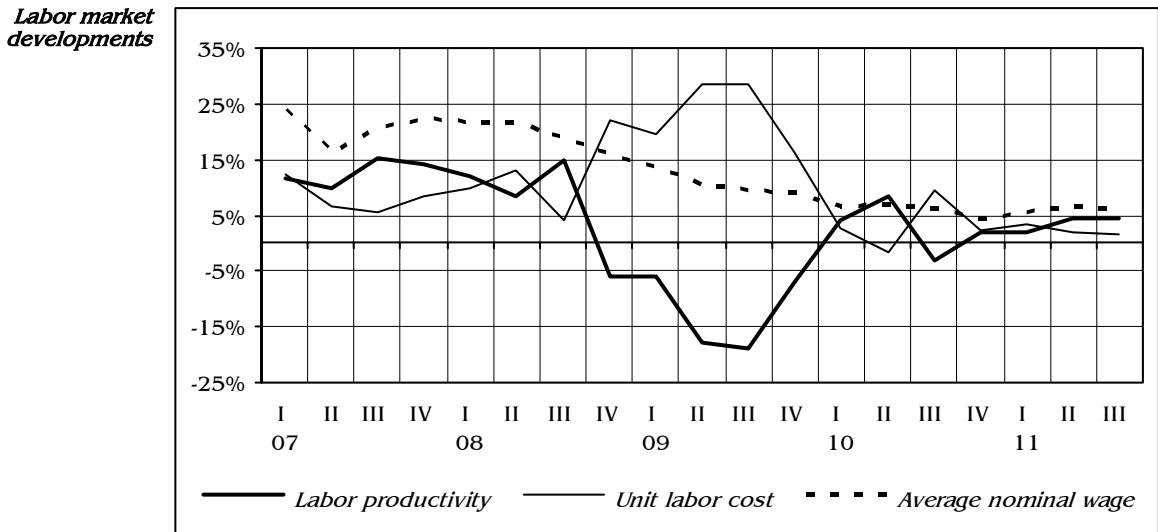
⁴⁸ Labor market indicators of the third quarter of 2011 are the Central Bank estimates based on actual figures of August and September and estimated figures of October of 2011. Growth estimations presented in this section are relative to the same quarter of the previous year, unless otherwise specified.

the previous year had a significant impact on the growth of nominal wages in the private sector.

In the third quarter demand for labor further increased mostly due to a reported increase of output in industry and services. As a result, the average number of the employed reached 2 percent while the quarterly unemployment rate fell against the same period of the previous year by 0.9 pp and reached 6 percent.

In the third quarter, concomitant with economic growth, labor productivity grew by around 5 percent.

As a result of these developments, unit labor costs have not changed notably thus had an estimated near-to-neutral impact on inflation.



3.6. IMPORT PRICES AND PRODUCER PRICES

3.6.1. Import Prices

In the third quarter of 2011 prices of basic food products and intermediate goods in world markets tended to fall and stabilize.

According to the Central Bank estimates, in the third quarter the dollar prices of import have reduced by 17.1 percent y-o-y against the second quarter and amounted to 10.5 percent.

Indicator	Q3 2010	Q4 2010	Q1 2011	Q2 2011	Q3 2011
Import (total)	19.3	18.7	22.9	17.1	10.5
Import (services)	2.7	3.1	6.9	13.6	10.4
Import (goods)	23.8	22.8	27.2	17.9	10.6
Capital goods ⁴⁹	0.0	0.0	0.0	0.0	0.0
Consumption goods	2.7	3.1	6.9	13.6	10.4
Intermediate goods	57.8	52.8	56.3	25.0	8.8
Diamond ⁴⁹	0.0	0.0	0.0	0.0	0.0
Oil products	11.8	15.8	36.8	48.8	47.2
Natural gas	16.9	16.9	16.9	0.0	0.0

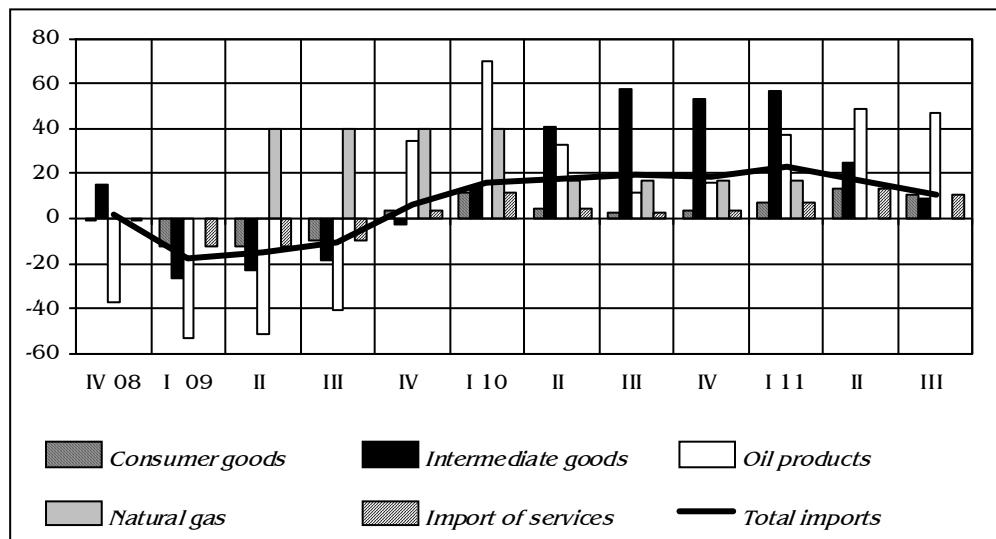
The y-o-y growth of dollar prices this quarter was attributable to persistently high prices of intermediate goods and food products as well as the 47.2 percent y-o-y increase in prices of oil products. The dollar prices of intermediate goods and food products have risen by 8.8 percent y-o-y compared with 25 percent increase recorded in the previous quarter. Prices

⁴⁹ 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.

of intermediate goods and oil products had, respectively, 2.7 pp and 3.5 pp of impact on total import prices.

The dollar prices of imported consumption goods have grown by 10.4 percent y-o-y, which was driven by high inflation (5.8 percent) and high exchange rate appreciation (4.2 percent) recorded in partner countries. The dollar prices of imported consumption goods had 2.4 pp of impact on total import prices. The Russian ruble and Euro exchange rates appreciation ensured the strongest contribution, among main partner countries, to total import prices, making up 0.8 pp each.

In Q3 2011 prices of import goods tended to fall and stabilize



In the third quarter, given the 10.5 percent y-o-y increase in dollar import prices and the 0.9 percent y-o-y depreciation of the average nominal AMD/USD exchange rate, the dram prices of imported goods included in the consumption basket increased an average by 9.4 percent y-o-y.

5.6.2. Producer Prices⁵⁰

In the third quarter of 2011 all branches of the economy (except construction) reported an increase of price indexes, with the GDP deflator having mounted to around 105 percent in the period January-September of 2011.

Industry reported the highest price increases, with quarterly growth having reached 7.4 percent y-o-y. In the period January-September the growth has been 10.9 percent y-o-y mainly due to the increased volumes reported in *metal ore mining* (7.1 percent), *processing industry* (9.2 percent) and *energy and gas production and distribution* (19.1 percent), which is a result of increased international prices of non-ferrous metals (compared to the prices recorded in the previous period of January-September) and continued recovery of external and domestic demand.

Agriculture posted 8.5 percent y-o-y growth of prices⁵¹, and in the period January-September the growth has been 19.9 percent y-o-y. This is explained by high inflation recorded in the branch in the period January-April because of slower recovery of plant growing, whereas in the period May-September prices were falling all the time.

⁵⁰ The National Statistics Service of the Republic of Armenia has been publishing an economic activity indicator (EAI) since the start of 2011. The section Prices and Tariffs includes brief information on price change. Recently, the price change has been presented as per economic branch (with no detailed information though), which was used by the Central Bank to estimate total GDP deflator indicator.

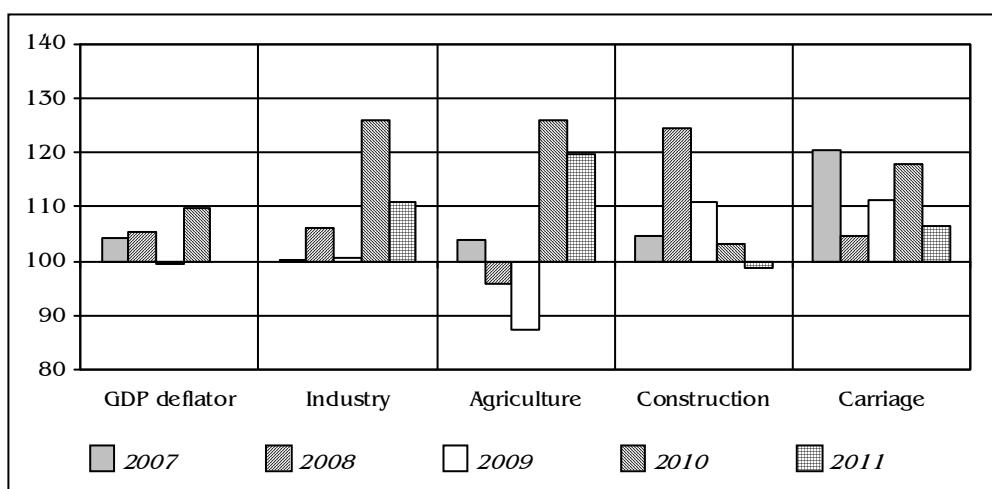
⁵¹ Sales prices of producers of agricultural product are presented.

Plant growing reported 4.4 percent increase in prices due to faster growing domestic and external demand for agricultural products. Moreover, prices of *potato* and *melons and gourds* risen by 19.1 percent y-o-y and 21 percent y-o-y, respectively, notably contributed to the price increase. In the period January-September a price increase of 31.3 percent has been reported in *animal breeding* due to contracted production volumes and price increases on milk and dairy products (47.7 percent), meat (20 percent) and egg (21.1 percent).

Construction reported deflation, 6.9 percent y-o-y, and the decline in the period January-September has been 1.7 percent y-o-y mainly due to rapid response of prices of building materials to the contraction of construction volumes.

Carriage costs increased by 3.1 percent y-o-y, with the January-September growth having reached 6.6 percent y-o-y driven by increased tariffs on *railroad transport* (8.2 percent), *motor transport* (3.2 percent) and *pipeline transportation* (9.7 percent).

In January-September 2011 the highest price increases were recorded in agriculture and industry



3.7 INFLATION EXPECTATIONS

The Central Bank conducted the Q3 2011 survey of inflationary expectations among financial organizations, households, and non-financial organizations of real sector.

The 12-month inflation tending to subdue in the course of the last two quarters was mainly consistent with the diminishing behavior of inflation as outlined in the Central Bank forecasts. Based on the third quarter results, the 42.8 percent of banks (compared with 23.8 percent in the previous quarter) took a low 2.5 - 5.5 percent range for the 12-month inflation. Nevertheless, since the inflation environment has been much higher during the last one year, and adaptive expectations (these are expectations which are based on actual expectations deriving from the previous period) still prevail in Armenia, most banks (57.2 percent) and credit organizations (60.7 percent) further took the 5.5 - 8.5 percent range for the 12-month inflation. It should be noted however that, based on the third quarter results, no respondent took a range above 8.5 percent.

According to the results, banks and credit organizations will further be sticking to expectations of stable market interest rates for the upcoming 12-month horizon. Some fall in interest rates is anticipated in the government bonds market and foreign currency lending.

The Central Bank of the Republic of Armenia

Yerevan - 0010, V. Sargsyan 6. <http://www.cba.am>