

THE CENTRAL BANK OF THE REPUBLIC OF ARMENIA

*Approved under
the Central Bank Board
Resolution No. 28 A,
23/02/2010*

**STATUS REPORT
ON IMPLEMENTATION OF
THE MONETARY POLICY
PROGRAM 2009**

(Inflation Report)



**YEREVAN
2010**

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1. SUMMARY

Q4 2009 ACTUAL INDICATORS AND DEVELOPMENTS

The main macroeconomic developments in the fourth quarter of 2009 were high inflationary environment and faster recovering global economy and domestic economies. Faster than expected increase of prices of raw materials and some food products in global markets, revived economy and strictly expansionary monetary and fiscal policy implementation during the year have resulted in notable acceleration of the rate of inflation in the fourth quarter, having persisted within the target until November. In December, however, the 12-month inflation indicator increased sharply to 6.5 percent, outstripping the target by nearly 1 pp, which was due to more prominent seasonal growth of agricultural products in December. Note that under the above developments the annual average inflation in 2009 has been just 3.4 percent.

Inflation in the fourth quarter was 3.7 percent largely due to 5.8 percent increase in food products (alcohol and tobacco included) (with 3.1 pp contribution to inflation). This in turn has been determined by seasonal price increase in the following items: "Fruit", by 35.9 percent (with 0.9 pp contribution to inflation) and "Vegetable and Potato", by 44.2 percent (with 2.1 pp contribution to inflation). The price increase in item "Vegetable and Potato" was totally driven by price increases in 4 products: tomato, cucumber, green pepper and eggplant (with 4.2 pp contribution to inflation). Prices of non-food products and service fees have increased by 3.0 percent and 0.7 percent, respectively, with a total 0.7 pp contribution to the quarter's inflation. The impact of inflationary pressures was reflected in the behavior of core inflation, too. Interestingly though, core inflation in the fourth quarter was merely 1.7 percent¹, while the 12-month core inflation has increased by 1.5 pp against the previous quarter's indicator and made up 5.25 percent.

Economic slowdown, driven by global economic crisis, reached its peak in the second quarter of 2009 (21.8 percent y-o-y) but trended downward in the next quarters, reflecting gradual improvement of the macroeconomic conditions thanks to stimulatory fiscal and monetary policy measures. As a result, as expected, the fourth quarter saw somewhat lesser economic decline of 5.3 percent y-o-y under which circumstance the decline in the period January-December has been up to 14.4 percent y-o-y. And, save for construction branch where the slowdown decelerated, the rest of branches of the economy reported growth over the quarter.

Industry reported growth of value added nearly by 1.4 percent y-o-y (7.6 percent y-o-y decline in January-December); agriculture reported 2.1 percent growth y-o-y (0.1 percent y-o-y decline in January-December); and services reported 0.7 percent growth y-o-y (0.7 percent y-o-y growth in January-December, as well).

Due to rigidities existing in the labor market, in the fourth quarter nominal wages in the economy have slightly grown driven by the rise of wages in both budget-supported organizations and firms in the private sector. The growth rate of wages has decelerated in comparison with that of recorded over the first three quarters of the year. The unemployment rate has also responded to the economic slowdown with a certain time-lag. As a result, the labor productivity kept on declining in the fourth quarter though at a slower rate. These developments have resulted to increase of unit labor costs, thus creating an estimated 0.9 percent inflationary pressures in the consumer market, according to the Central Bank.

¹ The core inflation calculation methodology developed by the Central Bank is detailed in the CBA Review (Q1, 2008), and core inflation indicators are regularly published in that paper.

In the fourth quarter the rate of the decline of domestic demand slackened, mainly due to considerable increase in public expenditures. The latter was determined by expansionary anti-crisis policy launched by the Government. Private spending, also has contributed to alleviation of decline of domestic demand.

In the fourth quarter the decline of domestic demand was around 6 percent, recovering by 11.4 pp compared to the same indicator of the previous quarter. Public expenditures increased by about 8 percent, reflecting the Government's expansionary anti-crisis policy. The decline in public spending has decelerated, too. In the composition of private spending, private investments declined nearly by 23 percent and private consumption by 0.4 percent (improving 23.8 pp and 1.5 pp respectively compared with the third quarter's same indicators).

Despite trends of stabilization, private spending kept on staying below the natural level. As estimated by the Central Bank, real private sector spending has been 3.4 percent below the natural level, thus creating 1-1.2 percent inflationary pressures in consumer market. It should be noted however that, in private spending, consumption of durable goods has reduced considerably, which places no essential impact on the change of CPI.

In the fourth quarter the fiscal sector's impact on the aggregate demand has been 7.8 pp expansionary, according to the calculated fiscal impulse indicator. This was conditioned by increased public expenditures and increased lending to the economy as part of anti-crisis measures launched by the Government, with the impulse generated due to less expansionary impulse of revenues but more expansionary impulse of expenditures. The generation of expansionary impulse of revenues has been attributable to faster declining state revenues versus GDP. In the fourth quarter tax revenues of the state budget have decreased by 11 percent in relation to the same period of the previous year. Relative to the same quarter of the previous year, expenditures, including net lending, have grown by 35 percent. According to the calculated impulse indicator, expenditures had 5.5 percent expansionary impact on the aggregate demand.

According to the Central Bank estimates, in the fourth quarter the combined impact of domestic demand and labor market on prices has been 1.6-1.8 percent inflationary.

With the global economy showing trends of recovery and developments in domestic economy, current account deficit was reduced in the fourth quarter in relation to the same quarter of the previous year by USD 102.5 million to amount to USD 410.2 million, with its share making up 15.1 percent of GDP. Based on yearly results, with high declining rate of GDP persisting, the share of current account deficit in GDP has grown and made up 14.0 percent against the previous year's 11.6 percent.

In the fourth quarter of 2009, macroeconomic stabilization trends solidified attributable to the slowing of the decline in the global economy as well as owing to the Central Bank efforts to keep inflation within the target and expansionary monetary and fiscal policy implementation in cooperation with the Government since the second half of the year. These trends were more evident in the performance of monetary indicators as they have grown steadily in the fourth quarter, too. The dollarization of the economy has grown either, reflecting change in foreign currency resources attracted and allocated.

Trends of active lending to the economy persisted, fuelling faster growth of dram loans over foreign currency loans. However, growth rates of dram loans still remain inadequate.

Expansionary monetary policy brought about high dram excess liquidity in the banking sector, which in turn has contributed to interest rate cuts in secondary markets of repo operations and government securities.

The aforementioned developments have steered the fulfillment of the inflation target and the monetary policy directions during the quarter. On the whole, in the fourth quarter the Central Bank continued implementing monetary policy based on prudent combination of tasks to stimulate economic activity and ensure price stability. Despite the expectations of higher inflation in the forecast horizon, given still high declining rates of GDP, CBA refrained from interest rate lifts based on necessity to contribute to the acceleration of economic recovery. This policy helped to somewhat improve macroeconomic situation, reflecting some positive shifts in real sector.

2. INFLATION DEVELOPMENTS

2.1. INFLATION BY GOODS AND SERVICES; CORE INFLATION

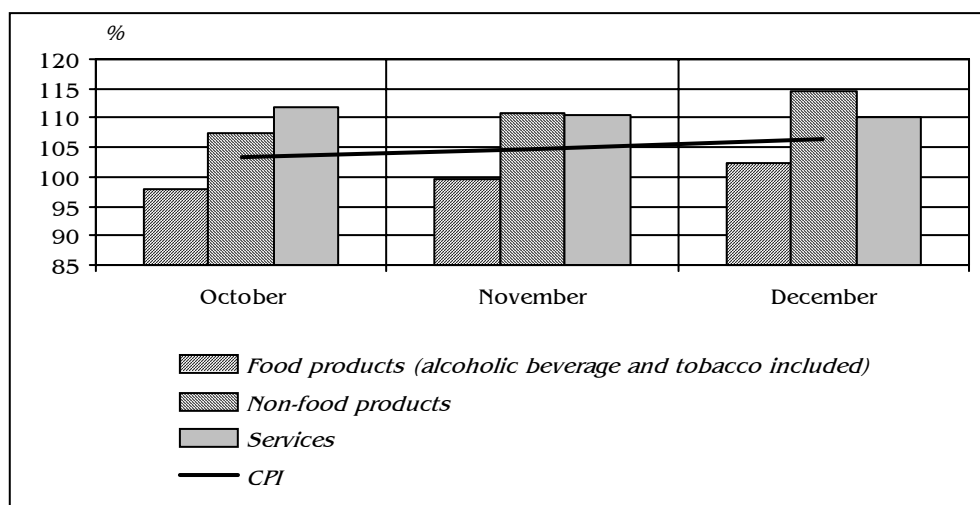
In December 2009, inflation was 6.5 percent against December 2008 (the previous year's respective indicator was 5.2 percent). Price changes were as follows: food products (alcohol and tobacco included) - 2.2 percent (3.3 percent in the previous year); non-food products - 14.6 percent (0.2 percent); and service tariffs - 10.3 percent (11.4 percent), all having contributed to inflation by 1.2, 2.3 and 3.0 pp, respectively.

Price increase of food products (alcohol and tobacco included) by 2.2 percent was mainly due to sub-items "Sugar" (33.9 percent)", "Fruit" (15.5 percent), "Meat products" (3.3 percent), "Vegetable" (6.1 percent), "Fish" (33.7 percent), all having contributed to inflation by 0.5, 0.4, 0.3, 0.3 and 0.2 pp, respectively. Whereas price decrease was recorded with regard to items "Egg" (-12.1 percent) and "Bread products" (-2.6 percent), mitigating inflation by -0.2 and -0.4 pp, respectively.

Price increase of non-food products by 14.6 percent was mainly due to sub-items "Personal usage cars and petrol" (23.9 percent), "Medicament" (29.1 percent), "Garment and knitwear" (11.0 percent), "Detergents" (20.1 percent), "Beauty items" (14.7 percent) and "Footwear" (8.7 percent), all having contributed to inflation by 0.8, 0.5, 0.3, 0.3, 0.2 and 0.2 pp, respectively.

The main contribution to inflation of the group "Services" came from increased tariffs in items "Household utility services" (19.1 percent), "Transport services" (16.0 percent), "Medical services" (7.2 percent) and "Education system services" (7.5 percent), all having contributed to inflation by 1.4, 0.7, 0.7 and 0.3 pp, respectively.

The 12-month CPI in Q4 2009 by the main items of goods and services

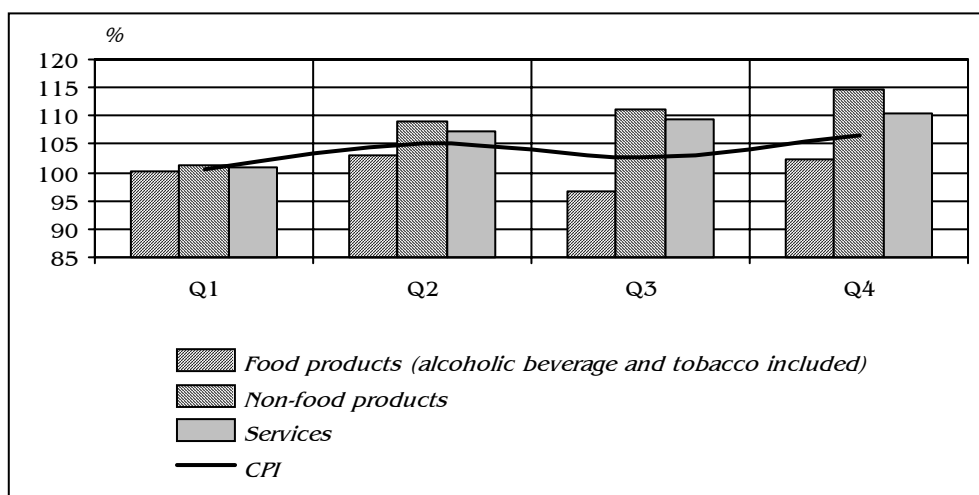


In the fourth quarter of 2009, inflation was 3.7 percent versus the end of the third quarter, driven by 5.8 percent increase in prices of food products (alcohol and tobacco included), 3.0 percent increase in non-food prices and 0.7 percent rise in service fees.

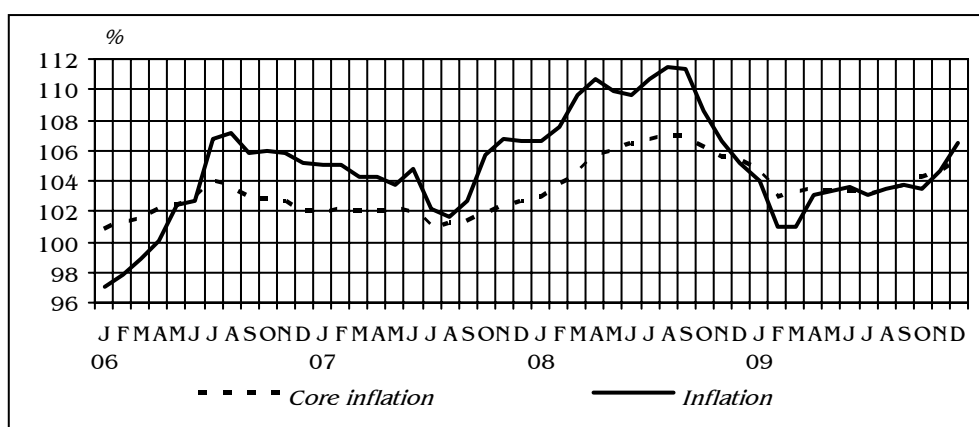
Inflation in the fourth quarter was 4.9 percent versus the fourth quarter of the previous year; and inflation in the period January-December 2008, versus the same period of 2007, has been 3.4 percent.

Core inflation in December of 2009, versus the previous year's December, was 5.25 percent. The main contribution to core inflation came from price increases on petrol (29.3 percent, with 0.9 pp contribution), air fare (47.6 percent, with 0.8 pp contribution), university tuition fee (8.1 percent, with 0.2 pp contribution), beef (5.3 percent, with 0.2 pp contribution) and hospital services (4.2 percent, with 0.2 pp contribution).

CPI changes by the main goods and services (to December 2008)



Inflation and core inflation, 2006-2009 (% to the same month of the previous year)



Statistical review of inflation fluctuations

In order to review the changes in Consumer Price Index and in price indexes of individual items included in consumer basket, as well as to discover the factors determining their fluctuations, the influence of three components (trend, seasonal and irregular components) used in Statistics theory was separated and assessed for the time period from January 2006 to December 2009.

Share of components causing fluctuations in monthly price indexes (January 2006 to December 2009) (%)

Item	Trend component	Seasonal component	Irregular component	Total
CPI	0.0	72.5	27.5	100.0
1. Bread products	9.8	29.6	60.7	100.0
2. Meat products	0.3	30.5	69.2	100.0
3. Fish products	0.1	35.2	64.8	100.0
4. Dairy products and oils	3.8	48.7	47.6	100.0
5. Fruit and vegetable	0.6	93.0	6.4	100.0
6. Other food products	11.4	53.4	35.2	100.0
7. Non-alcoholic beverage	0.9	25.8	73.3	100.0
8. Alcoholic beverage and tobacco	6.2	39.5	54.3	100.0
9. Garment and footwear	9.5	40.8	49.7	100.0
10. Rent, electricity, and fuel	6.1	36.2	57.7	100.0

11. Home appliances	12.1	26.8	61.1	100.0
12. Health services and medication	0.8	37.9	61.3	100.0
13. Transport and communications	2.4	45.7	52.0	100.0
14. Leisure and items of cultural products and services	4.3	81.9	13.7	100.0
15. Other goods and services	0.1	29.7	70.2	100.0

The calculations show that in the period January 2006 to December 2009, in comparison with the period January 2005 to December 2008², the influence of irregular component on CPI has increased by 3.3 pp, while the influence of seasonal component and trend component has decreased by -3.3 pp and -0.1 pp, respectively.

The influence of the three components has changed as follows.

Trend component had stronger impact on items "Home appliances" (11.9 pp), "Bread products" (9.4 pp), "Other food products" (9.1 pp), "Garment and footwear" (4.3 pp) but weaker impact on items "Alcohol and tobacco" (-23.9 pp), "Other goods and services" (-18.0 pp), "Non-alcoholic beverage" (-9.2 pp) and "Meat products" (-6.2 pp).

Monthly price index variation coefficients, 2006-2009 (%)

Item	2006	2007	2008	2009
CPI	1.2	1.8	1.2	1.6
1. Bread products	0.2	3.1	3.1	1.5
2. Meat products	0.8	0.7	0.7	0.7
3. Fish products	14.8	7.0	13.8	9.7
4. Dairy products and oils	0.5	3.3	1.2	1.6
5. Fruit and vegetable	14.8	15.6	14.1	15.2
6. Other food products	0.7	1.3	0.9	1.5
7. Non-alcoholic beverage	0.5	0.8	1.8	0.1
8. Alcoholic beverage and tobacco	0.0	0.0	0.1	0.2
9. Garment and footwear	0.4	0.8	0.4	0.9
10. Rent, electricity, and fuel	0.7	0.5	2.2	5.2
11. Home appliances	0.3	0.3	0.5	0.8
12. Health services and medication	1.6	0.7	2.0	0.8
13. Transport and communications	1.7	1.0	1.2	1.8
14. Leisure and items of cultural products and services	1.0	1.3	0.7	1.7
15. Other goods and services	0.2	0.3	1.2	0.2

Seasonal component had stronger impact on items "Alcohol and tobacco" (24.2 pp), "Transport and communications" (19.3 pp), "Dairy products and oils" (15.8 pp), "Home appliances" (10.6 pp), "Other goods and services" (7.9 pp) but weaker impact on items "Meat products" (23.2 pp), "Fish products" (20.6 pp), "Garment and footwear" (12.5 pp) and "Leisure and items of cultural products and services" (9.0 pp).

Irregular component had stronger impact on items "Meat products" (29.4 pp), "Fish products" (22.4 pp), "Other goods and services" (10.0 pp), "Garment and footwear" (8.2 pp) but weaker impact on items "Home appliances" (22.5 pp), "Transport and communications" (21.5 pp), "Dairy products and oils" (15.9 pp), "Other food products" (14.9 pp) and "Bread products" (14.8 pp).

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

Data in the table indicate that the CPI volatility in 2009 has increased in relation to 2008: prices were more volatile in items “Dairy products and oils”, “Fruit and vegetable”, “Other food products”, “Home appliances”, “Transport and communications” and “Leisure and items of cultural products and services” but less volatile in items “Bread products”, “Fish products”, “Non-alcoholic beverage”, “Health services and medication” and “Other goods and services”.

2.2. FULFILLMENT OF INFLATION TARGET

With the Government’s excessively expansionary fiscal policy in 2009 designed to spur up economic activity, monetary policy of the Central Bank was aimed at stimulating the economy while ensuring price stability. At the same time, continued rise in prices of raw materials and food products in global markets has had impact, especially in the fourth quarter, on domestic commodities markets thus resulting in intensification of inflationary pressures that were most observable in December. As a result, the year ended with the 6.5 percent 12-month inflation which exceeded the upper border of the target band by 1 pp, whereas the average annual inflation has been 3.4 percent.

The inflationary environment and monetary policy directions preceding the 12-month period have been characterized by the following developments: the monetary policy program of the first quarter of 2009 forecasted 5.9 percent inflation³ for the fourth quarter of 2009 which was exceeding the upper border of the target band (4% +/- 1.5%). While the year 2008 ended with an actual level of 5.2 percent inflation, staying at the upper border (see Chart 1), there were a number of inflation factors already known at the time of forecast, such as sharp depreciation of the dram on early March, the rise of public utility service fees from April 1 and the planned implementation of expansionary fiscal policy for the year. So, the forecast has been such in consideration of the above direct and indirect influences.

Albeit the actual 12-month inflation of the first quarter was merely 1 percent owing to considerable domestic price falls under deteriorated global economic crisis and inflationary environment in international markets as well as foreign exchange policy designed to maintain financial stability, and was below the lower border of the band by 1.5 pp, in the next quarter too, the Central Bank forecasted somewhat higher figures of inflation for the yearend (under a temperate scenario though) in consideration of persisted inflationary environment (see Chart 2).

In reality, given the peaking global economic crisis and shrinking domestic demand, the impact of the above-mentioned inflation factors was felt at a certain time lag, contributing to high inflation at the end of the year. Starting from the second quarter up to December, driven by continued adjustment of import prices and increased public utility fees as well as expansionary monetary policy implementation through prudent combination of economic stimulation and price stability measures, inflation somewhat rose and stayed within the lower border of the band. The actual 12-month inflation was 3.6 percent in the second quarter; 3.7 in the third quarter; and 4.6 percent in end-November. And the 2 percent inflation recorded in December, mostly fuelled by seasonal price increases on several agricultural items like tomato, cucumber, green pepper and

³ See “The Monetary Policy Program; Inflation Report (Q1 2009)”.

eggplant (with a total of 1.4 pp contribution), made only possible for end-year inflation to exceed the upper border of the band, making up 6.5 percent.

Overall, in view of prudent combination of tasks to stimulate economic activity and ensure price stability, the Central Bank has lowered the refinancing rate during the second and third quarters from 7.75 percent in end-March to 5.0 percent in end-September. In the meantime, the Central Bank has carried out a policy of quantitative easing, involving long-term repo transactions, active participation in secondary markets of government securities and large-scale injection of dram resources into the banking sector through credit programs under a coordinated policy action with the Government. In the fourth quarter, given inflation risks driven by revival in external and domestic economic activity, the Central Bank left the refinancing rate unchanged, at 5.0 percent. Notwithstanding this, the Central Bank continued implementing quantitative easing to stimulate economic activity, without detriment to price stability.

Inflation Forecasts made in December 2008 and March 2009 for Q4, 2009; and Actual Inflation

Chart 1. Inflation forecast in December 2008

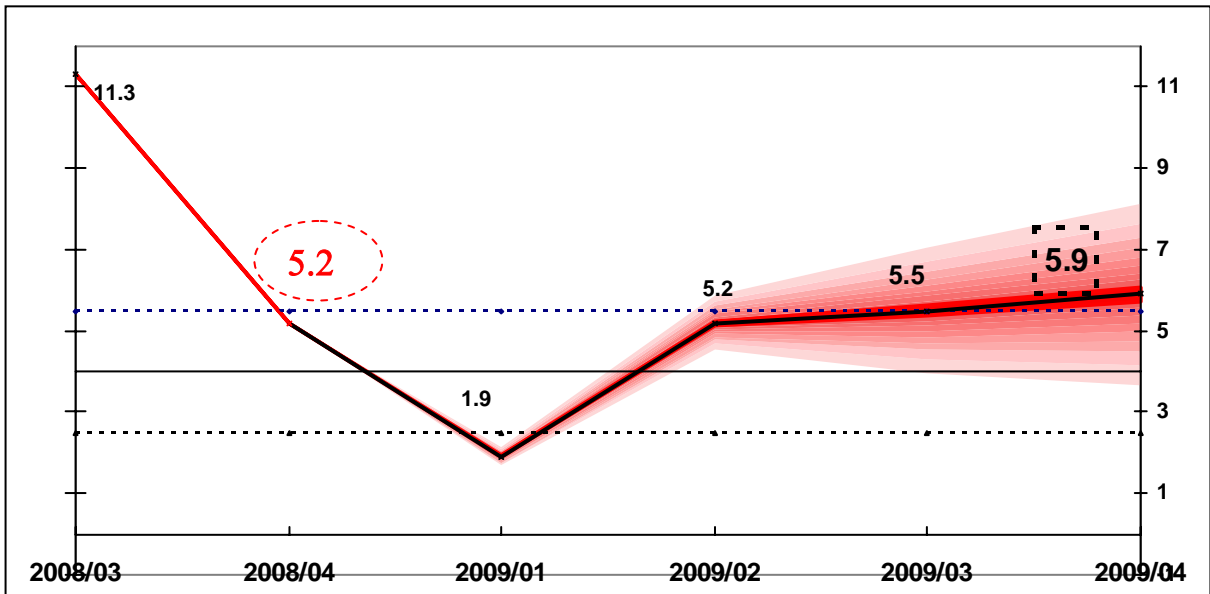
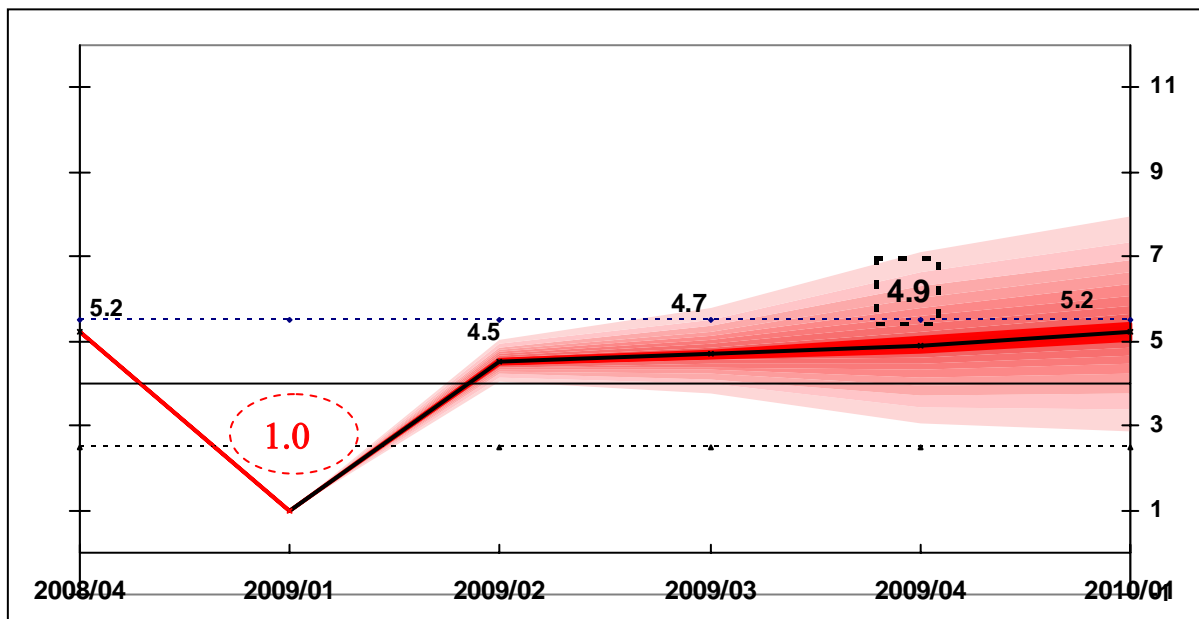




Chart 2. Inflation forecast in March 2009



 *Inflation at the time of forecast*

 *Inflation being forecast for reporting quarter*

3. INFLATION FACTORS

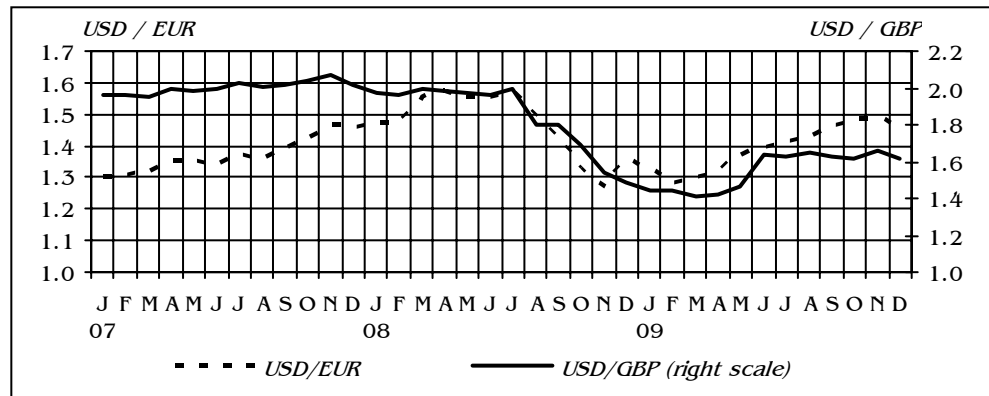
3.1. EXTERNAL ENVIRONMENT

In 2009, first ever since WW2, the global economy posted downturn of about -0.8 percent. However, already in the fourth quarter signs of world economic recovery were evident, prompting international financial institutions to revise their forecasts of the world economic growth outlook. According to new forecasts by the IMF, in 2010 the world economy will recover at the rate of 3.9 percent (0.75 percent more than the previous forecast). Notwithstanding the evidence of stabilization trends observable during the quarter, industrialized countries were still implementing expansionary fiscal and monetary policies to regain financial stability, stimulate aggregate demand and ensure further economic growth.

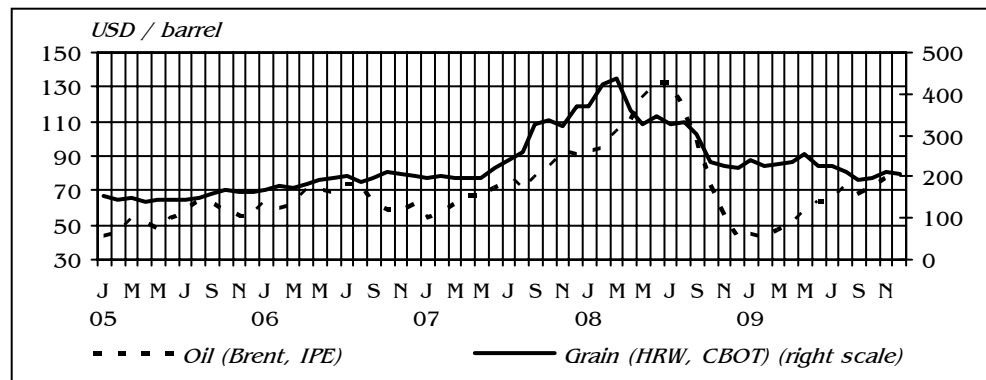
In the fourth quarter prices in global commodity markets kept on increasing, already exceeding their previous year's level. Price increases were mainly due to recovery of the global economy. Also, weakened position of the US dollar in the fourth quarter was another contribution to the rise of dollar prices of raw materials.

In the fourth quarter the US dollar depreciated against Euro by 3.9 percent, reaching an average 1.49 for the euro.

US dollar kept on depreciating versus euro in the fourth quarter, too



Oil prices again rose during the fourth quarter



In the fourth quarter oil prices have grown by 9.5 percent q-o-q, with "Brent" reaching an average USD 75 a barrel (with 34.0 percent growth y-o-y). The increase of oil prices during the quarter was attributable mostly to optimistic expectations for the world economic recovery. The prices of industrial metals have grown, too: copper price, for example, has increased by 13.5 percent compared with the previous quarter and amounted to USD 666.5 per ton on average. The y-o-y increase has been 70.5 percent.

In the fourth quarter wheat prices have fallen by an average 10.0 percent y-o-y, fluctuating in the corridor of USD 5.4 - 5.7 a bushel and dropping by 1.6 percent q-o-q. As estimated by the US Department of Agriculture, in the 2009/2010 marketing year some 674 million tons of crops of wheat are expected in comparison with the previous year's 682

million tons. Since the expected volume of the crops in 2010 will again exceed the estimated consumption, the world stocks of wheat will slightly increase this year, too, by around 25 tons, to amount to 190.9 million tons. A most impressive increase is expected in Kazakhstan, from 12.5 million tons to 17.0 million tons, while decreases are expected in Russia, from 63.7 million tons to 61.7 million tons, and in Ukraine, from 26 million tons to 20.5 million tons.

The prices of sugar have continued their considerable rise during the quarter with 9.9 percent increase q-o-q, reaching an average USD 23.4 cent/pound, and rising by 84.2 percent y-o-y. The main reason for such price increase is the expected decrement of the world stocks.

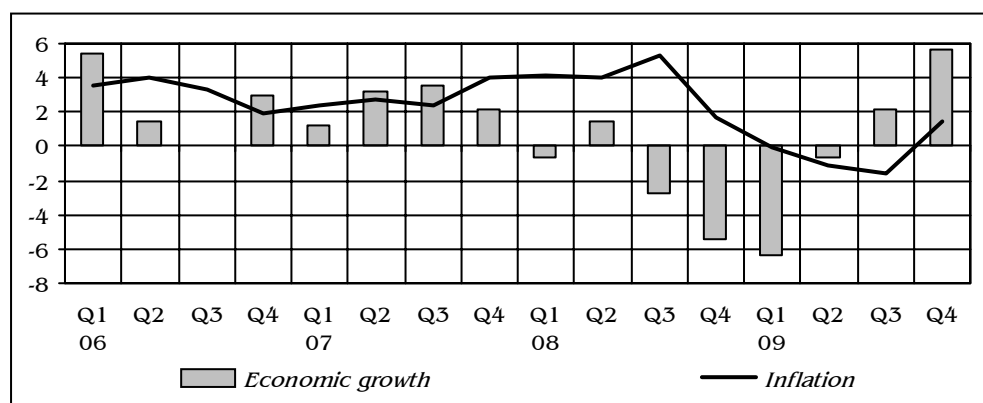
Below is a review of economic developments in the USA, Euro-zone and Russia, which make the largest share in the global economy and which are the main partners to Armenia. The review of economic developments of countries neighboring Armenia will follow.

Preliminary estimates suggest that in the fourth quarter the **United States of America** continued the recovery from the crisis which has started since the previous quarter. Some annualized 5.7 percent economic growth q-o-q was recorded in the fourth quarter compared to the previous quarter's 2.2 percent growth. The main contribution to the growth came from increased consumer expenditures (with 1.4 pp contribution), private investments (with 3.8 pp contribution) and exports (with 1.9 pp contribution).

In the fourth quarter the deficit of net exports was reduced to 3.0 percent of GDP (4.1 percent in the same period of the previous year), driven by faster reducing imports over that of exports in terms of both quantity and value.

In the fourth quarter some 1.5 percent y-o-y inflation was recorded in the US (-1.5 percent deflation was recorded in the previous quarter). This has been attributable to fast growing prices in commodities and fuel markets. Though in the fourth quarter stabilization trends in economies were evident, the Federal Reserve System remained committed to a stimulatory monetary policy strategy, while keeping a target corridor for interest rates of federal funds in the range of 0-0.25 percent and further implementing quantitative easing measures.

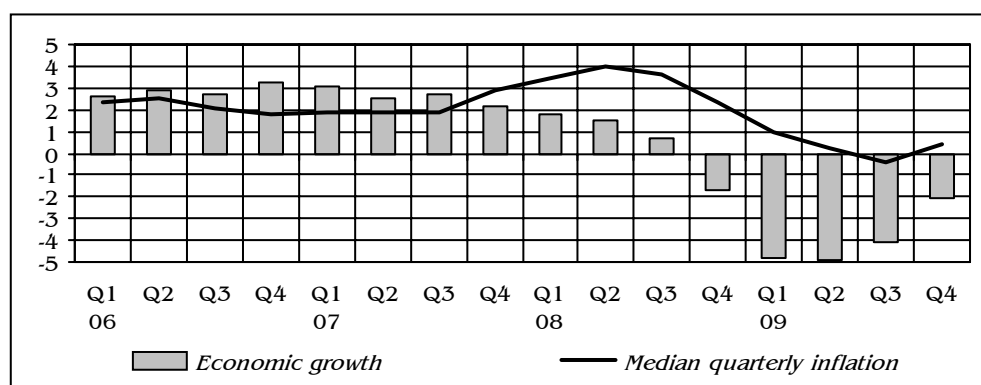
In the fourth quarter the USA posted inflation



According to the preliminary data from the EuroStat, in the fourth quarter **Eurozone** posted some 0.1 percent economic growth against the previous quarter, while 2.1 percent decline was recorded y-o-y (in the previous quarter these indicators were 0.4 percent and -4.0 percent, respectively).

In the fourth quarter the consumer price index grew by 0.4 percent y-o-y against 0.4 percent deflation recorded in the previous quarter. During the quarter the European Central Bank kept interest rates the same, at the 1.0 percent level, whilst maintaining a policy of quantitative easing.

Eurozone posted price increases



Trends observable from the end of the third quarter for recovering economy of **Russia** persisted in the fourth quarter. Relative to the same period of the previous year, the GDP decline has been 2.9 percent due to persisted high prices of oil and gradually recovering world demand. Based on annual preliminary results, the GDP decline has been 7.9 percent.

Decline in industry in the fourth quarter reached 2.6 percent y-o-y, and 10.8 percent based on annual results. In the fourth quarter the decline in non-tradable sectors, i.e. trade and construction, has been 6.1 percent and 9.8 percent, respectively. Based on the 2009 results, the decline in construction and trade has been 17 percent and 5.5 percent, respectively.

In view of the said developments as well as new forecasts of world output, the IMF has revised Russia's growth indicator for 2010 upside to have reached an estimated 3.6 percent. Nonetheless, risks to weak domestic demand and structural limitations in the economy remain.

In the fourth quarter, with a favorable global economic environment, current account tended to improve amidst net inflow of capital and financial assets. Current account surplus reached USD 15.6 billion, some USD 7.1 billion higher from that of recorded in the fourth quarter of the previous year. Net inflow of funds via the capital and financial account reached USD 9.0 billion against USD 25.4 billion-worth net outflow recorded in the previous quarter. This has been mainly due to net inflow of funds by the banking sector. With these balance of payments flows, reserves of the Central Bank of Russia have increased by USD 28.8 billion in the fourth quarter and amounted to USD 439 billion as of January 1, 2010.

With the balance of payments surplus, the nominal exchange rate of Russian ruble vs. US dollar kept on appreciating during the fourth quarter. As a result, in the fourth quarter the average nominal exchange rate of Russian ruble vs. US dollar has appreciated by 5.9 percent against the previous quarter's average, while y-o-y depreciation has been 8.1 percent. In the fourth quarter, the Russian Central Bank has acted as net buyer in the foreign exchange market in order to halt the ruble to appreciate further.

The trend of subsiding inflation remained to be seen during the fourth quarter, with y-o-y inflation making up 9.3 percent (11.5 percent in the previous quarter). Although the inflation rates slow down, it is however estimated that inflationary effects as a result of expansionary monetary and fiscal policies will be most prominent over the first half of 2010.

In the fourth quarter the Central Bank remained committed to implementing an interest rate cutting policy, having thrice reduced interest rates. They were reduced from 10 percent in September to 8.75 percent in December. The consideration was to increase accessibility to loan resources and to stimulate demand. An interest rate cuts policy is determined by positive trends of inflation dynamics and gradually declining inflation expectations.

Macroeconomic Situation in Neighboring Countries ⁴

Turkey: After economic downfall by 9.7 percent on average in the previous three quarters, the Turkish economy recorded another slowdown of 3.3 percent y-o-y in the third quarter⁵. This was an improvement in relation to the previous quarter's 7.9 percent decline. However, when seasonal factor excluded, still some 1.7 percent negative growth was recorded in relation to the previous quarter. Economic decline in the period January-September has been 8.4 percent. On the demand side, the largest negative contribution to the economic decline in the quarter has come from investments, with 3.8 pp contribution. The decline in private sector consumption in the third quarter was 0.9 percent y-o-y. Overall, domestic demand (excluding stocks) had some 4 pp negative impact, whereas net external demand had 2 pp positive impact.

The largest slowdown was reported in processing industry, construction and wholesale and retail trade sub-sectors where the decline rates were, respectively, 12.4 percent, 19.5 percent and 16.3 percent in January-September.

With the domestic and foreign demand reducing, current account deficit in the period October-November has been USD 991 million under USD 220 million-worth net outflow of capital. As a result, in the period January-November current account deficit has been USD 9.9 billion, down by USD 28.9 billion or 74.4 percent. This was largely due to considerable shrinkage of trade balance deficit, whereas net inflow of capital and financial account in the period mentioned has been USD 2.4 billion, down by 93.2 percent compared to the previous year's indicator.

In the period January-November foreign direct investment, net has been USD 5.8 billion, reducing by 60 percent. Some USD 851 million-worth net inflow was posted with regard to portfolio investment against net outflow of USD 5.2 billion recorded in January-November of the previous year. Item 'Other investment' has reported net outflow of USD 4.2 billion determined by net outflow of other private sector (excluding banks).

As a result of these flows, in the period January-November balance of payments has resulted in decrease of official reserves of the Central Bank of Turkey by USD 481 million (item 'Errors and omissions' has posted huge net inflow of USD 6.9 billion).

In the fourth quarter Turkish lira depreciated versus US dollar, with an average nominal exchange rate of lira appreciated by a mere 0.8 percent compared to the previous quarter's 4.6 percent appreciation, whereas the average appreciation has been 3.7 percent against the fourth quarter of the previous year.

In view of developments occurring globally and domestically, consumer price growth rates climbed during the fourth quarter to reach 5.7 percent y-o-y against the previous quarter's 5.3 percent. The main cause was December price increase on unprocessed food and base effect. Such price increase is a result of transient factors rather than tendency of generation of total price level. Core inflation has been within the target band.

In consideration of favorable developments in credit markets and gradual recovery of economic activity during the fourth quarter the Central Bank of Turkey decided to be slower in reducing interest rates, so the Bank set the refinancing rate on a 6.5 percent level in November down from 7.25 percent in September.

Azerbaijan: real GDP growth rates were maintained in 2009, too, thanks to extraction of oil, natural gas and other carbohydrate resources. The GDP growth has been 9.3 percent, of which 3.2 percent in the non-oil sector⁶. Growth in

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, lending organizations or countries, investors, etc, from the regional standpoint are becoming increasingly influential on economic developments of countries. Therefore countries periodically monitor macroeconomic developments not only in neighboring countries but also partner countries in the Region. Note, that Iran is not included in the selection because the latter's numerical data are not complete and are issued in such delays when they lose timeliness.

⁵ Official economic growth data for the fourth quarter of 2009 are not available.

⁶ Source: Azerbaijan Central Bank Statistical Bulletin, January-December, 2009, Table 1.1.

extraction has been 14.9 percent. It should be noted however that, with GDP deflator dropped by 21.2 percent, the nominal GDP has declined by 13.85 percent in relation to the same period of the previous year. Industry's contribution to the GDP growth has been 50.0 percent; agriculture – 6.7 percent; construction – 7.4 percent; transport and communications – 8.6 percent; wholesale and retail trade – 7.0 percent; social services – 11.7 percent; and net production and import taxes – 8.9 percent⁷.

Since the second half of 2009 Azerbaijani economy has been in a low inflationary environment, with an average annual inflation of 1.5 percent. This has been due to price decreases on food products, whereas inflation on non-food products and services has been 3.4 percent and 7.1 percent, respectively⁸. In the period mentioned, the nominal income of population have increased by 8.0 percent and average monthly wages have grown by 8.6 percent to make up USD 370.7 (Manat 298.0)⁹.

Although the country's trade balance has been positive, with an estimated surplus of USD 8.6 billion, it has shrunk about 4.7-fold in relation to the surplus recorded for the same period of the previous year. This was determined by about 2.6-fold reduction in foreign trade volumes compared to the same period of the previous year. As such, exports have decreased about 3.3-fold¹⁰. Crude oil boasted 81.6 percent of value of Azerbaijani exports in 2009, with export volumes however having reported 72.9 percent reduction relative to 2008¹¹.

In January-September of 2009, inflow of foreign direct investment has narrowed considerably, about 40.5 percent, in relation to the same period of the previous year. Inflow of FDI amounted to USD 2.0 billion in which leaders are Great Britain (49.2 percent), USA (14.7 percent), Japan (7.7 percent), Norway (4.8 percent), Turkey (3.8 percent), France (2.7 percent), Czech Republic (2.3 percent), Switzerland (2.1 percent) and Korea (0.8 percent)¹².

In 2009 too, the Central Bank of Azerbaijan remained conducting a policy aimed to stabilize or, at least, halt depreciation of the manat's exchange rate. As a result, in the period January-December manat has depreciated vis-a-vis US dollar by a mere 0.26 percent, while the average annual exchange rate appreciation has been 2.32 percent y-o-y¹³. A block of economists and analysts believe that some USD 1.5 billion was spent for the manat's exchange rate stabilization purposes¹⁴.

Relative to the end of December of 2008, economy lending has grown by 17.4 percent, yet non-performing loans have increased at the same time nearly 2-fold¹⁵. Furthermore, there has been some 1.3 percent y-o-y reduction in the volumes of bank deposits in both national currency and foreign currency. As of end-December 2009, the share of FX deposits in total deposits has been 53.4 percent¹⁶.

In support of financial stability of the banking sector and economic activity stimulation, the Central Bank of Azerbaijan conducted expansionary monetary policy in the first half of 2009. In particular, on February 2 it lowered the refinancing rate by 3 percent, and 2 percent, on March 2, and a further 1 percent, on May 25, setting it at the level of 2 percent¹⁷. Along with this, the ratio of reserve requirement in national currency as well as in foreign currency was reduced by 2.5 percent and set at the level of 0.5 percent¹⁸. In 2009, however, the manat broad money grew just by 1.45 percent against the previous year's 38.5 percent¹⁹.

⁷ Source: <http://abc.az/rus/news/41900.html>.

⁸ Source: Azerbaijan Statistics Committee, http://www.azstat.org/sdds/en/P_I/L_C_P.shtm.

⁹ Source: Azerbaijan Central Bank Statistical Bulletin, January-December, 2009, Table 1.1.

¹⁰ Source: <http://abc.az/rus/news/42232.html>.

¹¹ Source: <http://abc.az/rus/news/42261.html>.

¹² Source: Azerbaijan Central Bank Statistical Bulletin, January-December, 2009, Table 1.4. <http://abc.az/rus/news/41947.html>.

¹³ Source: Azerbaijan Central Bank Statistical Bulletin, January-December, 2009, Table 1.1.

¹⁴ Source: <http://abc.az/rus/news/41988.html>.

¹⁵ Source: Azerbaijan Central Bank Statistical Bulletin, January-December, 2009, Table 2.8.

¹⁶ Source: Azerbaijan Central Bank Statistical Bulletin, January-December, 2009, Table 2.3.

¹⁷ Source: <http://www.nba.az/default.aspx?go=699>.

¹⁸ Source: Azerbaijan Central Bank Statistical Bulletin, January-December, 2009, Table 2.12.

¹⁹ Source: Azerbaijan Central Bank Statistical Bulletin, January-December, 2009, Table 2.4.

Foreign exchange reserves of the Central Bank of Azerbaijan have decreased in 2009 by 16.9 percent (first time in the course of the last three years) and amounted to about USD 5.2 billion as of December 30 2009²⁰.

Georgia: since the second quarter of 2008, the country had been posting economic decline. In the period January-September 2009 the economic decline has been 5.5 percent²¹. In the GDP structure the largest growth was recorded with regard to public administration (13.1 percent), industry (13.0 percent), trade sector (12.1 percent), agriculture (8.5 percent) and transport (6.9 percent)²².

In the first nine months of 2009, inflation in Georgia has been 1.7 percent y-o-y, while some 3.0 percent inflation was recorded in relation to December of the previous year. Moreover, compared to the previous December, deflation was recorded with regard to all commodity groups, whereas nondurable goods and service fees have increased by 3.2 percent and 5.5 percent, respectively²³. For the period 2010-2012 the National Bank of Georgia set a 6 percent inflation target.

As a result of export-import transactions during 2009, the country's trade balance deficit has somewhat improved to amount to 3.2 billion in relation to the previous year's USD 4.8 billion. The improvement was driven by some 30.6 percent decrease of imports (CIF) and 24.1 percent decrease of exports (FOB) in relation to the previous year²⁴.

Both inflow of foreign direct investment and inflow of gross portfolio investments have reduced considerably, with FDI having amounted to USD 509.8 million in January-September 2009 (representing more than 2.5-fold decrease y-o-y) and with gross portfolio investments having only amounted to USD 15.6 million (representing about 40-fold decrease y-o-y)²⁵. Relative to 2008, inflow of money transfers from abroad has reduced by about 16 percent: in 2009 this indicator reached USD 841.6 million²⁶.

With foreign currency inflow narrowing, in 2009 the average exchange rate of lari has depreciated vis-a-vis the US dollar by 10.8 percent y-o-y; and relative to the end-December of 2008, lari's depreciation has been 1.1 percent²⁷. The National Bank's intervention in domestic foreign exchange market in the form of net sales of foreign currency has been USD 189 million in 2009, whereas in October-December 2008 alone, net sales by the National Bank had amounted to USD 557.5 million²⁸.

Pursuing to support financial stability of the banking sector in the times of global financial crisis, the National Bank of Georgia implemented an expansionary monetary policy during 2009 by lowering the refinancing rate on February 18 (by 1 percent), March 18 (0.5 percent), April 15 (0.5 percent) and November 25 (1 percent), down to 5.0 percent²⁹. Under such conditions, the growth of lari broad money in 2009 has been 14.9 percent against 13.3 percent reduction recorded in the previous year³⁰.

The volumes of bank lending have reduced: loans in national currency, by 26.5 percent and loans in foreign currency, by 8.3 percent³¹. The share of deposits attracted by banks has increased, with deposits in national currency, by

²⁰ Source: http://www.cbar.az/infoblocks/money_reserve_usd.

²¹ Source: National Bank of Georgia, "Bulletin of Monetary and Banking Statistics", January-December 2009, Table 1.1. Indicators on GDP and its components will be published on March 30 2010.

²² Source: http://www.statistics.ge/_files/english/nad/GDP%20at%20current%20prices.xls.

²³ Source: National Bank of Georgia, "Bulletin of Monetary and Banking Statistics", January-December 2009, Table 1.1.

²⁴ Source: National Bank of Georgia, "Bulletin of Monetary and Banking Statistics", January-December 2009, Table 5.4.

²⁵ Source: National Bank of Georgia, "Bulletin of Monetary and Banking Statistics", January-December 2009, Table 5.3.

²⁶ Source: National Bank of Georgia, "Bulletin of Monetary and Banking Statistics", January-December 2009, Table 5.8.

²⁷ Source: National Bank of Georgia, "Bulletin of Monetary and Banking Statistics", January-December 2009, Tables 1.1 and 4.7.

²⁸ Source: National Bank of Georgia, "Bulletin of Monetary and Banking Statistics", January-December 2009, Table 4.5.

²⁹ Source: National Bank of Georgia, Press Release, January-September 2009 www.nbg.gov.ge

³⁰ Source: National Bank of Georgia, "Bulletin of Monetary and Banking Statistics", January-December 2009, Tables 2.3 and 2.4.

³¹ Source: National Bank of Georgia, "Bulletin of Monetary and Banking Statistics", January-December 2009, Table 3.5.

16.8 percent. Albeit foreign currency deposits have grown in 2009 by 6.4 percent, yet the dollarization of the economy is persisting: as of December 30 2009, the FX deposits have constituted 73.4 percent in total deposits³².

Foreign exchange reserves of the National Bank of Georgia have grown during 2009 by about 42.6 percent and amounted to USD 2.1 billion as of December 30 2009³³. In the same period of time, Georgia's foreign debt has increased too: as of December 30 2009 it has been USD 3.4 billion³⁴. The increase of foreign debt was attributable to the loans attracted from international financial organizations and a USD 500 million-worth of sale of government bonds at the London Stock-Exchange³⁵.

3.2. BALANCE OF PAYMENTS³⁶

3.2.1. Current account

With the world economy and domestic economy showing trends of recovery, in the fourth quarter current account deficit shrank by USD 102.5 million y-o-y and amounted to USD 410.2 million, with its share constituting 15.1 percent of GDP. The shrinkage has been attributable largely to trade balance deficit reduced faster over the shrinkage of incomes and remittances.

In 2009 with GDP declining at a high pace, the share of current account deficit in GDP has increased, making up 14.0 percent compared to 11.6 percent recorded in the previous year.

In the fourth quarter trade balance deficit was reduced by USD 185 million and amounted to USD 676.4 million. The y-o-y declines in exports and imports were 10.5 percent and 19.0 percent, respectively. The decline of the trade balance deficit has been attributable to faster reducing imports over that of exports. According to the 2009 results, the decrease in exports and imports has been 34.4 percent and 25.6 percent, respectively.

The main cause for the deceleration of declining rates of exports in dollar terms was attributable to the y-o-y rise in metal prices as well as the low level of exports observable in the fourth quarter of the previous year. High declining rates of export of goods in real terms still persisted. The decline in exports in dollar terms was mainly due to items "Products of prepared food" and "Precious and semi-precious stones, precious metals and articles thereof", with 4.7 pp and 4.8 pp impacts, whereas items "Mineral production" and "Base metals and articles thereof" contributed positively, unlike their negative contributions in the previous quarter, by 3.1 pp and 6.0 pp, respectively.

Prices persisted to increase in global commodities markets, already in excess of the previous year's levels in general. This, coupled with decelerated reduction of domestic demand, has led to the slower decrease in imports in dollar terms. High declining of imports in real terms persisted. The decline was driven largely by items "Transport means", "Precious and semi-precious stones, precious metals and articles thereof", "Mineral production" and "Products of prepared food", with their contributions making up 8.1 pp, 2.4 pp, 1.9 pp and 1.7 pp, respectively. Item "Machinery and equipment" however has contributed positively, with its impact making up 3.8 pp.

There have been no essential shifts in terms of geographic distribution of external trade, and the trends of the preceding quarter persisted. The shrinkage of the trade balance deficit was driven by

³² Source: National Bank of Georgia, "Bulletin of Monetary and Banking Statistics", January-December 2009, Table 3.15.

³³ Source: National Bank of Georgia, "Bulletin of Monetary and Banking Statistics", January-December 2009, Table 5.1.

³⁴ Source: National Bank of Georgia, "Monetary and banking statistics bulletin", January-December 2009, Table 5.2.

³⁵ Source: Georgian Business Consulting, October 9 2009, www.gbc.ge.

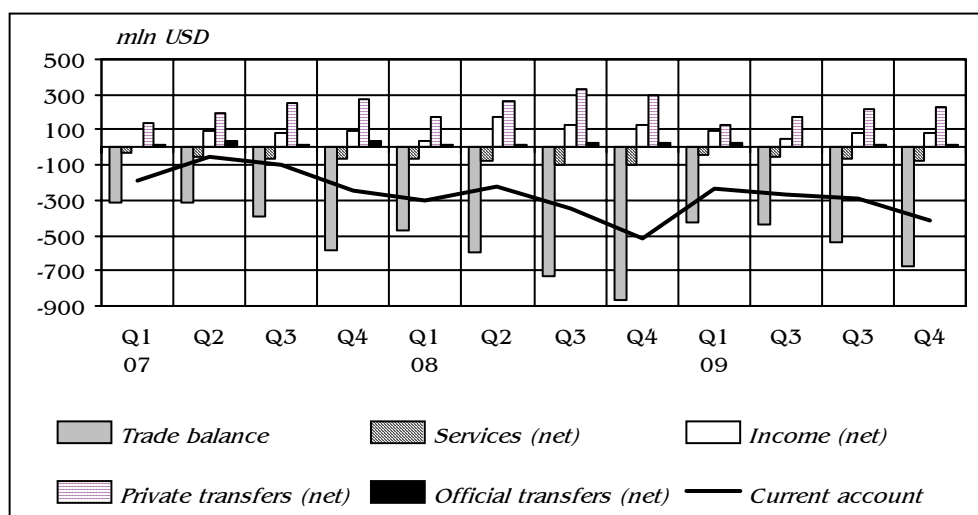
³⁶ Q4 2009 indicators are the Central Ban estimations.

continued reduction in trade balance deficit of all groups of countries. In particular, trade balance deficit with the EU states was reduced by USD 103.7 million (36.0 percent); and with CIS states, by USD 38.5 million (12.3 percent). Reduction of trade balance deficit with the USA, Turkey, China and Japan has been USD 25.8 million, USD 26.4 million, USD 23.0 million and USD 27.0 million, respectively.

The decline in the trade balance deficit has led to the reduction of the balance of services deficit: in the fourth quarter it shrank by 24.6 percent y-o-y to amount to USD 70.4 million mostly due to a decrease in the balance of transport services deficit. Decline in export of transport services has been 15.0 percent and decline in import of transport services has been 19.0 percent y-o-y. The export of travel services persisted almost on the same level while import of travel services has increased by 5.0 percent y-o-y. As a result, in the fourth quarter export of services has decreased by 3.3 percent y-o-y and import of services, by 10.8 percent y-o-y.

The slow down of declining rates of private remittances³⁷ determined by the developments in the Russian economy³⁸ (in Russia, relative to the fourth quarter of the previous year, the GDP decline slowed down to 2.9 percent y-o-y) and somewhat low level of transfers recorded in the fourth quarter of the previous year. The narrowed flow of non-commercial transfers via the banking system was somewhat offset by increased inflow of cash, so observable during 2009³⁹. In the fourth quarter net inflow of seasonal workers' income has reduced by 20.4 percent y-o-y and amounted to USD 164.5 million while item "Income on investment" reported net outflow of USD 72.6 million. In the outcome, item "Income" reported net inflow amounting to USD 92.0 million. In the fourth quarter declining rates in private transfers slowed down and made up 21.8 percent y-o-y.

In the fourth quarter current account deficit reduced in relation to the previous period



3.2.2. Capital and financial account

In the fourth quarter the capital and financial account posted net inflow amounting to USD 337.4 million (maintained at the level recorded in the same period of the previous year). Net inflow of funds generated primarily from public loans and foreign direct investment. However, the

³⁷ In the fourth quarter of 2009, some 23.6 percent y-o-y decrease in net non-commercial transfers of individuals via the banking system was recorded. As such, inflow of non-commercial transfers was reduced by 21.6 percent y-o-y and outflow of non-commercial transfers, by 10.5 percent y-o-y.

³⁸ The main portion of private remittances comes from Russia.

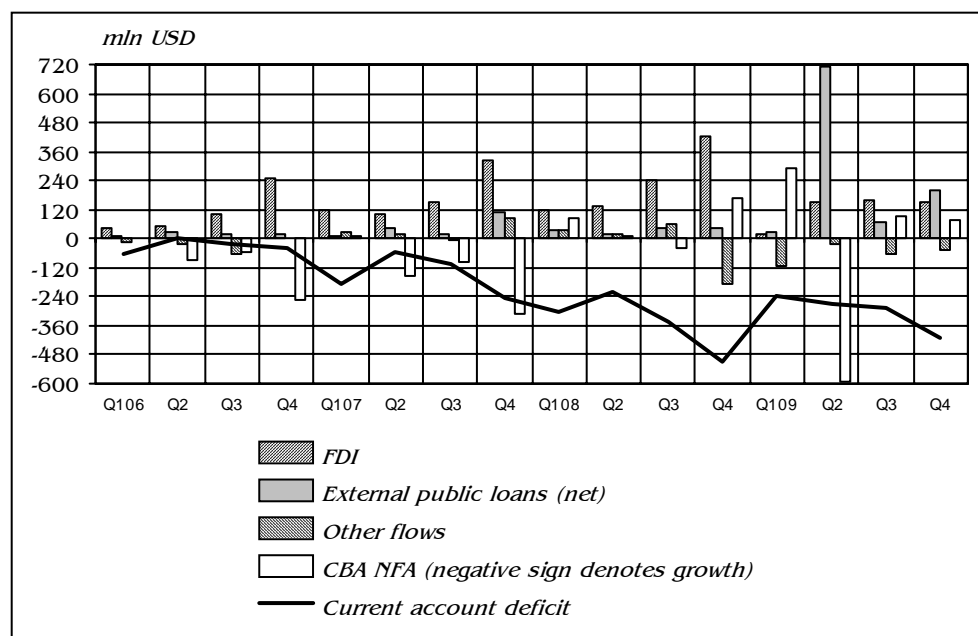
³⁹ Mainly because of increased distrust to the Russian banking sector at that time.

inflow of these funds has not been sufficient to finance the current account deficit, which resulted in reduction of net foreign assets of the Central Bank by USD 72.7 million.

Items of the capital and financial account posted the following flows: inflow of capital transfers amounted to USD 37.5 million (USD 45.5 million in the fourth quarter of the previous year). Net Inflow of public loans amounted to USD 196.5 million.

Foreign direct investment has reduced by 65.3 percent y-o-y and amounted to USD 148.2 million.

In the fourth quarter current account deficit exceeded net inflow on capital and financial account



Item "Other investment"⁴⁰ reported net outflow of USD 44.7 million determined primarily by increase of net foreign assets of the private sector (commercial banks excluded) by USD 40.0 million.

3.3. INTEREST RATES, EXCHANGE RATE AND MONETARY DEVELOPMENTS

3.3.1. Interest rates

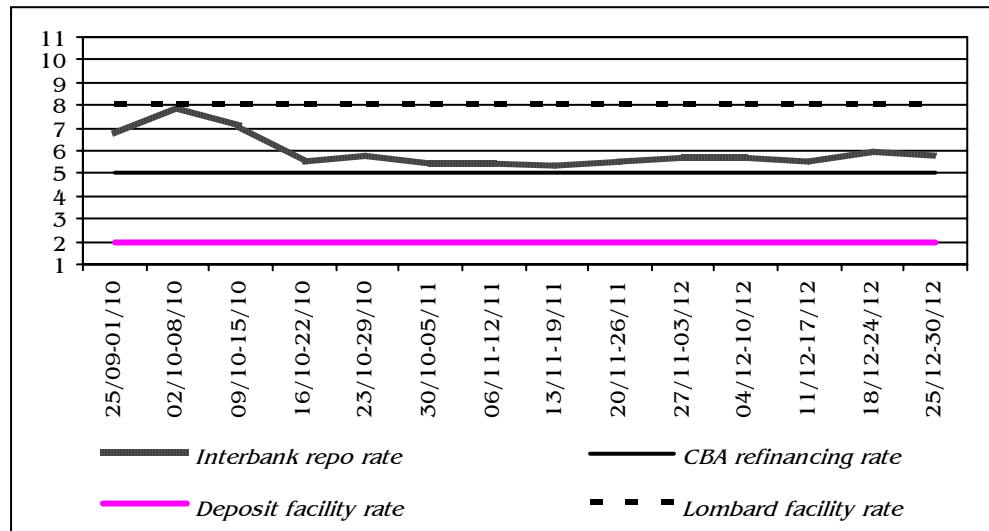
In the fourth quarter of 2009 the Central Bank continued implementing a monetary policy aimed at stimulating economic activity and maintaining price stability. In consideration of moderate inflationary pressures and macroeconomic developments consistent with the Central Bank forecasts, the Board of the Central Bank left the Refinancing Rate unchanged, at 5.0 percent.

In the meantime, given the rule of even distribution of interest rates on standing facilities against the repo interest rate, these rates were left unchanged, too, at the level of 2.00 percent and 8.00, accordingly.

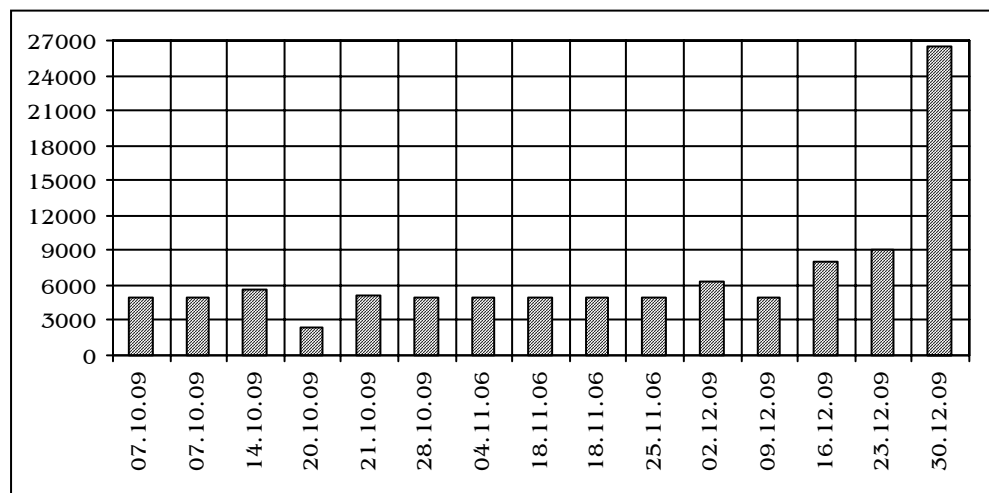
In the fourth quarter the banking sector saw high excess liquidity which affected the Central Bank operations. In particular, the Central Bank continued offering commercial banks to enter into repo transactions each Wednesday. As a result, the average weekly volumes of repo operations performed in the fourth quarter amounted to AMD 5.7 billion (AMD 12.3 billion in the previous quarter). The Central Bank further resorted to using the long-term repos, with a total volume of AMD 1.0 billion at the end of the quarter (AMD 1.5 billion in the previous quarter).

⁴⁰ Net foreign assets of the banking sector and other private sector.

Interest rate on CBA operations and market repo operations



CBA repo operations in the fourth quarter (million drams)



During the quarter the average daily volume of deposit invested by commercial banks with the Central Bank amounted to AMD 4.5 billion compared to AMD 13.2 billion in the previous quarter.

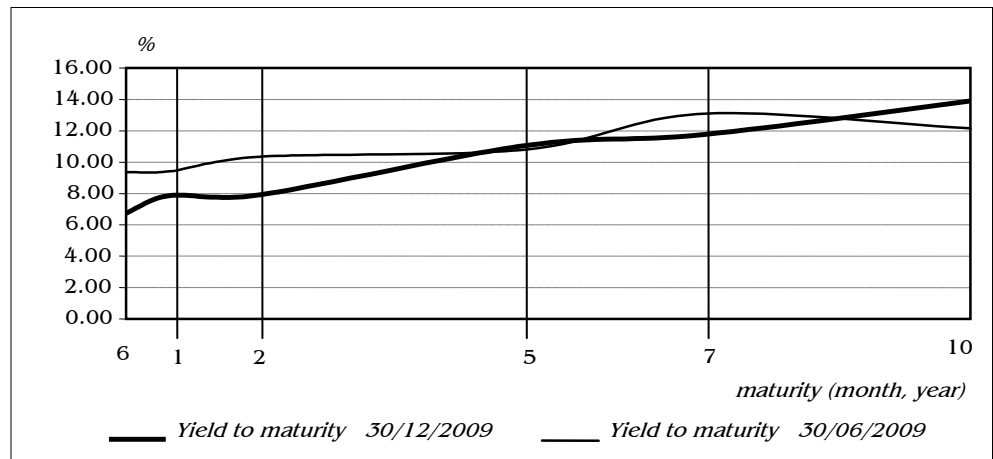
The volume of operations performed in the interbank and intrabank repo market during the fourth quarter amounted to AMD 146.9 billion. The total volume of repo operations in 2009 amounted to AMD 371.7 billion, AMD 78.1 billion lesser than the volume in the year before. The market repo rate was 5.79 percent in December against 7.48 percent in June and 8.25 percent in December of 2008. The share of operations between commercial banks in total constituted 37.4 percent in 2009, and 48 percent in 2008.

Short-term treasury bills of nearly AMD 10 billion were allocated in the fourth quarter (AMD 14 billion in the previous quarter). The total volume of short-term treasury bills allocated in 2009 has increased by AMD 26.6 billion and amounted to AMD 57.7 billion.

Interest rates in primary market of treasury bills have reduced during the fourth quarter. In 2009, the average yield on short-term and medium-term papers were, respectively, 8.9 percent and 13.36 percent against 10.68 percent and 13.84 percent recorded in June.

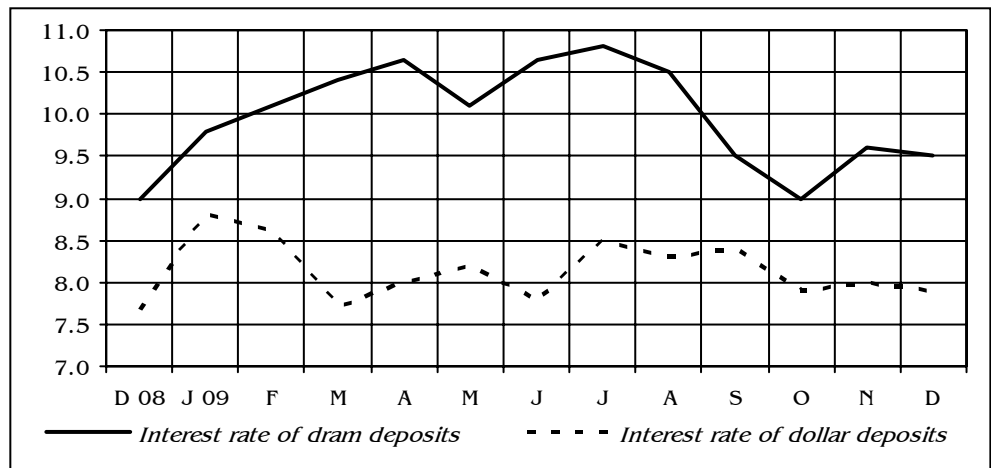
The yield curve analysis shows that in the secondary market of government securities yields have fallen by an average of around 10. pp. Convexity of the curve has changed notably (from 0.18 to 0.37), which points to the widened spread between interest rates of long-term and short-term treasury bills.

In the secondary market interest rates of long-term securities have risen

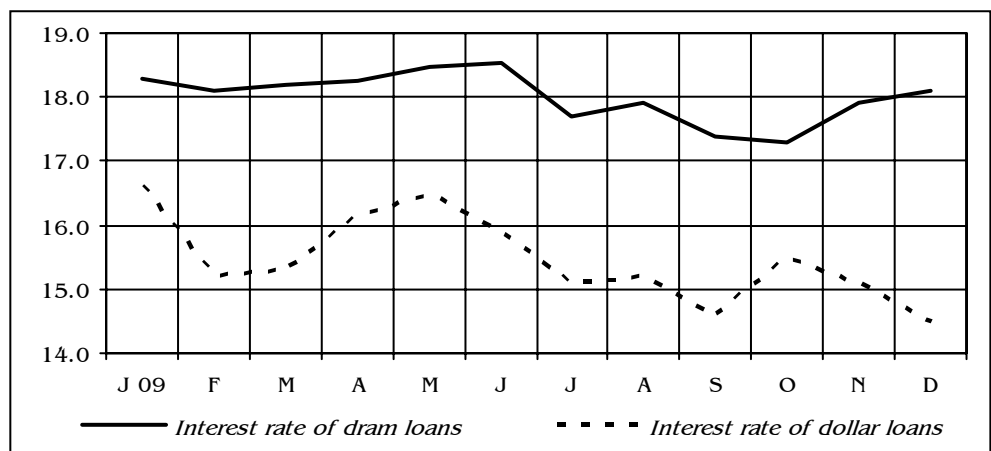


Interest rates of loans and deposits in Armenian dram and US dollar trended as follows: in December interest rates of dram and dollar deposits were 9.5 percent and 7.9 percent, respectively. Relative to June of 2009, interest rates of dram deposits have fallen by 1.1 pp whereas interest rates of dollar deposits have remained almost unchanged. As a result, the spread of interest rates of dram and dollar deposits has been 1.6 pp against 2.8 pp recorded in June.

Interest rates of deposits attracted by the banking sector



Interest rates of loans made by the banking sector



In December of 2009 interest rates of dram loans made up 18.1 percent, and dollar loans, 14.5 percent, down by 0.4 pp and 1.4 pp, respectively, in relation to June of 2009. As a result, in September the

spread of interest rates of dram and dollar loans was 3.6 pp in relation to 2.6 pp recorded in June.

In December of 2009, the interest rate spread of loans and deposits in Armenian dram made up 8.6 pp, growing by 0.7 pp from 7.9 pp recorded in June, while the interest rate spread of loans and deposits in US dollar made up 6.2 pp, dropping by 1.5 pp from 8.1 pp recorded in June.

In December of 2009, relative to the previous quarter, interest rates of dram deposits remained unchanged, whereas interest rates of foreign currency deposits dropped by 0.5 pp. Interest rates of dram loans increased by 0.7 pp, while interest rates of foreign currency loans remained almost unchanged.

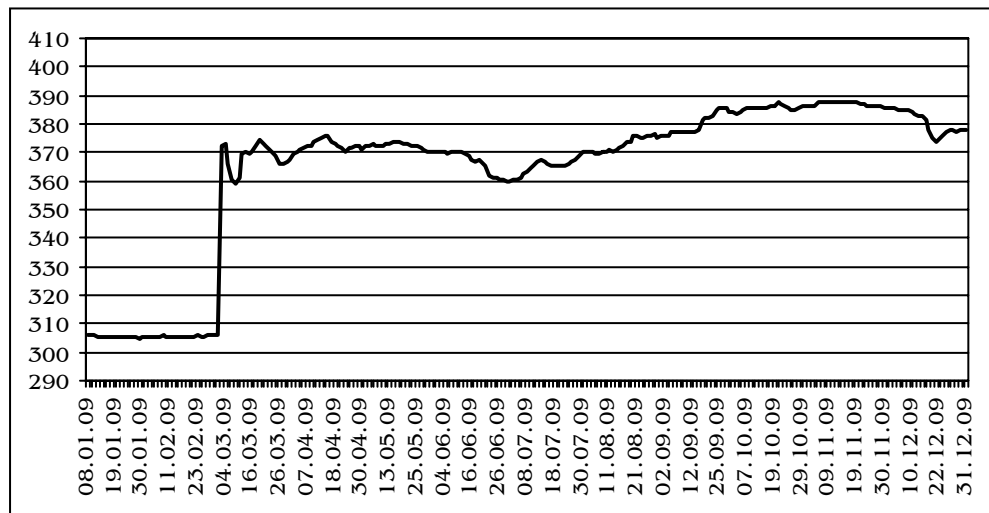
3.3.2. Exchange rate

At the end of the fourth quarter, relative to the end of the previous quarter, the dram has appreciated versus the dollar by 1.69 percent to 377.89 from 384.28 for one dollar. Whereas in the fourth quarter, relative to the fourth quarter of the previous year, the average exchange rate depreciation has been 20.29 percent to 384.40 from 306.41 for one dollar. The same indicator in the previous year was +3.48 percent.

In the yearend of 2009, relative to the same period of the previous year, the AMD/USD exchange rate has depreciated by 18.83 percent.

The aggregate volume of interbank market transactions carried out during the fourth quarter amounted to USD 2366 million, down by 13.9 percent from the fourth quarter volumes of the previous year (USD 2749 million). Based on annualized results, there has been some 0.4 percent reduction, i.e. USD 8685 million against USD 8720 million.

The dram's exchange rate versus the US dollar in 2009

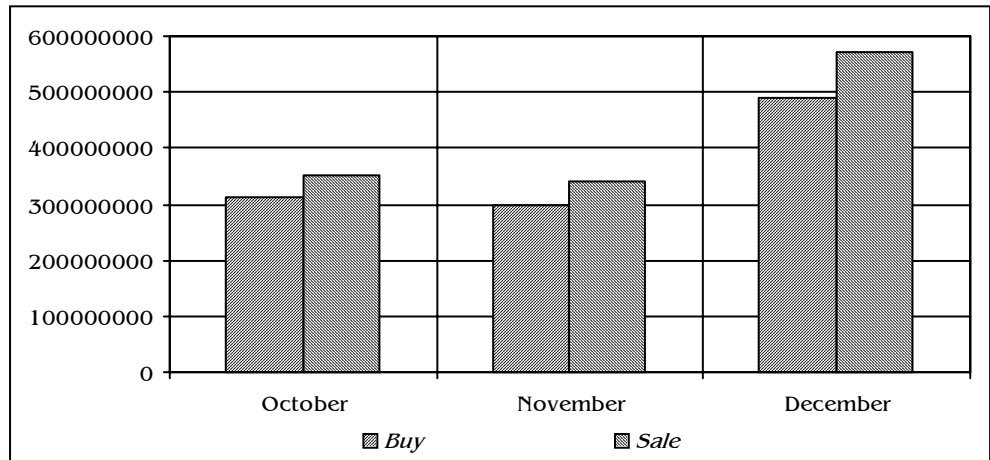


The volumes of transactions in the EUR/AMD exchange market have decreased, with an aggregate volume reaching EUR 211.50 million, down by 14 percent against the previous year's indicator. Based on annualized results, the volume of operations has increased by 24.35 percent and amounted to EUR 962.60 million.

In the fourth quarter the Central Bank purchased a total of USD 8.49 million and sold a total of USD 102.63 million from/to commercial banks to

handle the dram supply and moderate volatilities in the dram's exchange rate. Based on annualized results, purchases have amounted to USD 40.56 million and sales, USD 736.66 million.

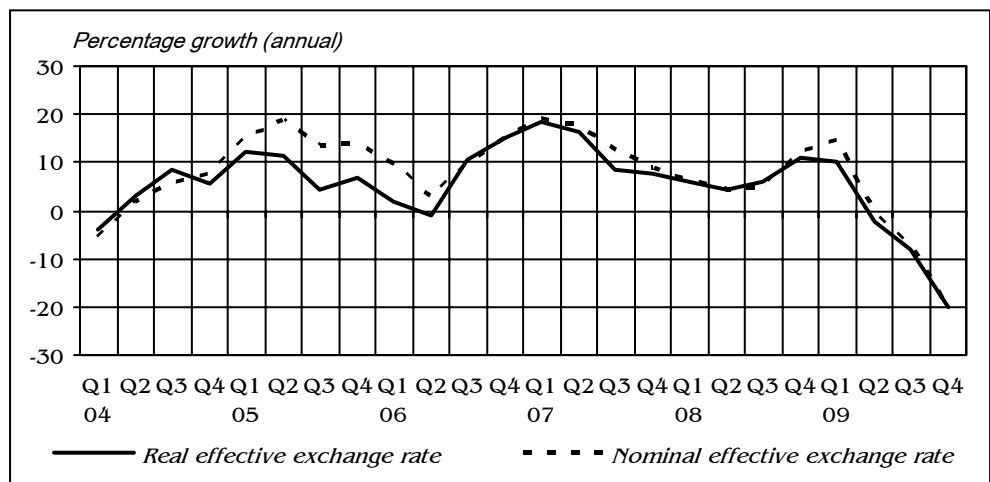
Operations in foreign exchange market in the fourth quarter



Persisted high y-o-y depreciation of the dram's exchange rate versus the dollar as well as average weighted appreciation of partner countries' exchange rates against dollar has resulted in 20.6 percent y-o-y and 5.4 percent q-o-q depreciation of the nominal effective exchange rate of Armenian dram. In December the nominal effective exchange rate depreciated by 19.9 percent y-o-y.

In the fourth quarter the average quarterly inflation in Armenia was 4.9 percent y-o-y, and the weighted average inflation in partner countries was 3.9 percent y-o-y. The weighted average inflation in partner countries has been mainly influenced by inflation in Russia and Ukraine, by 1.9 and 1.0 pp, respectively. As a result, in the fourth quarter, coupled with depreciation of the nominal exchange rate, the real effective exchange rate depreciated by 20.0 percent y-o-y (7.9 percent in the previous quarter), while the depreciation in December of 2009 was 18.1 percent in relation to December of the previous year. The real exchange rate adjustment in 2009 created good conditions for improving trade balance deficit and mitigating the real GDP decline.

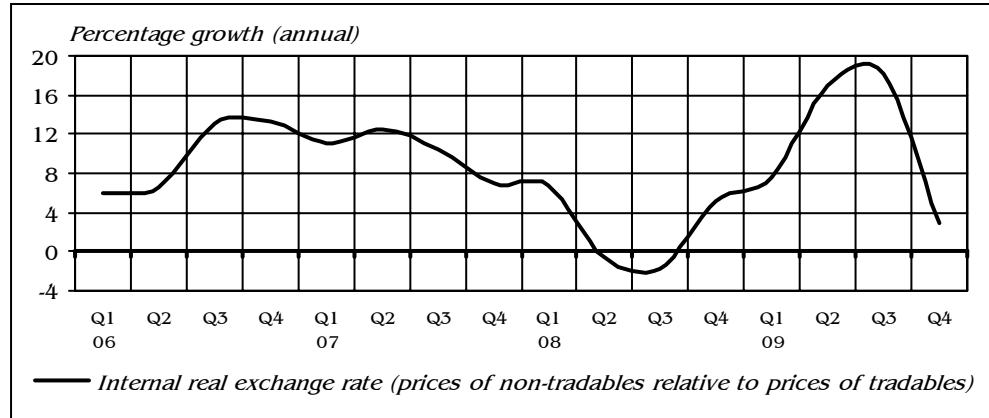
In the fourth quarter real and nominal exchange rates further depreciated



In the fourth quarter the internal real exchange rate appreciated by 2.9 percent y-o-y (appreciation in the previous quarter was 18.1 percent), which is a result of faster growth of prices in non-tradable sector over prices in tradable sector.

In the fourth quarter prices of non-tradable goods and services have increased by 10.5 percent y-o-y, and prices of tradable goods have increased by 7.42 percent versus 17.3 percent and -0.7 percent, respectively, recorded in the previous quarter. The y-o-y growth of prices of tradable goods was driven by y-o-y depreciation of the dram's nominal exchange rate and y-o-y growth of international prices. Growth of prices in non-tradable sector was determined mainly by y-o-y increase of gas and electricity fees.

In the fourth quarter domestic real exchange rate appreciated at a slower pace

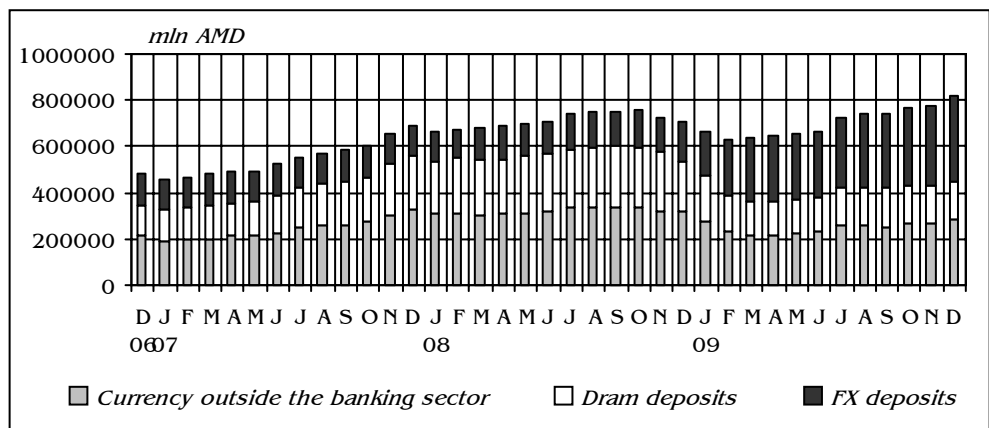


3.3.3. Monetary developments ⁴¹

The fourth quarter of 2009 has been somewhat different from previous quarters as trends of macroeconomic stabilization brought in slowing of economic decline. Under such conditions, the Central Bank continued its monetary policy aimed at stimulating economic activity and maintaining price stability. In the fourth quarter, too, monetary indicators showed relatively strong performance.

Dram broad money has grown by 7.0 percent due to the increase of currency in circulation by 11.1 percent, whereas dram deposits have grown merely by 0.8 percent. It should be noted that actual annual trends of these figures were largely in line with expectations: dram broad money and dram deposits reduced by 16.2 percent and 24.1 percent, and currency in circulation, by 10.6 percent, respectively.

Starting from the second half of 2009 implemented expansionary monetary policy affected money aggregates



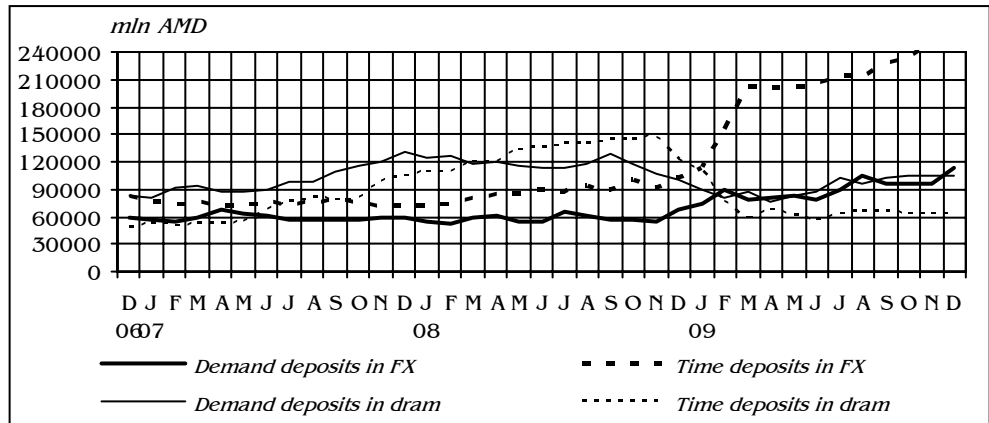
In the reporting period, the dollarization of the economy persisted, reflecting 13 percent q-o-q and 114.4 percent y-o-y growth of foreign currency deposits in dram terms (in dollar terms, the growth was 14.9

⁴¹ Starting from the third quarter of 2008, the Inflation Report covers summary balance sheet indicators of depositary institutions, i.e. the Central Bank, commercial banks and credit organizations.

percent and 74.0 percent, respectively). For comparison, in the previous quarter this indicator grew by 13.8 percent q-o-q and 118.9 percent y-o-y, respectively.

Foreign currency deposits have grown mostly due to the increase of demand deposits by 18.2 percent and time deposits have increased by 10.7 percent, whereas according to annual results, time foreign currency deposits posted the largest growth, 2.4-fold (AMD 147.5 billion) and demand foreign currency deposits, 1.7-fold (AMD 46.7 billion). In the fourth quarter no marked shifts were observed in respect of dram deposits yet these have decreased by 47.6 percent, according to annual results (AMD 58.2 billion) while demand dram deposits grew by 4.7 percent. This points out to the currency substitution during the year determined by sharp depreciation of the exchange rate, resulting in conversion of dram savings to those of foreign currency.

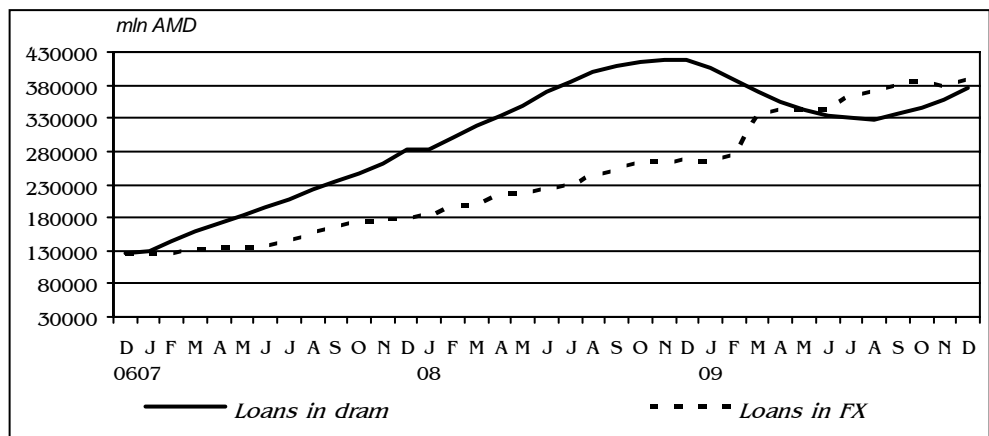
Due to faster dollarization in 2009, in the deposits structure the dram/FX ratio again changed in favor of foreign currency



As a result of flows of the above components, broad money has grown by 9.6 percent q-o-q and 15.1% y-o-y.

By supply-side factors, monetary aggregates have grown totally owing to net domestic assets of depositary institutions, with 30.8 percent or AMD 108.1 billion increase q-o-q, while net foreign assets have decreased in this period of time by 9.3 percent or AMD 36.8 billion.

In the fourth quarter dram loans outgrew FX loans



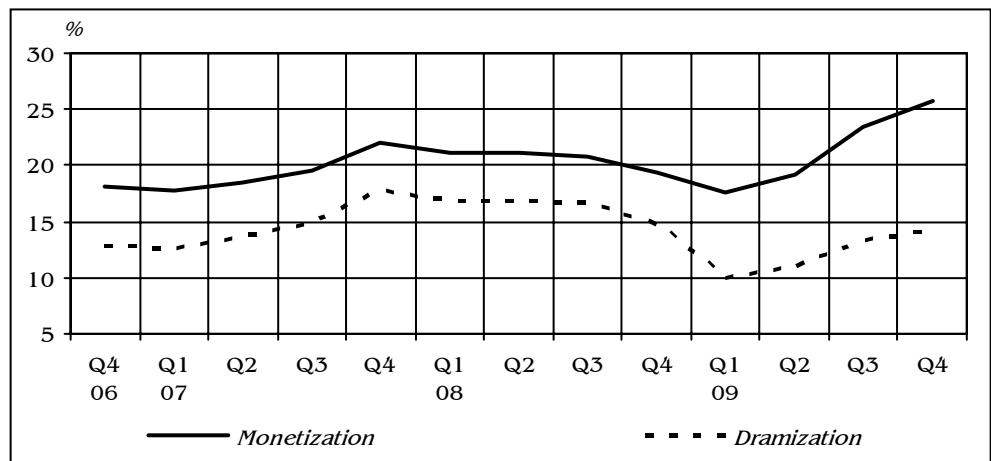
In the fourth quarter the economy lending kept on spurring up, again attributable largely to loan resources provided by the banking sector to the economy as part of anti-crisis measures taken jointly by the Central Bank and the Government. Lending volumes have grown by 6.8 percent q-o-q and 13.0 percent y-o-y. Despite persisted dollarization, dram loans reported somewhat faster growth over foreign currency loans during the quarter. However, the growth rates of dram loans were not satisfactory. Volumes of

lending in dram have increased by 11.9 percent and in foreign currency (in dram terms), by a mere 2.0 percent (in dollar terms, the growth was 3.7 percent). According to annual results, the shifts in these figures were as follows: 9.9 percent decrease and 45.1 percent increase (17.8 percent), respectively.

The dram to foreign currency ratio of funds made available for lending was still on the side of foreign currency, making up 49/51 in the yearend versus the previous yearend's indicator of 61/39.

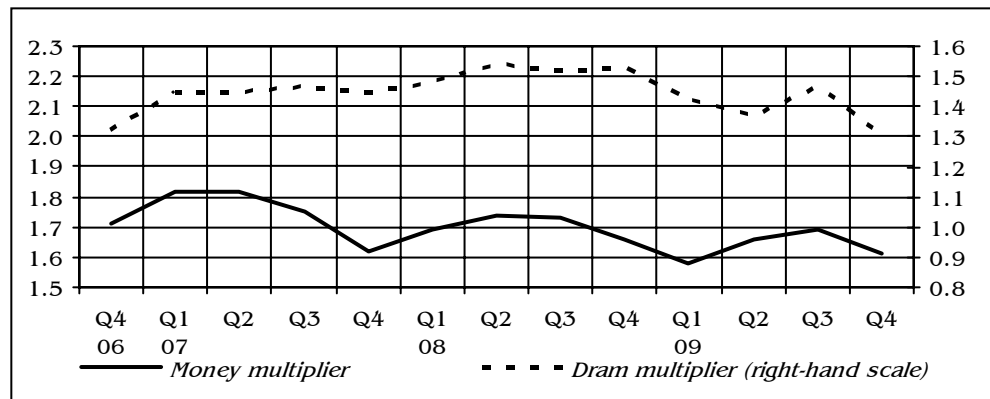
In the fourth quarter the dollarization of the economy (measured as a ratio of foreign currency deposits to broad money) made up 44.7 percent, representing more than 1.8-fold increase in relation to the respective indicator recorded in the previous year and 3.1 percent increase in relation to the previous quarter.

Since the second half of 2009 the monetization and dramization ratios have somewhat grown



The next indicators of financial intermediation - money and dram multipliers, have declined during the year by 2.7 percent and 18.7 percent, respectively; since the second half of the year however, driven by effects of quantitative easing, the decline rates have slowed down notable and will go on that way.

The money and dram multipliers

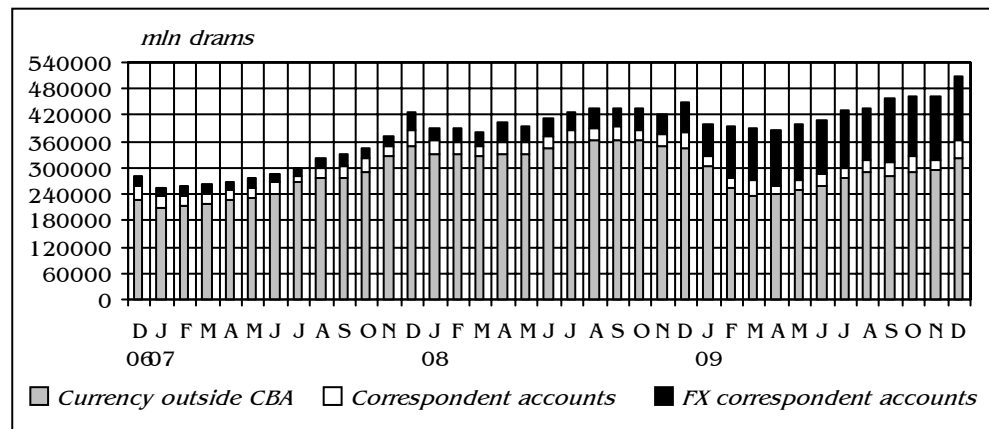


Monetary base

With stabilization back on track and as a result of expansionary monetary policy carried out since the second quarter of the year, the Central Bank has increased, at faster rates, money supply in the fourth quarter, too. At the end of December, the q-o-q growth of monetary base has been 10.8 percent (versus 13.2 percent growth in the previous quarter, whereas monetary base reported 9.3 percent decline in the first half of the year). The seasonal growth of monetary base driven by increased demand

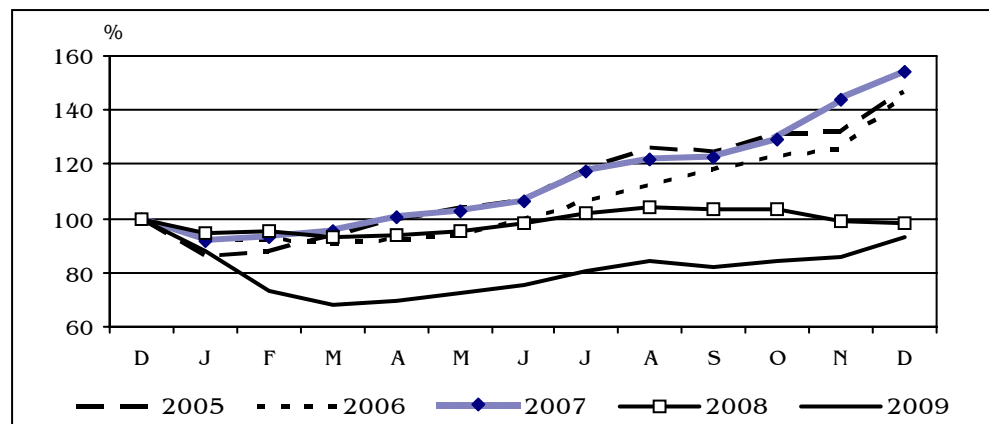
for dram, typical to the end-year time, came mainly from some 13.8 percent growth of currency outside the Central Bank.

In the fourth quarter growth of monetary base was driven by high growth rates of currency outside CBA



Currency outside the Central Bank recurred its performance seen over 2008 with only a difference that it decreased at a faster rate during the first quarter but increased at a faster rate in the yearend of 2009.

Relative to recent years, the first quarter of 2009 was prominent with considerable slowing of growth rates of currency outside CBA



3.4. AGGREGATE DEMAND AND AGGREGATE SUPPLY

3.4.1. Aggregate demand

Domestic demand

Private consumption and investments⁴²: In the fourth quarter the domestic demand showed some improvement in decline rates largely driven by notable increase of public expenditures as part of realization of anti-crisis policy by the Government. Private spending also made contribution to the improvement of the domestic demand.

In the fourth quarter the domestic demand has decreased nearly by 6 percent in real terms, showing some 11.6 pp improvement compared to the previous quarter's same indicator. Real growth of public expenditures was 7.7 percent in relation to the same quarter of the previous year, reflecting effects of expansionary fiscal policy of the Government.

In the fourth quarter private spending has decreased nearly by 8 percent in real terms, representing some 11.8 pp improvement in compared to the previous quarter's same indicator. In the structure of private spending, investments have reduced nearly by 23 percent, reflecting

⁴² The real growth indicators of private consumption and investments for the fourth quarter are the Central Bank estimations. The actual figures of these indicators are as of the third quarter of 2009. Estimations of real growth presented in this section are relative to the same quarter of the previous year, unless otherwise stated.

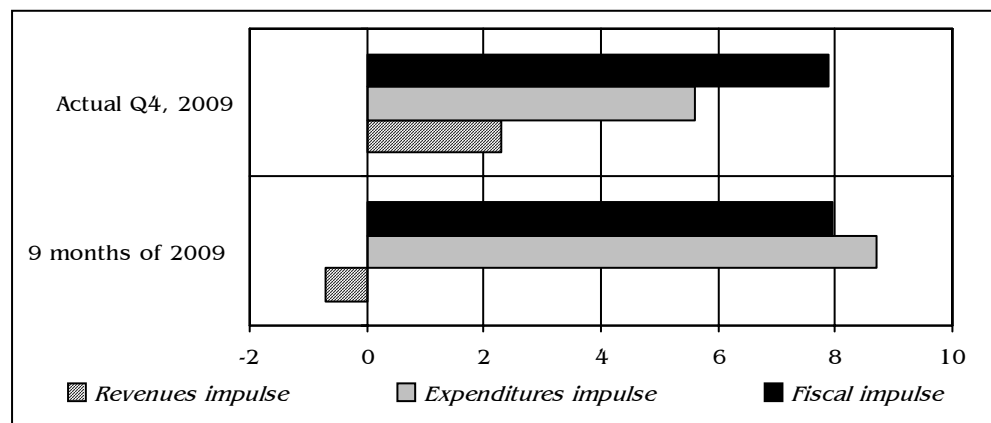
more than 38 percent slowdown in construction financed by households and organizations. The reduction in private consumption has been 0.4 percent attributable to private disposable income which had declined in relation to the previous year's respective indicator. Notwithstanding continued decline, the reduction of private investments and private consumption in the fourth quarter was somewhat improved against the previous quarter's same indicators by 24 and 1.5 pp, respectively, reflecting the gradual recovery process.

In the fourth quarter the real private sector expenditures had restrictive impact on inflation. Based on the Central Bank estimations, the estimated level of real private expenditures has been below its equilibrium by 3-4 percent, creating 1-1.2 percent deflationary pressures in the consumer market. It should be noted, however, that in the structure of private expenditures consumption of durable goods was reduced considerably, which has not caused significant changes of CPI.

Public consumption and investments⁴³: In the fourth quarter the fiscal policy's impact on the aggregate demand remained to be expansionary due to increased public expenditures and economy net lending owing to realization of anti-crisis programs by the Government. The fiscal sector had 7.8 pp expansionary impact on the aggregate demand because of generated expansionary revenue and expenditure impulses.

Decline in economic activity in Armenia further affected budget performance, especially on the part of collection of tax revenue. The indicator of state budget revenue was thus considerably lower from the projected revenue levels outlined in quarterly proportions set by the Government. However, slowing decline of economy was by now a good sign for the weakening of decline rate in tax revenue. Overall, based on the quarterly results, the state budget revenue had some 2.3 percent expansionary impact on the aggregate demand, which was determined by faster declining rates of GDP in relation to revenues.

In the fourth quarter fiscal impulse had expansionary impact



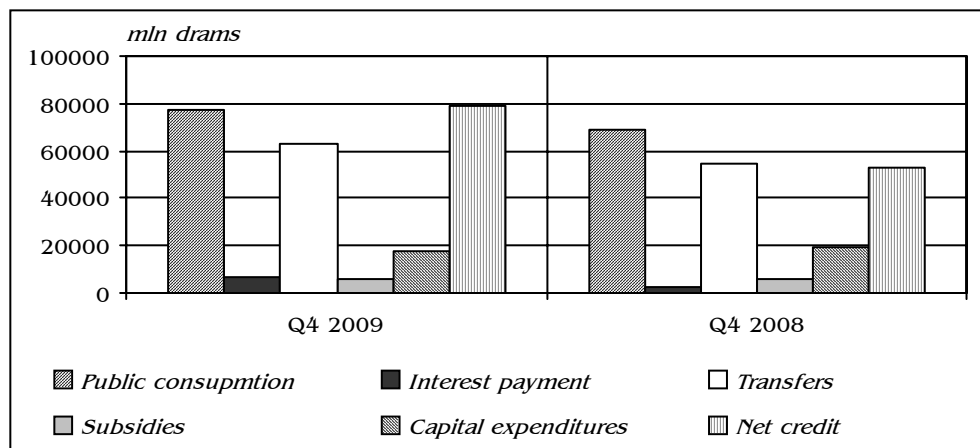
On the part of expenditures, the fourth quarter's impulse reached 5.5 pp⁴⁴ expansionary, which was determined by the increase of expenditures and economy lending in relation to the same period of the previous year and somewhat lower GDP level. In the fourth quarter public

⁴³ Preliminary actual data on consolidated budget were used in the analysis of the fiscal sector for the fourth quarter of 2009. Also, net lending was included in public expenditures to assess the impact on the aggregate demand. The calculation of impulses was also based on the fourth quarter preliminary consolidated budget indicators and done in comparison with the same period of the previous year, using an approach of comparable statistics.

⁴⁴ The GDP used in the calculation of the revenues impulse represents actual nominal GDP and the GDP used in the calculation of the expenditures impulse represents estimated level of potential GDP.

expenditures, including net lending to economy, have grown by about 35 percent in relation to the same period of the previous year. Current expenditures have increased by 11.7 percent; expenditures in Item 'Transactions with non-financial assets', by 50 percent. In current expenditures, public consumption has grown by nearly 12 percent y-o-y and allowances and pensions, by 14.8 percent y-o-y.

In the fourth quarter expenditures in the consolidated budget reported slight declines on transfers only



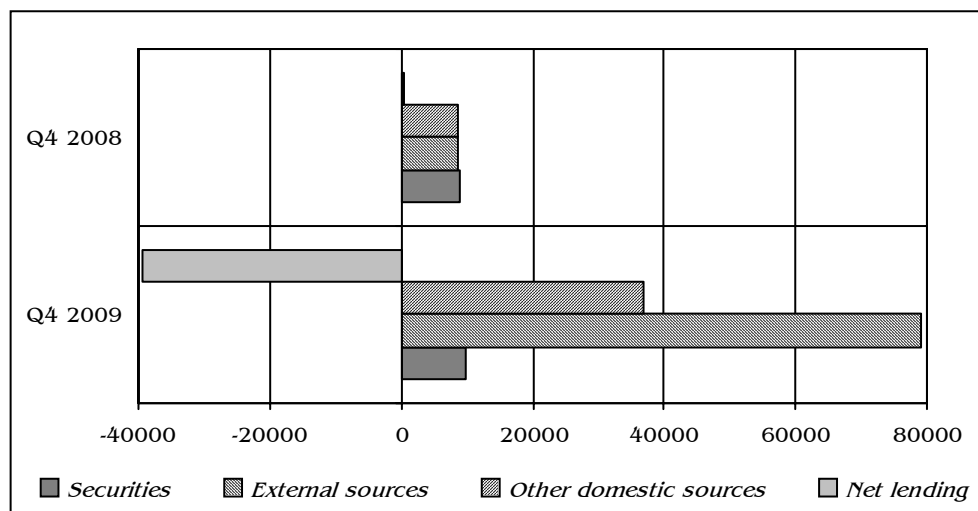
Expenditures in item 'Transactions with non-financial assets (capital expenditures)' have notably increased in the course of the first three quarters and the fourth quarter of the year due to external financing received through PIUs. The share of expenditures disbursed from domestic financing made up 68 percent, and external financing, 32 percent (77 percent and 23 percent in the same quarter of the previous year).

In the fourth quarter the deficit was one third of the year's respective indicator, and 92 percent of which was financed from external sources and 8 percent, from domestic sources.

To sum up, total revenue has reduced by 14.4 percent; tax revenue has shrunk by 16.1 percent and the tax to GDP ratio, by 16.5 percent, down by 0.6 pp in relation to the previous year. Based on annual results, expenditures, including net lending to economy, have grown by 21 percent and the expenditures to GDP ratio, by 31 percent, up by 8.3 pp in relation to the previous year.

The Government has implemented expansionary fiscal policy to mitigate economic decline by stimulating the domestic demand, so the policy was estimated to have been about 8 percent expansionary.

Main macroeconomic indicators in Q4, 2008 and Q4, 2009 (in real terms)



In the fourth quarter external financing prevailed in the sources of deficit financing

Item	Q4, 2008 – Q4, 2007	Q4, 2009 – Q4, 2008
Real GDP	11.1	-20.8
Domestic demand	11.3	-16.6
Consumption	7.8	-5.2
Public	5.7	-10.7
Private	8.2	-4.1
Capital investment	17.4	-35.2
Public	-11.4	14.5
Private	19.7	-38.2
Export ⁴⁵	-6.9	-5.0
Import	12.9	-18.0

3.4.2. Aggregate supply⁴⁶

The economic decline, triggered by global economic crisis, trended down during next quarters after its peak of 21.8 percent y-o-y recorded in the second quarter of 2009, posting some improvement on the macroeconomic situation thanks to stimulating fiscal and monetary policies. As it was expected, economic decline in the fourth quarter was by far lesser, 5.3 percent y-o-y, under which circumstance the decline indicator in the period January-December had reduced to 14.4 percent y-o-y. During the quarter, all branches of the economy reported growth, with an exception of construction where the decline rates have slowed down though.

Industry reported about 1.4 percent y-o-y growth in value added in the fourth quarter (some 7.6 percent y-o-y decline in the period January-December), mainly due to the growth recorded in metallurgy and metal ore mining sub-branches.

Particularly in metallurgy and metal ore mining sub-branches, the real growth in the period January-December has been 20.9 percent and 10 percent, respectively, which is mainly reported in the fourth quarter, driven by persisting global metal prices increase. During the quarter growth was posted in production volumes in aluminum foil (about 2-fold), aluminum roll (1.8-fold), copper and zinc concentrate (by 39.4 percent and 66.6 percent, respectively), and ferro-molybdenum (by 13.6 percent). In the period January-December growth has been posted also with regard to rubber and plastic items and tobacco products, by 16.7 percent and 17.6 percent, respectively.

At the same time, production volume in food industry declined by 6.2 percent in the period January-December of 2009. During the quarter the flour and macaroni production volumes have reduced by 5.9 percent and 7.8 percent, respectively, due to low wheat crops⁴⁷. Decreases were recorded in production volumes of brandy (33.6 percent), animal fat (42.9 percent), canned food (57.1 percent), non-alcoholic beverage (8.1 percent) and salt production (14.4 percent).

⁴⁵ Relates to export and import of goods and services.

⁴⁶ Growth indicators are relative to the fourth quarter of the previous year, unless otherwise specified.

⁴⁷ In 2009 nearly 340 thousand tons of wheat was produced from around 170 thousand ha sowing area versus 400 thousand ha sowing area in the previous year. Rainy weather was mainly conducive for the wheat cultivation but there have been hail and overly moisture days, too. The usage of low-fertile seeds as well as one-sided fertilization was the main reason for low productivity.

Volumes have shrunk in the production of construction materials (by 24.3 percent in the period January-December) mainly due to reduced volumes in cement, branded concrete, aluminum and metallo-plastic items because of declined construction volumes as well as in chemical production (34.1 percent in the period January-December) due to reduced production of caustic soda and suspended production volumes of synthetic corundum.

In light of these developments, the demand in electricity and natural gas in the fourth quarter has shrunk, by 11.6 percent y-o-y thanks to increased output by hydro-power plants, Armenian nuclear power plant, and windmills.

Construction, reflecting reduced capital inflow and household income, reported somewhat a slower decline, around 19.2 percent, in value added as opposed to the previous quarters, with the decline indicator for January-December having reached 42.3 percent. In the period January-December of 2009, the decline in construction volumes has been attributable mostly reduced volumes of construction financed by households by, 70.5 percent y-o-y, whereas construction volumes financed by private organizations increased by 4.3 percent y-o-y.

As a result, there has been a notable change in the construction financing sources: reduced household construction was concurrent with increased construction supported by private organizations, international loans, state budget and community funds.

Concerning branch structure of construction, in the period January-December the deepest decline has been posted with regard to construction in trade (54.2 percent), residential housing (65.4 percent), social and private services (32.2 percent) and education (25.9 percent), whereas increase has been recorded in construction in energy (2.8-fold), financial activity (3.8-fold), public healthcare (52-fold), transport and communications (22 percent) and processing industry (10.3 percent).

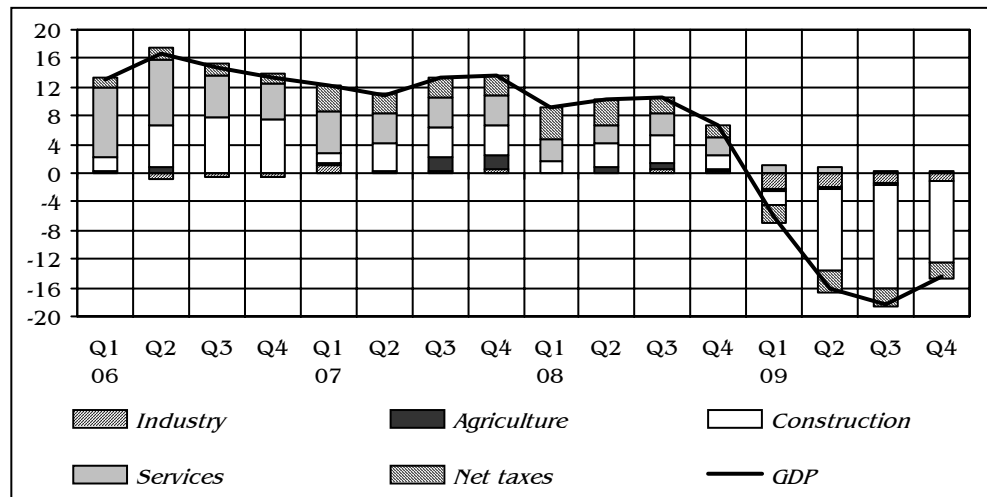
Agriculture reported about 2.1 percent y-o-y growth in value added in the fourth quarter, whereas the decline in value added in the period January-December has been 0.1 percent y-o-y. Some 1 percent growth in animal breeding in January-December has been attributable to increased volumes of animal produce (exception of milk). Particularly, animal and poultry volumes for slaughter as well as egg production have increased by 0.2 percent and 9.4 percent, respectively.

In the plant vegetation growing sub-sector the decline in gross product has been attributable to reduced volumes in grains (9.7 percent), potato (8.5 percent), edible greens (0.7 percent) and fodder crops (0.8 percent). Increased output was recorded for fruit and berries (4.5 percent), gourd (18.6 percent) and grape (12.3 percent). As a result, the decline in the plant vegetation growing sub-sector in the period January-December has been 0.7 percent.

Services reported some 0.7 percent growth for the quarter and the January-December period. The growth rate slowed down in wholesale trade (with consumer goods and agricultural product trade having declined most) and car sales, which reported, respectively, y-o-y 7.9 percent and 38.2 percent decrease.

In the meantime the volume of rendered services has increased in the period January-December by 1.3 percent y-o-y. High growth has been posted with social services (26.6 percent), hotel and restaurant (9.2 percent), healthcare (7.4 percent), education (5.7 percent), communications (2.8 percent) and financial services (0.5 percent).

Real GDP growth rate and economy sectors' contributions



3.5 LABOR MARKET⁴⁸

In the fourth quarter of 2009, some growth in nominal wages was observed in the economy fostered by increase of wages in budget-supported organizations and private sector companies. The unemployment rate also responded to the economic slowdown with a certain time-lag. As a result, the labor productivity decreased abruptly and, with nominal wages rising, led to the increase of unit labor costs. These developments demonstrated that the labor market has created certain inflationary pressures.

According to the Central Bank estimations, the average growth of nominal wages in the economy in the fourth quarter has been around 9 percent. Wages have notably increased in healthcare, education and trade but decreased in construction. It is important to note that the wage growth rates have somewhat slowed down in the fourth quarter compared to the previous quarters of the year.

During the fourth quarter of 2009 the deterioration of the labor market indicators continued, which has been observed since the beginning of the year. In the fourth quarter the average quarterly unemployment rate has increased by 0.7 percentage point reaching to 7 percent. Moreover during 2009 the number of officially unemployed has risen by 8.7 percent and the number of employed reduced by 1.4 percent.

During the quarter labor productivity has dropped by some 5 percent due to the slowdown of economic activity.

As a result of these developments, the unit labor costs have increased, creating around 0.9 percent inflationary pressures in the consumer market.

3.6. IMPORT PRICES AND PRODUCER PRICES

3.6.1. Import prices

In global commodities market in the fourth quarter, prices remained trending upward, mainly surpassing their previous year's level. It is worth mentioning that the rising inflation trends remained both at the intermediate goods and basic food markets. The price increase was mainly driven by trends for the world economic recovery. Most industrialized countries posted q-o-q output during the third quarter, which exceeded

⁴⁸ The fourth quarter labor market data are the Central Bank estimates based on actual figures for October and November and estimations for December. The growth estimates in this section are relative to the same quarter of the previous year, unless otherwise specified.

expectations. Further, the weakening of the US dollar in the fourth quarter has also contributed to the price increase of raw materials in dollar terms.

According to the Central Bank estimations, in the fourth quarter the dollar prices of imports have increased for the first time in the year, by 5.4 percent y-o-y (versus the previous quarter's decrease of about 8.3 percent).

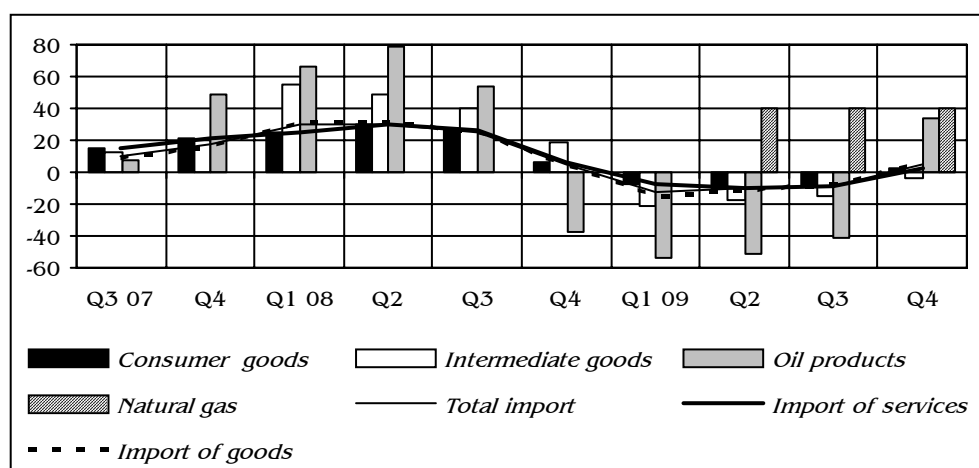
Item	Q4, 08	Q1, 09	Q2, 09	Q3, 09	Q4, 09
Import (total)	5.6	-12.7	-10.6	-8.3	5.4
Import (services)	6.5	-7.4	-10.0	-9.1	3.1
Import (goods)	5.3	-14.4	-10.8	-8.0	6.1
Capital Goods ⁴⁹	0.0	0.0	0.0	0.0	0.0
Consumption Goods	6.5	-7.4	-10.0	-9.1	3.1
Intermediate Goods	18.2	-21.1	-17.7	-15.1	-3.7
Diamond ⁴⁹	0.0	0.0	0.0	0.0	0.0
Oil Products	-37.2	-53.5	-51.7	-40.9	34.2
Natural Gas	0.0	0.0	40.0	40.0	40.0

The y-o-y growth in dollar prices has been attributable to striking rise in prices of oil products and respectively moderate growth in prices of consumer goods, while the prices of intermediate goods keep on falling.

Prices of intermediate goods have decreased by 3.7 percent y-o-y as opposed to some 15.1 percent y-o-y decrease in the previous quarter, which was attributable to falling prices of wheat and metals. The impact of prices of intermediate goods on total prices has been -1.0 percent.

The dollar prices of oil products have risen in the fourth quarter owing to optimistic expectations for the world economic recovery, which has been an improvement in relation to the indicator recorded for the same quarter of the previous year. Oil prices have risen by 34.2 percent y-o-y (against 40.9 percent drop in the previous quarter), making some 2.2 pp contribution to total import prices.

In the fourth quarter prices of imported goods rose



In the fourth quarter prices of consumption goods have increased by 3.1 percent y-o-y, making some 0.6 pp contribution to total import prices. On the whole, slight depreciation of the exchange rate in partner countries (1.8 pp) has not offset the inflation impact (4.1 pp). As Euro appreciated and inflation was recorded in European countries, the impact of Euro-zone on total import prices has been 0.6 pp.

⁴⁹ The lack of estimates on prices of capital goods and diamond is due to their sharp volatility. Therefore a change in prices is estimated to be zero.

Given some 5.4 percent rise in international prices and 25.5 percent y-o-y depreciation of average nominal AMD/USD exchange rate, the dram prices of imported goods included in the consumer basket have increased by 3.4 percent y-o-y.

3.6.2. Producer prices⁵⁰

The GDP deflator in the period January-December of 2009 has been 101.5 percent y-o-y, lagging behind the respective indicator of the previous year by 6.9 pp. Producer price increase during the quarter was due to the rise in prices in industry and cargo transport.

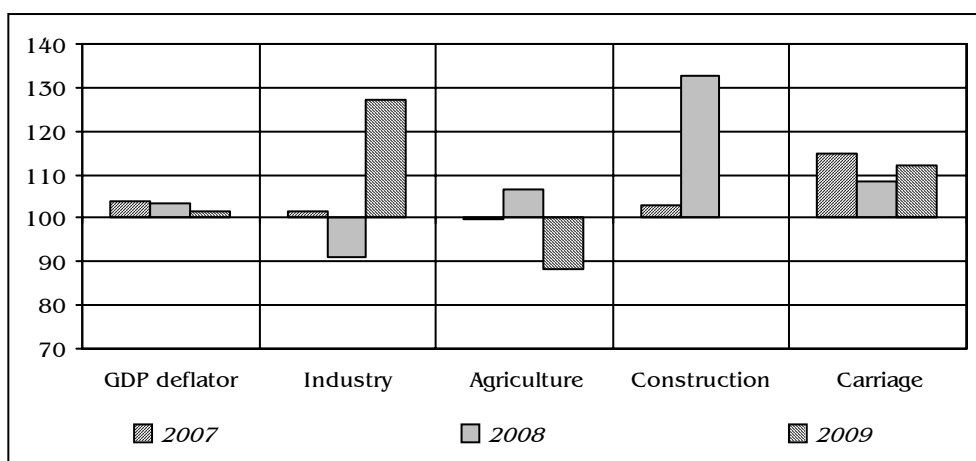
In **Agriculture**, in the fourth quarter prices have dropped by 11.9 percent y-o-y mainly attributable to rich crops of fruit and vegetables and a resultant drop in their prices. Prices of meat products (beef and mutton in particular) have grown nonetheless.

In **Construction**, prices persisted on their high in the fourth quarter as had been the case for the fourth quarter of the previous year, which was driven also by slowed declining in construction.

Industry posted some 27.3 percent y-o-y rise in producer prices in the fourth quarter, determined by y-o-y 33.7 percent rise in electric energy, gas and water supply tariffs and y-o-y 2.7 percent growth in the processing industry in the period January-December. At the same time, prices of mining industry have dropped by 16.8 percent y-o-y due to the lower international average prices for non-ferrous metals this year compared with the previous year.

Carriage costs have increased by 11.9 percent y-o-y as a result of y-o-y 8.8 percent rise in railway carriage costs (as new tariffs of railway service were set starting January), y-o-y 17.7 percent rise in air transportation and 14.6 percent rise in pipeline transportation fares (as gas tariffs were risen effective April 1, 2009, from USD 110 to USD 154).

In the fourth quarter prices rose in carriage and industry sub-branches but fell in agriculture sub-branches



3.7 INFLATION EXPECTATIONS

The Central Bank summarized the surveys on inflation expectations of financial organizations, households, and non-financial organizations of real sector for the fourth quarter of 2009.

According to the surveys, covering banks and credit organizations, expectation of high inflation has not changed notably for the next 12-month

⁵⁰ The price indices of branches of the economy represent output price indices.

period. Most banks pointed to the range of 2.5-5.5 percent and credit organizations to the range of 5.5-8.5 percent, for the 12-month inflation. So, the financial sector's expectations for inflation are mainly anchored, since these are close to the target bound set by the Central Bank yet maintain risks of high inflation.

Expectations of households and non-financial organizations of real sector concerning future prices of food products are set to upside growth as for the fourth quarter 59.4 percent of respondents expect price increases relative to the third quarter's 35.0 percent, while 36.9 percent expect a stable level compared to 59.7 percent in the third quarter.

Based on the results of survey, both commercial banks and credit organizations expect unchanged market interest rates for the upcoming one-year horizon with a little inclination for downside expectation though. Expectations of interest rates of dram funds attracted and allocated are mainly stable while some banks and credit organizations even expect lower interest rates of foreign currency funds.