

THE CENTRAL BANK OF THE REPUBLIC OF ARMENIA

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on 24.02.2012*

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

(Inflation Report)

Q4, 2011



YEREVAN
2012

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1. SUMMARY

ACTUAL INDICATORS AND DEVELOPMENTS IN Q4, 2011

In the fourth quarter of 2011 the inflation environment further eased, and the 12-month inflation rested within the confidence band at the end of the year as a result. This was driven by both domestic and external macroeconomic developments. Prices of food products and raw materials in world markets continued falling amid the world economic growth slowdown and escalation of debt problems in the Euro-area. In the meantime, attributable to tightened monetary conditions earlier the year, contractionary fiscal policy implementation, slowly recovering domestic demand, and increased supply of agricultural products, no inflationary pressures were observed in the domestic environment.

Conditioned by the aforementioned factors, in the fourth quarter the 12-month inflation was 4.7 percent, reducing by 1.5 pp relative to the previous quarter's indicator. Price increase in food products made 3.1 pp of contribution to the 12-month inflation, of which 2.3 pp alone fuelled by price increases in such items as "sugar" "coffee, tea, cocoa", and "meat". Price increases in non-food products and service tariffs made, respectively, 0.7 pp and 0.9 pp of contribution to the 12-month inflation.

The Central Bank estimations based on y-o-y economic growth (EAI) indicator for the period January-December 2011 did not deviate from the forecast scenario, and are in the range of 4.1 – 4.5 percent¹. The drop of this indicator is totally offset by higher-than-expected growth in industry and agriculture as a result 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 17.0 percent, 14.5 percent and 3.1 percent in industry, agriculture and services, respectively. In construction, the value added is estimated to reduce by around 13 percent.

In the fourth quarter the average quarterly unemployment rate reduced, reflecting the growing demand for labor. Despite the slowing of the productivity growth rate in the fourth quarter, the growth of average nominal wages did not decelerate much in comparison with previous quarters, reflecting existing rigidities in the labor market. As a result, unit labor costs have somewhat increased, creating minor inflationary pressures in the economy.

In the fourth quarter private sector expenditures grew by around 3.5 percent y-o-y relative to the previous year. Public expenditures in real terms grew by 1.2 percent y-o-y, while domestic demand increased by 3.7 percent y-o-y relative to the same period of the previous year. The growth rate of private spending slowed in the fourth quarter driven by external and internal factors.

In the fourth quarter the gap between private spending and their potential was still negative although it further narrowed as a result of slowing growth rate of private spending. In the light of the aforementioned developments, the private sector spending had some 0.1 – 0.2 pp of impact on inflation in the fourth quarter.

The fiscal policy in the fourth quarter was further driven to maintain macroeconomic stability and ensured congruence with collection of revenues and savings on certain items of public expenditures. As a result, the fiscal policy's impact on aggregate demand, hence, inflation was 0.9 pp contractionary instead of the forecast neutral. This was driven by

¹ See the 50 percent probability interval of the Real GDP Growth (Cumulative) Projection Probability Distribution Chart in the Monetary Policy Program, Q1, 2012.

contractionary impulse from revenues (in line with the forecasts) and neutral impulse from expenditures (instead of projected expansionary).

Again, in the course of 12 months the fiscal policy's impact on aggregate demand was 1.3 pp contractionary, mostly explained by a restrictive effect from savings on expenditures.

In light of the above-mentioned developments in domestic demand and labor market, some deflationary pressures were observed in the economy during the fourth quarter of 2011, which were in the range of 0.5 – 0.6 pp y-o-y, according to the Central Bank estimates.

During 2011 current account improved markedly and, according to estimations, will reach some 11.8 percent of GDP against 14.5 percent recorded in the previous year. In the fourth quarter however, the current account further improved y-o-y on the background of slowing world economic growth rates and more uncertainties. These developments coupled with somewhat a sluggish domestic economic activity led to the slowdown of growth rates in export and import, individual remittances in dollar terms. With reducing international metals prices, the growth of real export remained strong driven by persisted high growth in industry. In the fourth quarter the growth of real import remained high, too, which was partly a result of high reducing y-o-y rates of real volumes observed in the fourth quarter of the previous year. The growth rates of inflow of non-commercial remittances of individuals via the banking system slowed down, influenced by the developments in Russian economy. As a result of the aforementioned developments, in the fourth quarter the current account deficit reduced by USD 30.7 million y-o-y and amounted to USD 288.2 million.

Continued easing of the inflation environment and the path of inflation in the forecast horizon determined the attainment of the inflation target and monetary policy directions for the fourth quarter. As a result, the directions were maintained in line with the baseline scenario outlined in the Monetary Policy Program Q4 2011, and the Central Bank implemented a neutral monetary policy.

In the fourth quarter, though the monetary policy developments were again mainly consistent with the scenario, nearly all monetary indicators outstripped annual growth rate benchmarks to some extent. So, broad money grew by 10.4 percent, dram broad money, by 11.4 percent, and monetary base, by 17.6 percent. The level of dollarization tended to subdue further in the fourth quarter by 0.5 pp relative to the previous quarter and by 1.3 pp against the same period of the previous year. The last quarter of the year was prominent for the highest growth of lending to the economy (8.9 percent) in comparison with the previous quarters' respective indicator, with quarterly growth rates of foreign currency deposits reaching 11.0 percent versus those of dram deposits, amounting to 6.6 percent.

2. INFLATION DEVELOPMENTS

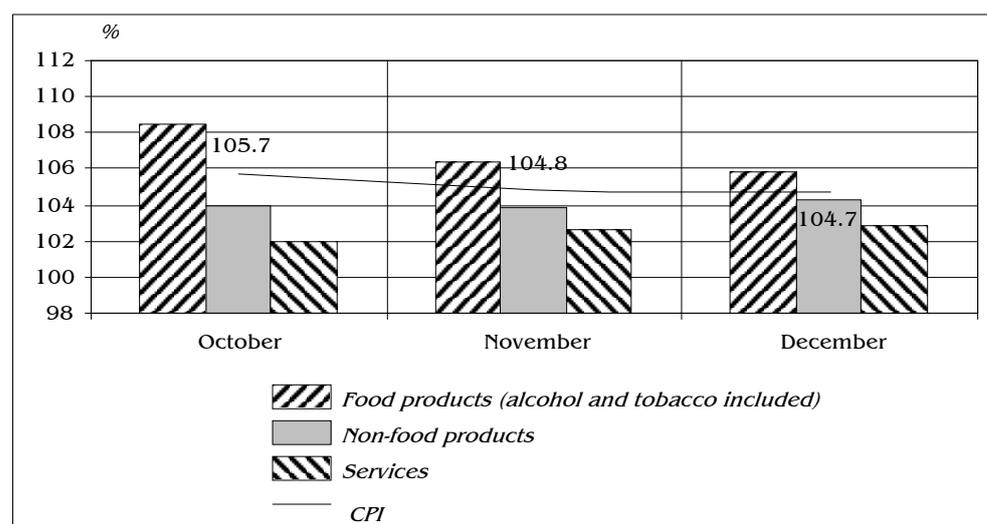
2.1. INFLATION BY GOODS AND SERVICES; CORE INFLATION

In December 2011, relative to December 2010, consumer price index has risen by 4.7 percent. Prices have grown as follows: food products (alcohol and tobacco included) by 5.8 percent; non-food products by 4.3 percent; and service tariffs by 2.9 percent, all having contributed to inflation by 3.08 pp, 0.67 pp and 0.90 pp, respectively.

Main contributions to the 4.7 percent inflation indicator

Commodity groups	Price change, %	Contribution to inflation, pp
Food products		
Meat products	12.7	1.29
Coffee, tea, cocoa	18.9	0.67
Fats and oils	11.8	0.38
Sugar	35.4	0.38
Dairy products	6.8	0.29
Bread products	2.5	0.25
Confectionery	12.2	0.25
Fruit	-12.3	-0.45
Vegetable	-1.0	-0.06
Non-food products		
Personal car and fuel	9.0	0.22
Garment and knitwear	7.6	0.21
Footwear	5.1	0.09
Services		
Medical services	12.6	0.46
Transport services	7.9	0.27
Legal and banking services	17.6	0.13
Public catering	6.9	0.13
Household services	6.0	0.08
Communications	-1.6	-0.08

CPI in Q4 2011 based on the 12-month results, by main commodities and services



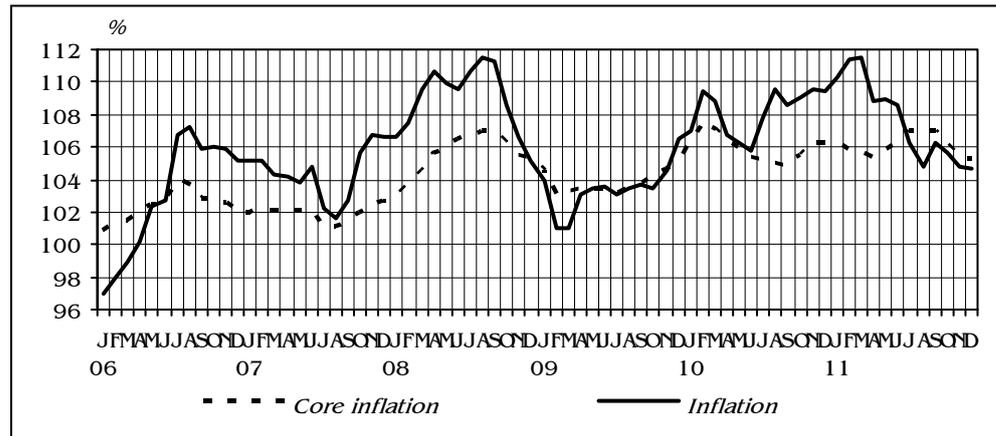
In the fourth quarter consumer price index rose by 4.1 percent compared to the end of the previous quarter; the heaviest impact on this indicator came from the increase of prices of food products (6.7 percent) with 3.6 pp of contribution. Prices of non-food products and service tariffs have increased by 1.7 percent and 0.5 percent, respectively.

In the period January-December of 2011, relative to January-December of 2010, inflation has been 7.7 percent (it was 8.2 percent and

3.4 percent in 2010 and 2009, respectively). This figure of 7.7 percent was due to 11.2 percent price increase of food products, 3.4 percent price increase of non-food products and 3.6 percent rise in service tariffs, all having contributed to headline inflation by 6.02 pp, 0.53 pp and 1.12 pp, respectively.

In December of 2011, relative to December of 2010, core inflation has been 5.29 percent. The largest contribution to it came from such items as “beef” (contribution 0.8 pp), “surgery services at hospitals” (0.4 pp), “butter” (0.3 pp), “pork” (0.3 pp), “petrol” (0.3 pp), “air transport fare” (0.3 pp), “candy” (0.2 pp), “homemade cheese from cow milk” (0.2 pp), “sugar” (0.2 pp), “chicken legs” (0.2pp), “ground coffee” (0.1 pp), and “chopped meat” (0. pp)².

Inflation and core inflation, 2006-2011 (on a 12-month basis)



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 January 2009 to December 2011³.

Calculations show that in the period from January 2009 to December 2011 the influence of seasonality component on CPI has been 70.5 percent; the influence of irregularity component, 29.4 percent; and the influence of trend component, 0.1 percent. In comparison with the period from January 2009 to December 2011, the influence of irregularity component has increased by 0.8 percent, whereas the influence of seasonality component and trend component has dropped slightly by 0.4 percent and 0.3 percent, respectively.

For the time period from January 2009 to December 2011, the influence of the three components has changed as follows:

- the influence of seasonality component on **price index of food products** was 77.9 percent, up by 3.2 percent compared to the period from January 2008 to December 2010; in the meantime the influence of irregularity component and trend component has decreased by 1.5 percent and 1.7 percent, respectively;

² 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.

³ The methodology of calculation is provided in the paper “Inflation in the Republic of Armenia, 2nd half of 1999”.

- the seasonal and irregularity components had almost identical impact (45.5 percent and 45.3 percent) on **price index of non-food products** in the period from January 2009 to December 2011; the impact of trend component reached 9.2 percent. Note that the impact of irregularity component has reduced by 18.0 percent and the impact of seasonality and trend components has risen, respectively, by 9.7 percent and 8.4 percent compared to the period from January 2008 to December 2010);
- the irregularity component had the largest impact on **service tariffs**, making up 47.0 percent, followed by that of seasonality component (44.7 percent) and trend component (8.2 percent). The irregularity component's impact has increased by 14.4 percent, while the impact of seasonality and trend components has reduced, respectively, by 11.5 percent and 2.9 percent in comparison with the period between January 2008 and December 2010.

For the period from January 2009 to December 2011, the **seasonality component** had the strongest impact on such items as "vegetable and potato" (82.7 percent), "education services" (75.5 percent), "fruit" (73.1 percent), "footwear" (64.5 percent), "residential and public utility services" (53.8 percent), "items of culture" (52.3 percent), and "sugar" (51.1 percent); the **irregularity component** had the strongest impact on such items as "jewelry items" (83.8 percent), "bread products" (82.6 percent), "alcohol and tobacco" (79.8 percent), "kitchen utensils" (75.1 percent), "textiles" (72.3 percent), "fish" (71.3 percent), "household services" (71.0 percent), and "other services for household" (71.0 percent) and the **trend component's** impact has been relatively strong on such items as "gardening items" (27.6 percent), "beauty and apparel" (26.6 percent), "fuel" (21.3 percent), "stationery" (19.5 percent), "furniture" (19.4 percent), "home appliances" (17.0 percent), and "medicament" (16.9 percent).

Share of components causing fluctuations in monthly price indexes (January 2009 – December 2011), %

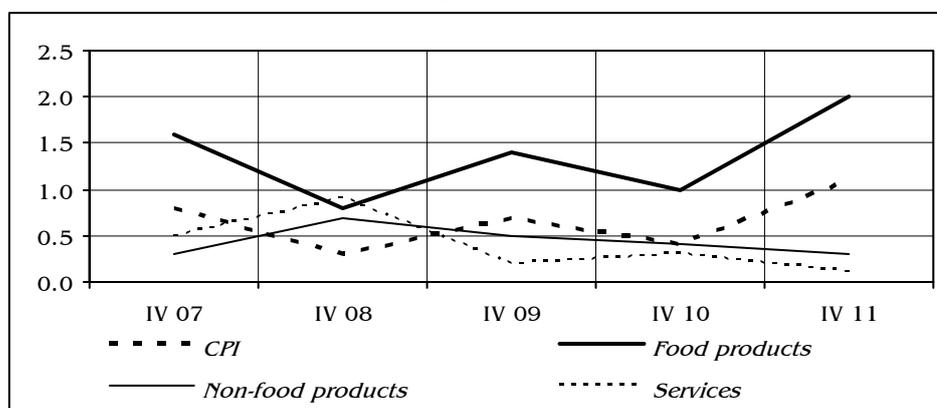
Item	Trend	Seasonality	Irregularity	Total
CPI (relative to previous month)	0.1	70.5	29.4	100.0
Food products (alcohol and tobacco included)	0.5	77.9	21.6	100.0
Bread products	1.4	16.0	82.6	100.0
Meat products	4.2	32.6	63.2	100.0
Fish products	0.7	28.0	71.3	100.0
Dairy products	3.9	36.1	60.0	100.0
Egg	2.8	46.0	51.2	100.0
Fats and oils	12.4	41.7	46.0	100.0
Fruit	1.4	73.1	25.5	100.0
Vegetable and potato	0.3	82.7	17.0	100.0
Sugar	0.0	51.1	48.9	100.0
Coffee, tea, cocoa	5.7	32.4	61.9	100.0
Confectionery	12.8	22.8	64.4	100.0
Other products	0.6	32.9	66.5	100.0
Non-alcoholic beverage	5.8	34.4	59.8	100.0
Alcohol and tobacco	0.0	20.2	79.8	100.0
Non-food products	9.2	45.5	45.3	100.0
Garment and knitwear	0.5	45.7	53.8	100.0
Footwear	0.5	64.5	35.2	100.0
Fuel	21.3	40.8	37.9	100.0
Furniture	19.4	41.7	38.9	100.0
Carpets	2.1	43.3	54.6	100.0

Textiles	0.2	27.5	72.3	100.0
Home appliances	17.0	22.0	61.0	100.0
Kitchen utensils	6.0	19.0	75.1	100.0
Detergents	15.4	26.3	58.3	100.0
Building materials	13.5	25.5	61.0	100.0
Items of gardening	27.6	43.5	28.9	100.0
Medicament	16.9	23.0	60.1	100.0
Personal cars and fuel	2.5	40.5	57.0	100.0
Items of culture	0.0	52.3	47.7	100.0
Stationery	19.5	38.4	42.1	100.0
Beauty and apparel	26.6	10.6	62.8	100.0
Items of jewelry	0.6	15.6	83.8	100.0
Personal cleanliness items	15.4	34.2	50.4	100.0
Services	8.2	44.7	47.0	100.0
Household services	1.4	27.6	71.0	100.0
Other services for household	1.6	27.7	70.8	100.0
Residential and public utility services	6.3	53.8	39.9	100.0
Healthcare services	0.0	45.8	54.2	100.0
Transport services	3.1	30.6	66.2	100.0
Communications services	4.2	26.2	69.6	100.0
Culture services	13.5	26.4	60.1	100.0
Educational services	0.8	75.5	23.7	100.0
Leisure and rest services	2.9	41.5	55.6	100.0
Public catering	1.8	33.2	65.0	100.0
Legal and banking services	6.3	28.8	64.9	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.

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



In the fourth quarter of 2011, relative to the fourth quarters of the last five years, the CPI variation coefficient reported the largest rise of 1.1 percent; relative to the fourth quarter of the previous year it rose by 0.7 pp. This is attributable to the CPI variation coefficient increased to 2 percent this quarter from 1 percent in the previous year. The increase of food product price index variation coefficient was a result of price index variation coefficients increased in such items as "coffee, tea, cocoa", "confectionery", "vegetable and potato". The variation coefficients dropped in such items as "dairy products", "eggs", "fish", "fruit". The non-food product price index and service tariff index variation coefficients dropped, too, in such items as "footwear", "jewelry items", "fuel" and "leisure and rest services".

Monthly price index variation coefficients in fourth quarters, 2007-2011, %

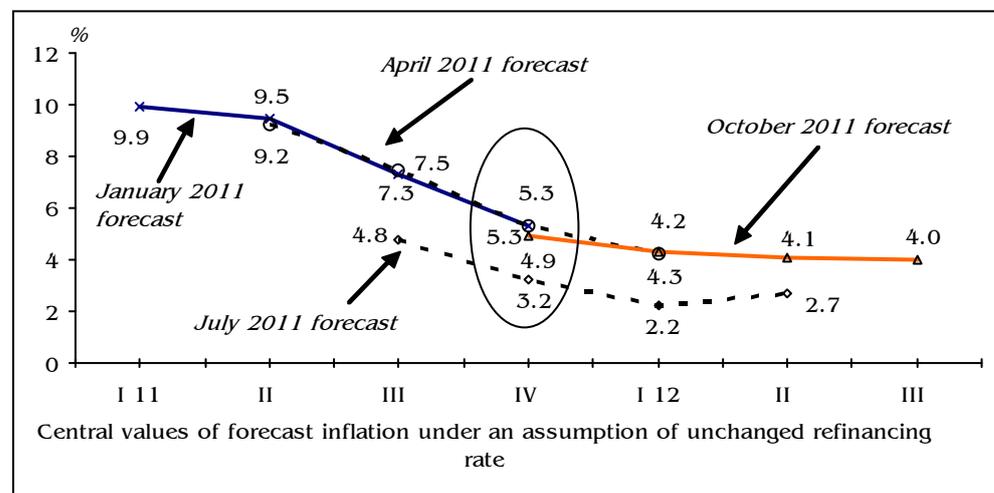
Item	Q4 2007	Q4 2008	Q4 2009	Q4 2010	Q4 2011
CPI (relative to previous month)	0.8	0.3	0.7	0.4	1.1
Food products (alcohol and tobacco included)	1.6	0.8	1.4	1.0	2.0
Bread products	4.4	2.4	0.0	1.4	0.3
Meat products	0.4	0.7	0.5	1.1	0.5
Fish products	7.1	5.1	5.5	3.8	1.0
Dairy products	0.6	0.9	0.1	5.4	0.9
Egg	1.6	0.3	1.2	5.7	0.8
Fats and oils	11.9	2.1	0.8	2.3	0.6
Fruit	6.5	3.8	10.3	6.1	3.5
Vegetable and potato	9.1	4.5	10.0	14.7	15.6
Sugar	5.5	0.7	2.2	1.4	0.8
Coffee, tea, cocoa	0.2	0.4	0.1	0.2	1.6
Confectionery	1.4	0.2	0.5	0.1	1.6
Other products	0.9	0.3	0.3	0.1	1.3
Non-alcoholic beverage	0.9	0.2	0.1	0.2	0.7
Alcohol and tobacco	0.0	0.1	0.1	0.0	0.1
Non-food products	0.3	0.7	0.5	0.4	0.3
Garment and knitwear	1.2	0.4	0.8	0.5	1.5
Footwear	0.8	1.0	0.4	2.8	1.8
Fuel	4.1	0.2	0.8	0.9	0.5
Furniture	0.4	0.2	0.1	0.2	0.4
Carpets	0.1	0.1	1.9	0.2	0.0
Textiles	0.7	0.2	0.1	0.5	0.4
Home appliances	0.2	0.2	0.4	0.2	0.7
Kitchen utensils	0.3	0.6	0.1	0.0	0.1
Detergents	0.1	0.2	0.5	0.1	0.8
Building materials	0.8	0.3	0.9	0.3	0.2
Items of gardening	0.5	0.0	0.8	0.1	0.1
Medicament	0.9	0.0	0.9	0.2	0.4
Personal cars and fuel	1.1	3.7	2.2	0.9	0.9
Items of culture	3.0	0.1	1.0	2.3	5.1
Stationery	0.4	0.4	1.8	0.0	0.1
Beauty and apparel	0.2	0.2	0.3	0.2	0.2
Items of jewelry	2.1	3.2	0.4	3.4	1.1
Personal cleanliness items	0.1	0.3	0.2	0.0	0.2
Services	0.5	0.9	0.2	0.3	0.1
Household services	0.7	0.6	0.5	0.0	0.8
Other services for household	0.8	0.7	0.4	0.0	1.0
Residential and public utility services	0.0	0.0	0.0	0.0	0.1
Healthcare services	0.2	2.8	0.5	0.4	0.7
Transport services	3.1	2.1	1.0	1.6	1.8
Communications services	0.0	0.0	0.1	0.0	0.0
Culture services	7.7	0.8	0.9	0.2	0.2
Educational services	0.1	0.5	0.1	0.0	0.0
Leisure and rest services	0.1	0.1	0.1	1.9	1.2
Public catering	0.1	0.2	0.0	0.0	0.2
Legal and banking services	1.5	0.0	0.0	0.0	9.5

2.2. FULFILLMENT OF INFLATION TARGET

Though the year 2011 started with high inflation environment, when the 12-month inflation was at its 3-year highest (11.5 percent) at the end of March, it however tended to ease in the course of the following months. As a result, the year ended with an annual 4.7 percent inflation figure, which is within the confidence band. Note that the diminishing path of the 12-month inflation during the year was 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 4.4 percent deflation recorded between April-September 2011 against 0.4 percent inflation recorded in the same period of the previous year). In consideration of external and domestic macroeconomic developments in the upcoming one-year time horizon and the expected impact of the monetary policy, the 12-month inflation in 2012 will behave relatively stable, resting within the confidence band throughout the year.

The inflation environment and monetary policy directions during the previous 12-month horizon prior to the fourth quarter of 2011 were characterized by the following trends. Despite persisting high inflation environment at the start of the year (in March, the WB food index hit a peak of around 35.0 percent) and given the diminishing influence of supply shock during the year which waned out in the second half of the year as well as the lagged impact of tightening of monetary conditions since the beginning of the year, as was envisaged under the monetary policy program 2011, the Central Bank's monetary policy programs outlined fast downscaling trajectory of the 12-month inflation and its resting within the confidence band in the one-year horizon.

The 12-month inflation indicator forecast



Persistently high inflation environment of the first quarter of 2011 (5.2 percent inflation against 5-year average of 2.5 percent) eased to some extent in the next three quarters, determined by moderated expectations and second-round effects, relative stability of prices of main commodities in world markets, non-inflationary developments in the Armenian economy. The impact of the domestic labor market and private spending on prices has been, by and large, neutral, the fiscal policy has had contractionary effect and prices of agricultural products went down owing to increased supply reported in this sector.

In view of the moderation of the inflation environment, the second, third and fourth quarters saw, respectively, -1.6 percent, -2.8 percent and

4.1 percent of inflation relative to 1.6 percent, 0.24 percent and 4.5 percent of inflation recorded for the same quarters of the previous year. This pushed the 12-month inflation to subdue to 4.7 percent in end-December from 11.5 percent in end-March. Price increases on food products remained the main contribution to the 12-month inflation (3.1 pp), driven primarily by price increases in items such as "sugar", "meat products", and "coffee, tea, cocoa" (with a total contribution of 2.3 pp).

Aimed to mitigate second-round effects and expectations of high inflation and to bring inflation closer to the confidence band, the Central Bank began tightening monetary conditions since the start of 2011, with the refinancing rate having increased by a total of 1.25 pp in the period January-April and amounted to 8.5 percent.

Starting from May of 2011, in view of actual moderation of the inflation 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 Board of the Central Bank estimated that the likelihood of the inflation environment expanding again is much low, meaning that interest rates in financial market are 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. The Central Bank will continue implementing a neutral monetary policy in the fourth quarter, too, mostly believing that in the forecast horizon the 12-month inflation would be within the confidence band of $4\% \pm 1.5$ pp, which has been the case at the end of the year, as a matter of fact.

3. INFLATION FACTORS

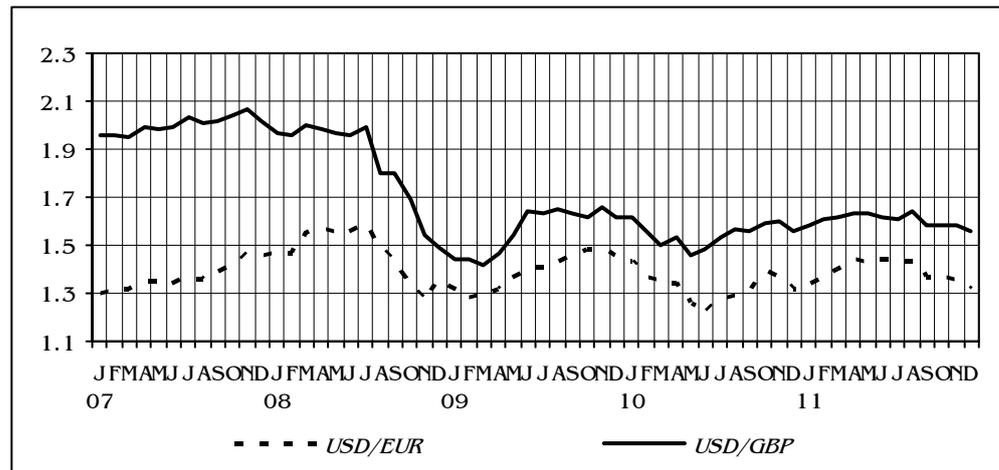
3.1. EXTERNAL ENVIRONMENT

In the fourth quarter of 2011 world economic growth rates slowed down and economic growth outlook further deteriorated amid persisting debt problems in the Euro-area and economic hardships in advanced countries. The IMF January report of economic growth outlook for 2011 revised the estimation of world output growth down to 3.8 percent against 5.2 percent recorded in the previous year. Though the economic growth slowdown was mainly conditioned by economic hardships in advanced countries (average growth rate in these countries in 2011 was 1.6 percent against 3.2 percent recorded in 2010), emerging countries also saw their economic growth rates slowing, down to 6.2 percent from 7.3 percent recorded in 2010. As regards inflation, both advanced and emerging countries faced with considerable domestic inflationary pressures amid noticeable price increases on main commodities early in 2011. As a result, according to preliminary IMF estimations, average inflation mounted to 2.7 percent (1.6 percent in 2010) in advanced countries and 7.2 percent (6.1 percent in 2010) in emerging countries.

The fourth quarter was remarkable in that price in world commodities markets fell in the face of slowing of world economic activity and escalation of debt problems in the Euro-area. Notwithstanding this, average annual prices were maintained at the level much higher from levels recorded in the previous year.

In the fourth quarter financial markets were very volatile amid intensified political debate over debt problems in the Euro-area, more uncertainties over fiscal consolidation in the U.S.A. and downgrades by credit agencies. At the end of the year, the U.S. dollar appreciated versus Euro by an average 4.5 percent q-o-q and reached 1.25 dollar for one Euro, driven by disseminated optimism about the U.S. economic developments as well as persisting tightness in European financial markets. Despite notable weakening at the end of the year, the Euro exchange rate tended to appreciate during the year, with an average appreciation making up 4.9 percent in 2011.

In Q4, 2011 Euro depreciated versus the U.S. dollar

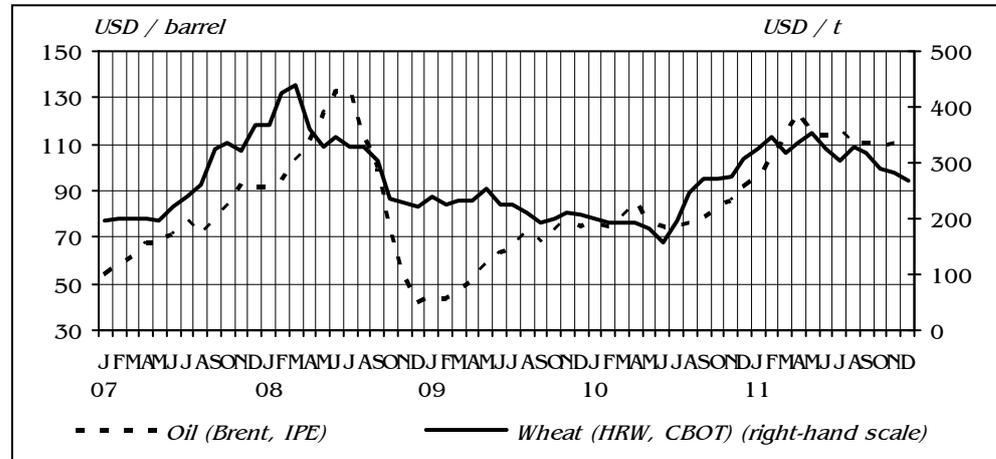


In the fourth quarter oil prices decreased by 3.3 percent q-o-q, with "Brent" averaging around USD 109 a barrel. In 2011 international oil prices reported an average 40 percent rise against the previous year.

Prices of base metals further trended down driven by the slowing of world economic activity. Prices of precious metals also fell stably during the quarter, attributable to expectations about unleashing of financial problems in banking sectors of European countries and increased demand for liquidity deriving therefrom. In the fourth quarter the copper price at the

London Metal Exchange fell by 16.4 percent q-o-q and averaged around USD 7530 per ton (average y-o-y growth making up 17.1 percent against the previous year). Average quarterly gold price went down by around 1.3 percent against the previous quarter and reached USD 1683 per troy oz. (average y-o-y growth of more than 28 percent against the previous year).

In world commodity markets in Q4, 2011 prices trended down



In the fourth quarter international prices of food products decreased considerably, with the FAO-released food price index having fallen by an average 6.4 percent against the previous quarter. In 2011, average annual growth of this index was about 22.8 percent against the previous year. Average quarterly wheat price at the Chicago Board of Trade reached USD 7.6 a bushel, decreased by 11.4 percent q-o-q (in 2011 the y-o-y growth was more than 41 percent). According to January estimates by the US Department of Agriculture, in the 2011/2012 marketing year some 692 million tons of crops of wheat are expected against the previous marketing year's 652 million (increase by 6.1 percent). Given a projected world demand of 681 million tons, the world wheat stock is forecast to be replenished by around 210 million tons, which will come closer to a 12-year peak.

In the fourth quarter the price of rice dropped by 9.2 percent q-o-q and reached USD 15.5 per short hundredweight (45.4 kg). International rice price reported an average 22.5 percent increase in 2011.

In the fourth quarter international sugar prices reported a sharp decrease, 13.7 percent q-o-q. In 2011, relative to the previous year, prices have increased by 21.4 percent, however.

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.

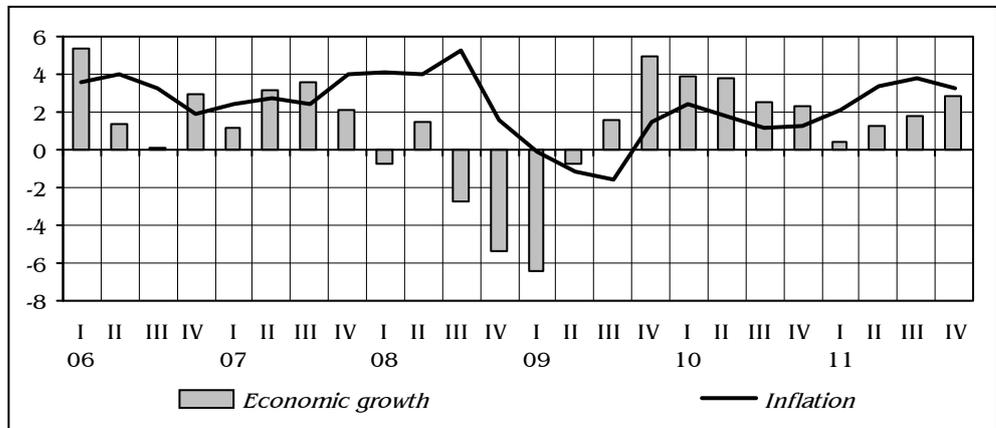
Though in the *United States of America* in the fourth quarter economic growth rates notably recovered, the economy is yet to enter the territory of sustainable growth while in the medium term the downside risks remain. Preliminary estimates by Economic Analyses Bureau of the U.S. Department of Commerce suggest that in the fourth quarter the U.S. economy posted an annualized 2.8 percent growth q-o-q compared to 1.8 percent growth recorded in the previous quarter. The growth was fuelled primarily by gross private investment (with 2.35 pp contribution) and consumer spending (with 1.45 pp contribution), whereas net exports (-0.11 pp) and public sector expenditures and investment (-0.93 pp) had negative contribution to the economic growth.

In the fourth quarter the deficit of net exports in GDP increased slightly, reaching 3.8 percent from 3.7 percent recorded in the previous quarter. This indicator is nonetheless higher from the 3.4 percent value recorded for the same period of the previous year. The deterioration of the deficit during the quarter was determined by higher growth rate of import in value terms while the growth rates of export exceeded those of import in real terms.

In the fourth quarter average quarterly inflation in the U.S. economy subdued to 3.3 percent y-o-y from 3.8 percent y-o-y recorded in the previous quarter. At the end of the year the U.S. inflation figure was roughly 3.0 percent. In the fourth quarter the inflation environment was driven mainly by price falls on fuel, vehicles and cars.

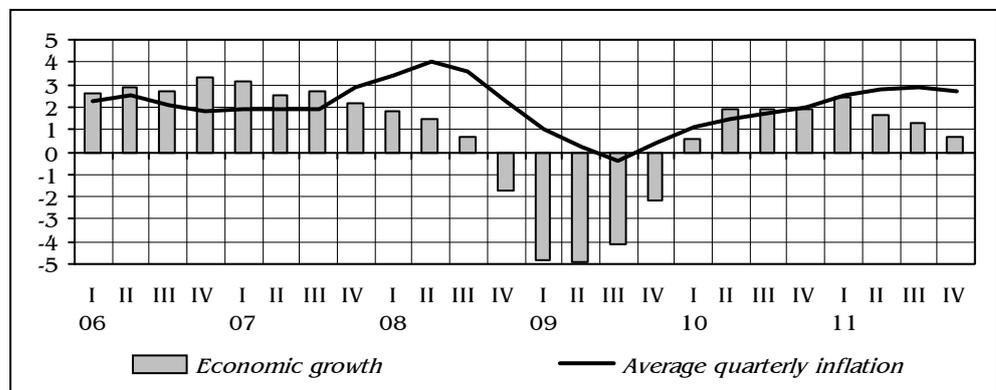
In the fourth quarter the U.S. Federal Reserve System maintained its policy target in the range of 0 - 0.25 percent in consideration of still slow pace of economic recovery as well as pessimistic expectations from global economy. In January the Fed announced its decision to keep interest rates low up until late 2014.

In the U.S.A. in Q4, 2011 economic activity grew and inflation subdued



According to preliminary estimates of the EuroStat, economic decline of 0.3 percent was posted in **Euro-area** in the fourth quarter of 2011. In the meantime, the y-o-y economic growth rates slowed down amounting to 0.7 percent (compared with 0.1 percent and 1.3 percent q-o-q and y-o-y, respectively, in the previous quarter).

In Euro-area in Q4, 2011 economic growth rates slowed down notably



In the fourth quarter the consumer price index rose by an average 2.7 percent y-o-y against 2.9 percent inflation recorded in the previous quarter. At the end of the year inflation in the Euro-area was 2.7 percent, which is above the European Central Bank's target and also outstrips the 2010 indicator by 0.5 pp. Inflation in the fourth quarter was driven mainly by

price increases on transport services and other services, whereas falling of prices on communications and garment made some downward impact on inflation.

Though the inflation indicator is still above the target level of 2 percent, the ECB eased the monetary conditions in November and December by lowering the refinancing rate a total of 0.5 pp and setting it at the 1.00 percent level. In the meantime, the ECB appeared with a decision to launch a "non-standard" policy measures in order to tackle liquidity issues in the banking system and further stimulate the economy.

Economic growth in *Russia* continued in the fourth quarter amidst growing uncertainties from the external environment and persisted tightness in financial market. Economic growth in the fourth quarter was 4.6 percent y-o-y, and 4.3 percent for 2011, according to estimations by the Ministry of Economic Developments. The GDP growth in 2011 was driven mainly by increased volumes in processing industry (6.5 percent) and construction (5.1 percent) as well as an unprecedented growth in agriculture (22.1 percent). Retail trade posted 7.2 percent growth. On the demand side, the economic growth was fuelled by increased consumption and investment as well as recovered stock, whereas net export's contribution to the economic growth has been negative.

In the fourth quarter the rate of inflation further decelerated despite faster depreciation of the ruble. Inflation reached 6.8 percent y-o-y against 8.1 percent y-o-y recorded in the previous quarter. Prices of agricultural products fell faster in the fourth quarter, pushing the 2011 inflation down to 6.1 percent from 8.8 percent recorded in the previous year.

In the fourth quarter, in view of falling oil prices as well as developments in domestic economy and global financial markets, the current account surplus has increased by USD 16.9 billion and reached USD 29.6 billion. With huge net outflow of capital, which amounted to USD 30.5 billion in the fourth quarter (USD 16.5 billion in the fourth quarter of the previous year), foreign currency reserves of the Central Bank of Russia have reduced by USD 8.6 billion (net outflow on item *error and omission* was USD 7.7 billion). Net outflow of capital by banks amounted to USD 7.4 billion and net outflow of capital by other private sector reached USD 22.5 billion. Based on the 2011 annual results, net outflow of capital has been USD 75.3 billion, with the current account surplus amounting to USD 101.1 billion. Further, the share of the current account surplus in the GDP has been roughly 5.0 percent. As of end-December 2011 foreign currency reserves of the Central Bank of Russia have totaled USD 498.6 billion.

In the fourth quarter uncertainties over the future path of the ruble exchange rate persisted in the face of instabilities in global financial markets and continued capital outflow. These developments added to the pressures on the ruble exchange rate thus boosting up the demand for foreign currency and weakening the ruble. Despite the Russian Central Bank's foreign currency interventions (a net sale of USD 7.5 billion in the fourth quarter), the ruble depreciation versus the U.S. dollar accelerated in the fourth quarter and reached 7.5 percent q-o-q against 3.8 percent q-o-q recorded in the previous quarter. During 2011 the average nominal ruble exchange rate versus the U.S. dollar was still below the previous year's average, under which circumstance the appreciation has been 3.2 percent.

In the fourth quarter the Russian Central Bank was less active in its refinancing operations, which was the case back in the third quarter when bank liquidity and confidence problems intensified.

In its late December meeting the Board of the Russian Central Bank decided to lower the refinancing rate by 0.25 pp to keep it at 8.0 percent.

The fixed terms lending facility rate was lowered accordingly, whereas the fixed terms deposit facility rate was raised by 0.25 pp. The narrowing of the spread between the interest rates, which is supposed to reduce interest rate volatility in the money market, is considered neutral in the monetary policy implementation point of view.

Macroeconomic Situation in Neighboring Countries ⁴

Turkey: in the third quarter of 2011 economic growth rates slowed to some extent and amounted to 8.2 percent y-o-y⁵ compared with 8.8 percent recorded in the previous quarter. Yet, the economic growth indicator exceeded expectations. Export continued increasing in spite of the slowdown of the global economic growth rates. Whereas the demand for import of goods and services further tended to decline. As a result, net export's contribution to the economic growth has been positive. In the domestic demand structure, growth rates of investment reduced sharply and reached 15.2 percent y-o-y, while private consumption remained strong, amounting to 7.0 percent y-o-y.

The following developments were seen in economy's sectors: in the third quarter growth rates in the processing industry slightly accelerated and reached 8.9 percent y-o-y, whereas the mining industry further posted a decline, making up 0.3 percent y-o-y. Growth rates in retail and wholesale trade and construction slowed down and amounted to 9.6 percent and 10.6 percent y-o-y, respectively.

The fourth quarter indicators suggest that, in the face of tightening of monetary conditions, the domestic demand will continue growing moderately, helping the economy become more balanced. According to the government estimations, the economic growth in 2011 will be 7.5 percent compared with 9.0 percent recorded in the previous year.

The current account was further revised during the fourth quarter⁶ as already in the period October-November 2011 the current account deficit reached the level of the same period of previous year, amounting to USD 9.3 billion. In the fourth quarter growth rates of export and import slowed down considerably to make up, respectively, 14.4 percent and 13.0 percent in October-November. In the period January-November the current account deficit has been 1.8-fold deeper in comparison with the level reported for the same period of the previous year. Based on annual estimations, the share of the current account deficit in GDP will be around 10.0 percent against 6.5 percent recorded in the previous year.

In October-November 2011 net inflow of capital has been USD 6.5 billion against USD 7.4 billion recorded in the same period of the previous year. Based on the fourth quarter (December excluded) results of balance of payment transactions, official reserves of the Central Bank of Turkey have decreased by USD 1.1 billion (net inflow on item error and omission was USD 1.6 billion).

In the fourth quarter, in view of expected developments of world economy and balance of payment transactions, the Turkish lira kept on depreciating highly in the fourth quarter. In this time, the Central Bank of Turkey was active in the foreign exchange market as provider of foreign currency while reducing the reserve requirement ratio. As a result, average nominal exchange rate of the Turkish lira versus the U.S. dollar depreciated in the fourth quarter by 6.0 percent q-o-q, and the y-o-y depreciation in the fourth quarter was 26.2 percent.

In the fourth quarter the inflation rate speeded up and amounted to 9.2 percent y-o-y against 6.4 percent y-o-y recorded in the previous quarter. This was driven by the increase of regulated prices at the beginning of the quarter, developments in prices of unprocessed food during the quarter as well as high

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 Q4, 2011 economic growth are not available.

⁶ Official balance of payment figures for December of 2011 are not available.

depreciation rates of the Turkish lira. Based on the 2011 annual results, inflation has been 10.5 percent compared with 6.4 percent recorded in the previous year.

Inflation developments in the last quarter prompted the Turkish Central Bank to revise the monetary policy directions as high depreciation of lira brought in new inflation risks. Besides, large adjustments to regulated prices resulted in high inflation recorded in October. To curb inflationary expectations, the Central Bank embarked, starting from October, on tightening the monetary conditions by raising the upper border of the spread of overnight borrowing and lending rates and revising the volumes of one-week repo transactions. So, the one-week repo rate was left at a 5.75 percent level and the overnight borrowing rate at a 5.0 percent level, whereas the overnight lending rate was raised up to 12.5 percent from 9.0 percent. In the meantime, the Monetary Policy Committee believed that implementing a tight monetary policy was further needed while ensuring that inflation developments would be congruent with the medium-term inflation target (of 5.0 percent for 2012).

Azerbaijan: on the whole, during 2011 the real GDP growth rates were slower but GDP growth rates faster in the non-oil sector. In the meantime, real GDP has grown by 0.1 percent, and 9.4 percent in the non-oil sector⁷. With about 8.7 percent decline of GDP in the oil sector, industry output has decreased by 5.0 percent⁸. During 2011 growth has been posted in the non-oil sectors, including information and telecommunications (11.8 percent), trade (10.6 percent) and agriculture (5.8 percent).

During 2011, relative to December of the previous year, inflation in Azerbaijan has been 5.4 percent and average inflation amounted to 7.9 percent. Average annual inflation was fuelled by price increases on food products (10.4 percent), non-food products (2.6 percent), and service tariffs (4.7 percent)⁹.

During 2011 trade balance of Azerbaijan run with surplus, reaching USD 16.8 billion, USD 3.9 billion of which came from export-import transactions carried out in the fourth quarter of 2011. Export has increased by 24.6 percent in relation to the previous year and totaled USD 26.6 billion; import has increased by 47.8 percent and reached USD 9.8 billion¹⁰. Based on the 2011 annual results, crude oil accounted for 86.62 percent of value of Azerbaijani exports (86.53 percent in 2010 and 81.57 in 2009)¹¹. According to the IMF estimations, the current account surplus in GDP in 2011 will reach 22.7 percent.

During 2011, relative to the previous year, gross inflow of foreign direct investment has increased by around 6.2 percent and amounted to USD 3.2 billion (manat 2.5 billion), with Great Britain as the largest investor (44.6 percent), U.S.A. (14.4 percent), Japan (9.1 percent), Norway (5.1 percent), and Turkey (4.1 percent)¹².

In 2011 too, the Central Bank of Azerbaijan implemented a policy to maintain stability of the manat exchange rate. As a result, during 2011 manat appreciated versus the U.S. dollar by 1.5 percent, and the average exchange rate appreciation has been 1.6 percent y-o-y¹³.

In 2011 the volumes of loans provided to the economy by banks have grown by 8.6 percent, with volumes of loans in local currency increased by 9.6 percent¹⁴. Note that the fourth quarter saw loans in local currency grown by 6.8 percent in volume but foreign currency loans reduced by 3.4 percent. In the resident business loan portfolio trade & services hold the largest share (28.6 percent), followed by construction (8.8 percent), industry (5.9 percent), agriculture (4.7 percent) and transport and communications (4.1 percent). At the end of the year non-performing loans constituted 6.4 percent of total economy lending (5.4 percent in end-2010)¹⁵.

⁷ Source: <http://www.azstat.org/macroeconomy/indexen.php>.

⁸ Source: <http://www.azstat.org/macroeconomy/indexen.php>.

⁹ Source: http://www.azstat.org/sdds/en/P_I/L_C_P.shtml.

¹⁰ Source: http://www.azstat.org/sdds/az/F_T/x_tic01.shtml.

¹¹ Source: <http://abc.az/rus/news/61386.html>.

¹² Source: <http://abc.az/rus/news/61551.html>.

¹³ Source: <http://www.cbar.az/other/azn-rates>.

¹⁴ Source: Azerbaijan Central Bank Statistics Bulletin, January-December, 2011, Table 2.7.

¹⁵ Source: Azerbaijan Central Bank Statistics Bulletin, January-December, 2011, Table 2.9.

The volumes of bank deposits have grown a total of 33.0 percent, with deposits in local currency and foreign currency increased by 35.1 percent and 30.3 percent, respectively. In the lending sector too, the main growth of volumes of deposits in local currency was posted in the fourth quarter, amounting to 21.3 percent whereas the volumes of deposits in foreign currency declined by 3.8 percent. The dollarization of the economy has therefore subdued by 0.9 percent in 2011 (by 5.8 percent in the fourth quarter) and reached 43.1 percent at the end of the year¹⁶.

During 2011 foreign currency reserves of the Central Bank of Azerbaijan have increased by about USD 4.1 billion (63.6 percent) and totaled USD 10.5 billion as of December 31, 2011¹⁷. About USD 3.5 billion of these reserves alone were replenished during December of 2011¹⁸. In the meantime, Azerbaijan State Oil Fund assets have grown by nearly USD 7.0 billion (30.9 percent) and reached USD 29.8 billion as of December 31, 2011¹⁹.

Georgia: in the period January-September of 2011 real GDP growth has been 6.2 percent. The following sectors posted considerable growth: financial intermediation (26 percent), manufacturing (12 percent), hotel and restaurant industry (10.7 percent), telecommunications (8.5 percent) and trade (7.5 percent). Meanwhile, value added declined in mining industry (6.3 percent) and construction (1.6 percent). According to preliminary estimates from the Georgian Statistics Service, in 2011 the real GDP grew by 6.8 percent²⁰.

In 2011 average inflation in Georgia was 8.5 percent y-o-y, and 2.0 percent relative to December of the previous year. Compared to the previous December, inflation was reported for non-durable goods (1.3 percent) and service tariffs (5.9 percent), while deflation was reported for semi-durable goods (3.0 percent) and durable goods (3.3 percent)²¹.

In 2011, relative to 2010, export volumes (FOB) have increased by 39.1 percent and amounted to USD 2.2 billion, and import volumes (CIF) have increased by 34.5 percent and reached USD 7.1 billion. As a result of export-import transactions Georgia's trade balance deficit deteriorated by 32.5 percent, reaching USD 4.9 billion²². According to the IMF estimations, the current account deficit in the GDP in 2011 will make up 10.8 percent against 9.6 percent recorded in the previous year.

Gross inflow of foreign direct investment started to grow along with further recovery of the Georgian economy. In the first nine months of 2011 inflow of FDI amounted to USD 643.1 million, which represents 7.0 percent increase relative to the same period of the previous year. In the FDI inflow structure the largest investors are: the Netherlands (20.9 percent), Denmark (15.2 percent), Cyprus (12.6 percent), and Turkey (10.6 percent)²³. Moreover, during 2011, relative to 2010, inflow of money transfers from abroad has increased by 20.5 percent and reached USD 1.3 billion²⁴.

With such foreign currency inflow dynamics, in January-December 2011 the average exchange rate of Georgian lari appreciated versus the U.S. dollar by 5.7 percent y-o-y. Relative to end-December of 2010, lari's appreciation has been 6.1 percent²⁵. Note that in the fourth quarter the lari exchange rate behaved mainly stably versus the U.S. dollar. In consideration of pressures from appreciation of the lari exchange rate, the National Bank of Georgia purchased USD 300.0 million, net, in the domestic foreign exchange market during 2011²⁶.

¹⁶ Source: *Ibid*, 2011, Table 2.4.

¹⁷ Source: http://www.cbar.az/infoblocks/money_reserve_usd.

¹⁸ Most likely, replenishment came from State Oil Fund of Azerbaijan.

¹⁹ Source: <http://abc.az/rus/news/62173.html>.

²⁰ The Q4 2011 real GDP growth figures and 2011 annual data will be released on March 20th of 2012.

²¹ Source: National Bank of Georgia's Monetary and Banking Statistics Bulletin, January-December, 2011, Table 1.1.

²² Source: http://www.geostat.ge/index.php?action=page&p_id=157&lang=eng.

²³ Source: http://www.geostat.ge/cms/site_images/_files/english/bop/FDL_2011Q3-eng.pdf.

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

²⁵ Source: National Bank of Georgia's Monetary and Banking Statistics Bulletin, January-December, 2011, Table 4.7.

²⁶ Source: *Ibid*, 2011, Table 4.5.

During 2011 bank lending has grown by 23.3 percent, with volumes of loans in local currency increased by 47.5 percent and loans in foreign currency, by 14.8 percent²⁷. The growth rates of the economy lending decelerated noticeably in the fourth quarter. Thus, the resident business portfolio constituted 55.2 percent, including trade (48.5 percent), industry (20.8 percent) and construction (10.3 percent)²⁸. Non-performing loans constituted 2.55 percent of total lending volumes, as of January 1, 2012²⁹.

During 2011 the volume of deposits attracted by banks has increased by 20.7 percent, with deposits in local currency grown by 54.4 percent and deposits in foreign currency, by 7.7 percent. During the fourth quarter banks were active enough in attracting deposits, and in that period of time deposits in local currency and foreign currency grew by 26.1 percent and 4.1 percent, respectively. The dollarization in the Georgian economy has therefore subdued by 7.8 percent relative to December of the previous year; as of December 31, 2011, foreign currency deposits constituted 64.4 percent in total³⁰.

During 2011 foreign exchange reserves of the National Bank of Georgia have grown by 24.5 percent (2.3 percent in the fourth quarter) and amounted to USD 2.82 billion as of December 31, 2011. This represented an addition of USD 554 million against the relevant figure recorded as of end-2010³¹.

3.2. BALANCE OF PAYMENTS³²

3.2.1. Current account

In 2011 the current account of Balance of Payments improved considerably and it is estimated to reach 11.8 percent of GDP against 14.5 percent recorded in the previous year. In the fourth quarter the current account further improved y-o-y notwithstanding the slowing growth rates of the world economy and more uncertainties. These developments, coupled with certain slowing of the domestic economic activity, slackened growth rates of export and import and those of individual remittances in dollar terms. With the fall in international metals prices, the growth of export of goods in real terms remained strong, fuelled by persistently high growth reported in industry. In the fourth quarter import in real terms remained strong as well, which is explained in part by high y-o-y declining rates in real volumes recorded in the fourth quarter of the previous year. The inflow of non-commercial remittances of individuals slowed down, incurring the impact of the developments in the Russian economy during the fourth quarter. As a result of these developments, the deficit of current account reduced by USD 30.7 million y-o-y and amounted to USD 288.2 million in the fourth quarter.

Export and import of goods in dollar terms have increased, respectively, by USD 77.4 million y-o-y (21.9 percent y-o-y) and USD 104.8 million y-o-y (11.3 percent y-o-y). As a result, trade balance deficit has grown by USD 27.4 million y-o-y and totaled USD 604.8 million.

High growth of real export was conditioned by persisted strong growth of domestic industry as well as high international metals prices. As a result, the y-o-y growth of export of goods and services in dollar terms amounted to 24.1 percent. The growth of dollar value³³ of export of goods and services amounted to 17.1 percent y-o-y, amidst falling international metals prices. Based on the 2011 estimations, export of goods and services in real and dollar terms amounted to roughly 19.0 percent and 25.0 percent, respectively.

²⁷ Source: *Ibid*, 2011, Table 3.5.

²⁸ Source: *Ibid*, 2011, Table 3.10.

²⁹ Source: *Ibid*, 2011, Table 3.5.

³⁰ Source: *Ibid*, 2011, Table 2.3.

³¹ Source: *Ibid*, 2011, Table 5.1.

³² The Q4, 2011 indicators are the Central Bank forecasts.

³³ In the period January-December the growth of export (FOB) has been 27.7 percent. Real growth of export and import of goods are the Central Bank estimations.

The growth of export³⁴ in dollar terms was driven mainly by positive contributions from such items as “products of prepared food” (8.6 pp) and “precious and semiprecious stones, precious metals and articles thereof” (6.1 pp)³⁵. Item “mineral production” had 0.5 pp of contribution while contribution of item “base-metals and articles thereof” has been negative (-2.0 pp).

The developments in external and domestic economic environment reflected the dynamics with import of goods as the growth of import of goods and services in real terms reached 5.5 percent y-o-y, which in part incurs the impact of shrinkage of real volumes of import recorded in the fourth quarter of the previous year. The growth of import³⁶ of goods and services in dollar terms amounted to 10.3 percent y-o-y. Based on the 2011 estimations, import of goods and services in dollar and real terms amounted to around 14.0 percent and up to 1.0 percent, respectively. In the first half of 2010 there was a decline in import in real terms.

Import was driven by positive contributions mainly from such items as “mineral production” (4.8 pp), “transport means” (1.8 pp) and “products of prepared food” (1.5 pp). The above-mentioned items more than offset negative contributions of such items as “machinery and equipment” (3.6 pp) and “base metals and articles thereof” (2.3 pp).

In view of geographic distribution of external trade, the y-o-y increase of the trade balance deficit in the fourth quarter of 2011 was driven by USD 20.0 million increase of trade balance deficit with the group “Other countries” and USD 14.3 million increase of trade balance deficit with the group “CIS countries”. The increase of trade balance deficit with the group “Other countries” was mainly conditioned by increases of deficit with Brazil, U.S.A. and India, by USD 15.4 million, USD 10.6 million and USD 10.0 million, respectively. There has been trade balance surplus with Canada and Georgia and the trade balance deficit with the EU states remained almost the same recorded in the fourth quarter of the previous year.

In the fourth quarter the deficit of services balance was roughly the same as recorded in the same quarter of the previous year, and amounted to USD 58.2 million. There has been a surplus reported in travel, which exceeded the level of surplus recorded in the same quarter of the previous year. The deficit of balance of transport services has grown determined by increased trade balance deficit. In the outcome, in the fourth quarter the y-o-y growth of export and import of services reached 9.2 percent and 7.0 percent, respectively.

In the fourth quarter growth rates of net inflow of non-commercial private remittances via the banking system decelerated and amounted to 11.2 percent y-o-y, which was due to some slowing of growth rates in the Russian economy in the fourth quarter as well as the influence of new expectations. Based on the 2011 results, net inflow of private remittances via the banking system has grown by 19.6 percent.

In the fourth quarter of 2011 net inflow of seasonal worker income has grown by 14.5 percent y-o-y and amounted to USD 320.0 million. This notably outstripped net outflow in item “income on investment”. As a result, item “income” posted net inflow of USD 151.4 million. Net inflow of private transfers has increased by 4.8 percent y-o-y and reached USD 173.2 million (a low y-o-y growth of private transfers also reflects the changes of the relative weights). Based on the 2011 results, net inflow of seasonal worker

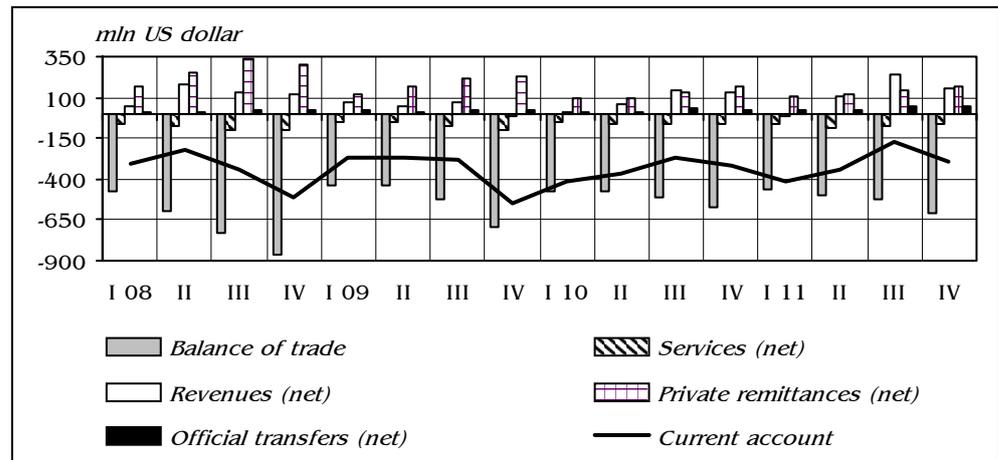
³⁴ Contributions have been calculated according to external trade statistics, which is based on the data included in customs declarations. In the balance of payments these are further adjusted to include data of trade executed without customs declarations as well as other estimations.

³⁵ Export and import breakdown by sector and geography is presented, respectively, in FOB and CIF prices.

³⁶ In the period January-December the growth of import (CIF) has been 10.7 percent.

income and private transfers has grown by 29.9 percent and 14.5 percent, respectively.

In Q4, 2011 current account improved y-o-y



3.2.2. Capital and Financial Account³⁷

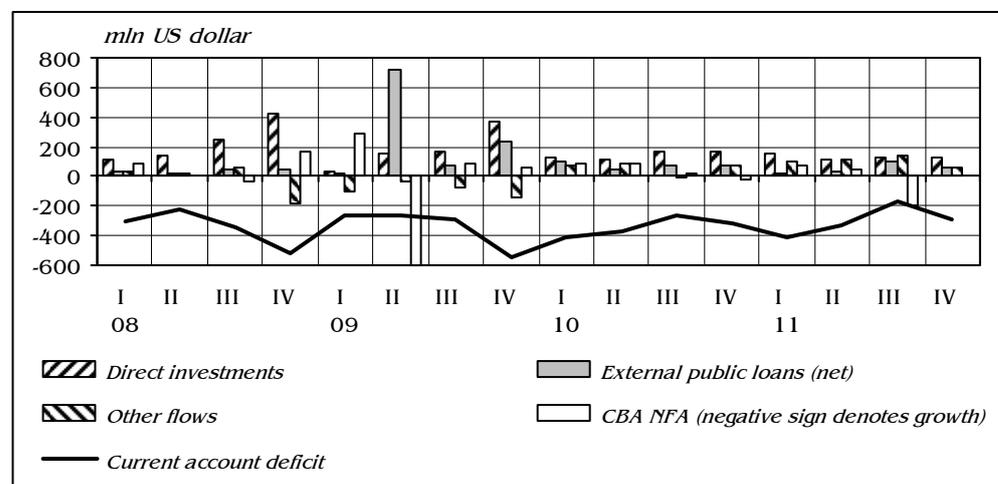
During 2011 the capital and financial account reported net inflow of USD 1276.7 million, which is USD 104.3 million more from the relevant 2010 indicator. In the fourth quarter of 2011 the capital and financial account posted net inflow of USD 282.4 million, which is USD 58.6 million less than the relevant indicator recorded for the same period of the previous year. The latter was almost enough to finance the deficit of current account. As a result of balance of payment flows net foreign assets of the Central Bank have slightly decreased (by USD 5.8 million).

In the fourth quarter the inflow of capital transfers amounted to USD 35.8 million (USD 33.9 million in the fourth quarter of the previous year).

Net inflow of foreign direct investment amounted to USD 132.2 million and net inflow of public loans, USD 56.8 million, compared to USD 71.6 million recorded in the fourth quarter of the previous year.

Net foreign assets of private sector have decreased by USD 57.6 million (by USD 72.0 million in the fourth quarter of the previous year). Net foreign assets of the banking sector have decreased by USD 104.2 million while net foreign assets of other private sector (commercial banks excluded) have grown by USD 46.6 million.

In Q4, 2011 net inflow on capital and financial account was enough to finance the current account deficit



³⁷ All indicators pertaining to the Q4 2011 capital and financial account are the Central Bank estimates.

3.3. INTEREST RATES, EXCHANGE RATE, AND MONETARY DEVELOPMENTS

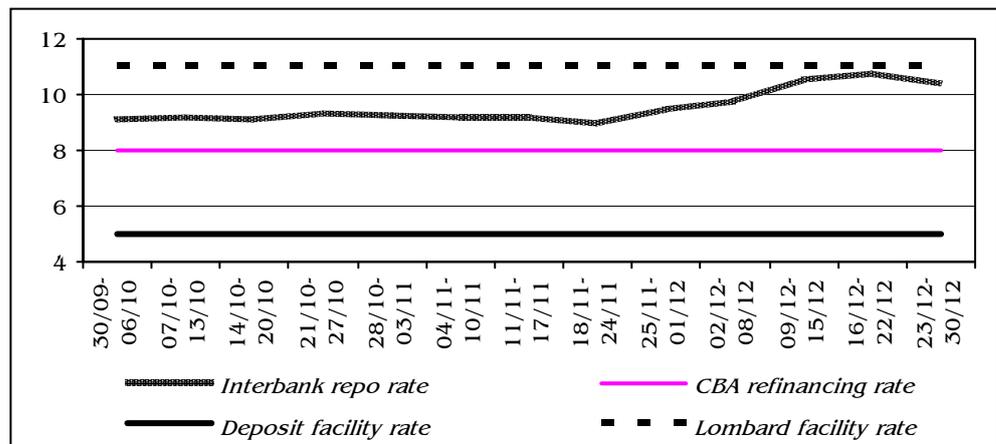
3.3.1. Interest rates

In the fourth quarter of 2011 the Board of the Central Bank left the refinancing rate unchanged, at the 8.0 percent level. Lombard repo rate and deposit facility rate were left unchanged, 11.0 percent and 5.0 percent, respectively.

During the fourth quarter interest rates remained roughly the same compared with the previous quarter's average. The change in reserve requirement mechanism, which was introduced in December, stipulated that provisioning against attracted foreign currency deposits be only in Armenian Dram instead of previously practiced requirement of 75 percent in Dram and 25 percent in foreign currency, perhaps fostered an increased demand for the dram hence interest rate rise in a short run.

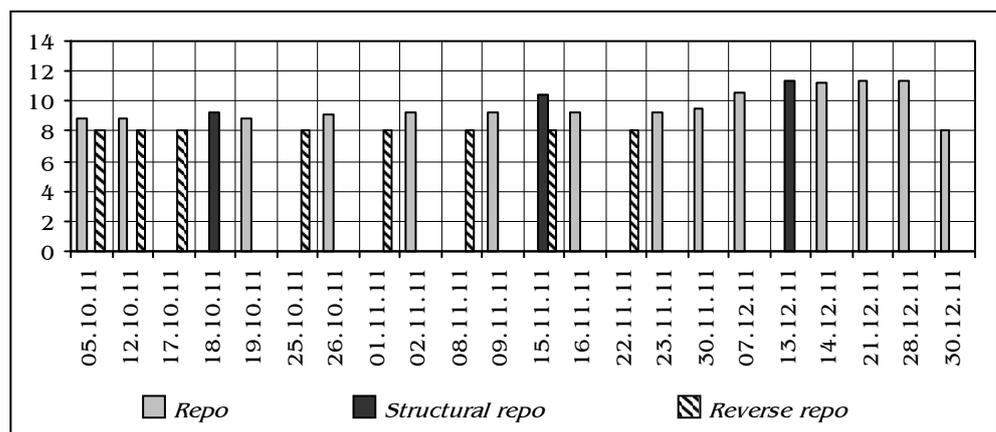
The above factors had their impact on interest rates of the Central Bank operations and interest rates of funds attracted and allocated by commercial banks.

CBA Refinancing Rate, Standing Facility Rate and Interbank Repo Rate



During the fourth quarter the Central Bank continued offering, each Wednesday, repo transactions to commercial banks. Average reported weekly volumes of repo operations performed amounted roughly to AMD 13.6 billion, with an average interest rate of 9.7 percent (AMD 8.0 billion and with an average interest rate of 9.8 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 10.35 percent (AMD 1.5 billion and with an average interest rate of 10.93 percent in the previous quarter). In the fourth quarter the Central Bank entered into reverse repo transactions, with aggregate volumes of nearly AMD 47.0 billion and with an average weighted interest rate of 7.98 percent (AMD 60.0 billion and with an average interest rate of 8.10 percent in the previous quarter).

The CBA repo operations (bln AMD)



In the meantime, commercial banks used standing facilities. Lombard repo operations with a total volume of AMD 159.1 billion were concluded with the Central Bank, while aggregate volume of funds deposited with the Central Bank amounted to AMD 128.5 billion (AMD 27.2 billion and 243.9 billion, respectively, in the previous quarter).

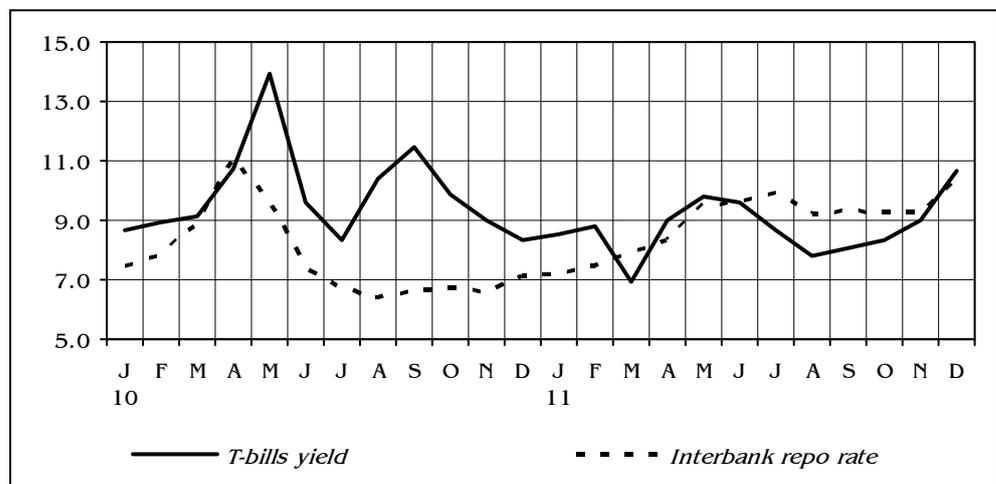
The interbank loan market, i.e. the Overnight Bourse, has been active. During the quarter the volume of interbank loans was nearly AMD 834 billion compared with AMD 740.3 billion recorded in the previous quarter, with an average interest rate increased by 1.08 pp to 8.91 percent.

In the fourth quarter aggregate volume of operations performed in the interbank and intrabank repo markets amounted to AMD 268.0 billion, down by AMD 8.4 billion against the previous quarter. The average market repo rate rose by 0.12 pp against the previous quarter's average and amounted to 10.08 percent.

The share of operations of commercial banks in total repo operations executed reached 28 percent against 30 percent recorded in the previous quarter. Average interest rate in interbank repo market did not change much in relation to the previous quarter's average and amounted to 9.45 percent.

In the fourth quarter total issue volume of short-term treasury bills reached AMD 19.0 billion (AMD 12.5 billion in the previous quarter). Total amount of short-term treasury bills allocated was AMD 16.5 billion compared to AMD 12.5 billion recorded in the previous quarter. In primary market of government securities, interest rates trended upward, which was more pronounced in the short-term segment. Relative to the previous quarter, average interest rate has risen by 1 pp to 9.17 percent in short-term segment.

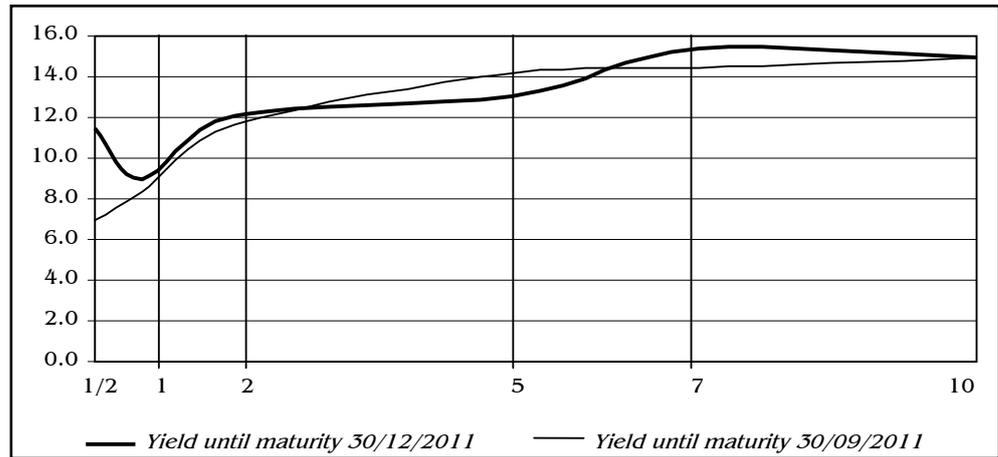
T-bills and Interbank Repo rates



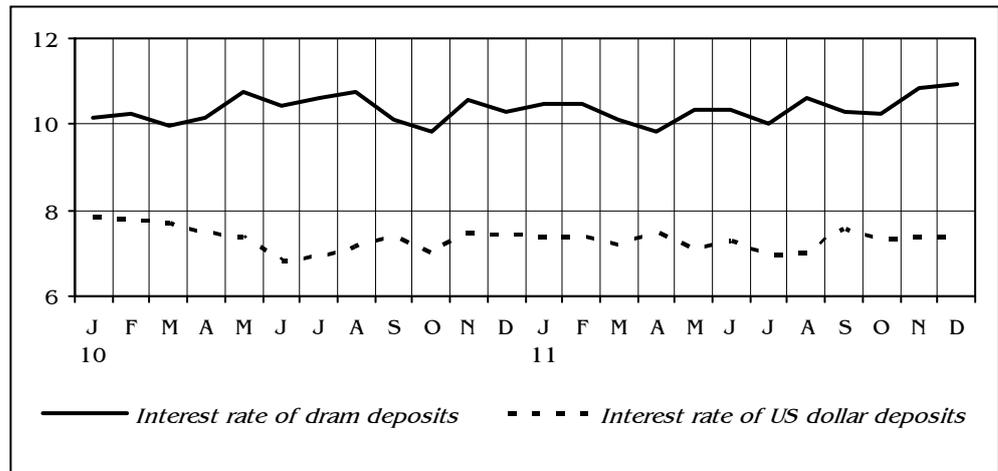
The yield curve analysis shows that in the secondary market of government securities yields have increased by 2.59 pp in short-term segment but fallen by 0.34 pp in medium segment. In the long-term segment yields have grown by 0.46 pp. As a result, convexity of the curve has changed, from 0.4 to 0.27, pointing out to the narrowed spread of interest rates of long-term and short-term securities.

In the fourth quarter interest rates of loans and deposits in Armenian dram and U.S. dollar trended as follows: average interest rates of dram and dollar deposits were 10.67 percent and 7.38 percent, respectively. Relative to the previous quarter, average interest rate of dram deposits has grown by 0.38 pp and interest rates of dollar deposits, by 0.20 pp. The spread of interest rates of dram and dollar deposits made up 3.29 pp (3.11 pp in the previous quarter).

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

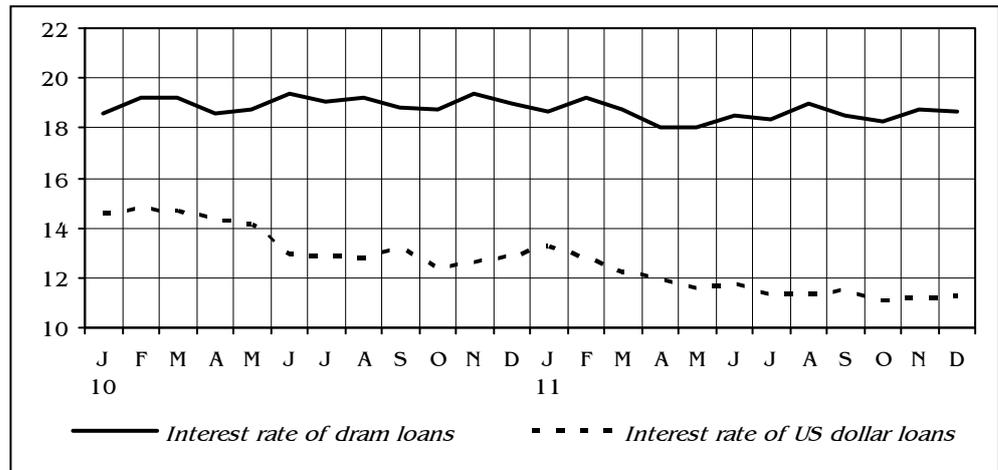


Interest rates of deposits attracted by the banking sector



In the fourth quarter average interest rates of dram loans and dollar loans were 18.6 percent and 11.2 percent, respectively. Relative to the previous quarter, average interest rate of dram loans remained unchanged while interest rate of dollar loans fell by 0.2 pp. As a result, the spread of interest rates of dram and dollar loans made up 7.4 pp compared to 7.2 pp recorded in the previous quarter.

Interest rates of loans provided by the banking sector



In the fourth quarter the interest rate spread of loans and deposits in Armenian dram stayed at the same level recorded in the previous quarter while the interest rate spread of loans and deposits in U.S. dollar reduced by 0.4 pp to 3.82 pp compared with 4.22 pp in the previous quarter.

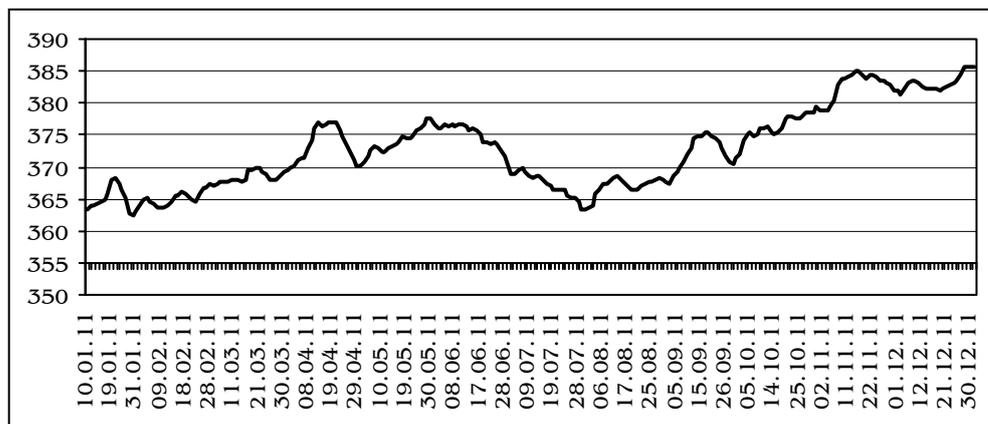
3.3.2. Exchange Rate

At the end of the fourth quarter of 2011, relative to the end of the previous quarter, the average dram exchange rate versus the U.S. dollar depreciated by 3.56 percent and reached dram 385.77 from dram 372.05 for one dollar.

Relative to the same quarter of the previous year, the average quarterly dram exchange rate versus the U.S. dollar depreciated by 5.30 percent and reached dram 380.90 from dram 360.73 for one dollar.

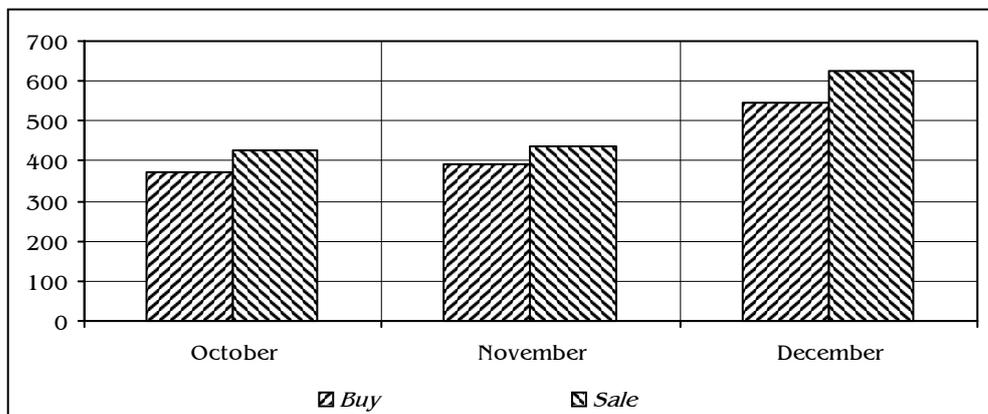
At the end of 2011, relative to the end of the previous year, the dram depreciation versus the U.S. dollar has been 5.9 percent.

AMD / USD exchange rate in 2011



The aggregate volume of interbank market transactions executed during the fourth quarter amounted to USD 2794 million, which represents 10.13 percent increase in relation to the respective indicator of USD 2537 million recorded in the fourth quarter of the previous year. Annual growth of such operations by volume has amounted to 19.19 percent, reaching USD 9980 million from USD 8373 million.

Gross volumes of foreign exchange operations in Q4, 2011 (mln US dollar)



In the fourth quarter the aggregate volume of Euro/Dram exchange transactions amounted to EUR 261.39 million, growing by 20.18 percent compared to the same quarter of the previous year. Annual operations by volume amounted to EUR 882.68 million, up by 9.08 percent compared with the previous year's respective figure.

To handle steep dram exchange rate fluctuations, the Central Bank purchased a total of USD 0.3 million from and sold a total of USD 34.15 million to commercial banks during the fourth quarter. Based on the annual results, the Central Bank has purchased USD 39.28 million and sold USD 136.90 million.

In the fourth quarter the nominal effective exchange rate of the dram appreciated by 0.7 percent q-o-q. This was primarily due to nearly 3.2

percent q-o-q appreciation of average quarterly AMD/USD exchange rate and an average 4 percent depreciation of partner countries' currencies versus the U.S. dollar³⁸.

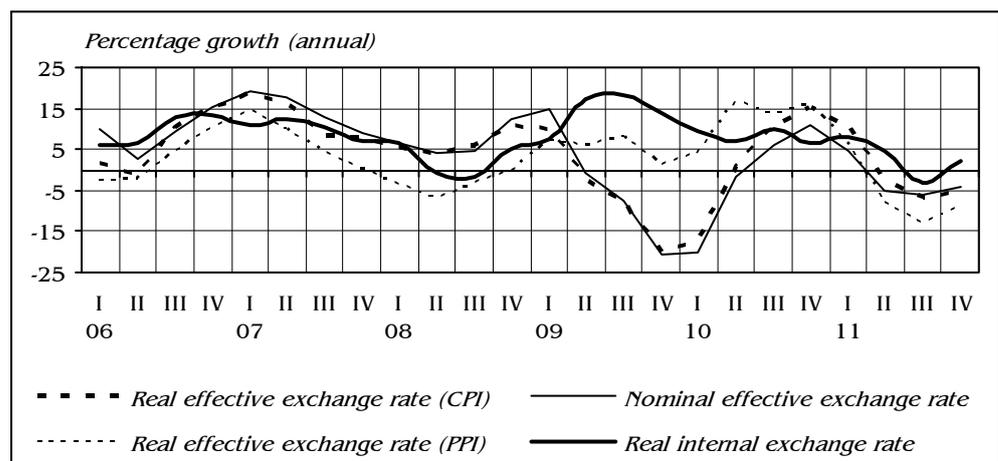
Though the nominal effective exchange rate of the dram has appreciated against the previous quarter, it still remains depreciated in relation to the previous year. During 2011 the depreciation of nominal effective exchange rate against the previous year has been 2.7 percent, mostly driven by average weighted 2.9 percent appreciation of partner countries' exchange rates versus the U.S. dollar, which notably exceeded average weighted 0.2 percent appreciation of the dram exchange rate versus the U.S. dollar.

During the quarter, the real effective exchange rate calculated by CPI (consumer price index) appreciated by 1.7 percent q-o-q amid 0.7 percent q-o-q appreciation of the dram's nominal effective exchange rate. Furthermore, inflation in Armenia amounted to an average 2.3 percent q-o-q whereas it reached 1.2 percent in the partner countries.

During 2011 the dram's real effective exchange rate depreciated by an average 1.2 percent in relation to the previous year, driven by an average 2.9 percent appreciation of trade partner countries' currencies versus the U.S. dollar, which was somewhat offset by average annual inflation in Armenia slightly exceeding inflation in the partner countries. Note that average inflation in the partner countries has been 5.6 percent. Average weighted inflation in the partner countries was most influenced by inflation in Russia (8.4 percent y-o-y) and Iran (20 percent y-o-y), with their contributions of 1.8 pp, 1.1 pp, respectively, as well as by 1 pp contribution from Euro-area.

At the same time, the PPI (producer price index)-calculated real effective exchange rate has appreciated by about 5.6 percent q-o-q³⁹ under such circumstances the y-o-y depreciation was 9 percent. This was mainly driven by high y-o-y growth of producer prices in the partner countries. The CPI-calculated real effective exchange rate has depreciated by 6.2 percent relative to 2010, which was influenced by faster increase of producer prices in the partner countries over producer prices in Armenia as well as an average 2.9 percent appreciation of the partner countries' currencies versus the U.S. dollar.

In Q4, 2011 real exchange rate depreciated



In the fourth quarter the internal real exchange rate⁴⁰ appreciated by 2.1 percent y-o-y, against the previous quarter's 3.3 percent depreciation,

³⁸ The indicator denotes a weighted average of trade partner countries' currencies.

³⁹ Partner countries' figures used in the calculation are preliminary.

⁴⁰ Internal real exchange rate is calculated as a ratio of prices of non-tradable goods to prices of tradable goods.

as prices of non-tradable goods grew faster than prices of tradable goods⁴¹. Note that the internal real exchange rate has appreciated by 6.9 percent q-o-q.

In the fourth quarter prices of tradable goods grew by 7.6 percent y-o-y and prices of non-tradable goods and services, by 9.9 percent y-o-y, compared with 9.9 percent and 6.3 percent, respectively, recorded in the previous quarter. During 2011 real internal exchange rate appreciated by around 3 percent since prices of non-tradable goods grew faster than prices of tradable goods.

3.3.3. Monetary Developments

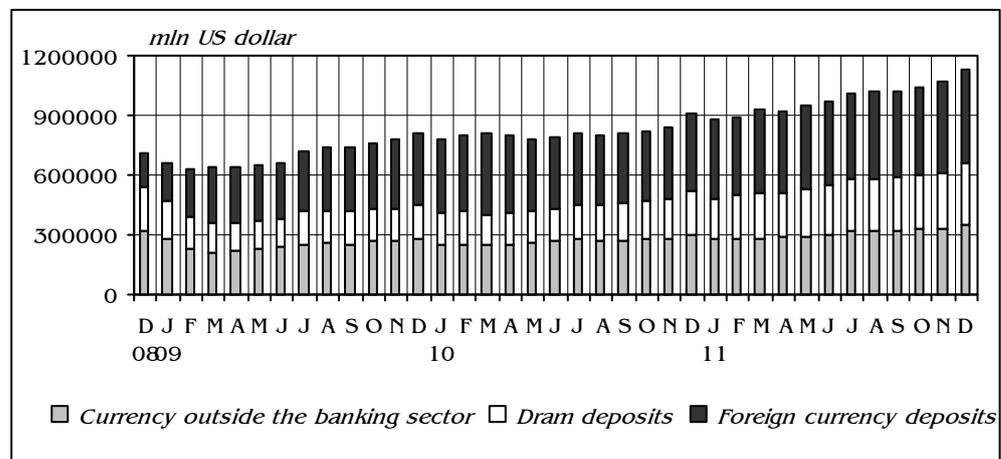
Recent forecasts for the fourth quarter of 2011 which were made amid some slowing of the global and domestic economic growth as well as existing uncertainties over development prospects in political and economic landscape in a number of advanced and emerging countries envisaged a monetary policy scenario most congruent with economic developments.

As it was forecast, in the fourth quarter the 12-month inflation demonstrated a downsloping path and the Central Bank, therefore, implemented a neutral monetary policy in the fourth quarter also in consideration of estimations on relatively stable inflation patterns and expectations for moderate inflation in the upcoming one-year horizon. This means that the Central Bank left the refinancing rate unchanged.

In the fourth quarter the monetary developments were mainly consistent with the scenario although the monetary indicators somewhat exceeded projections. So, foreign currency deposits grew by 9.1 percent or AMD 38.9 billion, with term deposits making up AMD 31.0 billion or nearly 10.0 percent and demand deposits accounting for AMD 7.9 billion or 6.9 percent. As such, foreign currency deposits were attracted entirely from households while demand deposits from companies, amounting to AMD 36.7 billion and AMD 9.5 billion, respectively.

During the quarter the growth of dram deposits again exceeded expectations, making up 14.1 percent or AMD 38.3 billion, with term deposits increased by 17.4 percent or AMD 21.6 billion and demand deposits increased by 11.3 percent or AMD 16.7 billion. Dram term deposits attracted from households and dram demand deposits attracted from companies reported growth by AMD 11.8 billion and AMD 16.3 billion, respectively.

In Q4, 2011 growth rates of dram deposits again exceeded expectations



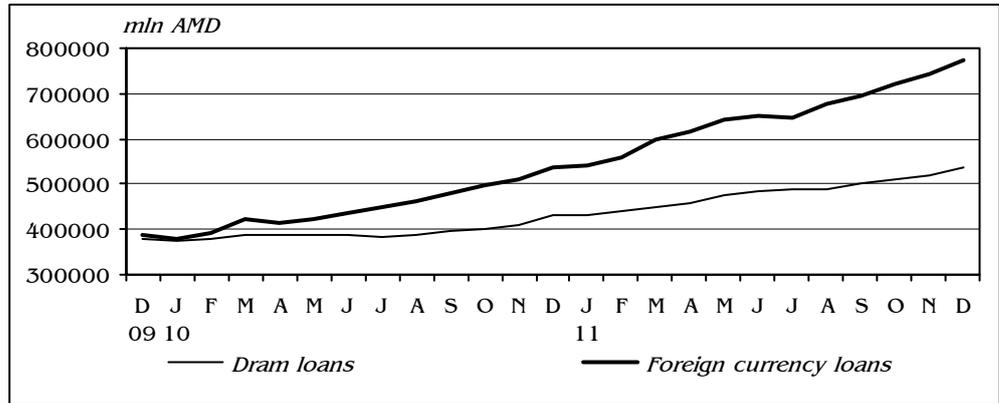
⁴¹ Prices of non-tradable and tradable goods were calculated based on expert judgment over prices of a consumer basket, taking goods and services into relevant categories.

During the fourth quarter currency outside the financial system has grown by 9.1 percent or AMD 29.2 billion.

As a result of the aforementioned developments, broad money has increased by 10.4 percent and dram broad money, by 11.4 percent.

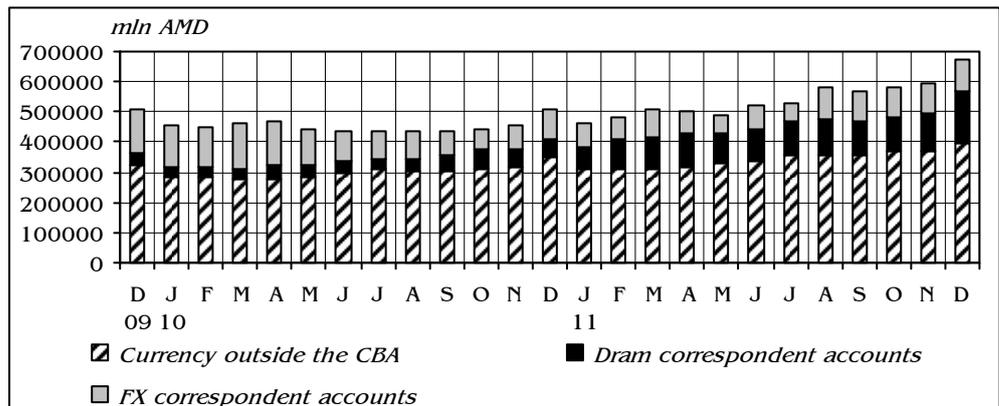
The fourth quarter was prominent as it reported the highest growth of lending to the economy, 8.9 percent or AMD 108.5 billion, with foreign currency loans again grown faster (making up AMD 76.3 billion or nearly 11.0 percent) and dram loans grown by AMD 33.1 billion or 6.6 percent, predominantly owing to consumer loans.

In Q4, 2011 growth rates of loans and FX loans in particular were the highest



In the fourth quarter the growth of monetary base was 17.6 percent totally owing to dram components: currency outside the Central Bank grew by 10.9 percent and funds on correspondent accounts of commercial banks with the Central Bank, by 67.3 percent. This increase was determined by the change in reserve requirement mechanism, introduced in December, which stipulated that provisioning against attracted foreign currency deposits be only in Armenian Dram instead of previously practiced requirement of 75 percent in Dram and 25 percent in foreign currency. However, FX correspondent accounts did not change much as a result of this change, having only reduced by AMD 2.1 billion or 2.0 percent. In the outcome, the dram component of monetary base has grown at a faster pace, making up 22.1 percent.

In Q4, 2011 monetary base grew totally owing to the growth of dram components

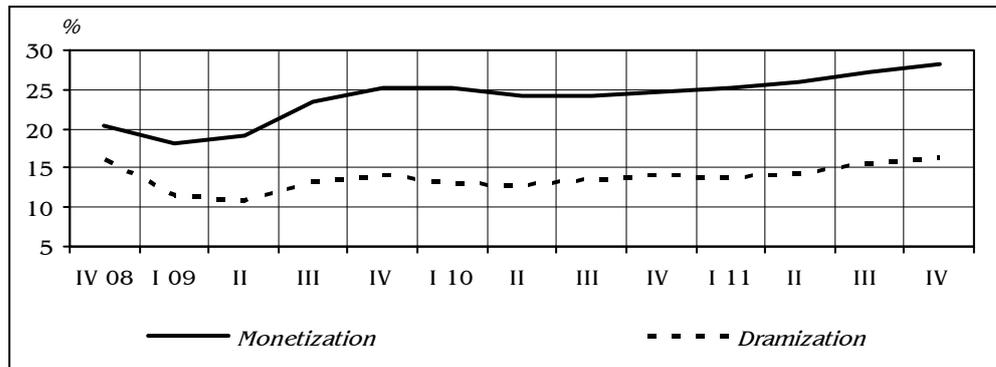


In the fourth quarter the monetary indicators were as follows: based on the 2011 results the broad money and dram broad money grew by 23.7 percent and 26.4 percent, respectively; currency in circulation increased by 14.8 percent; dram deposits and foreign currency deposits grew by 42.7 percent and 20.0 percent, respectively; monetary base grew by 32.3 percent and lending to the economy increased by 35.3 percent.

At the end of the year the dollarization of the economy (measured as a ratio of foreign currency deposits to broad money) was 41.5 percent, down by 0.5 pp relative to the same indicator of the previous quarter and by 1.3 pp relative to the same period of the previous year, which was driven by continued slowing of FX deposit growth rates over those of dram deposits since the beginning of the year.

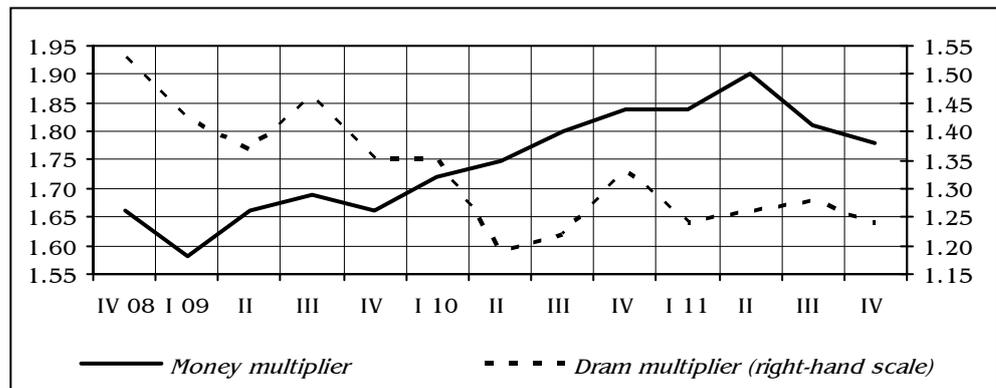
The monetization and dramization ratios, which are measures of financial intermediation, amounted to 28.2 percent and 16.4 percent, respectively, growing by 15.2 percent and 16.7 percent relative to the same indicators of the fourth quarter of the previous year.

Monetization and dramization ratios



Other indicators of financial intermediation, i.e. money multiplier and dram multiplier performed as follows: the money multiplier has decreased by 1.5 percent, reaching 1.78 at the end of the year, with its y-o-y decrease of 3.3 percent; the dram multiplier has decreased by 3.2 percent q-o-q and by 6.9 percent y-o-y, making up 1.24 percent at the end of the year. Note that such decreases were driven by the change in reserve requirement mechanism which resulted in huge growth of the monetary base and its dram constituent in particular.

Money multiplier and dram multiplier



3.4. AGGREGATE DEMAND AND AGGREGATE SUPPLY

3.4.1. Aggregate Demand

Domestic demand

Private consumption and investments⁴²: In the fourth quarter of 2011 the growth of private spending in real terms was estimated 3.5 percent, determined by the real increase of private consumption. In the meantime public expenditures have grown by 1.2 percent. In the light of the aforementioned developments, domestic demand has grown by 3.7 percent.

⁴² The real growth indicators of private consumption and investments for the fourth quarter are the Central Bank estimates. The actual figures of these indicators are as of the third quarter of 2011. Estimations of real growth presented in this section are relative to the same quarter of the previous year, unless otherwise stated.

The growth of private consumption in real terms in 2011 was estimated 3.6 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. In the fourth quarter the annual growth rate of private consumption is estimated roughly 4 percent.

In the fourth quarter private investments declined by around 3 percent in spite of high economic activity and noticeable growth of lending to the economy during 2011, under which circumstance the reduction of the annual indicator is estimated 5.5 percent. This change was determined by the developments in construction⁴³.

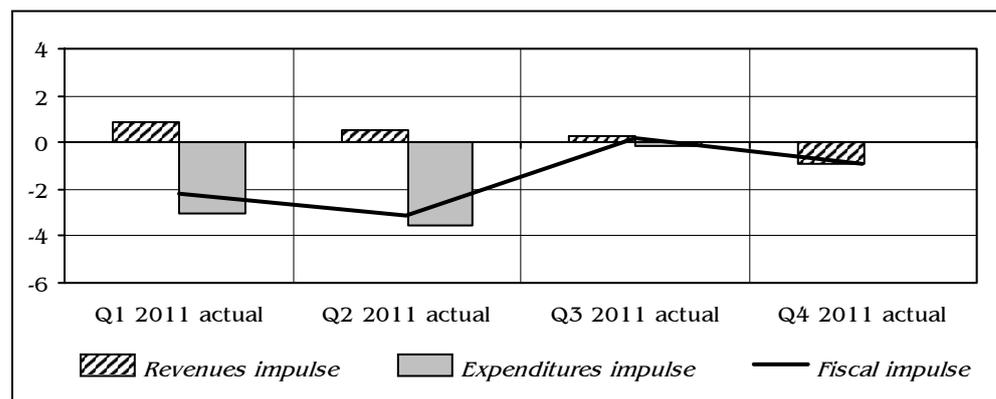
Note that the growth rate of private spending decelerated in the fourth quarter due to the influence from both domestic and external factors.

Composite economic indices⁴⁴ as calculated and published by the Central Bank point out to the slowed growth rate of private spending. In the fourth quarter the growth rate of consumer confidence index slowed down, reaching 2.4 percent compared with 11.8 percent rise of the same index recorded in the previous quarter. Current conditions and business activity indices have reduced as well, by 2.7 percent and 6 percent, respectively.

In the fourth 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 some minor (0.1 – 0.2 pp) of deflationary pressure on inflation.

Public consumption and investments: In the fourth quarter of 2011 the performance of the budget remained congruent with the trends which were shaped during the previous quarters, that is collection of revenues in compliance with projected quarterly proportions and saving of expenditures on certain items. In the light of these developments, the impact of the fiscal sector⁴⁵ on aggregate demand hence prices was 0.9 pp contractionary instead of the projected neutral. The contractionary impulse was totally due to restricting influence from revenues and neutral influence from expenditures instead of the projected expansionary.

In Q4, 2011 the fiscal impulse had slightly a contractionary impact



It is remarkable that in the fourth quarter too, the economic recovery trends positively affected the attainment of the indicator on projected budget revenues.

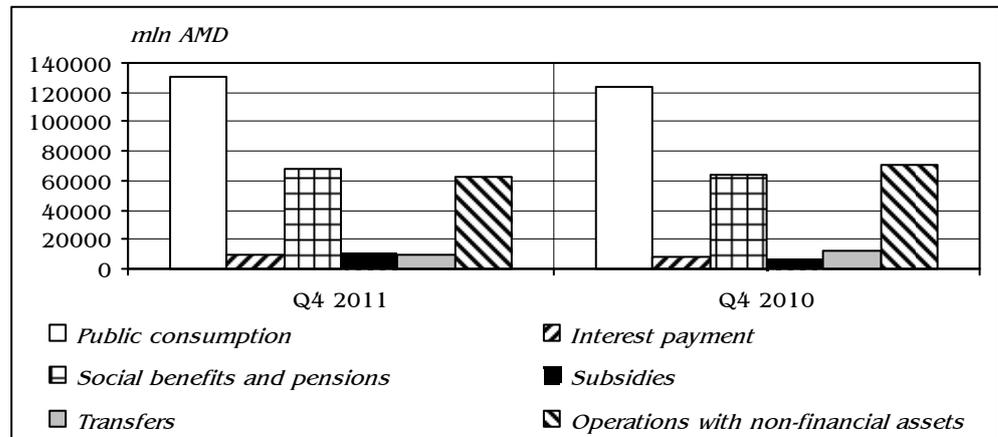
⁴³ See section Aggregate supply in this report.

⁴⁴ See <http://www.cba.am/am/SitePages/statsscci.aspx>.

⁴⁵ Consolidated budget indicators which were prepared on the basis of preliminary actual data of the fourth quarter of 2011 (including PIU funds) were used for the review of the fiscal sector. The fiscal impulse was estimated against the fourth 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.

The growth of tax revenues of the consolidated budget and social security charges has been 9.2 percent relative to the fourth quarter of the previous year. In the structure of tax revenues, the share of indirect taxes has reduced and the share of direct taxes has increased, by 0.6 pp and 0.5 pp y-o-y, amounting to 62.9 percent and 26.8 percent, respectively. There has been a reported increase of 0.1 pp in other taxes, making up 10.2 percent in total. The decrease of indirect taxes was mainly due to reduced share of excise duty, which amounted to 18.0 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 12.3 percent and 38.1 percent, respectively. The y-o-y growth of indirect taxes was 9.7 percent and direct taxes, 13.05 percent. In the structure of direct taxes, there has been an increase in respect of all taxes (excluding the property tax), with profit tax having grown by 8.4 percent and income tax having grown by 14.5 percent. Other revenues reported decline of 26.7 percent.

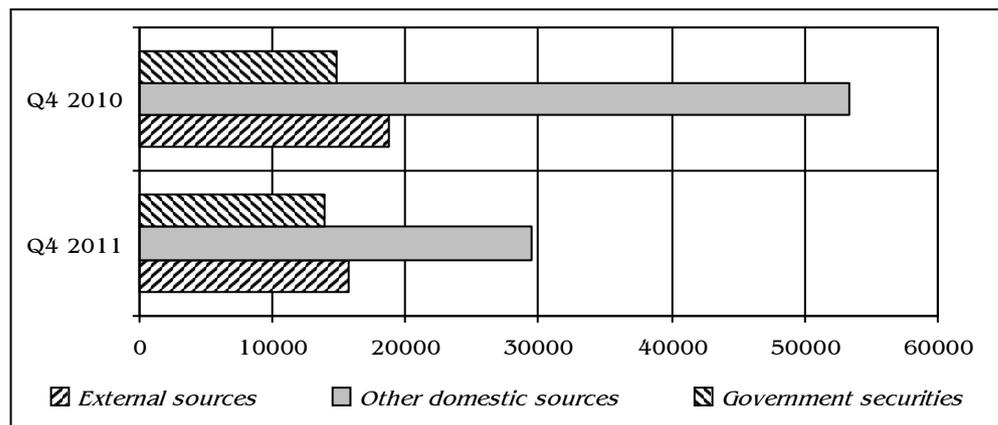
In Q4, 2011 budget expenditures reported a decline in item 'operations with non-financial assets'



In the fourth quarter, the budget expenditures executed constituted roughly 29 percent of the annual projection. Savings on certain expenditures items were reported in the fourth quarter as had been the case during the past nine months of the year. At the same time, y-o-y growth of 2.2 percent in expenditures was recorded in the fourth quarter. Current expenditures have grown by 6.9 percent y-o-y, in which public consumption has increased by 5.9 percent y-o-y. Expenditures on item *transactions with non-financial assets* have reduced by 11.6 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 percent and 28.0 percent, compared to the previous year's figures of 64.6 percent and 35.4 percent, respectively.

In Q4, 2011 financing from other domestic sources prevailed in budget deficit financing



With revenues and expenditures indicators shown above, in the fourth quarter the budget deficit reached AMD 58.9 billion or about 40 percent of the annual projection. The latter was financed primarily from domestic sources (73.4 percent) and external sources (26.6 percent).

About 32 percent of domestic sources or AMD 13.8 billion represented net proceeds from allocation of government securities.

Based on the annual results, it should be noted that state budget revenues were slightly over-performed against the annual program, while the growth of revenues in relation to the same period of the previous year has been 9.6 percent. The y-o-y growth of tax revenues has been 10 percent. A preliminary actual indicator suggests that savings of public expenditures amounted roughly to AMD 40.0 billion, a prevailing part of which generated in the course of the first nine months of the year. The y-o-y growth of expenditures (PIU funds included) has amounted to 3.5 percent.

Y-o-y growth of main macroeconomic indicators in Q4, 2011 (in real terms)

Indicator	Q4 2011 – Q4 2010
Real GDP	4.2
Domestic demand	3.7
Consumption	3.4
Public	2.4
Private	3.6
Capital investment	-3.3
Public	-2.5
Private	-3.4
Net external demand	18.8
Export ⁴⁶	24.1
Import	5.5

In the light of the revenues and expenditures figures mentioned above, the budget deficit has amounted nearly to AMD 108.3 billion or about 73 percent of the annual projection.

Based on the annual results, the fiscal policy's impact on aggregate demand hence prices has been 1.3 pp contractionary, which is mainly due to restrictive influence generated from savings of expenditures. The implementation of the contractionary fiscal policy was most pronounced during the first half of the year.

3.4.2. Aggregate supply⁴⁷

The GDP y-o-y growth in the fourth quarter amounted to 6.5 percent.

Looking at the y-o-y economic growth indicator of the period January-December 2011, it should be noted that the Central Bank estimate calculated on the basis of Economic Activity Indicator did not deviate from the scenario and is within the 4.1 – 4.5 percent interval⁴⁸. 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 17 percent y-o-y mainly due to the increased volumes in *metal ore mining*

⁴⁶ The export and import indicators include the services indicators.

⁴⁸ See the 30 percent interval in the Real GDP Growth (Cumulative) Projection Probability Distribution Chart, the Monetary Policy Program Q1, 2012.

(13.4 percent), *food production*⁴⁹ (16.7 percent), *beverage production*⁵⁰ (19.7 percent), *items of finished metal manufactures* (92.7 percent), *production of building materials* (7 percent) and *production of parent metals* (9.9 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 (21.6 percent), driven by increased economic activity and more electricity exports to Iran, further contributed to the growth of value added.

Construction: nearly 13 percent y-o-y decline in value added is estimated. The reduction in construction volumes financed by *international loans* (41.4 percent reduction), *organizations* (23.4 percent reduction), *households* (32.2 percent reduction) and *humanitarian aid* (12 percent reduction) was somehow offset by increased volumes owing to *state budget* (16.8 percent growth) and *local budgets* (about 5.9-fold 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 postponed major road construction and supporting infrastructures projects.

Services: the growth of value added is estimated around 3.1 percent y-o-y as a result of increased volume of *services rendered*, *retail trade turnover* and *wholesale trade turnover* by 6.1 percent, 2.2 percent and 5.5 percent, respectively. The increase in the volume of services rendered was driven by growth recorded in *financial and insurance activities* (24.3 percent), *information & communication* (1.1 percent), *healthcare* (13.7 percent) and *education* (2.1 percent).

Agriculture: the growth of value added is estimated to reach 14.5 percent y-o-y, which is a result of 26.6 percent growth in *plant growing* and 0.1 percent growth in *animal breeding*. The growth in animal breeding was due to increased volumes in *slaughtered animal and poultry* (2.9 percent) and *milk production* (0.1 percent), which entirely offset the 9.8 percent reduction in *egg production*. The growth in plant growing was conditioned by increased output in *wheat* (34.8 percent), *potato* (15.6 percent), *vegetables* (11.5 percent), *berries* (83.7 percent), *grapes* (3 percent) and *melons and gourds* (36.5 percent). The growth in plant growing was due to both improved climatic conditions as well as certain government programs implemented in this field⁵¹.

3.5. LABOR MARKET⁵²

In the fourth 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. In the fourth quarter the growth rate of nominal wages in the economy somewhat outpaced the growth rate of

⁴⁹ The food production grew owing to increased production volumes in *canned food* (45.4 percent), *grains* (41.4 percent), *sugar* (2.2-fold), *confectionery* (11.5 percent), *macaroni* (20.1 percent), *meat products* (14.8 percent), *meat* (2.5 percent), *cheese* (2.8 percent), *mountain yoghurt* (15.2 percent), and *cottage cheese* (28.6 percent).

⁵⁰ The beverage production grew owing to increased production volumes in *brandy* (21.5 percent), *wine* (6.3 percent), *spring water* (21.1 percent), *confectionery* (11.5 percent), *macaroni* (20.1 percent), *meat products* (14.8 percent), *meat* (2.5 percent), and *natural juice* (24.7 percent).

⁵¹ 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.

⁵² Labor market indicators of the fourth quarter of 2011 are the Central Bank estimates based on actual figures of October and November and estimated figures of December of 2011. Growth estimations presented in this section are relative to the same quarter of the previous year, unless otherwise specified.

productivity. In view of the aforementioned developments, unit labor costs have slightly grown, creating minor inflationary pressures.

In the fourth quarter of 2011 the growth of average nominal wages was 6.0 percent. Based on the annual results of 2011, the same indicator amounted to 6.0 percent as well. The nominal wage increase in the fourth quarter was driven by wage increases in private sector as well as moderate increase of wages in some budget-supported organizations.

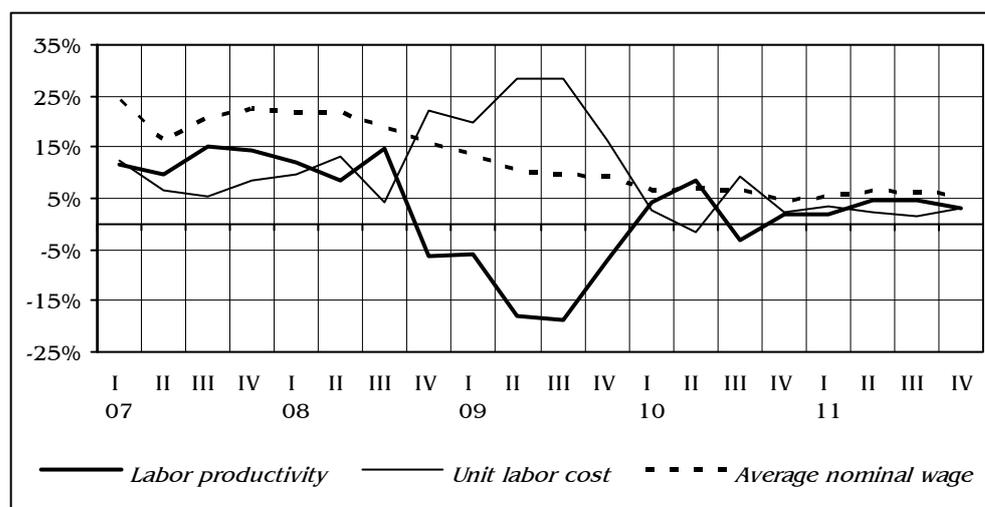
Increased productivity in industry and services, growing demand for labor as well as the single-payment window introduced in the healthcare system and inflation recorded at the start of the year had a significant impact on the growth of nominal wages in the private sector.

In the fourth quarter of 2011 demand for labor continued increasing mostly due to a reported increase of output in industry and services. As a result, the average number of the employed reached 0.4 percent while the average quarterly unemployment rate fell against the same period of the previous year by 0.8 pp and made up 6 percent. In 2011, the average unemployment rate fell by 0.8 pp and amounted to 6.2 percent.

In the fourth quarter, amid the slowing of the economic activity, the labor productivity growth rate decelerated and reached 3.0 percent.

With existing rigidities in the labor market, the growth rate of nominal wages did not fully respond to the slowing of the productivity growth rate and some 2.8 percent rise in unit labor costs was recorded, as a result. In the outcome, minor inflationary pressures of 0.2 pp were observed in the economy.

Labor market developments



3.6. IMPORT PRICES AND PRODUCER PRICES

3.6.1. Import Prices

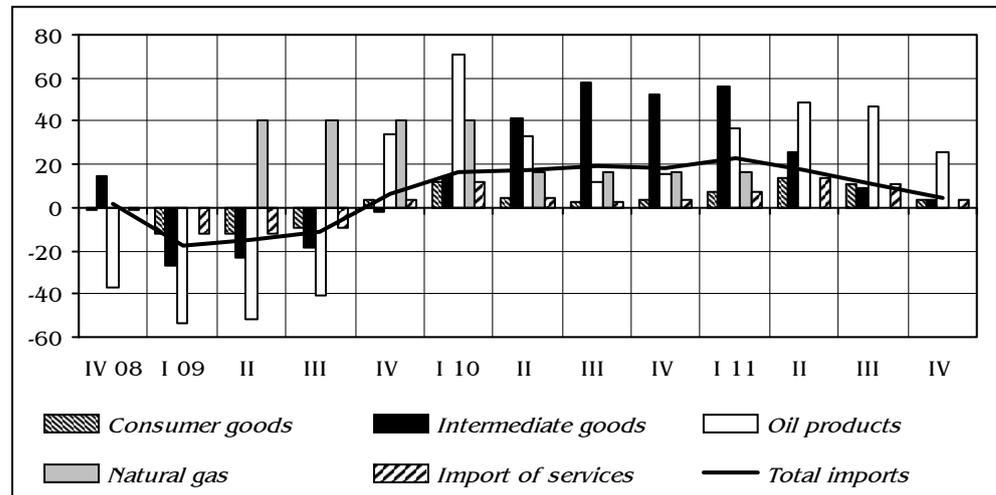
In the fourth quarter of 2011 prices in world commodities markets trended mainly downward, with growth rates of food products and raw materials decelerating relative to the same period of the previous year.

According to the Central Bank estimates, in the fourth quarter the dollar prices of import have grown by 4.4 percent y-o-y against 10.7 percent growth recorded in the previous quarter.

Indicator	Q4 2010	Q1 2011	Q2 2011	Q3 2011	Q4 2011
Import (total)	18.7	22.9	17.3	10.7	4.4
Import (services)	3.1	6.9	13.7	10.5	3.1
Import (goods)	22.8	27.2	18.2	10.7	4.8
Capital goods ⁵³	0.0	0.0	0.0	0.0	0.0
Consumption goods	3.1	6.9	13.7	10.5	3.1
Intermediate goods	52.8	56.3	25.6	9.1	3.6
Diamond ⁵³	0.0	0.0	0.0	0.0	0.0
Oil products	15.8	36.8	48.8	47.2	25.9
Natural gas	16.9	16.9	0.0	0.0	0.0

The prices of oil products remained high: relative to the same period of the previous they have grown by 25.9 percent y-o-y against 47.2 percent y-o-y growth in the previous quarter. In the fourth quarter oil prices had the largest impact (1.9 pp) on total import prices, followed by the impact of intermediate goods and food products (1.1 pp), mostly due to increased gold prices.

In Q4, 2011 prices of imported goods dropped



The dollar prices of imported consumption goods have grown by 3.1 percent y-o-y, driven by 4.6 percent inflation in the partner countries, which was somewhat mitigated by around 1.7 percent depreciation of currencies of the partner countries. Under such conditions, the dollar prices of imported consumption goods had 0.7 pp of impact on total import prices. In the fourth quarter of 2011, in view of 4.4 percent y-o-y growth of import dollar prices as well as 5.6 percent y-o-y depreciation of the average nominal AMD / USD exchange rate, the dram prices of imported goods in the consumer basket have grown an average by 6.9 percent y-o-y.

Based on the annual results of 2011, the import dollar prices have grown by 13.4 percent relative to 2010, mainly attributable to roughly 39 percent increase of prices of oil products and 20.6 percent rise in commodities prices.

In 2011, in view of 13.4 percent average annual growth of import dollar prices and 0.2 percent y-o-y appreciation of the average nominal AMD/USD exchange rate, the dram prices of imported goods in the consumer basket have grown an average by 8.9 percent.

⁵³ 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.

3.6.2. Producer Prices ⁵⁴

In the fourth quarter of 2011 all branches of the economy (excluding construction) reported an increase of price indexes, with the GDP deflator having reached 104.5 in the period January-December of 2011.

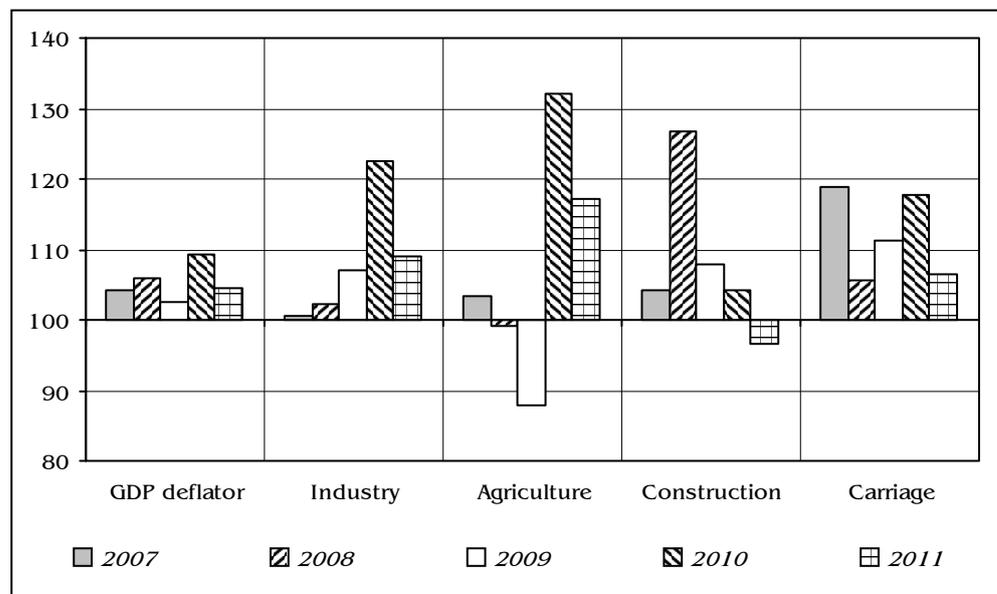
Industry reported the highest price increases, with quarterly growth having reached 6.6 percent y-o-y. In the period January-December the growth has been 9.1 percent y-o-y mainly due to the increased volumes reported in *metal ore mining* (3.4 percent), *processing industry* (8.1 percent) and *energy and gas production and distribution* (15.6 percent), which is a result of increased international prices of non-ferrous metals (compared to the prices recorded in the previous period of January-December) and continued recovery of external and domestic demand.

Agriculture posted 8.5 percent y-o-y growth of prices⁵⁵, and in the period January-December the growth has been 17.1 percent y-o-y. Plant growing reported 2.2 percent increase in prices due to faster growing domestic and external demand for agricultural products. Moreover, prices of *potato* and *melons and gourds* increased by 14.2 percent y-o-y and 14.3 percent y-o-y, respectively, notably contributed to the price increase. In the period January-December y-o-y price increase of 27.6 percent has been reported in *animal breeding* as a result of price increases on milk and dairy products (41.3 percent), meat (20.7 percent) and egg (19 percent).

Construction reported 8.4 percent y-o-y deflation, and the decline in the period January-December has been 3.5 percent y-o-y mainly due to the response of prices of building materials to the contraction of construction volumes.

Carriage costs have increased by 6.4 percent y-o-y, with the January-December growth having reached 6.4 percent y-o-y, driven by increased tariffs on *railroad transport* (11.1 percent), *air transport* (1.4 percent), *motor transport* (3.3 percent) and *pipeline transport* (7.1 percent).

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



⁵⁴ 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.

⁵⁵ Sales prices of producers of agricultural product are presented.

3.7. INFLATIONARY EXPECTATIONS

The Central Bank conducted the Q4 2011 survey of inflationary expectations among organizations in the financial sector as well as non-financial organizations (and households as a pilot project) of the real sector.

The 12-month inflation further tended to subdue during the fourth quarter and at the end of the year it rested within the confidence band. Because adaptive expectations (these are expectations which are based on actual trends of the previous period) prevail in the Armenian economy, the inflationary expectations of both households and financial system participants have decreased notably. Based on the fourth quarter survey results, 43.0 percent of banks and 52.0 percent of credit organizations expect inflation in the range of 2.5 – 5.5 percent for the 12-month horizon. While banks' expectations little vary from figures recorded previously, expectations of credit organizations have improved markedly (In the third quarter only 21.4 percent of credit organizations expected inflation in the 2.5 – 5.5 percent range). Furthermore, 10 percent of credit organizations expects inflation up to a 2.5 percent level. The rest part of banks and credit organization expect inflation within 5.5 – 8.5 percent.

According to the survey results, banks and credit organizations will further anticipate stable market interest rates for the upcoming 12-month horizon. Some fall in interest rates is expected for long-term government bonds market and foreign currency lending.

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