

**THE CENTRAL BANK
OF THE REPUBLIC OF ARMENIA**

*Approved under:
the Central Bank Board Decision No. 18A,
dated 28.02.23*

**STATUS REPORT ON IMPLEMENTATION OF THE
MONETARY POLICY PROGRAM
(Q1, 2022 – Q4, 2022)**

In the one-year period between the 1st quarter and the 4th quarter of 2022 Armenia's inflation environment has been high, with the latter largely determined by the influence of escalation of the Russian-Ukrainian conflict since the end of February, various sanctions imposed on Russia and many uncertainties derived from them. These factors, in the aftermath effects of the coronavirus pandemic, again led to significant supply chain disruptions that were expressed in international commodity markets by a sharp increase in the energy and food product prices, having thus caused spillovers on the domestic prices in Armenia through a number of imported goods. Persisting high inflation has also been fueled by a strong aggregate demand, in the services sector in particular, created as a result of a huge influx of international visitors and financial assets to Armenia in the wake of the Russian-Ukrainian conflict. At the same time, influenced by a large financial influx, a continuous appreciation of the dram was observable in the Armenian currency market during the year, containing the inflationary patterns to a certain extent.

Based on the current situation and in view of the principle of forward-looking policy implementation, the Central Bank of Armenia continued to pursue the tightening of monetary conditions in the period under review, raising the policy rate by a total of 3.0 pp, of which 1.25 pp in March 2022 alone, reacting to a mid-term high inflationary environment estimated in the context of high uncertainty since the end of February. In the period under review, the 12-month inflation increased significantly since March 2022, reaching 10.3% at the end of the second quarter; it then gradually decreased, as a result of the monetary policy implementation, down to 8.3% at the end of the year. It is estimated that the inflation rate will gradually subdue and stabilize around the 4% target, starting from the second half of 2023, owing to the effect of the consistent monetary policy implementation.

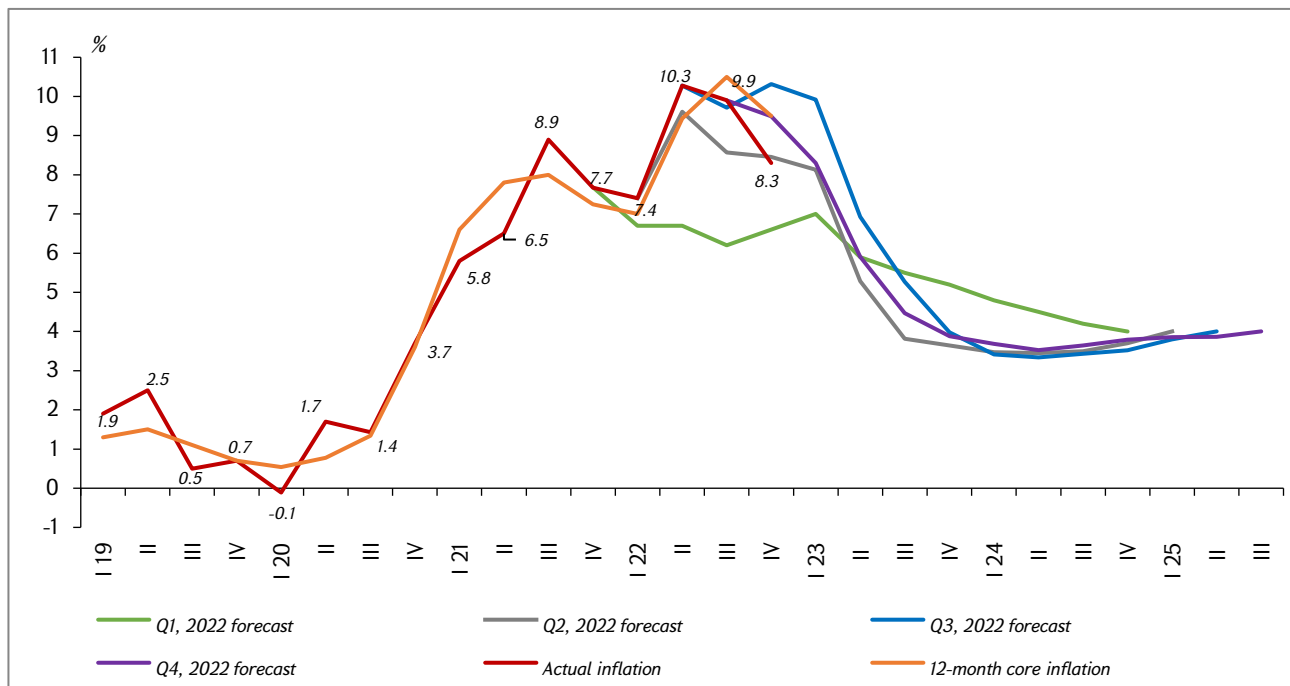
1. MONETARY POLICY IN THE PERIOD UNDER REVIEW

According to the main considerations of the scenario outlined in the 1st quarter MP program, the inflation environment would have to remain high in the course of the upcoming one year driven by the inflationary effects transmitted from external markets because of the escalation of the Russian-Ukrainian conflict, on the one hand, and the strong demand being created in the Armenian economy amid an estimated influx of international visitors and financial assets, on the other. It was predicted that in the medium term, in view of tighter monetary policy implementation and expected macroeconomic developments, the 12-month inflation would have to gradually decrease and stabilize around the 4% target.

It is noteworthy that in the beginning of the period under review, i.e. until March 2022, the 12-month inflation was gradually decreasing – in February it was 6.5% thanks to a progressive monetary response by the Central Bank of Armenia in the previous period when the inflation patterns all over the world were trending up. Staring from end-February, however, as geopolitical developments unfolded, the inflation environment has expanded considerably, with the inflation having notably outgrown the expected level. This is why, in the next quarters the projected path of inflation has been revised upside in the short run.

Chart 1

At the start of the period under review, the 12-month inflation has decreased in line with the projected path, yet it increased sharply since March 2022, driving short-term forecast for subsequent quarters to upside revision



Thus, the 2022 macroeconomic environment and, particularly, the inflationary developments in the Republic of Armenia have largely incurred the influence of the Russian-Ukrainian conflict, intensified since the end of February, and the various sanctions

imposed on the Russian economy and exceptionally high uncertainties derived from them. They were reflected in the significant slowdown of economic growth rates in the main partner countries of Armenia, as well as high inflation recorded in international energy and food product markets as a consequence of supply chain disruptions. In the short term, such developments have transmitted their negative impact on the Armenian economy mainly through somewhat weakened economic activity, and on Armenia's commodity market, through high prices of individual imported goods. At the same time, driven by the Russian-Ukrainian conflict, a significant increase in the country's risk-premium and the volatility in the domestic financial market in the short term has been observable too, contributing, in turn, to a certain rise in inflationary expectations and inflation risks. Starting from the second quarter of 2022, however, the growth rate of economic activity has speeded up owing to a large-scale influx of international visitors and tourists, as well as of financial transfers to Armenia. Consequently, the factors of external demand for domestic services have well contributed to high economic growth. Positive developments were also observed in the export sector, the IT and manufacturing industries in particular. Continuously growing demand has also contributed to the expansion of the general inflation environment and the maintenance of high inflation expectations. In the second half of the year, with energy and food prices reducing amid a contractionary monetary policy conducted by central banks in the main partner countries of Armenia, on the one hand, and the supply chain disruptions gradually phasing out, on the other, the inflationary impact from the external sector was reported to have somehow weakened, hence facilitating the overall inflationary environment of the Republic of Armenia to mitigate, yet sustained high demand in Armenia was further contributing notably to wage increases and growing prices of individual goods and services. In the course of 2022, determined by a strong demand from international visitors and influenced by a significant influx of financial transfers from abroad, Armenia's currency market has seen the domestic currency, the dram, appreciated markedly, helping the above-mentioned inflationary factors to somehow mitigate.

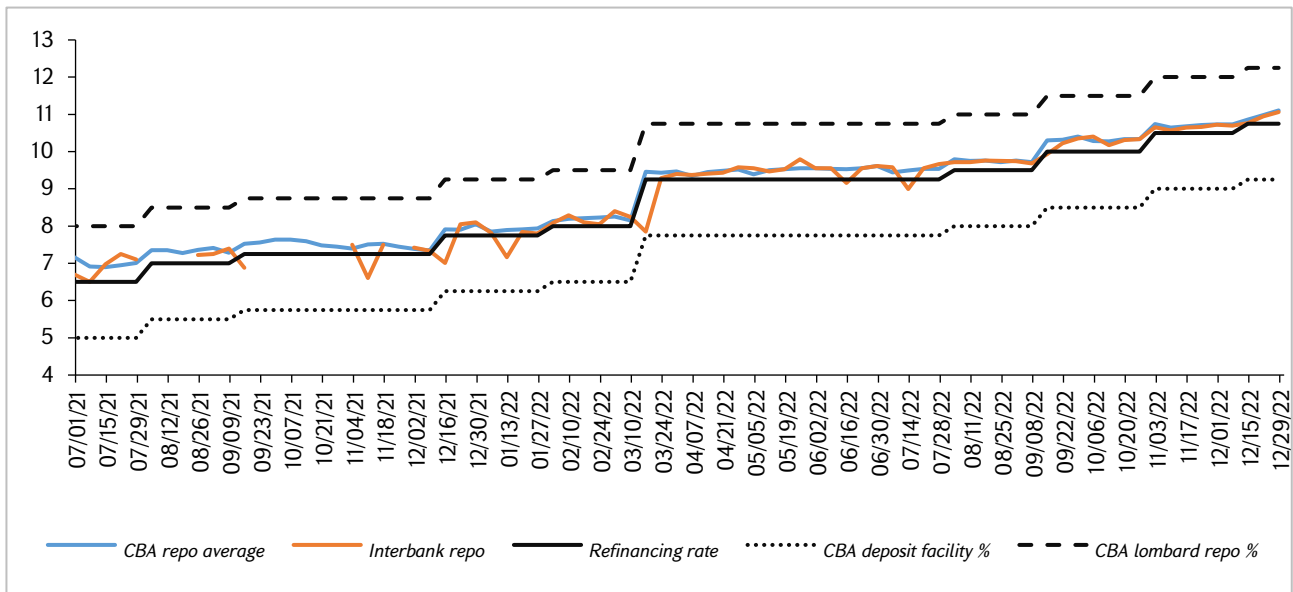
Under such circumstances, the Central Bank of Armenia continued to tighten monetary conditions during the first quarter of 2022 by raising the policy rate by 2.0 pp. Moreover, the monetary conditions were tightened, with a relatively large step of 1.25 pp, in March, responding to a high inflation environment estimated for mid-term perspective in the context of geopolitical developments. In the second quarter, the Central Bank refrained from changing the interest rate, taking into account the expectations of a gradual weakening of the inflationary effects under conditions of appreciation of the Armenian dram along with the increase in foreign demand. In the third and fourth quarters, however, despite some weakening of the inflationary effects on the Armenian economy from the external environment, the Central Bank tightened monetary conditions by raising the policy rate each time by 0.75 pp in view of persisting high demand and inflationary expectations in the domestic economy on the back of continued high influx of international visitors and tourists, and of financial assets.

There has been an increase in volatility observed in the Armenian financial market since the end of the first quarter of 2022, following the escalation of the Russian-Ukrainian conflict. Throughout the year the Central Bank of Armenia has been consistent in fulfilling

its goal of handling sufficient liquidity in the financial market, which helped the market interest rates shape mainly around the operational goal, i.e. the policy interest rate. Since the second quarter of the year, the dram had been appreciating continuously as a result of a considerably increased supply of foreign currency and grown demand for the Armenian currency in the financial market. To neutralize short-term disruptions and problems observed in the currency market in the middle of large-scale inflows of foreign currency, the Central Bank of Armenia arranged a situational intervention in the market, facilitating the normal functioning of the financial market.

Chart 2

The Central Bank of Armenia instruments and short-term market interest rates dynamics



To sum up, the 12-month inflation has increased significantly since March 2022, reaching 10.3% at the end of the second quarter; as a result of the implemented monetary policy, it gradually decreased to 8.3% at the end of the year. The 12-month core inflation behaved similarly in the course of the year, amounting to 9.5% at the yearend. It is estimated that the inflation rate will gradually reduce and stabilize around the 4% target starting from the second half of 2023 owing to the impact of a consistent monetary policy implementation.

2. INFLATION IN THE PERIOD UNDER REVIEW

High inflationary environment transmitted from the external sector and fueled by the growing demand in the domestic economy persisted throughout 2022 and demonstrated a trend of some easing only at the end of the year.

Thus, a sharp increase in the prices of items "Bread and cereals", "Meat", "Dairy products", "Oils and fats" has been observable in the domestic economy since the beginning of the year on account of the impacts transmitted from international food markets. The increase in international energy prices had its spillover effect on fuel prices. In the meantime, given the large influx of international visitors to the Republic of Armenia, the high demand created in the Armenian economy has added to inflationary pressures also in terms of locally manufactured goods and especially services, in which circumstance a number of tariffs for services with relative price rigidities (apartment rent, restaurants and hotels, hairdressing, financial, postal services), on a gradually increasing track throughout the reporting period, have been adjusted. In the fourth quarter of 2022, in expectation of weak demand from the world economy and tightening financial conditions, a decrease in prices of some goods (fuel, sunflower oil, grain) has been observable in international commodity markets, which was also reflected in the prices of goods imported to the Armenian economy. It should also be noted that the Armenian dram appreciated along with mounting external demand has notably curbed, starting from the third quarter of 2022, the price increases of imported goods.

Meanwhile, the risen prices of items "Tobacco" and "Alcoholic beverage" out of the core inflation components has incurred, as was estimated, the inflationary impact of the change in excise duty rates early in the year.

In addition to the above-mentioned factors, the acceleration of inflation since the start of the period under review has been driven significantly by highly grown prices of seasonal food products. Reduced sown areas pushed vegetable prices up, particularly for certain products, while unfavorable weather conditions had their impact on fruit prices, especially in the second quarter. Starting from the third quarter of 2022, the impact of these factors on inflation has mitigated to some extent.

In the first half of 2022, the tariffs of regulated services rose sharply due to the increase in the tariffs of water supply services since January, those of electricity since March, and those of natural gas since April.

Chart 3

The inflation environment intensified sharply in the first half of 2022 showed a sign of some easing at the end of the year

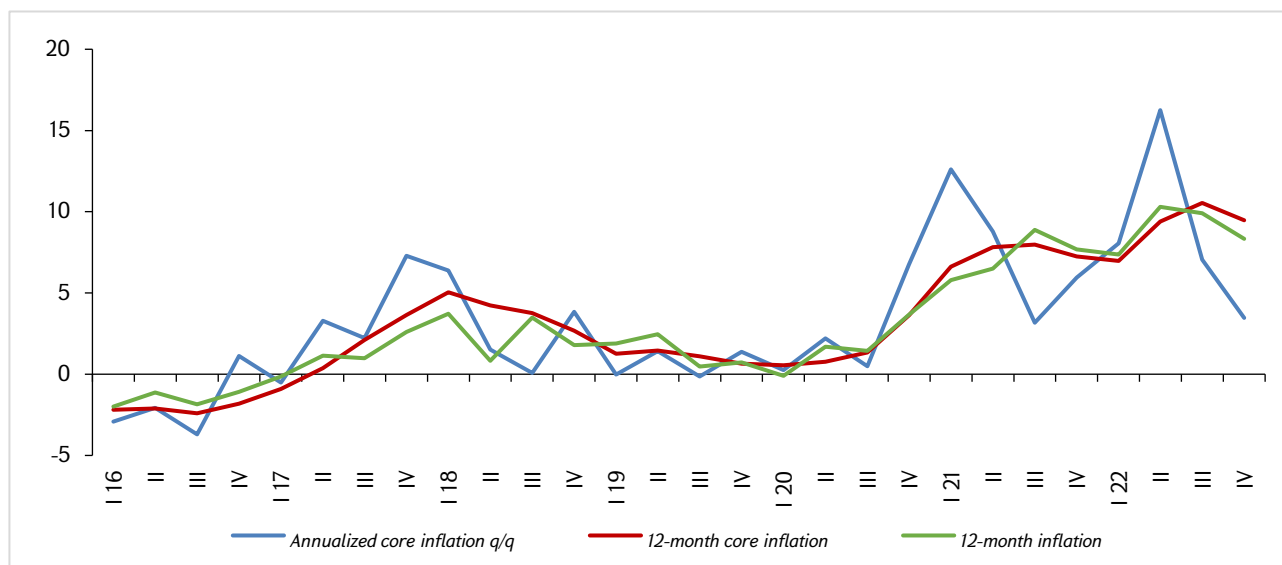


Table 1

Commodity/Item	Weight	12-month inflation: December 2022	Contribution to y/y inflation
Core inflation	75.1	9.5	7.1
Bread and cereals	8.1	14.1	1.1
Meat	9	12.3	1.1
Oils and fats	2.6	4.8	0.1
Sugar	0.5	-2.1	0.0
Dairy products	4.2	16.6	0.7
Alcoholic beverage	2.4	9.1	0.2
Tobacco	1.4	8.6	0.1
Clothing	1.3	7.4	0.1
Footwear	0.8	6.7	0.1
Household appliances	0.6	8.8	0.1
Fuel	6.8	2.6	0.2
Air passenger transportation services	0.6	47.1	0.3
Outpatient care services	2.7	3.3	0.1
Actual rent paid by the tenant for additional accommodation	1.0	63.0	0.6
Restaurants and hotels	1.0	8.8	0.1
Fees for services of banks, post offices	0.6	18.6	0.1
Imported food products	14.8	11.1	1.6
Seasonal food products	9.4	4.1	0.4
Eggs	1.3	-6.2	-0.1
Fruits	3.2	10.9	0.3
Vegetables	4.9	2.1	0.1
Regulated services	15.5	5.2	0.8