

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

*Approved under the Central Bank Board
Resolution No 207A, dated
29.11.2022*

**STATUS REPORT ON IMPLEMENTATION OF THE MONETARY
POLICY PROGRAM
(QIV 2021 – QIII 2022)**

In the period from the 4rd quarter of 2021 to the 3rd quarter of 2022, a high inflationary environment persisted in Armenia. Both the inflationary effects transmitted from the external sector and the growth of domestic demand contributed to it. The significantly weakening impact of the pandemic on the global economy from the end of 2021 onwards, resulted in a faster-than-expected recovery in economic activity and aggregate demand. However, such growth of global demand, amid disruptions of value chains, was accompanied by a significant expansion of the external inflationary environment, which transmitted a significant inflationary effect to the prices of the RA commodity market through a number of imported products. Still, under the impact of the pursued monetary policy, inflationary environment has softened somewhat since the end of 2021, with the 12-month inflation downsizing from 8.9% in September 2021 to 6.5% in February 2022. Beginning from end-February 2022, new inflation factors stemming from the aggravation of the Russian-Ukrainian conflict and the resulting sanctions against Russia emerged both in the international commodity markets and in the domestic economy leading, inter alia, to a significant expansion of the demand environment. Under their impact, a certain growth of 12-month inflation was observed in the second and third quarters of 2022, reaching 9.9% in September.

Given the existing situation and pursuant to the goal of ensuring price stability, during the reporting period, the Central Bank continued to pursue a stricter monetary stance, raising the policy rate by a total of 2.75 percentage point. About half of it, 1.25 percentage points, was in March 2022, as a response to the high inflation observed since the end of February amid the extraordinary high uncertainties. It is projected, that due to the described monetary policy steps, inflation in the medium-term 3-year horizon will gradually slacken and stabilize around the target of 4%.

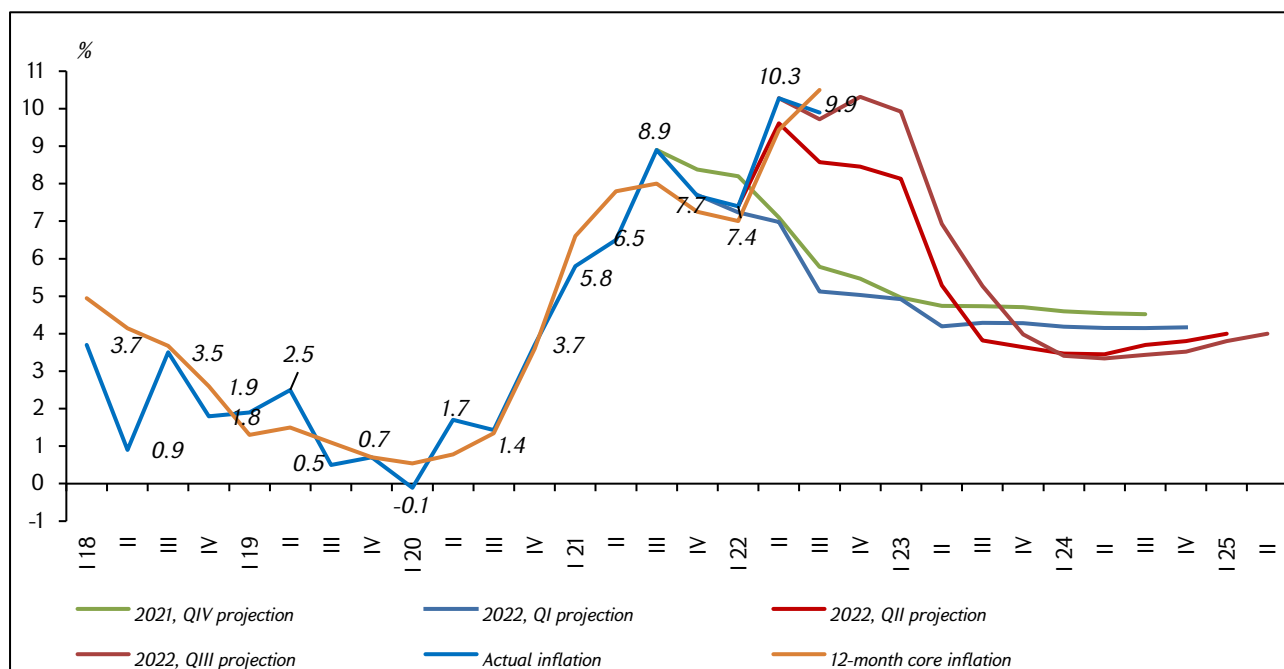
1. MONETARY POLICY IN THE PERIOD UNDER REVIEW

Under the basic assumptions of the scenario presented in the 2021, QIV program, as a result of the monetary policy implemented in the next one-year period, inflationary environment would weaken somewhat, still remaining high due to the ongoing global positive developments in demand combined with the factors of persisting value chain disruptions and limited supply. According to the projections, as a result of the gradual adjustment of the mentioned factors, in the medium term, the 12-month inflation would decrease and stabilize around the 4% target.

In line with the expectations, in the reporting period until March 2022, the 12-month inflation gradually decreased and already in February dropped to 6.5%, with a trend to approach its target level in the near future. However, geopolitical developments since the end of February caused a significant expansion of the inflationary environment and a much higher-than-expected inflation was observed. In view of this, in the second and third quarters, the projected path of inflation for the short-term period has been adjusted upwards.

Chart 1

During the observed period, the 12-month inflation dropped in line with the projected trajectory, and has increased sharply since March 2022, as a result of which, the short-term projection for that period has been revised upwards



Throughout October 2021 - February 2022, the recovery of global economic activity and external demand continued at a faster pace. In general, inflationary factors in Armenia persisted under the impact of inflationary effects still transmitted from the external sector and a certain positive environment of aggregate demand shaped amid the high energy prices and disruptions of supply

chains. The latter was strongly contributed by the high growth, especially in domestic services, which in turn, was affected by the higher-than-expected growth of tourism. At the same time, while a certain decrease in the 12-month inflation rates was observed since the end of 2021, as a result of the persisting inflationary effects and the expected changes in the prices of regulated services, the level of public inflationary expectations remained high. In view of these developments, the Central Bank continued raising policy rate by a total of 0.75 percentage points.

In the first three quarters of 2022, macroeconomic environment in Armenia and inflationary developments in particular, were greatly affected by the Russian-Ukrainian conflict, which intensified since the end of February, various sanctions applied to the Russian economy and the ensuing unprecedented uncertainties. The latter were manifested by a significant slowdown of the economic growth in the main partner countries of RA, as well as extraordinary high inflation in international energy and commodity markets as a result of disruptions in supply chains. The negative impact of such developments on the domestic economy was mainly reflected in a certain decrease of the short-term economic activity, and the high prices on certain imported products in Armenian commodity market. At the same time, as a result of the Russian-Ukrainian conflict, a significant growth of volatility of domestic financial market and the country's risk-premium was observed in the short term, which in turn contributed to a certain rise of inflationary expectations and inflationary risks. Starting from the second quarter of 2022, a significant acceleration of the economic activity was observed, mainly due to the high growth of the service sector driven by the extensive flow of international visitors and tourists and large-scale remittances. Thus, factors of external demand on domestic services had a decisive role for the high economic growth. Positive developments were also observed in the field of exports in IT and processing industries. Subsequently, as a result of the significant growth of foreign exchange supply and the demand for AMD in financial market, the AMD has significantly appreciated.

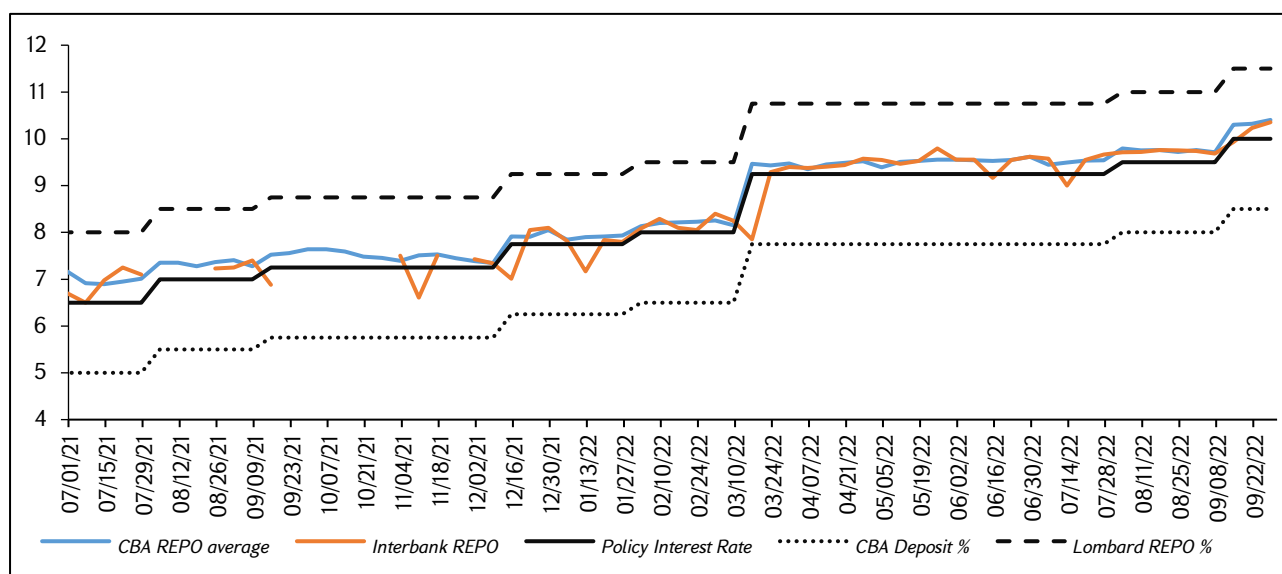
Under such developments, the Central Bank raised policy rate by 2.0 percentage points in March-September 2022. Notably, the Central Bank tightened monetary terms by a relatively large step of 1.25 percentage points in March, in response to the high inflationary environment caused by geopolitical developments. In the second quarter, the Central Bank refrained from changing the interest rate, given the expectations of a gradual weakening of the inflationary effects due to the appreciation of the Armenian dram in parallel with the increase in foreign demand. Furthermore, a relatively large tightening of monetary terms in the first quarter of 2022 deemed a sufficient response to further alleviation of the high inflation environment. In the third quarter, despite some weakening of the inflationary effects on the domestic economy from the external sector, the Central Bank consistently tightened monetary conditions and raised policy rate by 0.75 percentage points taking into account the larger than expected growth of demand

in the domestic economy amid the ongoing large inflow of international visitors and tourists and remittances, with the resulting projections of the inflationary environment expansion and persisting high inflationary expectations.

In the reporting period, short-term interest rates in Armenian financial market mostly shaped around the CBA policy interest rate. It should be noted that geopolitical developments in early 2022 lead to the growing uncertainty in Armenian currency market in March, which was reflected in the AMD volatility. Thus, in the initial period, amid an unprecedented uncertainty, a sharp depreciation of dram was observed. After that, due to the significant growth in the demand of international visitors (external demand) for domestic services and the large inflow of foreign remittances, a significant appreciation of the dram took place. With the view to offsetting short-term market disruptions and the ensuing problems, during that period, given the large-scale inflow of foreign currency, the Central Bank performed situational interventions in the currency market, contributing to the smooth operation of financial market.

Chart 2

Dynamics of CBA instruments and short-term market interest rates



To sum up, inflationary environment has softened somewhat since the end of 2021, and in February 2022, the 12-month inflation dropped to 6.5%, however, due to the emerging new factors, it grew again in the second and third quarters of this year, making 9.9% in September. Policy rate in the reporting period was raised by 2.75 percentage points in total, and was set at 10.0% in September 2022.

It is estimated, that as a result of consistent monetary policy, inflation during the 3-year forecast horizon will gradually decline approaching the target of 4% in the medium term.

2. INFLATION IN THE PERIOD UNDER REVIEW

At the beginning of the reporting period, a certain weakening of the inflation environment was followed by a sharp acceleration of inflation, reflected also in the dynamics of core inflation, still contributed by the inflation of imported food and non-food products, as well as the high demand in the RA economy. Thus, spill-over effects from international markets resulted in a sharp growth in the prices of “Bakery and Cereals”, “Meat Products”, “Oils and Fats” and “Sugar” commodity groups in the domestic economy. Furthermore, the growth of international energy prices affected domestic fuel prices. The sharp growth of international freight prices is also notable, as it had a direct impact on inflation of imported goods (in particular, electrical appliances, clothing and footwear, as well as personal care items). Furthermore, appreciation of the Armenian dram from the third quarter of 2022, in parallel with higher foreign demand, had a significant restraining effect on the growth of prices of imported goods. As a result, the 12-month increase in dram prices of imported food products at the end of the reporting period totaled 14.7%.

At the same time, the acceleration of aggregate demand due to the inflow of international visitors to Armenia has intensified inflationary pressures on local goods and services market, under which the prices of a number of services with relative price rigidity (apartment rent, restaurants and hotels, hairdressing, financial and postal services) have been adjusted. Notably, the growth of inflationary expectations and uncertainties caused additional inflationary pressures, especially on essential items.

Growth of prices of “Tobacco” and “Alcoholic Beverages” product groups, in line with the estimates, continued to be affected by inflationary impact of the change of excise tax rates at the beginning of the year.

In addition to the above-mentioned factors, low deflation of seasonal food products, not typical for the season, has significantly contributed to the acceleration of inflation. In particular, low deflation of vegetable prices was mainly the result of the reduction of sown areas for certain crops and the growth of exports. In the third quarter of 2022, the impact of those factors on inflation diminished, however, because of the unfavorable weather conditions a high growth of fruit prices was observed, at the end of the reporting period.

Tariffs of the regulated services in the first half of 2022 grew strongly because of the increase of water supply tariffs since January, electricity since March, and natural gas supply since April.

Chart 3

Some easing of the inflationary pressure from the end of 2021 was followed by a sharp acceleration of inflation from the second quarter of 2022

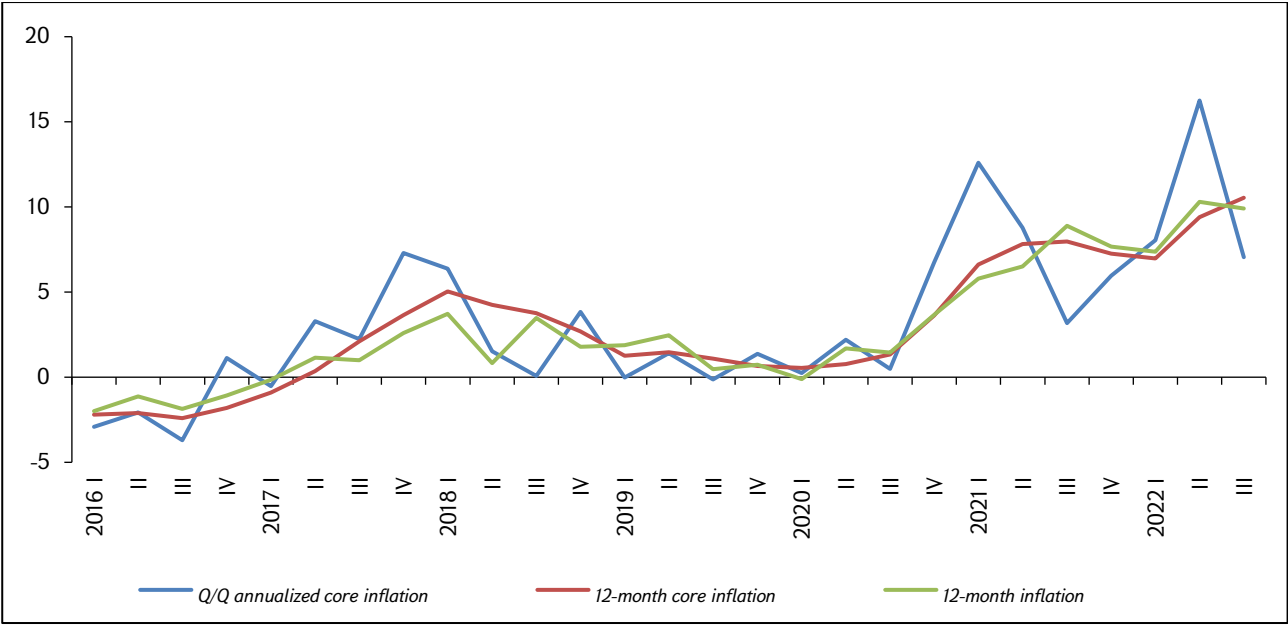


Table 1

Designation	Weights	12-month inflation in September 2022	Contribution to y/y inflation
Core inflation	75.1	10.5	7.9
Bread and cereals	8.1	19.4	1.6
Meat	9.0	11.9	1.1
Oils and fats	2.6	7.5	0.2
Sugar	0.5	1.1	0.0
Dairy products	4.2	20.8	0.9
Alcoholic beverage	2.4	9.0	0.2
Tobacco	1.4	8.7	0.1
Clothing	1.3	10.5	0.1
Footwear	0.8	9.2	0.1
Household appliances	0.6	7.4	0.0
Fuel	6.8	7.0	0.5
Air passenger transportation services	0.6	49.9	0.3
Actual rent paid by the apartment renter for additional accommodation	2.7	2.6	0.1
Restaurants and hotels	1.0	48.7	0.5
Fuel	1.0	8.6	0.1
Imported food products	0.6	15.7	0.1
Seasonal food products	14.8	14.7	2.2
Eggs	9.4	8.3	0.8
Fruits	1.3	-19.1	-0.2
Vegetables	3.2	21.0	0.7
Regulated services	4.9	4.3	0.2