

**CENTRAL BANK OF
THE REPUBLIC OF ARMENIA**

*Approved under
Central Bank Board Decision No. 83A,
dated 26.05.2020*

**STATUS REPORT ON IMPLEMENTATION OF THE
MONETARY POLICY PROGRAM
(Q2, 2019 - Q1, 2020)**

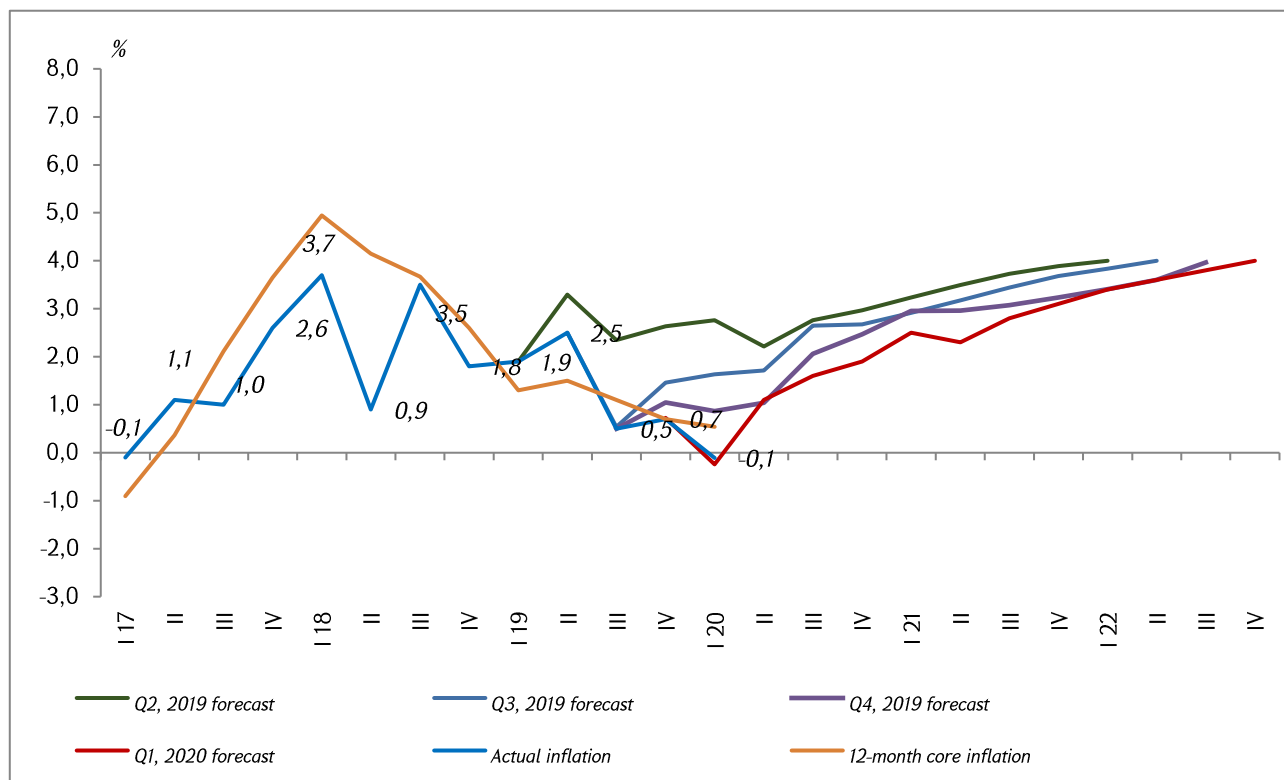
During the year preceding the second quarter of 2020, the inflationary environment persisted at a low level in Armenia. It was mainly attributable to more-than-expected contractionary fiscal policy carried out by the Armenian Government and the deflationary effects transmitted from the outside world. During 2019 some structural factors, such as increased competition in the commodity market and the shift in demand from non-durable consumer goods market to durable consumer goods market, were added to them. In March 2020, the prices of certain products were affected by the measures taken against the outbreak of the New coronavirus pandemic and its spread afterwards. In this situation, the Central Bank continued to pursue a stimulative monetary policy in the meantime, increasing the amount of stimulus by 0.25 percentage points in September 2019 and that much in March 2020, to reach the inflation target in the 3-year forecast horizon.

1. MONETARY POLICY IN THE PERIOD UNDER REVIEW

According to the monetary policy program for the second quarter of 2019, for the reporting period the inflationary environment was forecast to be low due to the expected weak aggregate demand. The latter, in turn, would be affected by the contractionary fiscal policy to be implemented and the impact of low inflationary environment persisted in the outside world. Under these conditions, the Central Bank would continue to pursue a stimulative monetary policy, giving preference to gradual recovery of inflation, which, if macroeconomic developments were to unfold in line with the baseline scenario, would be maintained also in the medium term. Under such a policy, the 12-month inflation rate would still be kept low in the short term, and in the medium term, it had to approach and stabilize around the target of 4%.

In the reporting period, the 12-month inflation had a downside deviation from the projection path, which was mainly due to a more-than-anticipated contractionary fiscal policy implemented in that time and weaker-than-expected demand in the external environment. Based on this, the Central Bank has revised the inflation forecasts and the path to recovery (see the chart). At the same time, starting from the second half of 2019, some supply-side factors containing the inflation, such as the impact of low prices in the outside world transmitted on to domestic prices, the increasingly competitive commodity markets, which alters the firms' pricing behavior and reduces their markups, and the increased effectiveness of the use of resources in the non-tradable sector of the economy, were observable.

According to the Central Bank forecasts, a low inflationary environment will persist in the short term and it will expand in the medium term, and at the end of the forecast horizon the 12-month inflation will stabilize around the target value



In view of a persisting low inflationary environment, the Central Bank pursued a stimulative monetary policy during the reporting period and continued to prioritize the gradual recovery of inflation, since, according to the Central Bank, the low inflation in the current macroeconomic situation contributed to the anchoring long-term inflation expectations. Taking into account the more-than-expected contractionary pace of the fiscal policy and the weakening of the inflationary environment in the international market of basic commodities, in the third quarter of 2019 the Central Bank slightly increased the amount of stimulus and lowered the refinancing rate by 0.25 percentage points.

The outbreak of the new type coronavirus (COVID-19) in a number of countries around the world since the beginning of the year, which was spreading rapidly in many countries around the world, including Armenia, in the first half of March, was a serious challenge for the Central Bank in the monetary policy point of view. According to the Central Bank, the impact of the pandemic is reflected in the simultaneous reduction of aggregate supply and demand, without having a significant direct impact on the headline inflation developments, and the role of monetary policy is limited in terms of counteracting the contagion of the virus. Under such a circumstance, the Central Bank Board, taking into account the currently low inflation environment, the expected developments and uncertainties in the world and Armenian economies, cut the refinancing rate further by 0.25 percentage points at its March 17th meeting. At the same time, the pandemic challenged the financial market of the Republic of Armenia through added uncertainty, leading to a significant increase in demand for dram liquidity, as well as a certain rise in interest rates in the medium- and long-term government bonds market. The Central Bank, through its main tool, has

injected a required amount of liquidity into the system, helping short-term interest rates shape around the policy rate of the Central Bank. In the reporting period, the Central Bank repeatedly signaled the financial market that, in view of predicted macroeconomic developments, the monetary conditions will be kept expansionary for as long a period of time as necessary, to fulfil the inflation target in the medium term.

2. INFLATION IN THE PERIOD UNDER REVIEW

In the year following the second quarter of 2019, 12-month inflation remained low and demonstrated patterns of volatility primarily attributable to agricultural product price changes because of the shift in crop seasonality. Thus, a notable rise in seasonal food prices in the second quarter of this year contributed to a certain increase in inflation, which amounted to 2.5% in June; in the second half of the year and at the beginning of 2020, again mainly due to the fall in prices of seasonal goods, the inflation subdued gradually, reaching -0.1% y/y in March. However, the 12-month core inflation rate has also decreased, to 0.5%, whereas the y/y rise in regulated service tariffs and seasonal food product prices has been 1.4% and -6.5%, respectively. Price deflation of seasonal food products was driven by the fall in prices of items “Vegetables” (-19.4%, y/y), “Fruits” (8.5%, y/y), and “Eggs” (-31.2%, y/y). The core inflation was mainly determined by prices of items “Alcoholic beverage”, “Tobacco”, “Bread and cereals”, “Footwear”, and “Fuel” having increased, respectively, by 11.0%, 7.2%, 1.44%, 3.6% and 2.7% y/y, and by tariffs of services “Outpatient care services”, “Hospital services” and “Education services” having risen by 5.1%, 2.3% and 3.7% y/y, respectively. The rise in prices of “Tobacco” and “Alcoholic beverage” mostly incurs the inflationary impact of a change in excise duty rates at the beginning of the year. At the same time, the decline in food prices in international markets continued spilling over to the domestic market, where a certain weakening of price inflation on food products was observable as well. The sugar and meat product markets have seen a significant price deflation relative to the same period of the previous year (-10.6% and -4.5%, respectively, with a combined contribution to inflation amounting to -0.5%). It should be noted that the inflationary impact of a change in customs rates on some goods in the beginning of 2020, as was estimated, amounted to about 0.2 percentage points.

The coronavirus pandemic has prompted structural shifts and certain changes in demand for individual goods in consumer markets both in the world and the Republic of Armenia. However, these changes have not yet been substantially reflected in prices and service tariffs in the course of March. Nor has some dram exchange rate depreciation in March been significantly reflected in the domestic prices for March. As of March, prices of certain food products, especially those of buckwheat, bulgur, rice, flour of cereals, garlic, onion, lemon and pepper, rose due to the growing demand.

Table 1

Designation	Weight	12-month inflation	Contribution to y/y inflation
Core inflation	72.7	0.54	0.39
Bread and cereals	8.99	1.44	0.13
Meat	9.87	-4.48	-0.44
Oils and fats	2.77	-3.46	-0.10
Sugar	0.6	-10.62	-0.06
Alcoholic beverage	2.77	10.99	0.30
Tobacco	1.77	7.20	0.13
Clothing	2.58	0.47	0.01
Footwear	1.52	3.57	0.05
Medicines and health products	4.83	0.78	0.04
Fuel	5.2	0.96	0.05
Air passenger transportation services	0.55	-9.02	-0.05
Education	1.48	3.71	0.05
Hospital services	2.57	2.27	0.06
Outpatient care services	2.44	5.14	0.13
Seasonal food products	10.5	-6.53	-0.69
Eggs	1.44	-31.19	-0.45
Fruits	3.35	0.94	0.03
Vegetables	5.74	-6.64	-0.38
Regulated services	16.7	1.41	0.24