

**CENTRAL BANK OF THE
REPUBLIC OF ARMENIA**

*Approved under
Central Bank Board Decision No 20A ,
dated 25.02.2021*

**STATUS REPORT ON IMPLEMENTATION OF THE
MONETARY POLICY PROGRAM
(Q1, 2020 - Q4, 2020)**

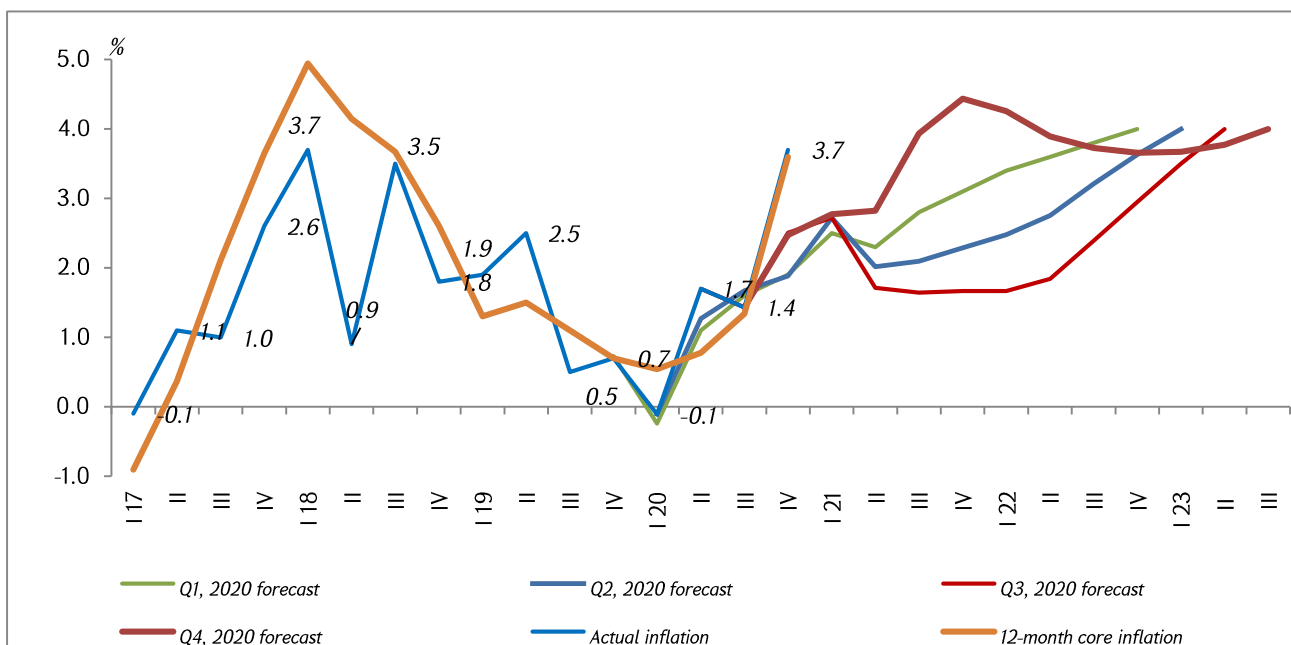
*The monetary policy carried out by the Central Bank of Armenia in 2020 was steered to ensuring a **4% target for the 12-month inflation** in the forecast horizon. The inflationary environment remained low during the year mainly due to a weak demand which had been driven notably by consequences of COVID-19 outbreak in the world and Armenia since the beginning of the year and health and economic effects of the martial law declared in the country on September 27th. They were reflected both in a decline of economic activity and considerable weakening of aggregate demand. In such a situation, the Government carried out a significant stimulative fiscal policy aimed at providing social and economic assistance. However, in the face of grown uncertainty stemmed from the pandemic and the martial law, the public has demonstrated precautionary behavior for consumption and investment, which, despite fiscal stimulus, has led to a weak domestic demand and a low inflationary environment. **In 2020, in order to bring 12-month inflation closer to its target, the CBA continued to pursue a stimulative monetary policy.** Thus, in January-November, the CBA has increased the size of stimulus by gradually reducing the refinancing rate by a total of 1.25 percentage points. In December, when inflation and inflationary expectations were expected to somehow accelerate in anticipation of inflationary effects from the external sector and patterns of depreciation of the dram in the currency market, the CBA raised, in a bigger step, the interest rate by 1.0 percentage point to **5.25%**. As a result, the 12-month inflation increased gradually during the year and at a faster pace at the end of the year, reaching 3.7% - rather close to the target - in December.*

1. MONETARY POLICY IN THE PERIOD UNDER REVIEW

The reporting period - the entire 2020 in this case - proved a rather difficult year for the world and, particularly, for Armenia, with a number of health and geopolitical developments and economic and social challenges which derived therefrom. Back in the beginning of the year, when the CBA was making MP program forecasts for the first quarter of 2020, the New Coronavirus rapidly spreading in the world started appearing in Armenia. In the program published, the CBA informed the public that the world was in a state of great uncertainty both in terms of healthcare and economic issues, the situation changing day by day, making any forecast, even the quantitative assessment of the current situation, strictly conditional, so the program was to be used mainly as a guide. According to the baseline scenario, the 12-month inflation would further stay low in the short run amid a significant decline in economic activity and weakening aggregate demand as a consequence of coronavirus pandemic and pandemic-driven restrictions; in the medium run it would approach and stabilize around the 4% target along with measures to conquer the pandemic and facilitate demand recovery.

In the reporting period, as expected, a low inflationary environment was shaped. In the second and third quarters of 2020, because of healthcare and economic restrictions imposed to overcome the coronavirus pandemic as well as the uncertainty about the economic outlook, a sharp decline in economic activity was observable, with significant reductions in all sectors of the economy. In such a situation, the Government implemented a considerably stimulative fiscal policy steered to providing social and economic support. However, in the midst of high uncertainty accumulated due to the pandemic, the people showed precautionary behavior. This has outpaced the fiscal stimulus, leading to weakened domestic demand and low inflationary environment. It should be noted that the martial law announced in Armenia on September 27th as well as the new wave of coronavirus that broke out and spread rapidly in the meantime have added to uncertainties in terms of outlook to economic recovery and inflation developments in the fourth quarter. In addition, the expectations that global economic activity and external demand would rebound by the end of the year led to a significant increase in inflation environment in both the international commodity markets and the main partner countries to Armenia, under which inflationary pressures spilled over to the Armenian economy through a number of import food products. At the end of the year, as a result of the aforementioned developments as well as depreciation of the dram, inflation in Armenia grew higher than expected and inflationary expectations increased.

According to the CBA forecasts, the inflationary environment will expand in the upcoming one-year period but it will subdue gradually in the medium term, and at the end of the forecast horizon the 12-month inflation will stabilize around the target, as a result



In a macroeconomic environment shaped under the developments described above, the 12-month inflation has proved lower than expected in the first three quarters, prompting the CBA to revise periodically the projection path of inflation downside. Already in the fourth quarter, the projection path of inflation to reach the target came in a short-term revision upside.

Using its main instrument – the 7-day repo agreements – the Central Bank has fully met the demand for dram liquidity in the domestic financial market which has grown high on the back of the Covid-19 pandemic and the declared martial law. Short-term market interest rates have responded appropriately to the policy rate changes, as they largely shaped around the policy rate. During the year, amid uncertainty related to the economic and political outlook, Armenia’s currency market saw the dram depreciating to some extent. The CBA, while adhering to the floating exchange rate policy, has taken a small situational part in the foreign exchange market in ensuring the normal functioning of the financial market.

In the reporting period, in consideration of possible inflationary effects under a weak aggregate demand, the Central Bank conducted a stimulative monetary policy. The CBA had the amount of stimulus increased by December, gradually reducing the refinancing rate by a total of 1.25 percentage points. At the end of December, taking into account some acceleration of inflation and inflation expectations under inflationary effects anticipated from the external sector as well as the increase in the country's risk premium, the Central Bank decided to raise, in a bigger step, the interest rate on the underlying instrument by 1.0 percentage point.

2. INFLATION IN THE PERIOD UNDER REVIEW

In the first quarter of 2020, the 12-month inflation remained low. Demonstrating certain volatility however, it has increased in the course of the year, approaching the target late in the year. Specifically, a weak inflationary environment early in the year owed primarily to the sizable fall in seasonal food prices, with prices of items “Vegetables” and “Eggs” in particular. Starting from the second quarter of 2020, inflation recovered to a certain extent, which is a result of some rise in prices of seasonal agricultural products, especially the price of fruits.

The inflation accelerated at the end of the year was attributable to the acceleration of core inflation, which was mainly driven by price inflation on imported food and non-food products. The latter has incurred the impact of both the rise in food prices in international markets and the depreciation of the dram. Price inflation in items “Bread and cereals”, “Oils and fats” and “Sugar” due to the reduction of supply of relevant products in international markets is worth mentioning. Meanwhile, an increase in international energy prices has had its impact transmitted onto the end-year rise in fuel prices. The 12-month inflation has also been driven by an increase in prices of medicines and health products, which almost entirely was determined by high demand shown during the pandemic. The acceleration of core inflation especially at the end of the year has been somehow driven by a sharp increase in air transport tariffs, which resulted from the easing air communication restrictions some countries had used to prevent the pandemic.

Regulated service tariffs demonstrated minor inflation volatility during the year, posting a 1.0% year-on-year growth.

The inflationary impact of a change in customs rates on some goods in early 2020, as was estimated, amounted to about 0.2 pp, while the price increase on items “Tobacco” and “Alcoholic beverage” still incurs the inflationary impact of a change in excise duty rates at the beginning of the year.

Table 1

Items/designation	Weight	12-month inflation: December 2020	Contribution to y/y inflation
Core inflation	72.7	3.63	2.64
Bread and cereals	7.73	7.37	0.58
Meat	9.58	-0.57	-0.05
Oils and fats	2.37	13.15	0.31
Sugar	0.53	38.12	0.20
Alcoholic beverage	2.79	12.27	0.34
Tobacco	1.39	6.63	0.09
Clothing	2.45	0.12	0.00
Footwear	1.31	0.49	0.01
Medicines and health products	4.62	5.82	0.27
Fuel	5.29	2.93	0.15
Air passenger transportation services	0.48	35.47	0.17
Education	3.14	2.03	0.06
Hospital services	2.66	1.37	0.04
Outpatient care services	2.37	2.84	0.07
Seasonal food products	11.47	7.53	0.86
Eggs	1.15	18.51	0.21
Fruits	4.19	11.38	0.48
Vegetables	6.13	2.84	0.17
Regulated services	15.88	1.01	0.16