

**CENTRAL BANK OF  
THE REPUBLIC OF ARMENIA**

*Approved under  
Central Bank Board Decision No.81A  
dated 25.05.2021*

**STATUS REPORT ON IMPLEMENTATION OF THE  
MONETARY POLICY PROGRAM  
(Q2, 2020 - Q1, 2021)**

*The period under review spans a year from April 2020 to March 2021, which has proved difficult for the healthcare system and economy in the world and Armenia. The outbreak of New Coronavirus disease (COVID-19) in the world in late 2019, aggravated by martial law declared in Armenia amid the hostilities in Artsakh since September 27, 2020 and the resulting economic and political uncertainties, posed serious health, social and economic problems and challenges to the world and Armenia, in particular. In Armenia, these were reflected in a notable decline in economic activity, considerably weakened aggregate demand, as well as a low inflationary environment in such conditions. In that situation, the Armenian Government has implemented a significant fiscal stimulus policy aimed at socio-economic assistance and the Central Bank of Armenia pursued a stimulative monetary policy steered to securing the 12-month inflation at a 4% target over the forecast horizon. Thus, in April-November, the CBA gradually reduced the refinancing rate by a total of 1.0 pp. Already in December, when inflation and inflation expectations were predicted to somewhat accelerate in anticipation of inflationary effects from the external sector and dram depreciation in the currency market amid positive signs for the recovery of world economy, the CBA increased the policy rate in a big step, 1.0 pp. In February 2021, it raised the policy rate again, by 0.25 pp to 5.5%. Even with such an increase, the monetary policy's stance remained expansionary. As a result, the 12-month inflation has increased gradually in the reporting period and, since the end of the year, it expanded even faster due to supply factors and amounted to 5.8% in March, stepping above the 4% target.*

## **1. MONETARY POLICY IN THE PERIOD UNDER REVIEW**

Early in the period under review, i.e. during the second quarter of 2020, the coronavirus rates were rising rapidly around the world, including Armenia, and restrictions imposed by governments led to considerable declines in economic activity in the world and Armenia, with weakened aggregate demand and notable deflationary patterns reported in key commodity markets. In the meanwhile, increased uncertainties about the outbreak of the pandemic and the economic development outlook put extra pressure on aggregate demand. In such a situation, the world's major financial institutions and central banks, including the Central Bank of Armenia, revised their estimations of key

macroeconomic indicators downside, and the central banks therefore envisaged implementing a more stimulative monetary policy to restore demand and ensure price stability. At the same time, in view of the sectoral nature and peculiarity of the economic shock, the Government embarked on programs embracing fiscal stimulus measures. In the second quarter of 2020, according to the CBA's baseline scenario, the 12-month inflation in the short run would still be kept low, as the effects of sluggish private demand would outweigh the fiscal policy stimulus. In the medium term, as a result of stimulative monetary policy implemented while fighting the pandemic and fostering a recovery of demand, inflation would gradually increase, stabilizing around the 4% target at the end of the forecast horizon.

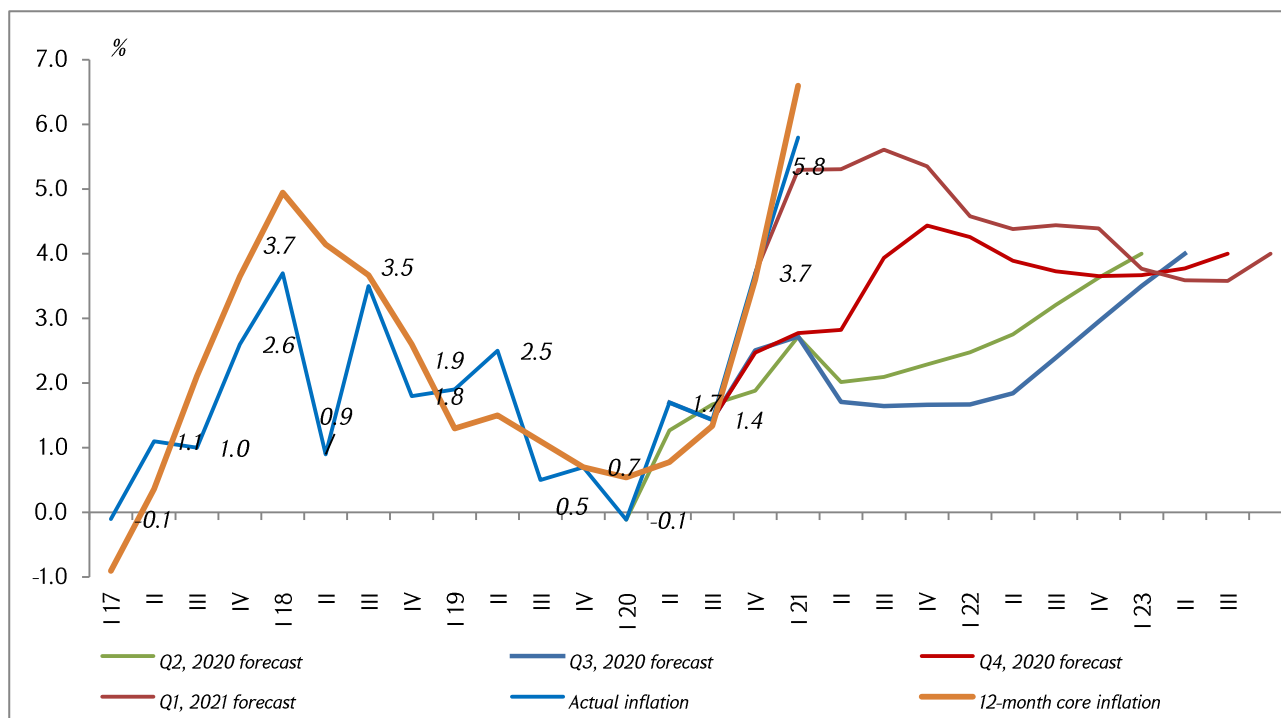
In the first half of a reporting year, as expected, the inflationary environment remained low. In the second and third quarters of 2020, because of healthcare and economic restrictions imposed to overcome the coronavirus disease as well as high uncertainty about the economic outlook, a sharp decline 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 increasingly accumulated uncertainty, people showed precautionary behavior, which has outpaced the fiscal stimulus, leading to weakened domestic demand and low inflationary environment in such conditions.

Driven by a macroeconomic environment shaped under the developments described above, the 12-month inflation stood lower-than-expected over these quarters, amounting to 1.4% at the end of September, prompting the CBA to revise periodically the projection path of inflation downside.

The declared martial law in Armenia since 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 of 2020. This had an additional negative impact on the slowly recovering private demand, deepening the economic decline. On the other hand, the positive developments and expectations for rebounding global economic activity and external demand late in the year, and a number of supply factors (forecasts of low supply of new harvest, increase in freight costs, consequences of disrupting production chains) led to a significant increase in inflation environment in the international commodity markets. This in turn drove the inflation environment in Armenia's main partner countries to expand further, under which inflationary pressures spilled over to the Armenian economy through a number of import food products. In the meantime, dram depreciation in the domestic currency market was observable, as the martial law and economic and political uncertainties persisted. Such trends lingered over the first quarter of 2021, and the supply factors influenced under the trends pushed the 12-month inflation rate higher than expected in the second half of the period under review (October 2020 to March 2021), reaching 5.8% in March; the inflation expectations somewhat increased, as well.

In view of the aforementioned developments, the projection path of inflation over the last two quarters of the reporting year has been presented with an upside adjustment in the short term.

***In the first half of the period under review, a low inflation environment persisted, as was expected, but in the second half, the 12-month inflation expanded at rapid rates, outstripping the 4% target***



The uncertainties arising from the Covid-19 pandemic and declared martial law during the period under review fostered a high demand for dram liquidity in the Armenian financial market. Following the CBA operations performed through its main instrument (7-day repo agreements), short-term market interest rates have responded appropriately to the policy rate changes and are largely shaped around it. 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 situational part in the foreign exchange market in ensuring the normal functioning of the financial market.

In the period under review, in consideration of possible inflationary developments under a weak aggregate demand, the CBA conducted a stimulative monetary policy. And, while the CBA had increased the amount of stimulus by December, gradually reducing the refinancing rate by a total of 1.0 pp, the interest rate of the main instrument had climbed from December 2020 to April 2021 in a big step (1.0 pp in December and 0.25 pp in February) in consideration that inflationary effects expected from the external sector would somehow accelerate the inflation and inflation expectations. At the same time, the CBA gave a signal to the financial market that in the near future too it be consistent in neutralizing any risk to accelerated inflation expectations, without harm to the recovery of domestic demand as much as possible.

## 2. INFLATION IN THE PERIOD UNDER REVIEW

A sluggish recovery of inflation has been observable starting from the second quarter of 2020, greatly driven by a certain increase in prices of seasonal agricultural products, especially fruits. Then, the inflation accelerated later in the year and exceeded the target already in the first quarter of 2021.

The inflation expanded at the end of the year was attributable to the acceleration of core inflation, which was mainly fueled 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. Thus, prices of items “Bread and cereals”, “Oils and fats” and “Sugar” have grown in the domestic economy under effects spilled over from international markets. Meanwhile, an increase in international energy prices has transmitted its impact on the fuel prices. The 12-month inflation has also been driven by an increase in prices of medicines, which almost entirely was determined by high demand shown during the pandemic. The acceleration of core inflation especially late in the year has been somehow driven by a sharp increase in air transport tariffs, as air communication restrictions some countries had used to prevent the pandemic, have been eased.

In the first quarter of 2021, inflation patterns continued to be seen in the main commodity markets amid positive expectations for demand recovery and a number of supply factors, which had directly influenced the expanding of inflation on food products imported to Armenia.

Regulated service tariffs demonstrated minor inflation volatility during the year, posting a 0.9% year-on-year rise in the first quarter of 2021.

The risen prices of fruits and highly grown prices of eggs in particular, as well as an increase in prices of item “Tobacco” and “Alcoholic beverage”, determined by market-specific shocks in the time of sluggish demand, is worth mentioning, and such a price increase has incurred, as was estimated, the inflationary impact of an excise duty rate change at the beginning of the year.

Table 1

Item/designation	Weight	12-month inflation: March 2021	Contribution to y/y inflation
<b>Core inflation</b>	<b>74.43</b>	<b>6.6</b>	<b>4.9</b>
Bread and cereals	7.68	9.4	0.7
Meat	9.66	3.4	0.3
Oils and fats	2.25	24.6	0.6
Sugar	0.44	40.9	0.2
Alcoholic beverage	2.87	9.0	0.3
Tobacco	1.59	9.6	0.1
Clothing	2.43	6.4	0.2
Footwear	1.55	8.2	0.1
Medicines and health products	3.97	12.2	0.5
Fuel	6.25	6.5	0.4
Air passenger transportation services	0.56	77.2	0.4
Education	3.18	2.1	0.1
Hospital services	2.68	0.7	0.0
Outpatient care services	2.94	3.2	0.1
<b>Seasonal food products</b>	<b>9.59</b>	<b>9.6</b>	<b>0.9</b>
Eggs	1.28	78.2	1.0
Fruits	3.65	10.9	0.4
Vegetables	4.67	1.4	0.1
<b>Regulated services</b>	<b>15.98</b>	<b>0.9</b>	<b>0.1</b>