

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

*Approved under the Central Bank Board  
Resolution No 170A, dated  
November 23, 2021*

**STATUS REPORT ON IMPLEMENTATION OF THE  
MONETARY POLICY PROGRAM  
(Q IV 2020 – Q III 2021)**

*Amid the ongoing global pandemic, with the new waves regularly breaking out all around the world, problems and challenges faced by the global economy and the healthcare system, as well as uncertainties about economic prospects persisted throughout the reporting period from the fourth quarter of 2020 to the fourth quarter of 2021. In spite of that, since the beginning of 2021, due to the widespread use of coronavirus vaccination and the avoidance of severe economic constraints have led to a faster-than-expected recovery in the global economy and external demand. Subsequently, inflationary environment in the international commodity markets and main partner countries of the Republic of Armenia has significantly expanded. Similar trends have been observed in Armenia, where the actual indicators of both economic growth and inflation have mostly surpassed the forecasts. In the reporting period, under the stronger inflationary impact transmitted from the external sector, a number of supply and demand factors in the Armenian economy and devaluation of dram in Armenian currency market, 12-month inflation demonstrated upward dynamics, reaching from 1.4% in September 2020 to 8.9% in September 2021. Given inflationary spill-over effects transmitted from the external sector and manifested in the RA economy and parallel increase of inflation expectations, the Central Bank, gradually offsetting the expansionary position during the reporting period, raised policy rate by overall 3.0 percentage points, bringing it to 7.25% in September.*

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

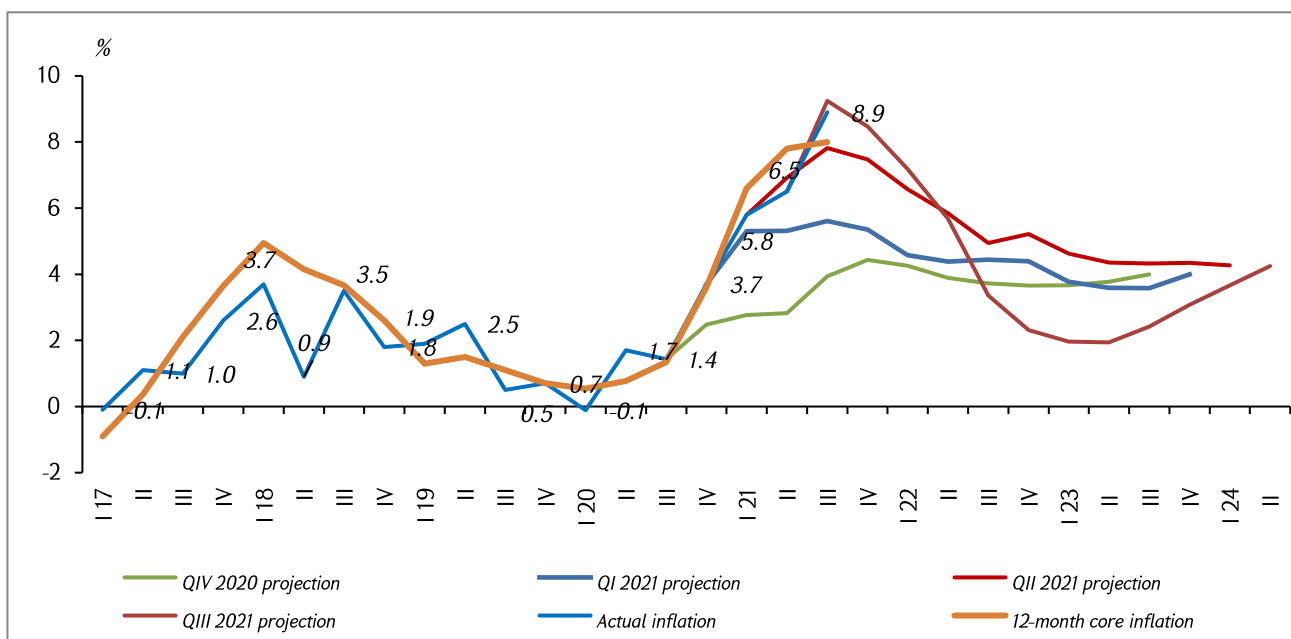
The monetary policy to be implemented at the beginning of the reporting period was based on a number of assumptions described below. In particular, amid the growing uncertainties against the background of martial law, quickly spreading second wave of the coronavirus, in the fourth quarter of 2020, low economic activity and weak demand were expected. Starting from 2021, some negative factors, such as the expected slowdown in financial intermediation, as well as the projected weak restraining effect of fiscal policy, would to some extent curb overall demand. However, under the influence of inflationary pressures from foreign commodity markets on domestic prices and the actual depreciation of dram, inflation was expected to accelerate in the next year. Given the expected expansion of the inflationary environment and the increase of country risk premium under the declared martial law, the Central Bank tended to gradually reduce monetary expansionary position in order to achieve the goal of inflation.

During the reporting period, macroeconomic developments both in the external sector and in the Armenian economy were more positive than expected. Thus, as a result of the widespread use of coronavirus vaccination and the avoidance of severe restrictions to a possible extent, a faster recovery of global economic activity and external demand has

been observed. Under the influence of a number of supply factors manifested against the background of positive demand developments (forecasts of low supply of new crops, increase in freight costs, disruption of production chains), significant inflationary developments were observed in the international commodity markets. This was also reflected in the formation of a high inflationary environment in the main partner countries of the Republic of Armenia, under which inflationary pressures were transmitted to the economy of the Republic of Armenia through a number of imported food products. In the second quarter of 2021, demand factors were added to supply factors of the impact of international food prices inflation on domestic prices, conditioned by the progressive growth in private consumption over the output capacity expansion opportunities. The latter was mainly due to the sharp increase in household consumption expenditures at the expense of the accumulated savings, as well as the large inflow of remittances. At the same time, amid martial law and economic-political uncertainties, depreciation of the Armenian dram was observed in the foreign exchange market at the beginning of the reporting period, which, in the conditions of fundamental improvement of the external balance, was mostly offset by further dram appreciation. **Under the impact of these factors, in the reporting period, as expected, 12-month inflation showed an upward trend, reaching from 1.4% in September 2020 to 8.9% in September this year.** Great uncertainty over the economic outlook has also raised inflation expectations to some extent. All this was also reflected in the core inflation performance: **during the aforementioned period, the 12-month core inflation also grew significantly, making 8.0% in September.** It is noteworthy that the quarterly annual core inflation mainly grew in the first two quarters of the reporting period, and then, until the third quarter of 2021, significantly dropped to 3%.

In light of these developments, the projected short-term inflation trajectory to reach the target in each subsequent quarter of the reporting year was adjusted upwards.

**12-month short-term inflation forecasts for the reporting period were periodically revised upwards**



Due to the uncertainties arising from the declared martial law during the reporting period, there was a high demand for monetary liquidity in the Armenian financial market, which the Central Bank fully satisfied mainly through its main instrument (7-day repo agreements). Subsequently, short-term market interest rates were mainly shaped around policy interest rate. During the reporting period of 12 months, the Central Bank, adhering to the floating exchange rate policy, took a situational participation in the foreign exchange market in order to ensure the normal functioning of the financial market.

Taking into account inflationary effects in the external sector and the Armenian economy, and, parallel to it, certain increase of inflation expectations, during the reporting period, the Central Bank, as planned, pursued a policy of tightening monetary conditions, gradually reducing and offsetting expansionary monetary position. To this end, the Central Bank through comparatively big steps raised the refinancing rate setting it at 7.25% in September. It is estimated that such a persistent tightening of monetary conditions has a sufficient impact on the regulation of progressive demand, curbing inflation and ensuring the inflation target in the medium term.

## **2. INFLATION IN THE PERIOD UNDER REVIEW**

Inflation has accelerated since the end of 2020, and, as projected, inflation environment in the reporting period remained high.

The growth of inflation by the year-end was mainly conditioned by the acceleration of core inflation, which was strongly driven by the rise in prices for imported food and non-food products. The latter has been affected by changes of food prices in international markets and devaluation of dram. Thus, spill-over effects from international markets resulted in a sharp growth in the prices of "Bakery and Cereals", "Oils and Fats" and "Sugar" commodity groups in the domestic economy. The growth of international energy prices affected fuel prices. As a result of the rise of fuel prices, as well as the easing of air communication restrictions introduced by some countries in order to prevent the pandemic, air transport tariffs have also grown significantly. As a result of the increase in fuel prices, as well as the easing of air communication restrictions used by some countries to prevent the epidemic, air transport tariffs have also increased significantly. 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).

In the first half of 2021, inflationary trends continued in the main international commodity markets because of the positive expectations of demand recovery and a number of observed supply factors, which also had a direct impact on the increase in inflation of imported food. At the same time, along with the faster-than-expected recovery of demand in the Armenian economy, inflation in the mentioned period accelerated for locally produced goods and services as well, leading to the adjustment of tariffs for a number of services with rigid prices (medical, hairdressing, legal and postal services).

In addition to the above-mentioned factors, the acceleration of inflation was significantly fueled by the weaker deflation of seasonal food products in the third quarter of 2021, which is not usual for the season. In particular, the lower-than-usual deflation of vegetables was the result of bad weather conditions, as well as the reduction of arable crops and the growth of exports.

During the year, tariffs for regulated services endured moderate inflationary fluctuations, with 0.6% year-over-year growth in the third quarter of 2021

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.

***The acceleration of quarterly inflation was mainly observed at the beginning of the reporting period, although it is still reflected in the 12-month inflation indicators.***

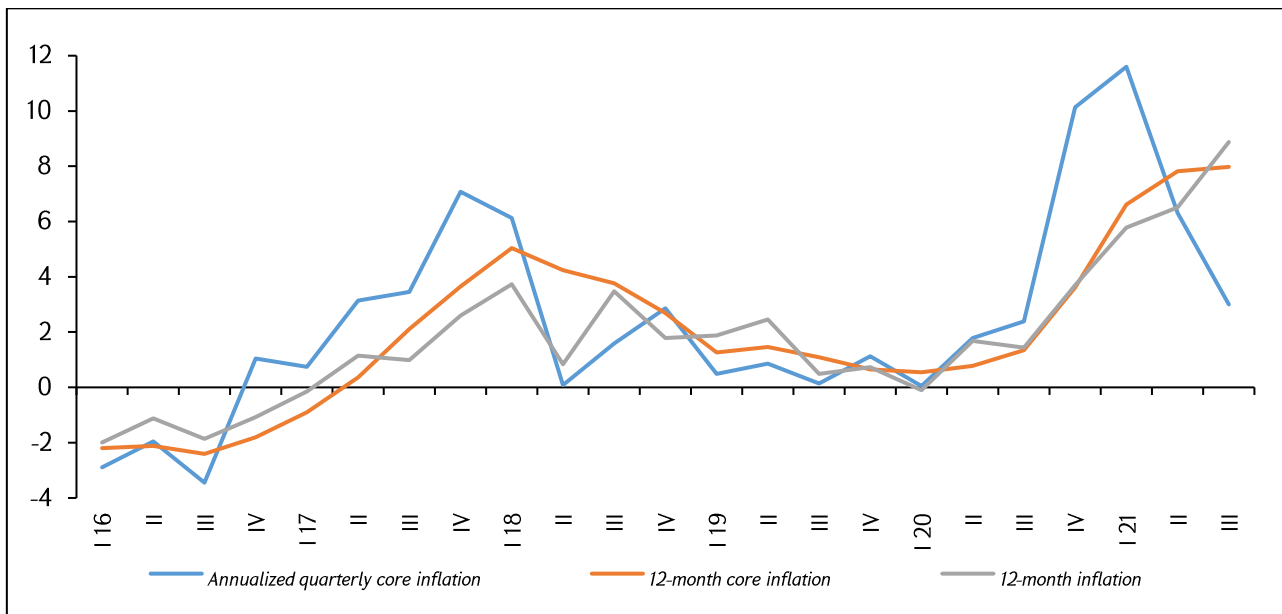


Table 1

Designation	Weight	12-month inflation	Contribution to y/y inflation
<b>Core inflation</b>	<b>74.4</b>	<b>8.0</b>	<b>5.9</b>
Bread and cereals	7.7	9.5	0.7
Meat	9.7	9.0	0.9
Oils and fats	2.3	27.1	0.6
Sugar	0.4	31.1	0.1
Alcoholic beverage	2.9	8.6	0.2
Tobacco	1.6	10.4	0.2
Clothing	2.5	12.9	0.3
Footwear	1.6	11.7	0.2
Household appliances	0.5	12.4	0.1
Medicines and health products	4.0	9.5	0.4
Fuel	6.0	10.3	0.6
Air passenger transportation services	0.6	22.2	0.1
Outpatient care services	2.9	2.3	0.1
<b>Seasonal food products</b>	<b>9.6</b>	<b>28.3</b>	<b>2.7</b>
Eggs	1.3	27.4	0.4
Fruits	3.7	-3.0	-0.1
Vegetables	4.7	64.5	3.0
<b>Regulated services</b>	<b>16.0</b>	<b>0.6</b>	<b>0.1</b>