

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

*Approved under
the Central Bank Board Decision No. 78 A,
dated 30.05.2023*

**STATUS REPORT ON IMPLEMENTATION OF THE
MONETARY POLICY PROGRAM
(Q2, 2022 – Q1, 2023)**

Early in the period between the 2nd quarter of 2022 and the 1st quarter of 2023 the inflation environment in the Republic of Armenia has expanded due to the influence of escalation of the Russian-Ukrainian conflict since the end of February, various sanctions imposed on Russia and many uncertainties derived from them. High inflation environment persisted up until the end of 2022, which was also driven by strong aggregate demand created on account of a large-scale influx of international visitors and financial resources to Armenia in the wake of the Russian-Ukrainian conflict. At the same time, influenced by the large financial influx, continued appreciation of the dram was observable in the Armenian currency market during the year. The contractionary monetary policy implemented by central banks of the leading countries since the end of 2022 has brought about a certain drop in the food and energy prices in international commodity markets, having thus caused spillovers on the domestic prices in Armenia through a number of imported goods. However, due to the influence of strong demand and inflation expectations in the Republic of Armenia, the prices in product groups that stand out with rigid prices continued to grow.

In view of the current situation, the Central Bank of Armenia further pursued a policy of tightening monetary conditions in the period under review and raised the policy rate by a total of 1.5 percentage points. As a result, although floating at a 10.3% level in the second quarter of 2022, the 12-month inflation then gradually subdued, owing to the contractionary monetary policy implementation, the dram appreciation, and weaker inflationary effects from the external sector, to reach 5.4% at the end of March of 2023. The 12-month inflation is estimated to further decrease in the near term and stabilize around the target value of 4% in the medium run.

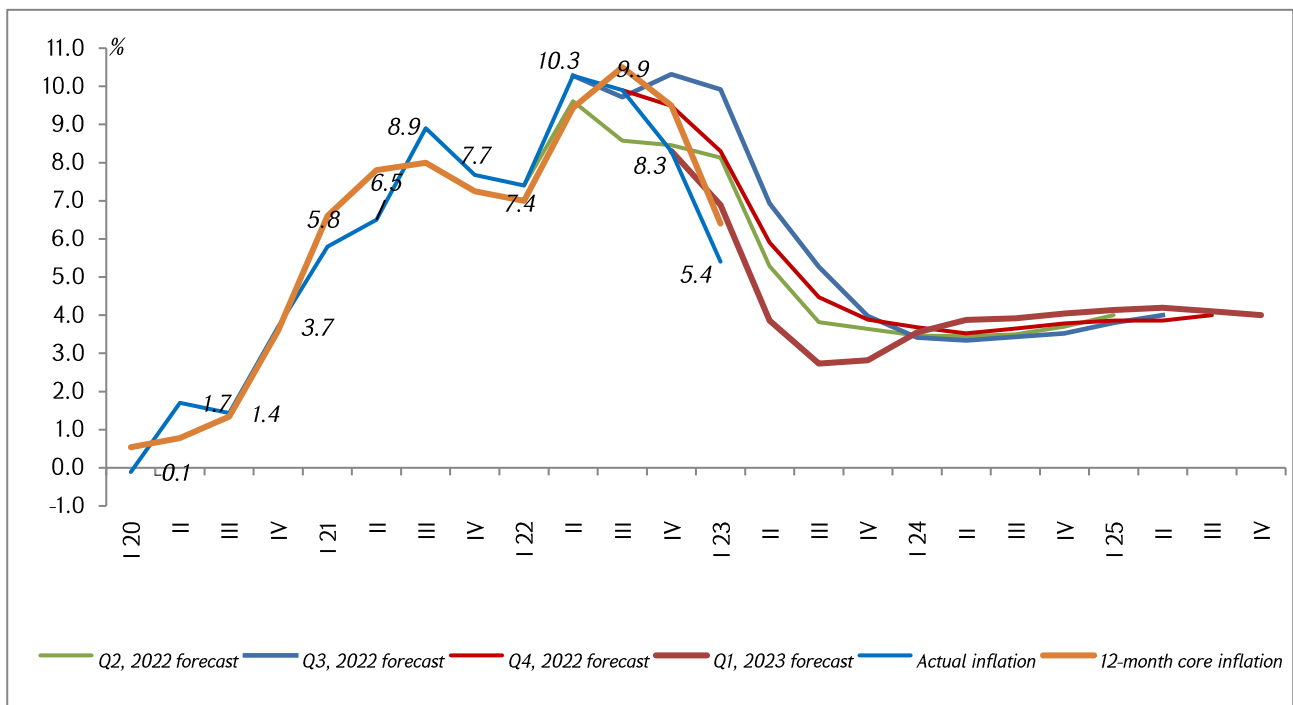
1. MONETARY POLICY IN THE PERIOD UNDER REVIEW

According to the main judgements of the scenario outlined in the monetary policy program for the second quarter of 2022, the inflation environment would have to remain high in the course of the upcoming one year driven by the inflationary effects transmitted from external markets following the escalation of the Russian-Ukrainian conflict, on the one hand, and the strong demand being created in the Armenian economy amid an estimated influx of international visitors and financial resources, on the other. Furthermore, the estimation was that the effects of global inflation patterns which prevailed in the structure of inflation factors and external demand would have to weaken during the year if the Armenian dram kept on appreciating, neutralizing the risks to inflation and inflation expectations. As a result, under the tightening of monetary policy and expected macroeconomic developments, the 12-month inflation would have to gradually decrease in the medium term and stabilize around the 4% target.

In the period under review, the 12-month inflation reduced at a faster-than-expected rate, which was mainly attributable to notable weakening of inflationary effects from the external sector and continued dram exchange rate appreciation. This has been concurrent with a gradual easing of tight monetary conditions by the Central Bank of Armenia. In that situation, in the last two quarters, the projected path of inflation for the short-term perspective has been adjusted downside.

Chart 1

In the period under review, the 12-month inflation has primarily followed a path to decline; based on this, the short-term estimate for the last two quarters has been revised downside



As the actual developments show, following the escalated Russian-Ukrainian conflict and various sanctions imposed on the Russian economy, Armenia has since the second quarter of 2022 seen a large influx of international visitors and financial resources, which was expressed by a considerably accelerated rate of economic activity. Factors of external

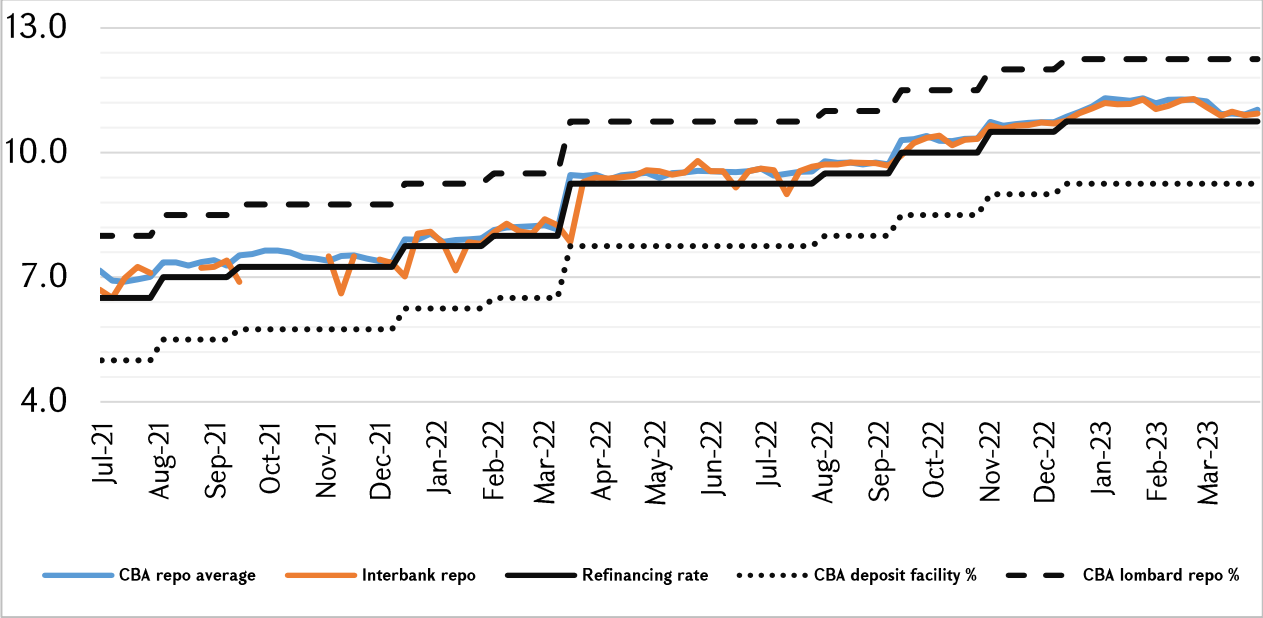
demand for domestic services have contributed to high economic growth. Positive developments have also been observable in the export sector, the IT and manufacturing industries in particular, pointing to trends in manufacture potential and export growth there. However, continuously growing demand has contributed to the expansion of the overall inflation environment and creation of high inflation expectations. In the period between the third quarter of 2022 and the first quarter of 2023, a certain weakening of the inflationary influence from the external sector has been observable owing to the fall in energy and food prices as a result of the contractionary monetary policy pursued by central banks in the main partner countries of Armenia, as well as the gradual adjustment to supply chain disruptions. As a result, the overall inflation environment in Armenia has eased significantly, but the demand persisting strong further contributed to the growth of wages and prices of individual goods and services. High demand coming from international visitors and significant inflow of financial transfers from abroad in the period under review helped the Armenian dram appreciate notably in the domestic currency market, thus contributing to a certain mitigation of the impact of the aforementioned inflation factors.

Taking into account these developments, the Central Bank of Armenia withheld from the interest rate change in the second quarter of 2022 in expectation of a gradual easing of the inflationary effects as a result of appreciation of the Armenian dram on the back of growing external demand. In the third and fourth quarters, however, despite some weakening of the inflationary effects on the Armenian economy from the external environment, the Central Bank tightened monetary conditions and raised the policy rate each time by 0.75 percentage points in view of growing demand and high inflation expectations in the domestic economy amid continued high influx of international visitors and tourists, and of financial resources. The first quarter of 2023 posted further deflationary patterns seen on imported food products, but the still high demand fueled price increases in product groups that stand out with rigid prices. In such a situation, the Central Bank of Armenia left the policy rate unchanged, sticking to relatively tight monetary conditions.

There has been an increase in volatility observed in the Armenian financial market since the end of the first quarter of 2022, following the escalation of the Russian-Ukrainian conflict. Throughout the year the Central Bank of Armenia has been consistent in fulfilling its goal of handling sufficient liquidity in the financial market, which helped the market interest rates shape mainly around the operational goal, i.e. the policy interest rate. In the period under review, the dram had been appreciating as a result of a considerably increased supply of foreign currency and grown demand for the Armenian currency in the financial market. To neutralize short-term disruptions and problems observed in the currency market in the middle of large-scale inflows of foreign currency, the Central Bank of Armenia arranged a situational intervention in the market, facilitating the normal functioning of the financial market.

Chart 2

The Central Bank of Armenia instruments and short-term market interest rates dynamics



To sum up, the 12-month inflation standing high at the beginning of the period under review, has then decreased rapidly to reach 5.4% at the end of March of 2023 thanks to the contractionary monetary policy implementation, the dram appreciation and significantly eased inflationary influence from the external sector. In the meantime, the 12-month core inflation has behaved similarly, amounting to 6.4%. It is estimated that by virtue of the impact of monetary policy implementation, the 12-month inflation rate will further reduce and stabilize around the 4% target in the medium term.

2. INFLATION COMPONENTS IN THE PERIOD UNDER REVIEW

The inflation environment transmitted from the external sector and fueled by the growing demand in the domestic economy persisted high already in the second quarter of 2022 and demonstrated a trend of some easing since the end of the year only. The latter is expressed in the behavior of individual product groups in the consumer basket.

Thus, following the escalation of the Russian-Ukrainian conflict, a sharp increase in the prices of items “Bread and cereals”, “Meat”, “Dairy products”, “Oils and fats” has been observable in the domestic economy since the end of the first quarter of 2022 on account of the impacts transmitted from international food markets. Increased international energy prices had their spillover effect on the fuel price rise. At the same time, given the large influx of international visitors to the Republic of Armenia, high demand created in the Armenian economy has added to inflationary pressures also in terms of locally manufactured goods and especially services, in which circumstance a number of tariffs for services with sticky prices (apartment rent, restaurants and hotels, hairdressing, financial, postal services), on a gradually increasing track throughout the reporting period, have been adjusted. In the fourth quarter of 2022, in expectation of sluggish demand from the world economy and tightening financial conditions, a decrease in prices of some commodities (fuel, sunflower oil, grain, sugar) has been observable in international commodity markets, which was also reflected in the prices of goods imported to the Armenian economy. It should also be noted that the Armenian dram appreciated along with mounting external demand has notably curbed, starting from the third quarter of 2022, the price increases of imported goods. Even though all this was reflected in considerably decreased q/q core inflation trends, the high growth of prices of core inflation components – services and a large group of non-food products – continues to significantly contribute to the domestic inflation developments.

Meanwhile, the risen prices of items “Tobacco” and “Alcoholic beverage” out of the core inflation components has incurred, as was estimated, the inflationary impact of the change in excise tax rates early in 2022 and 2023, especially on the part of tobacco products. The creeping inflation in the local market of alcoholic beverages as a result of the relatively reduced export volumes has somewhat contained the inflationary patterns in the overall product group.

In addition to the above-mentioned factors, the inflation accelerated since the start of the period under review has been driven significantly by highly grown prices of seasonal food products. Reduced sown areas pushed vegetable prices up, particularly for certain products, while unfavorable weather conditions had their impact on fruit prices, especially in the second quarter. Starting from the third quarter of 2022, the impact of these factors on inflation has mitigated to some extent.

In the second quarter of 2022 the tariffs of regulated services kept on rising due to the increase in the tariffs of electricity since March, and those of natural gas since April. The secondary inflationary effects of these services were particularly evident in the second half of 2022, and signs of easing were observable only by the end of the period under review.

The inflation environment sharply intensified in the first half of 2022 showed a sign of some easing at the end of the year

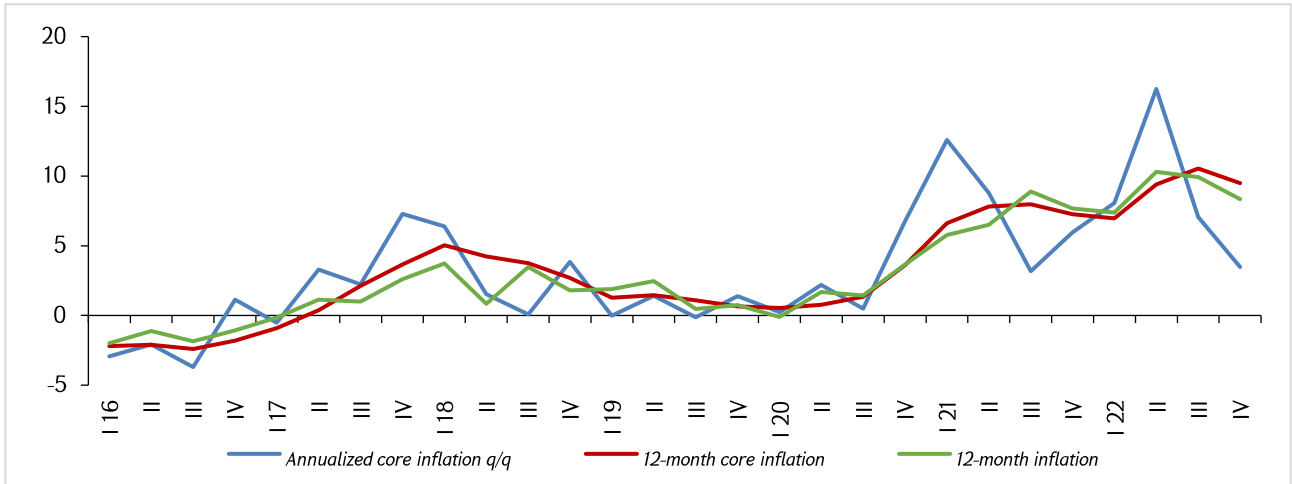


Table 1

Product/Item	Weight	12-month inflation: March 2023	Contribution to y/y inflation
Core inflation	73.9	6.4	4.7
Bread and cereals	8.5	6.0	0.5
Meat	10.6	7.5	0.8
Oils and fats	2.9	-6.0	-0.2
Sugar	0.5	-10.9	-0.1
Dairy products	4.4	12.0	0.5
Alcoholic beverage	2.5	7.8	0.2
Tobacco	2.0	8.8	0.2
Clothing	2.2	6.7	0.2
Footwear	1.2	8.9	0.1
Household appliances	0.6	5.9	0.0
Fuel	5.4	-2.6	-0.1
Air passenger transportation services	1.1	47.5	0.5
Outpatient care services	2.6	6.6	0.2
Actual rent paid by the tenant for additional accommodation	1.1	33.1	0.4
Restaurants and hotels	1.9	9.0	0.2
Fees for services of banks, post offices	0.8	21.4	0.2
Imported food products	15.3	3.6	0.6
Seasonal food products	11.0	1.7	0.2
Eggs	1.6	-1.1	0.0
Fruits	4.1	8.7	0.4
Vegetables	5.3	-0.7	0.0
Regulated services	15.1	2.0	0.3