

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

*Approved under  
the Central Bank of Armenia Board Decision No. 134 A,  
dated 22.08.2023*

**STATUS REPORT ON IMPLEMENTATION OF THE  
MONETARY POLICY PROGRAM  
(Quarter 3, 2022 – Quarter 2, 2023)**

*In the period between 3rd quarter of 2022 and 2nd quarter of 2023, the inflation environment in the Republic of Armenia has eased substantially. Thus, in the second half of 2022, despite following a certain decreasing path, the overall inflation further remained elevated, primarily driven by strong aggregate demand and inflation expectations created on the account of a large-scale influx of international visitors and financial resources to Armenia in the wake of the Russia-Ukraine conflict. The contractionary monetary policy pursued by central banks of the leading countries since the end of 2022 has brought about a notable decline 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. In the meantime, on the back of a large financial influx, the Armenian currency market saw the dram further appreciating in the period under review. Influenced by the aforementioned factors and the contractionary monetary policy implemented by the Central Bank of Armenia, both headline inflation and core inflation demonstrated rapidly decreasing patterns in the period under review. However, with strong demand and inflation expectations persisting in the Republic of Armenia, the inflation of service tariffs and some product prices is being adjusted relatively slowly.*

*In view of the situation at the time, the Central Bank of Armenia carried on implementing a policy to tighten monetary conditions in the first half of the period under review by raising the policy rate for a total of 1.5 percentage points. In the first half of 2023 to June, given the 12-month inflation decelerating significantly, on the one hand, and still high demand and inflation expectations, on the other, the Central Bank of Armenia left the policy rate unchanged. In June, with the inflation rates declining faster and taking into account that the risks of deanchoring inflation expectations might somehow phase out, the Central Bank of Armenia eased the monetary conditions by cutting the policy rate by 0.25 percentage points.*

*As a result, in the period under review the 12-month inflation has considerably subdued, reaching -0.5% in end-June of 2023.*

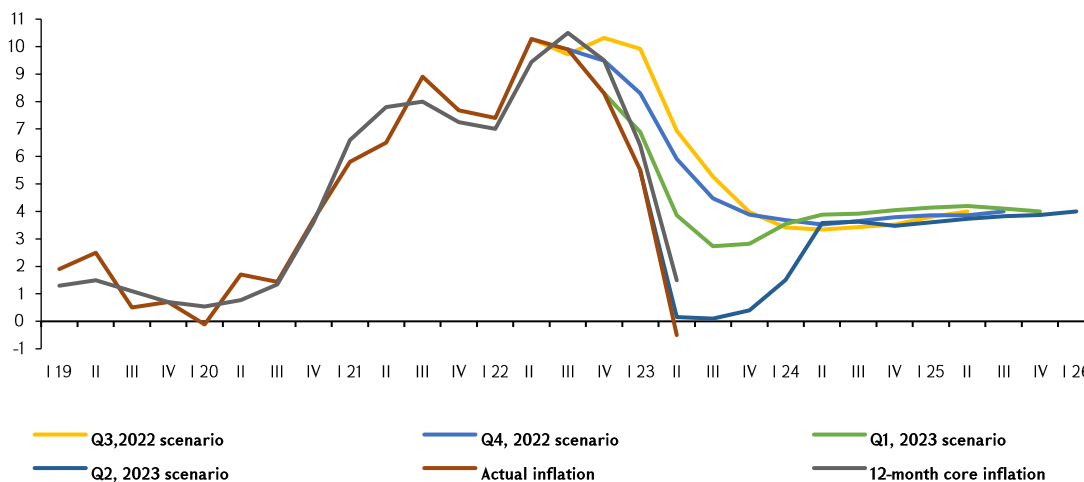
## 1. MONETARY POLICY IN THE PERIOD UNDER REVIEW

According to the main judgements outlined in the scenario provided in the monetary policy program for the third quarter of 2022, the inflation environment and inflation expectations would remain high in the near term, attributable to the inflationary effects transmitted from external markets as well as the strong demand being created in the Armenian economy in expectation of the influx of international visitors and financial resources. Furthermore, the estimation was that the effects of global inflation patterns and external demand would have to weaken in the mid-term perspective, provided that the Armenian dram kept on appreciating, and coupled with the effect of the contractionary monetary policy being carried out, would contribute to the slowing of inflation thus helping it stabilize around the 4% target since the end of 2023.

In the period under review, the 12-month inflation behaved unexpectedly, following even a steeper declining path in the wake of notably weakened inflationary effects from the external sector and continued dram appreciation. In that situation, in each subsequent quarter, the projected path of inflation for the short-term perspective has been adjusted considerably downside.

**Chart 1**

***In the period under review, the 12-month inflation has followed a steeper declining path; based on this, the short-term estimate for each subsequent quarter has been revised considerably downside***



According to the actual macroeconomic developments in the period under review, the rates of economic activity had been trending down in the global economy and the main partner countries of Armenia, largely because of the impact of the ongoing Russia-Ukraine conflict and various sanctions applied to Russia. Simultaneously, a slowdown in demand and significant easing of the inflation environment as well as a certain decrease in energy and food prices in the international commodity markets has been observable as a result of the contractionary monetary policy implemented by the central banks of partner countries with the aim to taming high inflation. Under such circumstances, the inflationary effects on the Armenian economy from the external sector have weakened significantly. In the period under review, a higher-than-expected activity has been reported in the domestic economy mostly

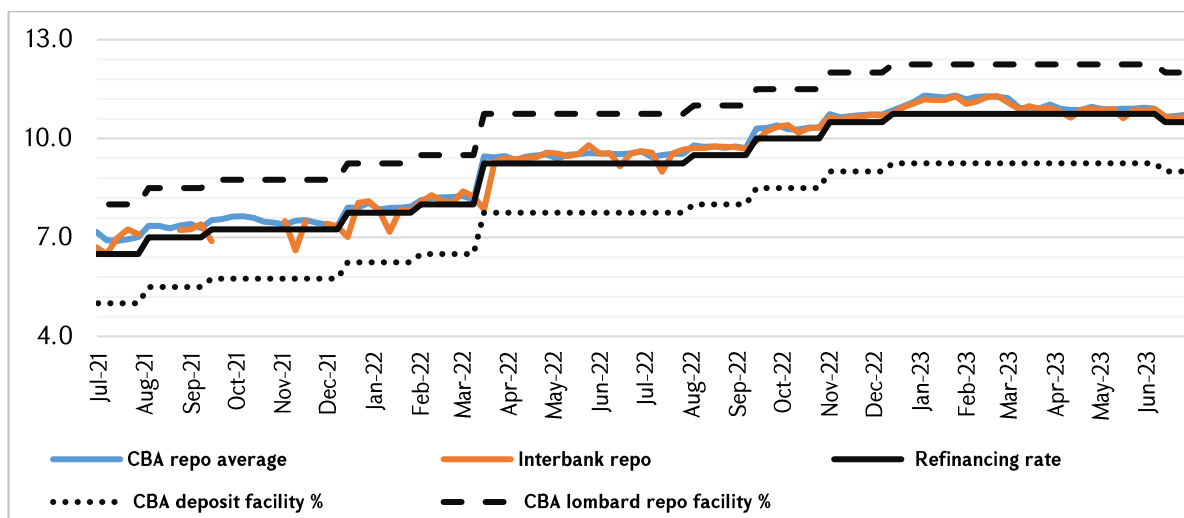
thanks to demand factors; these were primarily evident in a sizably grown external demand in the services sector, while incurring the impact of a large influx of international visitors, including tourists, and of financial resources. The export sector, the IT and manufacturing industries, in particular, benefited positive developments as well, pointing to trends in manufacture potential and export growth there. Meanwhile, influenced by a large demand coming from international visitors and a notable inflow of financial transfers from abroad, Armenia's currency market saw the dram appreciating considerably. Following a much weaker inflationary influence from the external sector, the implemented contractionary monetary policy and the appreciated dram exchange rate, the inflation environment has mitigated rapidly especially throughout the first half of 2023, yet persistently high demand and inflation expectations continued contributing to wage increases and inflation of goods and services standing out with "sticky" prices (see Chart 3).

In the light of such developments, despite somewhat weakened inflationary effects on the domestic economy from the external sector, the Central Bank of Armenia continued implementing a contractionary monetary policy in the course of the second half of 2022, as it lifted the policy rate by a total of 1.5 percentage points in view of the impact of persistently high demand and inflation expectations in the short term.

The inflationary effects transmitted from the external sector came significantly weaker owing to the deflationary patterns observable in respect of imported food products in the first half of 2023. However, with the demand remaining strong and inflationary effects deriving from the labor market, the price adjustment of goods and services that stand out with "sticky" prices proceeded at a slow pace. In such a situation, the Central Bank of Armenia left the policy rate unchanged up until June, keeping monetary conditions relatively tight. In June, as the deflationary trends continued and the risks of deanchoring inflation expectations were phasing out, the Central Bank reduced the policy rate by 0.25 percentage points to 10.5%.

In the period under review, taking into consideration the increased volatility in Armenia's financial market as a consequence of the escalated Russia-Ukraine conflict, the Central Bank of Armenia has been consistent in fulfilling its goal of handling sufficient liquidity in the domestic financial market, as a result of which the market interest rates have shaped mainly around the operational goal, that is the policy interest rate. The local currency, the dram, continued appreciating thanks to a considerably increased supply of foreign currency and grown demand for the dram in the financial market. The Central Bank of Armenia reacted to short-term disruptions and problems in the currency market in the middle of large-scale inflows of foreign currency through a situational intervention in the market, with the aim to helping it function normally.

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



To sum up, in the one-year period under review, the 12-month inflation has decreased by 10.8 percentage points, reaching -0.5% at the end of June of 2023, as a result of the contractionary monetary policy implementation, the dram appreciation and significantly eased inflationary influence from the external environment. The 12-month core inflation has behaved similarly, amounting to 1.5%. It is estimated that the 12-month headline inflation rate will remain below the target value in the near-term perspective but it will increase gradually and stabilize around the 4% target in the medium term.

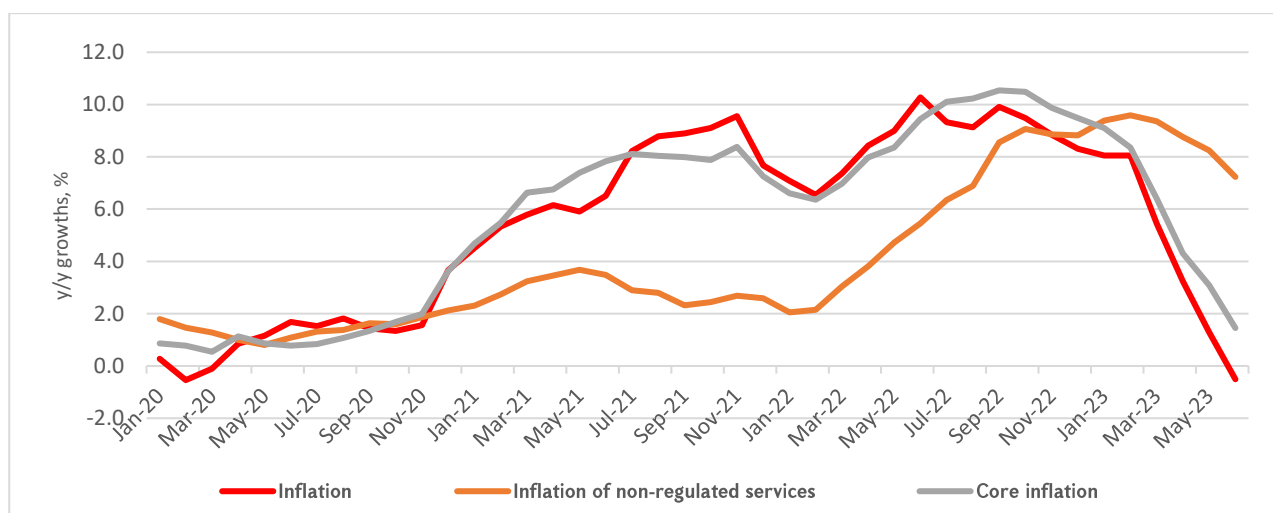
## 2. INFLATION COMPONENTS IN THE PERIOD UNDER REVIEW

Starting from the third quarter of 2022, the inflationary effects transmitted from the external sector have eased substantially. In the meantime, however, in the domestic inflation environment the prices of some goods and services remained elevated driven by the increase in demand.

Thus, following the escalation of the Russia-Ukraine conflict, the inflationary effects from international food product markets observable since the end of the first quarter of 2022 started weakening considerably, since the end of 2022, especially for the prices of items “Bread and cereals”, “Meat”, “Dairy products”, “Oils and fats”. This has been attributable to a fall in prices of some commodities (sunflower oil, grain, sugar) in international commodity markets in expectation of a sluggish demand and tighter financial conditions in the global economy. At the same time, year-end decreases in energy prices in the world have had their substantial impact on Armenia’s domestic fuel market prices. On the other hand, given the large influx of international visitors to the Republic of Armenia, high demand created in the Armenian economy has added to inflationary pressures in terms of locally manufactured goods and especially services, which required making adjustment to a number of tariffs for services with “sticky” prices (apartment rent, restaurants and hotels, hairdressing, financial, postal services) that have stayed elevated over the entire period under review.

**Chart 3**

***In the period under review, the inflationary effects transmitted from the external environment have eased significantly, and both the headline and core inflation have subdued sharply, although the prices of some goods and services remain high***



It is worth mentioning that the Armenian dram, which appreciated concurrent with growing external demand, has notably curbed the price increases of imported goods, starting from the third quarter of 2022.

At the same time, the increase in prices of product groups “Tobacco” and “Alcoholic beverage” out of Core Inflation elements suffered, as was estimated, the inflationary effect of the change in excise tax rates at the beginning of the year, especially regarding the tobacco articles. 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 considerably fueled by prices of seasonal food products grown high due to unfavorable weather conditions in the spring of 2022. Starting from the third quarter of 2022, the impact of these factors on inflation has mitigated to some extent and, starting from the first quarter of 2023, has phased out completely thanks to a noticeably warm weather.

The secondary inflationary effects of the increase in tariffs for regulated services in the first half of 2022 were particularly evident in the second half of 2022, and easing trends were observed only at the end of the period under review.

Table 1

Product/Item	Weight	12-month inflation: June 2023	Contribution to y/y inflation
<b>Core inflation</b>	<b>73.9</b>	<b>1.5</b>	<b>1.1</b>
Bread and cereals	8.5	-6.2	-0.5
Meat	10.6	3.1	0.3
Oils and fats	2.9	-20.8	-0.6
Sugar	0.5	-2.8	0.0
Dairy products	4.4	3.2	0.1
Alcoholic beverage	2.5	6.7	0.2
Tobacco	2.0	10.1	0.2
Clothing	2.2	4.2	0.1
Footwear	1.2	5.9	0.1
Household appliances	0.6	3.6	0.0
Fuel	5.4	-9.4	-0.5
Air passenger transportation services	1.1	22.8	0.3
Outpatient care services	2.6	6.0	0.2
Actual rent paid by the tenant for additional accommodation	1.1	22.8	0.3
Restaurants and hotels	1.9	6.6	0.1
Fees for services of banks, post offices	0.8	22.7	0.2
<b>Imported food products</b>	<b>15.3</b>	<b>-6.2</b>	<b>-1.0</b>
<b>Seasonal food products</b>	<b>11.0</b>	<b>-14.7</b>	<b>-1.6</b>
Eggs	1.6	21.7	0.3
Fruits	4.1	-6.5	-0.3
Vegetables	5.3	-28.1	-1.5
<b>Regulated services</b>	<b>15.1</b>	<b>0.1</b>	<b>0.0</b>